

# TAX INCENTIVES FOR AFFORDABLE HOUSING

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## HEARING

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

—————  
MAY 24, 2007  
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**Serial No. 110-44**

Printed for the use of the Committee on Ways and Means



U.S. GOVERNMENT PRINTING OFFICE

47-758

WASHINGTON : 2009

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**HEARING ON TAX INCENTIVES FOR  
AFFORDABLE HOUSING**

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**THURSDAY, MAY 24, 2007**

U.S. HOUSE OF REPRESENTATIVES,  
COMMITTEE ON WAYS AND MEANS,  
SUBCOMMITTEE ON SELECT REVENUE MEASURES,  
*Washington, DC.*

The Subcommittee met, pursuant to call, at 10:02 a.m., in Room 1100, Longworth House Office Building, Hon. Richard E. Neal [Chairman of the Subcommittee] presiding. [The Advisory of the hearing follows:]

# ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

## SUBCOMMITTEE ON SELECT REVENUE MEASURES

FOR IMMEDIATE RELEASE  
May 24, 2007  
SRM-5

CONTACT: (202) 225-1721

### **Neal Announces Hearing on Tax Incentives for Affordable Housing**

House Ways and Means Select Revenue Measures Subcommittee Chairman Richard E. Neal (D-MA) announced today that the Subcommittee on Select Revenue Measures will hold a hearing on certain tax incentives for affordable housing including the low-income housing credit (LIHTC), section 142 tax-exempt bonds, and section 47 rehabilitation credit. **The hearing will take place on Thursday, May 24, 2007, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

Oral testimony at this hearing will be limited to invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

#### **FOCUS OF THE HEARING:**

The hearing will focus on ways to simplify and modify certain low income housing programs which are established in the Internal Revenue Code (Code) and programs administered by the U.S. Department of Housing and Urban Development (HUD) to ensure greater efficiency and better coordination of federal housing programs.

#### **BACKGROUND:**

The Code contains certain incentives that are used to finance the development of low-income housing. The main provisions in the Code are the LIHTC, private activity tax-exempt bonds, and the historic rehabilitation tax credit. These incentives were enacted or substantially revised in the Tax Reform Act of 1986 (P.L.99-514), and later modified to some extent.

The LIHTC is a tax incentive to spur private investment in construction and rehabilitation of low-income housing. The credit is intended to lower the financing costs of housing construction and enable a percentage of the units to be rented below market rates to eligible tenants. The credit is allocated among the states annually according to the population of the state. Unused credits are added to a national pool and redistributed to the states that apply for excess credits. Over the 18-year history of the LIHTC, more than one million new and rehabilitated units have received support under the program.

Under the Code, state and local governments are permitted to use tax-exempt bonds to finance certain projects that would otherwise be classified as private activities. The development of privately-owned and operated multifamily residential housing falls within this category. In 2003, 2004 and 2005, the private activity bond volume for multi-family housing was \$5,672.8 million, \$5,007.2 million, and \$5,561.7 million, respectively. The rehabilitation credit under Section 47 of the Code provides an additional incentive for rehabilitation of historic structures and buildings placed in service before 1936. The credit has been an especially effective tool in building

affordable housing, creating more than 15,000 units of housing in 2006, 40% of which fell into the affordable category mostly due to combination with the LIHTC.

In announcing the hearing, Chairman Neal stated, **“Ensuring the availability of affordable housing for many low- and middle-income families continues to be a national priority. Federally subsidized housing plays a major role in achieving this goal. Many of the federal housing programs have not received the level of Congressional review needed to ensure maximum efficiency and effectiveness since 1986. This hearing is a first step in our overview of the major federal housing programs, including the tax incentives.”**

#### **DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:**

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, <http://waysandmeans.house.gov>, select “110th Congress” from the menu entitled, “Committee Hearings” (<http://waysandmeans.house.gov/Hearings.asp?congress=18>). Select the hearing for which you would like to submit, and click on the link entitled, “Click here to provide a submission for the record.” Once you have followed the on-line instructions, completing all informational forms and clicking “submit” on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You **MUST REPLY** to the email and **ATTACH** your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business **Thursday, June 7, 2007**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225-1721.

#### **FORMATTING REQUIREMENTS:**

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and **MUST NOT** exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at <http://waysandmeans.house.gov>.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

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\*Chairman NEAL. I would ask all to take their seats so that we can move forward here this morning, on a very important subject. I'd like to call this meeting of the Select Revenue Measures Sub-

committee to proceed. Would everybody, including our guests, please take their seats? Let me welcome all of you to our Subcommittee hearing on tax incentives for affordable housing.

For the past two decades, the Low-Income Housing Tax Credit has brought private sector developers and investors together with State, Federal and local governments in order to provide affordable housing to millions of families. It has truly been a successful and efficient government initiative. Now after these 20 years of operation, Committee Members believe it's time to review the program and to solicit suggestions for improvement. We are undertaking this review along with the Financial Services Committee, which has jurisdiction over certain housing programs outside of the tax Code.

Because many of these programs often overlap or potentially conflict, we hope to move consensus legislative proposals in conjunction with that Committee. Thomas Jefferson noted that the first and only object of good government was the care of human life and happiness. But for millions of working families, reliable and affordable housing can be elusive.

As we have recently witnessed in the aftermath of Katrina, lack of housing causes problems all across American society, from schools to law enforcement to, as Jefferson put it, basic happiness. There is a role for government here, and partnering with the private sector has answered the housing needs for millions of American families of modest means. Business and community leaders in the Gulf zone told us that they could not get back on track after the hurricane without assistance. For workers, keeping their jobs only answered one part of the question. With no place for their families to live, they simply did not want to go back. So this Committee responded with billions of dollars in additional housing credits. I know as a former Mayor that affordable housing is a key element to every successful community. And I also will tell you in terms of local economics, there is no issue that I dealt with during those 5 years as Mayor that was more complicated than housing.

As Mayor of Springfield, I was proud to play a part in affordable housing developments, ensuring that these projects received land from the city in order to make the project feasible. And each time I drive by these developments, which are still standing and in fact thriving today, I understand this is a public-private program that works.

Mr. Ramstad and I have offered legislation in the past to modernize the housing credit programs, and he has assured me that it is his intention to work with me again, and we expect to proceed. Mr. English and Ms. Tubbs-Jones have also offered legislation to improve the historic property tax credits, which also will be discussed today. All of us, along with Chairman Rangel and Jim McCrery are true believers in these housing programs. So I'm hopeful that we can move legislation forward this summer to ensure their long-term integrity and viability.

I'm pleased to welcome our witnesses today, who will assist the Committee in understanding how these programs work. We will hear from three panels representing Federal, State and local governments, both the for-profit and not-for-profit private sector.

Representing the Treasury Department, we will hear from Mike Desmond, Tax Legislative Counsel. Representing the Department of Housing and Urban Development, we will hear from Mr. Orlando Cabrera, the Assistant Secretary in the Office of Public and Indian Housing.

Our second panel, representing New York City, we will hear from Housing Commissioner Shaun Donovan. And representing the National Association of Local Housing Finance Agencies, we will hear from Olson Lee, the Deputy Executive Director of the city of San Francisco's Redevelopment Agency. Representing the National Association of State Housing Agencies, we will hear from the Executive Director and CEO of the Pennsylvania Housing Finance Agency, Mr. Brian Hudson.

On our third panel we will hear from Mr. Jeffrey Goldstein from my home State of Massachusetts, who is Executive Vice President and Chief Operating Officer of Boston Capital. Representing Enterprise Community Partners, we will hear from Mr. Jonathan Rose, President of the Jonathan Rose Companies in New York City.

Representing the Local Initiatives Support Coalition or LISC, we will hear from Mr. Benson Roberts, the coalition Senior Vice President for Policy and Program Development. Representing the National Association of Home Builders, we will hear from Steve Lawson of the Lawson Companies in Virginia Beach, Virginia. And representing the National Trust Community Investment Corporation, we will hear from its President, John Leith-Tetrault.

I look forward to all of the testimony we will hear today. And at this time I'd like to recognize my friend, Mr. English, for his opening Statement.

\*Mr. ENGLISH. Mr. Chairman, in the interest of brevity, I'm going to submit my written opening Statement for the record. But I would like to make a comment. And first off, that I think this hearing is timely and extremely important. I'm very grateful to you for making it a priority of this Subcommittee and I believe a priority of the Ways and Means Committee, to review the successes of this tax credit.

We think the Affordable Housing Tax Credit, on a bipartisan basis, has been an extraordinary success story. It's created an opportunity to provide affordable housing for millions of Americans in communities where there have been very tight housing markets. But even more so, in many communities, it has created a vehicle for community revitalization which literally has leveraged millions of dollars into some of our older communities and some of our older downtowns.

Frankly, Mr. Chairman, to appreciate the success story, you have to go no further than my own neighborhood in Erie, Pennsylvania. On Erie's West Side, we have an extraordinary structure that was empty for years called the Boston Store, that was the epitome of downtown Erie. And in part because of this tax credit and some other programs that were put into place, that Boston Store was renovated, revitalized and now is a beacon for affordable housing in the downtown, attracting people back into Erie's downtown. But it also has successfully, at the lower levels of the structure, been reused for commercial purposes. It's a fabulous success story that has changed the flavor of downtown Erie.

More than that, in my neighborhood on Erie's West Side, we had an old convent of the St. Josephite nuns called the Villa. There was a school there, and there was also a monastic community. And when that became vacant a number of years ago, some developers came in, and using this tax credit, they were able to put in place an immensely successful affordable housing project that brought back into my neighborhood, in many cases a lot of people who had lived much of their lives there. It has helped greenline our neighborhood, revitalize it and put a new sheen on it.

I'm a big believer in this program, but I think it's important that we as a Subcommittee hear the details and hear the challenges and hear how we can make this credit even more effective as an engine to drive neighborhood revitalization and create opportunities for affordable housing for millions.

Thank you, Mr. Chairman, for taking on this effort.

[The information follows:]

\*Chairman NEAL. Thank you, Mr. English. Without objection, any other Members wishing to insert Statements as part of the record may do so. I will ask all the witnesses, please speak directly into the microphone. And all written Statements by the witnesses will be inserted into the record as well.

Mr. Desmond, thank you for being here.

**STATEMENT OF MICHAEL J. DESMOND, TAX LEGISLATIVE  
COUNSEL, U.S. DEPARTMENT OF THE TREASURY**

\*Mr. DESMOND. Mr. Chairman, Ranking Member English, and distinguished Members of the Subcommittee, thank you for the opportunity to discuss with you today various Federal tax incentives for affordable housing, including the Low-Income Housing Tax Credit, the Rehabilitation Tax Credit, and tax-exempt bonds.

The Treasury Department believes that these tax incentives play an important role in encouraging the development of affordable housing units for Low-Income Households, and shares the view that the goal of affordable housing is best achieved by continuing to examine low-income housing needs and addressing them through programs that are reviewed periodically to see how they can be better targeted and improved.

Since it was enacted in 1986, the Low-Income Tax Credit has provided economic incentives responsible for producing more than 1 million rental units occupied by low-income households. An indication of the widespread appeal of the program is the fact that the program is usually oversubscribed, and that there are more applicants seeking allocations of the credit than there is credit available.

The Low-Income Housing Tax Credit is a complex program, however, and there are many ways in which it could be simplified to improve its effectiveness in serving the needs of low-income people while at the same time reducing the burden placed on the Internal Revenue Service and State agencies in administering the program. Simplification could also reduce the burden on property owners who take advantage of the credit, increasing its efficiency.

The Treasury Department has taken steps to reduce some of the complexity and uncertainty of the Low-Income Housing Tax Credit program by providing guidance through regulations. We are currently working on two projects relating to the credit. One project

deals with a utility allowance that is a factor in determining the rent that can be charged to tenants of low-income housing units. Inaccuracies in the current formula for computing the utility allowance have concerned for property owners, tenants and State and local housing agencies, an issue that I think is highlighted in some of the testimony that you'll hear later this morning. We expect that our regulations on the utility allowance will help to address this issue.

In a separate regulatory project, we are working on proposed regulations that will provide guidance concerning the circumstances in which an owner of Low-Income Housing Tax Credit property is allowed to discontinue operating a tax credit building as low-income housing under the qualified contract provisions of the statute, which come into play toward the end of the 15-year compliance period that's in the statute. We anticipate publishing both sets of those regulations later this summer.

Some aspects of the Low-Income Housing Tax Credit could benefit from simplification and clarification. We at the Treasury Department and with the Internal Revenue Service frequently meet with representatives of owners, tenants and housing agencies, who provide us with their input on the controversies they're facing, uncertainties they're facing, and complexities they're facing with respect to the credit.

For example, the actual tax credit rate is not fixed, although it's often referred to as the 4-percent or the 9-percent. It's actually adjusted on a monthly basis to achieve a total present value of the tax subsidy that's provided to owners over a 10-year credit period, equal to either 70 percent of the owner's eligible basis in the property, or 30 percent in certain cases.

It has been suggested that the credit percentage for newly constructed be fixed rather than adjusted monthly. Although these computations are fairly mechanical and routine, they do impose a burden on owners of property by requiring them to make monthly computations based on changing percentages.

Another suggestion is that the credit be taken ratably over the 15-year compliance period, rather than the 10-year period under the current statute, with increased applicable percentages to make up for any time-value benefit that the present accelerated credit provides. This would eliminate recapture of the credit in certain cases, and also eliminate the requirement for owners to have to post a bond when they dispose of the property before the end of the 15-year compliance period.

Additionally, whether certain types of students may be considered low-income for purposes of the credit is unclear, particularly in the case of single-parent households in which both the parent and the child are full-time students. Although we don't think the credit was intended to encourage the development of housing for all college students, the current uncertainty with respect to this issue has become a disincentive for low-income persons living in credit properties to go back to school.

Difficult development areas which are eligible for an increased credit amount have also been a source of complexity in recent years, because the areas designated as DDAs may change from year to year, making it difficult for developers who phase in their

properties over a period of years to estimate the financing needs that they have.

The Rehabilitation Tax Credit and tax-exempt housing bonds or other tax incentives can be combined with the Low-Income Housing Tax Credit to provide a greater incentive for affordable housing. When combined with the housing tax credit, these other incentives can provide a deeper Federal subsidy, but they can also raise complexity and administrative concerns when combined.

A range of proposals have been offered by stakeholders, including other witnesses at today's hearing, to modify these various affordable housing tax incentives. As the Committee considers these are other proposals, there are two competing interests that must be kept in mind—those of the property owners who provide the housing, and low of the low-income tenants who are the ultimate beneficiaries of the Federal tax incentives. These interests need to be balanced while taking into consideration the complexity of the statutes and the relative effectiveness of various proposals in targeting the Federal tax incentives.

Thank you, Mr. Chairman, Ranking Member English, and Members of the Subcommittee, for providing the Treasury Department with an opportunity to participate in today's hearing. We look forward to working with you on changes to the statute, and I would be pleased to answer any questions that you might have.

[The Statement of Mr. Desmond follows:]



## U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

EMBARGOED UNTIL 10 a.m. (EDT), May 24 2007  
 CONTACT Andrew DeSouza, (202) 622-2960

### TESTIMONY OF TREASURY TAX LEGISLATIVE COUNSEL MICHAEL DESMOND BEFORE THE SUBCOMMITTEE OF SELECT REVENUE MEASURES OF THE HOUSE COMMITTEE ON WAYS AND MEANS

Washington, DC—Mr. Chairman, Ranking Member English, and distinguished Members of the Subcommittee:

Thank you for the opportunity to discuss with you today incentives for affordable housing, including the low-income housing tax credit (LIHTC), the rehabilitation tax credit (RTC) and tax-exempt housing bonds (collectively, "the housing tax incentives"). The Treasury Department believes that affordable housing policies play an important role in encouraging the development of affordable housing units for low-income households. The Treasury Department shares the view that the goal of affordable housing is best achieved by continuing to examine low-income housing needs and addressing them through programs that are reviewed periodically to see how they can be better targeted and improved.

#### Background on the Low-Income Housing Tax Credit

Since it was enacted in 1986, the LIHTC has provided economic incentives responsible for creating significant amounts of affordable housing for low-income households. In fact, the LIHTC program is usually oversubscribed in that there are more applicants seeking allocations of the LIHTC than there is LIHTC available to allocate. The LIHTC is a complex program, however, and there may be ways to simplify the program and improve its effectiveness in serving the housing needs of low-income people while at the same time reducing the burden placed on the Internal Revenue Service (IRS) and State agencies administering the program. Simplification could also reduce the burden on property owners who take advantage of the program, increasing its efficiency.

The LIHTC provides an economic incentive in the form of tax credits to developers to build affordable rental housing. The LIHTC is allocated to owners of qualified low-income rental units. The tax benefit provided by the LIHTC reduces the financing cost for low-income housing, which results in lower rents to qualified tenants.

The LIHTC may be claimed over a 10 year period for a portion of the cost of rental housing occupied by tenants having incomes below specified levels. The 10 year tax credit period begins with the taxable year in which a qualified building is placed in service or, at the election of the building owner, the succeeding taxable year. The credit percentage for a newly constructed building that is not otherwise Federally subsidized is adjusted monthly by the IRS so that the 10 annual credit amounts generally have a present value of 70 percent of the portion of the owner's cost basis in the building allocable to low-income housing units ("qualified basis"). The credit percentage for new buildings that are otherwise

Federally subsidized and for existing buildings is calculated to have a present value of 30 percent of qualified basis.

For 2007 the aggregate first-year credit authority allocated to each State is \$1.95 per resident, with a minimum of \$2.275 million for certain small population states. These amounts are indexed for inflation. Because they are in the best position to determine local housing needs, State and local housing agencies allocate tax credits to particular projects pursuant to publicly announced qualified allocation plans (QAPs). Credit that is unallocated in one calendar year may be carried forward by these agencies to the following calendar year. Allocated credit that is not used may be returned to an agency by a building owner for reallocation.

Credit allocations generally must be made not later than the close of the calendar year in which the building is placed in service. Credit allocations may revert to the agency if less than 10 percent of the taxpayer's reasonably expected cost of the building, including land, is expended within the later of 6 months after the allocation is made or the end of the calendar in which the allocation is made. Credit authority allocated to a State but not used by the State in a timely manner reverts to a national pool for distribution to other States requesting additional authority.

Certain provisions permit a credit allocation prior to the year a building is placed in service. Rules are also provided for the allocation of costs to individual units in multi-unit projects and to property that is part of a project but used for purposes other than rental housing. The tax benefit that a building owner receives from the LIHTC may be recaptured if the required number of units is not rented to qualifying tenants for a period of 15 years or if a sale or other disposition of the building occurs during this period without meeting specific requirements for continuing to provide low-income housing.

In certain geographic areas designated by the Secretary of Housing and Urban Development, LIHTC amounts awarded to projects may be increased by up to 30 percent. These areas include Difficult Development Areas (areas where development costs are high relative to area incomes) and Qualified Census Tracts (generally census tracts where either at least 50 percent of households have incomes below 60 percent of area median income, or the poverty rate is at least 25 percent).

The LIHTC has been successful in producing more than a million rental housing units occupied by low-income households. Although rents are restricted under the LIHTC, rents are based on an average household income for the area rather than the individual household income of the tenant. Thus, units are leased only to eligible households with enough income to afford the rent, often excluding very low income households from benefiting from the credit.

The Treasury Department has taken steps to reduce some of the complexity and uncertainty in the LIHTC program by providing guidance through administrative regulations. For example, we are currently working on two regulation projects relating to the LIHTC. A utility allowance project, in particular, is an effort to address an issue that has caused concern for property owners, tenants, and State and local housing agencies. The statute requires inclusion in the gross rent that can be charged to qualified tenants of a utility allowance if any utilities are paid directly by the tenant. The Treasury Department and the IRS have received comments noting that the methods in the current regulations for calculating utility allowances often are inaccurate and outdated and, in many cases, result in flawed information being used for calculating rent adjustments. We anticipate issuing proposed regulations later this year that would permit more accurate utility allowance calculations. We also plan to issue proposed regulations that provide guidance concerning the circumstances in which a taxpayer is allowed to discontinue operating a LIHTC building as low-income housing. The statute provides for the termination of the requirement to operate the low-income portion of the building if the appropriate housing agency is unable to present within a specified period of time, after the 14th year of the compliance period, a qualified contract for the acquisition of the low-income portion of the building by

any person who will continue to operate such portion as a low-income building. The proposed regulations will define a qualified contract for these purposes.

Some aspects of the LIHTC could benefit from simplification and clarification. The Treasury Department and IRS frequently meet with representatives of owners, tenants, and housing agencies who provide us with information regarding controversies, uncertainties, and complexities within the LIHTC. For example, the actual tax credit rate is not fixed, but is adjusted on a monthly basis to achieve a total present value of the subsidy over the 10 year credit period equal to 70 percent of the eligible basis, or if applicable, 30 percent of the eligible basis. It has been suggested that the credit percentage for newly constructed housing that is not Federally subsidized be fixed rather than adjusted monthly by the IRS. Although the computations may be routine, they require owners to make monthly computations based on changing percentages.

Another suggestion is that the credit be taken ratably over the 15 year compliance period, with an increased applicable percentage to make up any time value benefit that the present accelerated credit provides, rather than accelerating the credit over the present 10 year credit period. This would eliminate recapture in some cases and eliminate the requirement to post bond in the case of early property dispositions.

The qualified contract regulations project that I previously mentioned is another example of complexity in the statute. Additionally, whether certain types of students may be considered low-income for purposes of the credit is unclear, particularly for a single parent household in which both the parent and the child are full-time students. Although the credit should not be used to encourage the development of housing for all college students, the current uncertainty has become a disincentive for low-income persons living in LIHTC properties to go back to school. Difficult Development Areas (DDAs) have also been a source of complexity in recent years, particularly because the areas designated as DDAs may change from year to year, making it difficult for developers who need to phase in developments over a period of years to estimate financing needs accurately.

There are many other areas of the LIHTC that cause uncertainty or burden and complexity. The Treasury Department would welcome the opportunity to work with this Subcommittee to address these issues and make the LIHTC more efficient and administrable.

#### **Background on the Rehabilitation Tax Credit**

The Rehabilitation Tax Credit provides an incentive in the form of tax credits to stimulate private-sector capital investment in historic and older buildings and revitalize historic communities. The RTC provides a 20 percent income tax credit for qualified rehabilitation expenditures incurred in connection with the substantial rehabilitation of a certified historic structure and a 10 percent income tax credit for the substantial rehabilitation of nonresidential structures built before 1936. A certified historic structure is a building that is listed in the National Register or is located in a registered historic district and is certified by the Secretary of the Interior as being of historic significance to the district. The RTC is jointly administered by the IRS and the National Park Service.

The RTC is sometimes combined with the LIHTC to use rehabilitated, historic structures as low-income housing. The amount of rehabilitation expenditures eligible for the low-income housing tax credit is reduced by the amount of rehabilitation tax credit allowed. The computation for annual depreciation includes a reduction of the depreciable basis by the amount of rehabilitation tax credit allowed. Like the LIHTC, the RTC is a complex provision. This complexity places burdens on property owners and the IRS alike and makes the credit less efficient. The RTC can be combined with other Federal tax programs like the LIHTC to provide a greater financial incentive. These combinations may, however, raise additional complexity and administrative concerns.

**Background on Tax-Exempt Private-Activity Housing Bonds**

The tax law also provides low- and moderate-income housing incentives in the form of tax-exempt private-activity bonds. In order for interest on tax-exempt bonds, including governmental bonds, to be excluded from taxable income, a number of specific requirements must be met. Private-activity bonds may be issued on a tax-exempt basis only if they meet the requirements for "qualified private-activity bonds," including targeting requirements that limit such financing to specifically defined facilities and programs such as low-income residential housing projects.

Exempt facility bonds may be used to fund qualified residential rental projects if at least 95 percent of the net bond proceeds are used to provide a qualified residential rental project. A qualified residential rental project is a multifamily rental project in which one of the following two requirements is met at all times during the qualified project period: (1) 20 percent or more of the residential units in such project are occupied by individuals whose income is 50 percent or less of area median gross income; or (2) 40 percent or more of the residential units in such project are occupied by individuals whose income is 60 percent or less of area median gross income.

Qualified private activity bonds are subject to State-by-State volume-cap limitation under section 146 of the Code. Allocations of tax exempt bond authority to specific low-income housing projects are generally made by the same State or local housing authorities that make allocations of LIHTC. Qualified private activity bonds are often combined with LIHTC to finance low-income rental projects. Use of the Tax Law to Encourage Low- and Moderate-Income Housing

The LIHTC, RTC and tax-exempt private activity housing bonds have been successful in promoting the construction of affordable housing for low-income households. As this Subcommittee considers ways in which to expand or modify these existing programs, two general observations should be made. First, any expansion of targeted tax incentives invariably puts additional strain on our tax system. Second, the housing tax incentives are, as currently structured, quite complex. This complexity places a significant burden on owners and developers of low- and moderate-income housing. This increases the cost of that housing and reduces the efficiency of the Federal subsidy provided by the housing tax incentives. The complexity of these programs likewise places a burden on the IRS to administer them. As this Subcommittee contemplates changes to the housing tax incentives, simplification of the incentives should also be considered.

**Conclusion**

Thank you Mr. Chairman, Ranking Member English and members of the Subcommittee for providing the Treasury Department with an opportunity to participate in today's hearing on this important subject. I would be pleased to respond to your questions.

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\*Chairman NEAL. Thank you, Mr. Desmond.  
Mr. Cabrera.

**STATEMENT OF ORLANDO J. CABRERA, ASSISTANT SECRETARY FOR PUBLIC AND INDIAN HOUSING, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**

\*Mr. CABRERA. Thank you, Mr. Chairman, Ranking Member English, and Members of the Subcommittee for inviting HUD to provide its input with respect to this hearing on the issue of tax incentives for low-income housing. My name is Orlando J. Cabrera, and I'm Assistant Secretary for Public and Indian Housing at the Department of Housing and Urban Development. It's my honor to represent the views of the Department of Housing and Urban Development before your Committee.

All of our comments are provided with a significant caveat. Our testimony focused on the Low-Income Housing Tax Credit and private activity bond programs from HUD's perspective. We believe our partners at Treasury and the Service who administer both programs daily have views on the issues that HUD will raise today, and we would be deferential to those views.

Nonetheless, we focused on ways to possibly improve the interplay between the Treasury programs and HUD programs in order to serve low-income, very low-income, and extremely low-income housing needs in a more effective way. Accordingly, these comments focused on two current tools most familiar to HUD, those mentioned—the tax credit and private activity bonds.

Technical issues that would help transactions that use HUD programs are pretty varied, together with the Low-Income Housing Tax Credit and private activity bonds, in order to construct or preserve affordable units. First of all, we believe that Low-Income Housing Tax Credit and private activity bond programs run by the States have been enormously successful in developing affordable housing units for the nation. They may not be perfect programs, but they're extraordinary ones that play to our strengths; private-sector execution with sound public policy. HUD's role in the program has been ancillary but important, and we believe that HUD's role should remain as such.

That said, HUD's stakeholders are important consumers of these products, and we would want to suggest ideas that make the programs more accessible to them. Proudly, we offer suggestions that work well with HUD programs to help construction and preservation of units in order to serve those low-income Americans. While more specifically, we will note issues that benefit from refinement. In either case, we would like to underscore the importance that HFAs retain the flexibility that they currently have under the Code.

HUD always welcomes—I'm sorry. Strike—excuse me. Those prerogatives appropriately belong to each—Mr. Chairman, pardon me. There's a typo.

\*Chairman NEAL. You're doing fine.

\*Mr. CABRERA. Our broader issues. I have a cold. And one of the things I've just discovered is I have a typo. Our broader issues are, and essentially in most cases, HUD, like everyone, is in the business of affordable housing and must undertake a subsidy-

layering-review-process that ensures that HUD and the transaction are in compliance with the Housing and Urban Development Reform Act 1989. What does that mean? It means that every transaction that involves public housing property or funds appropriated by Congress must be reviewed by the Department or through assignment by the States.

What deals do those encompass? Well, it encompasses all deals undertaken by public housing authorities on PHA-owned land using tax credits or bond allocation, all HOPE VI deals, all public housing transactions that seek to use a subsidy called Capital Funds with Low-Income Housing Tax Credits or bond proceeds from private activity bonds, and all deals that receive project-based Section 8.

With respect to HOPE VI deals that are financed with Capital Fund allocations, project-based Section 8 layering, Section 202 and 811 transactions, each of these have commonalities. They are by definition complicated deals that have many moving parts. Moving parts that are different in nature when compared between the programs but nonetheless similarly complicated. Deals with many moving parts require flexibility with time. Time is at a premium with respect to Section 202 and rightly so. However, in these cases, those place—the place and service dates and carryover dates are challenges for PHAs that have to undertake those deals, and many stakeholders who have to undertake those deals, particularly with the elderly and the disabled.

While HOPE VI transactions are in terms of percentage a small number of applications in the global pool of tax credit applicants, they by themselves require a lot of tax credits. HOPE VI grants, historically speaking, have been nearly—have been very difficult to finance. For example, only 65 of 237 HOPE VI deals have actually been completed, although the program is 15 years old.

It's not simply the size of the tax credit allocation that causes them pause. It's the fact that the allocation may not be used in a timely way and therefore lost to the HFA.

Our recommendation would be to provide HFAs with some flexibility in the HOPE VI program and in other contexts mentioned to assure that unused tax credits can be reallocated with less risk of effective loss of the tax credit or sanction to the HFA.

Mr. Chairman, I see that my time is up, so, in closing, HUD remains committed to helping the Low-Income Housing Tax Credit and private activity bond programs succeed by being a willing partner and facilitator as contemplated in the Code. Thank you once again for your invitation. I stand ready to answer any questions you may have.

[The Statement of Mr. Cabrera follows:]

**Statement of Orlando J. Cabrera, Assistant Secretary, Office of Public and Indian Housing, U.S. Department of Housing and Urban Development**

Chairman Neal, Ranking Member English, distinguished Members of the Subcommittee, my name is Orlando Cabrera and I am the Assistant Secretary for Public and Indian Housing at HUD.

The Low-income Housing Tax Credit (LIHTC) Program represents a major resource to affordable housing developers. Between 1987 and 2004, the most recent date that data is available, nearly 25,500 tax credit projects were developed and placed in service, representing more than one million affordable housing units. These credits are an important development resource for low-income housing pro-

grams in the Department, particularly public housing and supportive housing for the elderly (Section 202).

#### *LIHTC and Public Housing*

Public housing authorities (PHA) are eligible to apply for LIHTCs, and the program requirements for this funding source are consistent with the mission of these agencies. PHAs can use LIHTCs to both increase the supply of affordable housing in their community and to revitalize existing developments that are obsolescent or distressed.

To date, PHA participation in the LIHTC program has been limited, but diverse. As of 2005, approximately 230 PHAs across 44 states, the District of Columbia and Puerto Rico, had developed or were developing 775 tax credit projects for the construction of 97,930 units. This represents approximately 9% of all tax credit units developed, 3% of all tax credit projects, and 7% of all PHAs in the United States.

Projects involve both 9% tax credits and 4% tax credits with bonds, and include new construction as well as the redevelopment of existing properties. Two-thirds (66%) of the units developed by PHAs are new construction, versus 54% for the universe of LIHTC projects. The balance of remaining projects is for rehabilitation of existing developments, with less than 2% including a combination of new construction and rehabilitation. These projects vary in size, with the smallest project comprising only five units and the largest 475 units.

The greatest concentration of PHA sponsored projects is in the Northwest (52%), followed by the Northeast (21%). Small agencies managing fewer than 1,000 units of public housing represent half of all LIHTC projects undertaken by PHAs.

Across these projects, LIHTCs are an especially important form of leverage for HOPE VI developments. Since the inception of the HOPE VI program, 121 PHAs have received 237 HOPE VI revitalization grants. The program provides funding to PHAs for the revitalization of distressed public housing through new construction or rehabilitation of existing units. One goal is to create mixed-income communities that include a range of Federally subsidized housing types, market rate units and home ownership units. HOPE VI proposals are rated on their leveraging, with LIHTCs providing one of the major sources.

By 2005, 649 rental phases of development were planned across HOPE VI developments. Most (76%) of these phases included LIHTCs. HOPE VI developments account for 64% of all LIHTC projects managed by PHAs. It should be clear from these statistics that LIHTCs are a nearly indispensable resource for the HOPE VI program. In fact, the phase closing schedules for most HOPE VI projects are built around the allocation timetables for LIHTCs.

Some developers express concern that HOPE VI projects represent too high a percentage of all LIHTC projects. HOPE VI developments, however, only account for approximately 2 percent of all LIHTC projects.

HUD will continue outreach and training to encourage PHA participation in the LIHTC program. LIHTC equity provides a logical and important source of leverage for HUD programs, including HOPE VI and Capital Funds, and the significance of LIHTCs as a leverage funding source among PHAs will likely increase.

In addition to outreach, HUD also provides training and resource materials to assist PHAs in the use of LIHTCs and implementation of mixed-finance projects. These are important resources for PHAs, as some agencies require additional training and information in order to apply for and use LIHTCs as part of their development projects. Mirroring these needs, public housing industry groups such as the Local Initiatives Support Corporation, Enterprise Community Investment, Inc., the Neighborhood Reinvestment Corporation, and the National Association of Housing and Redevelopment Officials, also provide assistance to PHAs in the use of LIHTCs.

As part of these ongoing efforts to increase utilization of LIHTCs by PHAs, collaboration between HUD and IRS on LIHTCs and public housing is important. One idea is the development of an Inter-Agency Agreement (IAA) between HUD and other agencies to collaborate on information sharing and joint outreach efforts related to LIHTCs and public housing. Several examples include:

- Coordination across HUD, PHAs and housing finance agencies (HFA) to target states where LIHTCs are underutilized and volume cap is available.
- Assistance to HFAs interested in the development of Qualified Allocation Plan and Rules (QAP) preferences that increase tax credit unit production for very low-income families at or below 30% of AMI.
- Collaboration across HUD and HFAs to increase outreach to PHAs and provide training in LIHTC financing.

For the Department's Native American programs, the picture is improving. The use of low-income housing tax credits in Indian Country lags behind that of their

public housing counterparts. Many tribes want access to this valuable resource, but under current law and regulations, Indian Housing Block Grant funds used for tenant—or project-based rental assistance in conjunction with low-income housing tax credits are not exempt from the reduction in eligible basis that is available under Section 8 and similar programs.

The Department has been working closely with the IRS to develop the regulatory framework for such a change, but an amendment to the statute authorizing NAHASDA would create a more permanent and clearer resolution of this issue.

*LIHTC and Supportive Housing for the Elderly (Section 202)*

Beyond the public housing program, LIHTCs are also a very important funding source for the Section 202 program. The importance of LIHTCs to this program has increased in line with demographic shifts and programmatic costs. Growth in the elderly population has logically resulted in an increased need for supportive housing that targets the elderly. At the same time, the cost of constructing new units continues to rise making it more difficult for the Department to meet this need. Moreover, the need to renew the rental assistance contracts on existing projects is also increasing, which erodes the funding available to produce new units.

Given these challenges and the availability of LIHTCs, the Department's FY 2008 budget proposes an innovative demonstration program aimed at increasing production of Section 202 units. The demonstration project will seek to utilize LIHTCs and other housing resources (tax-exempt bond financing, HOME Program, private grants, etc.) to expand production under the Section 202 program.

Many view the conjoining of LIHTCs with the Section 202 program to be a step in the right direction for LIHTC projects that target the elderly. For example, according to a 2006 American Association of Retired Persons (AARP) study titled *Developing Appropriate Rental Housing for Low-Income Older Persons: A Survey of Section 202 and LIHTC Property Managers*, "Section 202 properties for older persons have somewhat more success than LIHTC properties for older persons in providing services." It is the goal of the Department to take positive aspects from both programs, drawing on development financing on the LIHTC side and service delivery on the Section 202 side, to produce additional units with strong senior services components.

As part of the demonstration, the Department is conducting a study and meeting with industry experts, stakeholders and housing advocates to identify implementation challenges and other issues related to expansion of the Section 202 program. Some of the areas being explored include:

- Identifying ways to complete projects in a timelier manner, utilizing various funding sources to expand the impact of the limited 202 dollars, and providing enhanced supportive services.
- Identifying and removing barriers (such as legislative exemptions) in the Section 202 Prepayment and Refinancing Program to facilitate the preservation and rehabilitation of existing properties;
- Identifying ways in which HUD can partner with other Federal, state, and local agencies to leverage Section 202 funds.

A draft of the study has been completed and is currently under review. A Notice of Funding Availability (NOFA) for the demonstration program is proposed for the 2008 funding cycle.

The Department has also proposed in its FY 2008 budget a similar demonstration program for Section 811, supportive housing for people with disabilities, that seeks to increase production by addressing certain barriers that would encourage the leveraging of difference sources of funding.

Mr. Chairman, and Members of the Subcommittee, the Department considers LIHTCs to be a significant resource in the affordable housing industry. When coupled with existing HUD programs such as HOPE VI, the Capital Fund, rental subsidies, and Sections 202 and 811, LIHTCs represent a crucial source of leveraged financing in the construction or rehabilitation of affordable housing families at various levels of income. The Department will continue to promote the use of tax credits among PHAs, Section 202 program providers, and other HUD programs.

*Conclusion*

As you have seen from our testimonies today, even though the LIHTC is not a HUD program, the Department does have some important administrative roles in it. We look forward to working with the Congress and our colleagues at the Department of the Treasury to address any difficulties in the program that may require solutions, legislative or otherwise, and I want the Subcommittee to be aware of what areas HUD is examining.

Thank you and I look forward to your questions.

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\*Chairman NEAL. Thank you, Mr. Cabrera. Mr. Desmond, you said that the current, quote “utility allowance” relies on flawed information for rent calculations. Can you explain as much as you’re able to what issues the new regulations will cover and whether this will solve the concerns raised by property owners?

\*Mr. DESMOND. Yes, Mr. Chairman. The issue with the current formula for computing the utility allowance is that it is based on utility costs for older Section 8-type housing. And that may be accurate for older Low-Income Housing Tax Credit buildings, but with respect to newer buildings where utility costs tend to be lower, it ends up imposing a higher utility allowance on those buildings.

What we’re trying to address through our regulation project is to provide more flexibility to the local housing agencies and to owners to use different formulas for coming up with a more accurate determination of the utility allowance. So it is merely to get the accuracy of that formula correct. The current rules are probably correct for older Section 8 housing, but for newer housing, we want to be sure that the formula that’s applied is a realistic formula with respect to the actual utility costs that are being incurred by owners—or by tenants.

\*Chairman NEAL. Thank you. Mr. Cabrera, you testified that combining the development financing of Low-Income Housing Tax Credits with the service delivery of Section 202, that the elderly housing program, shows promise. What is HUD doing to foster such synergy between HUD and the tax credit programs?

\*Mr. CABRERA. Assistant Secretary Montgomery is—who is the Assistant Secretary for Housing in FHA, has undertaken a pilot program in Section 202 to better cobble 202 subsidy with tax credits. One of the big issues is that 202 deals and 811 deals have to bring in a variety of layers of subsidies that both deal with the construction world, which is really the tax credit world, or alternatively, if possible, the PAB world, the private activity bond world, with actual intensive operating subsidy for services well beyond just the operation of the unit but services to the tenant.

And so I believe Assistant Secretary Montgomery has fashioned a program that better melds those two programs.

\*Chairman NEAL. And Mr. Desmond, several of the witnesses we will hear from today are advocating that the 9 and 4 percent housing credit amounts be fixed rather than adjusted or floating. Has Treasury reviewed the proposal? And if so, can you share your thoughts on this suggestion?

\*Mr. DESMOND. We have, Mr. Chairman, and I mentioned that in my testimony as well. I think the issue there is one of balancing the current flexibility. Now the rates float based on ultimately what is fixed to Federal interest rates. So as interest rates go up or down, the amount of the credit will go up and down over the credit period, now the 10-year credit period.

I think the proposal is based on simplifying the formula and the application of the formula for owners, possibly building on a little bit more predictability for their financing. It’s basically the choice

between a fixed rate and a variable rate that I think a lot of people face in determining how they're going to finance a particular project.

And if you fixed it at 4 percent and 9 percent, it would simplify the computations for owners, and it also may lead to a little bit more predictability of the amount of the credit that you'll be getting, obviously still putting the owners at risk with respect to interest rate variations. So I think it's a mechanical issue mostly based on simplicity and one that we have thought about.

\*Chairman NEAL. Mr. English.

\*Mr. ENGLISH. Thank you, Mr. Chairman. Mr. Cabrera, I wonder if you could share with us HUD's view on using historic buildings as a way to increase the amount of affordable housing. And specifically, as you know, I have a bill, H.R. 1043, that the Chairman referenced, which would increase the efficiency of using the Rehabilitation Tax Credit along with the Low-Income Housing Tax Credit. Do you think this is a good idea?

\*Mr. CABRERA. I think it's a good idea in terms of the stakeholder making a determination on the cost benefit analysis. So, for example, if you happened to be in a QCT, which I think is what your bill contemplates, as I recall the language, that augmentation in equity would certainly help the deal.

There are other things that I believe would also help the deal, but certainly in terms of the Historic Tax Credit, it would be of value.

\*Mr. ENGLISH. Thank you. Another question, should the HUD secretary's authority to designate difficult development area be changed to allow the Department to be more nimble in responding to future major disasters?

\*Mr. CABRERA. The short answer to that is yes, Mr. Ranking Member. The reason, though, I have to say is, in my previous life, I was an Executive Director of an HFA, and we were struck by six hurricanes. And one of the things you learn very quickly is DDAs have value, but they become a competitive issue, because you can only have so many DDAs under the Code.

So I would say providing the Secretary with that flexibility, with reasonable and local restrictions, such as there is actually a housing need. There is a presidentially declared disaster area that's, you know, receiving significant subsidy to address that disaster I think has—makes enormous sense.

\*Mr. ENGLISH. Does HUD have specific suggestions for how the Qualified Census Tract provisions of the Low-Income Housing Tax Credit ought to be changed?

\*Mr. CABRERA. HUD has specific thoughts. I'm a little worried about using the word "suggestions." But one of the big concerns—again, I'm going to put my former hat on for a moment—is QCTs move, and sometimes you might develop a deal that looks to address development in a QCT, but the lines change.

And so the issue becomes giving States the flexibility to address those areas or create a determination that preserves the 30 percent bump that you otherwise get under Section 42 in order to preserve the deal. Because what will wind up happening on occasion is you'll have a deal, and part of the deal or a phase of that same deal will

be outside of the QCT, lose its 30 percent bump, and now the deal is handled—is hampered in terms of the pro forma.

So, creating or crafting language that allows that kind of nimbleness, I think, yes, has some value as well.

\*Mr. ENGLISH. And I guess my final question is recognizing that we have limitations on what we could do and this has some budget consequences, do you feel that the case can be made, from your perspective, for substantially expanding the credit? In other words, increasing the amount of the credit available to States and communities, do you feel that there is the demand out there to fulfill this need, and to justify a significant expansion of the credit? And do you believe that's something the Administration could support if it were phased in?

\*Mr. CABRERA. I can't speak to the last part of your question, but I can say that—again, I'm going to rely on a former hat—when I walked into Florida housing, we were receiving five applications for every dollar of credit. Now as the market changed, mostly because of real estate economics in the State of Florida, that came down to four.

So, and my sense of life, as my good friend, Brian Hudson, who is testifying before you in a just a little while, he'd probably say that his experience is the same, and my colleagues or my former colleagues would probably agree with most of what I've just said. Namely, in most places in this country, particularly in places where there's a large population change or a lot of density, the tax credit is an enormously sought-after tool, and a valuable resource.

So, trying to deal with it from that angle would be fine. But I'd say that there are other things that can be done, so that, for example, there's flexibility within the credit. For example, in HOPE VI, it's very difficult to fashion a mixed income deal. It's very complicated, many times because of subsidy layering.

But if one were to fashion a way to take the ownership element for market rate units and the ownership element for tax rated units and allow them to work independently, that within the context of Section 42 could actually help induce more units. From the perspective of HUD, which is always looking at issues of mixed income when it looks at low-income housing, that's an important—that might be an important tool.

\*Mr. ENGLISH. Thank you so much. And thank you, Mr. Chairman.

\*Chairman NEAL. Thanks, Mr. English. The gentleman from California, Mr. Thompson, is recognized to inquire.

Mr. THOMPSON. Thank you, Mr. Chairman, and thank you for holding this very important hearing. Mr. Desmond, in your testimony, you mentioned the complexity of the program and went on to say that it results in increased cost and decrease in efficiency for the subsidy and a burden on the IRS. And I'm interested in knowing if you have any suggestions or recommendations to the Committee how we can alleviate some of those complexities.

And then also, and I don't know if it's part of the same question. I'll let you defer. But I know the industry has come up with a list of recommendations that change the tax credit and to also coordinate the credit with other Federal housing subsidies. And maybe if you could hit on those two issues or a combination of them.

\*Mr. DESMOND. Thank you, Mr. Thompson. The credit itself, the provision in Section 42, is one of the longest statutes in the Internal Revenue Code. It's over 30 pages long, depending on the compilation. So I think there is an enormous amount of complexity in the current statute.

Mr. THOMPSON. You don't have to go over each one, but—

\*Mr. DESMOND. I'll try not to.

Mr. THOMPSON. Thank you.

\*Mr. DESMOND. Any time you have a statute with that many provisions in it, it obviously places a burden upon the taxpayers who are taking advantage of it, in this case the owners, in administering it, understanding it and complying with all of its requirements over an extended period, the 15-year compliance.

Mr. THOMPSON. Is it appropriate to ask you to submit to the Committee suggestions as to how to work out some of those complexities?

\*Mr. DESMOND. I think there are some, and as you mentioned, many stakeholders have also made some suggestions. I will highlight several that I think have been suggested. I think one area of particular complexity and uncertainty is when you combine Section 42 credits with tax-exempt bonds under Section 142.

And there the issue of complexity comes up because of slight mechanical inconsistencies between the two provisions, which although they may be relatively mechanical, do cause considerable problems for owners who are financing projects with box tax credit bonds and tax-exempt bond financing. And for an extended use period, extended compliance period, they need to monitor both provisions and make sure that they're complying with two sometimes inconsistent requirements in both of those Code sections.

Three areas in particular, there's a transient housing rule for both Section 142, the bonds, and for the credit, that encourages people to stay for a long period of time in housing financed by those two provisions. And there are some inconsistencies between the way both 142, the bonds and the credit treat transient housing. I mentioned students in my oral testimony. There are some inconsistencies in treatment of students as tenants in housing finance by both provisions, and also there are some inconsistencies in what we call the next available unit rules, which means if a tenant goes over the income limits, what the owner has to do to replace that tenant with another eligible tenant, some inconsistencies.

So, one area in particular I think that could be improved is to look at the inconsistencies and try to make them a little bit more consistent, make it easier for owners to look at that, to comply with it.

Mr. THOMPSON. Could we get a more comprehensive list from you, I mean, submit it to the Committee? Is that okay, Mr. Chairman?

\*Mr. DESMOND. We'd be happy to come back to you on that.

Mr. THOMPSON. Then the other question I have is the 30 percent bump for difficult areas, is that enough? It seems like—does 30 percent work for everyplace? I know that some of us represent areas where land prices and housing prices are very, very high, and I would suspect that 30 percent wouldn't even help, let alone get a project.

\*Mr. DESMOND. I would, to respond to that question, I would echo my colleague from HUD's comments, that the current credit is in fact oversubscribed. I think we have seen similar observations that it's oversubscribed, in many cases by 5 to 1, that there are \$5 of applications for every dollar. So it appears that on the demand side, there is plenty of demand.

I think your question goes more specifically to the need for housing. Obviously, this is a supply side program and encourages the development of housing as opposed to other programs in the Federal housing incentive area that encourage the demand and give credit, Section 8 credits, for example.

So I think, to answer that question, you really need to look to something outside my lane, which is where is the demand for affordable housing? And this is certainly a very important component of responding to that demand, but it's just one component in the Federal housing structure.

Mr. THOMPSON. Thank you. And then, Mr. Cabrera, one quick question to wrap up here. In your testimony, you noted that seniors have a better time under 202 than the tax credit program. Can you shed a little light on that?

\*Mr. CABRERA. Congressman, can you repeat the question, please? I'm sorry.

Mr. THOMPSON. You had mentioned in your testimony, in your written testimony, that it's more difficult for seniors to work under the tax credit, more difficult under the tax credit program than the 202 program. Can you shed a little light on that?

\*Mr. CABRERA. The real issue is the development of the units. It's a challenge to develop Section 202 units both in terms of the time that it takes to develop the units and in terms of the layering that occurs. One of the challenges often has to do, and this is probably a uniform rule, with distinguishing that Federal grant which you can marry in only very difficult ways with the tax credit, and those things that are not technically—well, they might be considered Federal grants, but they're operating subsidy that are making the deal survive day-to-day. And trying to bridge those rules which are difficult to bridge is a challenge.

Getting room within the statutory stream or the regulatory stream to make that work better would help 202 deals, would help 811 deals, which are for the disabled, in our view. But again, we are extremely deferential to our colleagues at the Service. These are things that have to be workable for them as well.

Mr. THOMPSON. Thank you. Thank you, Mr. Chairman.

\*Chairman NEAL. Thank you, Mr. Thompson. And, Mr. Desmond, we will make the list as requested by Mr. Thompson part of the record. The chair would recognize the gentleman from Connecticut, Mr. Larson.

\*Mr. LARSON. Thank you, Mr. Chairman. Thank you again for holding this important hearing, and thank the witnesses for their testimony. I am a strong supporter of Stephanie Tubbs-Jones and Mr. English's proposal on Community Restoration and Revitalization Act of 2007.

Hailing from New England like the Chairman, there are many communities and many river towns. Hartford is located, as is Springfield, on the Connecticut River, and we have a number of old

factory dwellings and sites that could be rehabilitated but for the lack of Federal funding and usage with respect to housing. What would you propose to remedy this, and do you support the Jones-English/legislation?

\*Mr. CABRERA. Is the "you" me?

\*Mr. LARSON. Yes, Mr. Cabrera.

\*Mr. CABRERA. Congressman, I have to become more familiar with Congresswoman Tubbs-Jones' legislation, but I think one of the things that I would always come back to within the context of either Section 42 or Section 142 is provide greater latitude within the context of trying to get deals done with a variety of different subsidies, and not penalize the deal by virtue of their existence.

There are subsidies and then there subsidies. For example, project-based Section 8. Project-based Section 8 is a well known subsidy, and for very good reasons, there were limits imposed about who can access tax credits once you come out of the contracting project-based Section 8. Revisiting that issue is probably a terrific idea. Why? Well, one of the challenges today is the preservation of affordable units. And although it made sense at the time to deal with that, it probably doesn't—it doesn't make as much sense now.

A second thing that I would probably think about is revisiting the 10-year rule on acquisition tax credits. Why? Again, it's a preservation issue. At the time you had concepts in the Code; accelerated depreciation, for example, that really today aren't as salient. And so if the mission is let's preserve and build units, that is one way to do it. And so that's what I would offer.

\*Mr. LARSON. How would you expedite that?

\*Mr. CABRERA. I don't. I think you do.

\*Mr. LARSON. Well, in terms of—in terms of what kind of specific legislation? Is there anything—I take it you're not familiar with the Jones legislation, which I think seeks to amend Section 47? And maybe I'd yield to my colleague from Pennsylvania to—but I think the path that you're going down makes an awful lot of sense.

What we hear from interested parties and developers is that because they can't get their hands on the money and because of the constraints that are placed upon them, you have these structurally sound buildings that just continue to deteriorate and become a blight when they could otherwise become an important cog in the center of the community.

\*Mr. CABRERA. There's another side to that, though, and that is, it's often very difficult, and we face this as well. This is the counter-argument to the historic issue not in a QCT. So very often, for example, in public housing, many of those assets are 70 years old and the open and notorious question is should they be preserved? They are so old that maintaining them is far more expensive than just building something different.

Not necessarily, you know, public housing is a stream of finance. It is an operational stream of finance. So the tax credit, getting PHAs to a point where they can utilize a tax credit or private activity bonds or other pools of subsidy to create a wider spectrum of units financed in a variety of ways that serve the same bandwidth

of people, that's really what we've been focused on for quite a while now. I think that's probably the play that we most often use.

With respect to specific legislation, it's very hard to craft from this table right now. But at the end of the day, that would be the way that—that is the way that we usually—the track we usually take.

\*Mr. LARSON. I thank you very much.

\*Mr. CABRERA. Thank you.

\*Chairman NEAL. We'll eagerly await your answers, Mr. Larson. The gentleman from Minnesota, Mr. Ramstad, is recognized to inquire.

\*Mr. RAMSTAD. Thank you, Mr. Chairman. I'd like to thank my good friend, Chairman Neal, for holding this important hearing on affordable housing and for your outstanding leadership in this critical area.

I enjoyed working with you, Mr. Chairman, in the last Congress when you joined me in introducing H.R. 4873, which would have made several improvements to the housing bond and credit programs, and I look forward to working with you this session as well. Also, Ranking Member English was a cosponsor of that legislation and has been an important leader on affordable housing. I appreciate your contributions. I'm looking forward to working with both of you and all the Members of the Committee this year on common sense reforms to make these critical programs work even better.

In my suburban district, I represent 34 suburban cities and one township, and virtually all of the cities, all 34 cities, have a waiting list for affordable housing, which isn't too atypical vis-a-vis the rest of the country. Certainly housing is one of our most basic needs, and it should never—my basic belief is that it should never be priced far out of reach for America's families.

We worked on the reforms in H.R. 4873 with State housing agencies and other key groups who support affordable housing, and those groups are—many of them are represented on the other panels here today and are in audience, and we appreciate their collaborative efforts as well.

I am very much optimistic that we can produce a collaborative and consensus bill, and I hope the bipartisan spirit, the spirit of cooperation on the Committee will produce such a work product. If any area of legislation should be bipartisan, it should be housing. We're dealing with a basic need, as I said before, of the American people. And we need to help more Americans afford the housing they need.

In fact, the other month, a couple months ago, a study was done in the community where I live, in Minnetonka, Minnesota, and the bottom line, the conclusion of the study was that no firefighter or police officer could afford to buy a house, and most didn't have the income to support the rents being charged in that community.

Let me direct a question to you, Mr. Cabrera. And by the way, I'm glad that both Treasury and HUD are represented at this hearing. Both departments obviously play a critical role in making sure that our affordable housing programs work. And as we consider reforms this year to make the housing bond and credit programs more efficient, work better, serve people better, I trust we can

count on both Treasury and HUD to continue working with us in that spirit as well of bipartisan cooperation.

The question I have for you, Mr. Cabrera, one of the reforms I've proposed is allowing the low-income housing credit to be used for Section 8 moderate rehabilitation housing. Does HUD have a position on this proposal?

\*Mr. CABRERA. That's what I just mentioned, Congressman. I would say that that would—removing that restriction would be helpful in terms of helping preservation. Again, with the caveat that our good friends at Treasury have their concerns. From a policy perspective. If you have project-based vouchers, and you have a HAP contract that's expiring, and then you take that improvement and exclude it from the field of possibility in terms of affordability, that does not help the overarching policy goal of retaining affordability.

So we would say, yes, we would be in favor of that.

\*Mr. RAMSTAD. Okay. I just wanted to follow up on the previous colloquy that you had with the Speaker—with the Member. Well, thank you again, both of you, for your testimony, and thank you, Mr. Chairman, for allowing me to be here today as a Member of the full Committee but not this Subcommittee, I appreciate the invitation very much. Thank you.

\*Chairman NEAL. Thanks for your good work, Jim. The gentlelady from Pennsylvania, Ms. Schwartz, is recognized to inquire.

\*Ms. SCHWARTZ. Thank you. And good morning. I want to ask a little bit more about Section 8 housing. I come from a district that has had some issues with Section 8 housing. I understand of course that it's been a very successful initiative across this country.

One of the questions that certainly come up in my district and some of the concerns expressed about Section 8 housing has to do—well, a couple of them. One is in the concentration of Section 8 units. This is more about the scattered site single units rather than a building that has many units in it, that seems to be less of a problem in the way.

I think it might be the opposite, but it's sort of the scattered sites all across a part of my district, and really about two issues with that is the quality of the particular unit or home and the maintenance of that, the sort of ongoing. It may start out fine, but then the oversight that is, or lack thereof, of how that site is maintained by the owner, as well as by the tenant, and about perceived, you know, tolerance of criminal behavior and activity in those sites.

I know there are certain rules around all of this, but really my question I think for I guess mostly for HUD here is, what about the oversight from the Federal level to make sure that we are seeing full compliance? And how do you respond to, you know, particular situations such as in Northeast Philadelphia, which is an area I represent, that has had some very significant concerns about Section 8 housing?

And it's a community, of course, that's also concerned about moving from home ownership to rental units. There is a perception that some of these buildings are actually not Section 8 housing, they're just private rental, and that has caused a problem. But it's exacerbated in a neighborhood.

So, again, it's concentration and it is oversight and compliance for ongoing maintenance and quality of these units. So I believe you refer to it as standards of habitability. So it's really both initial standards and compliance with those standards, and ongoing oversight that these units continue to be maintained well.

Can you speak to your oversight and what response you have had? You may be well aware of the situation in Philadelphia.

\*Mr. CABRERA. I think that there are two answers. The first one has to do with the overall world of Section 8, whether it involves a property that is financed with Low-Income Housing Tax Credits or private activity bonds or not. And then those that have to do with those discrete programs.

So I'm going to address the more general world. There are two Section 8 programs essentially. They're not. There's only one, but there's two applications of it. There's tenant-based rental assistance where one receives a voucher and one goes to someone in the market and redeems that voucher for housing. So the concentration issues there are actually the choice of the landlord in the private marketplace.

The HQS standards, Housing Quality Standards, that apply to that, are pretty rigorously enforced, at least according to landlords that report to us. And in fact, they often say too rigorously enforced, and sometimes they say inconsistently enforced.

\*Ms. SCHWARTZ. Do you have data on that? Do you actually—

\*Mr. CABRERA. We have a lot of data.

\*Ms. SCHWARTZ. Can you say—

\*Mr. CABRERA. Sure.

\*Ms. SCHWARTZ. Would you say that it's really—the compliance data and to find out where it actually is working, where it isn't, and—

\*Mr. CABRERA. Absolutely.

\*Ms. SCHWARTZ. That would be certainly helpful. And how often you applied a penalty and—

\*Mr. CABRERA. HQS are done at least annually and certainly on move-in. But there's a second component to Section 8, which is project-based vouchers. And project-based vouchers attach to the unit, not the tenant. And so they are basically an operating subsidy for a number of units within a development or all of the units within a development. Those are more rigorous HQS standards than the tenant-based voucher system, because there is an assumption that you have reserved those vouchers for those units.

\*Ms. SCHWARTZ. Right. As I said, so maybe I'm not using the right—the project-based seems to have, you say better standards, has greater compliance. There's often a manager. There's someone who's actually watching it on a very regular basis.

\*Mr. CABRERA. Right.

\*Ms. SCHWARTZ. It's really the tenant vouchers that is the issue—that is an issue within my district.

\*Mr. CABRERA. Okay.

\*Ms. SCHWARTZ. So I would be interested to see information you have about violations and about compliance, about how rigorous those annual inspections are, and response that we see in terms of that compliance and what gets done. Certainly I think if

we start to see some real penalties applied, rather than sort of a bit of a slap on the wrist, fix this, and you move on, would be helpful in letting landlords know that this actually is—we're serious about this. And I think it has to come from the top, which is really—would be coming from the Federal level, would be very, very helpful to us.

\*Mr. CABRERA. We're happy to provide you the data that you requested.

\*Ms. SCHWARTZ. Okay.

\*Chairman NEAL. Thank—

\*Ms. SCHWARTZ. My time is up? Okay.

\*Chairman NEAL. I thank the gentlelady.

\*Ms. SCHWARTZ. Thank you very much.

\*Chairman NEAL. The gentleman from Oregon, Mr. Blumenauer, is recognized to inquire.

\*Mr. BLUMENAUER. Thank you, Mr. Chairman. I'm curious if you gentlemen may have some thoughts about ways that we stretch this scarce resource to get the most value of out of it.

One of the things that is intriguing to me is that in many parts of the country, we have opportunities to have some location efficiencies, that there are cost factors that are involved in terms of the transportation demands for the people who live in the housing, what's energy efficient. Paradoxically, many of the areas that are potentially location efficient in terms of energy demands, the carbon footprint of these people, something our Committee is looking at in a wide variety of contexts, have very high property values.

Is there some thought that you folks have given or some guidance that you can give us now, or upon reflection, to send back to the Committee, if there are adjustments that can be made in criteria to make allowance for projects that are location-efficient, that have fewer demands on the tenants, occupants themselves for transportation—which for many of these people, they spend more on transportation than they do on housing itself—and in terms of our societal efforts to try and be more energy efficient, reduce the carbon footprint, that we might be able to meet affordable housing goals plus our concern about global warning and energy independence? Any thoughts about adjustments to the programs?

\*Mr. DESMOND. Sure. I can address that, Congressman. There are, as you know, a number of incentives that have been put in the tax Code recently to incentivize energy-efficient homes, energy-efficient buildings that are not targeted to low-income or affordable housing. And I think those are very important incentives, those are very important programs.

We have been working at Treasury to try to implement many of the provisions from the Energy Tax Policy Act of 2005. And I would make an observation on that provision or that Act similar to the observation about Section 42, which is it's extremely complicated. There are many complexities in energy efficiency, and oftentimes the tax Code is not the best vehicle for measuring and determining energy efficiencies, things that are sort of outside the lane of tax administrators.

I think that energy efficiency is a very important goal, something that the Administration has supported in a number of different areas. I do just make the observation that if you want to take the

fairly complicated energy incentives in the Energy Tax Policy Act, those kinds of things for energy-efficient buildings and energy-efficient homes, and apply those to another program, such as Section 42, just an observation about the complexity that may result from that, and inefficiencies that will come about as a result of that in terms of owners trying to apply those and use those two fairly complicated areas and apply them together.

I think there is some work that can be done in that area, but I would just make that observation about whether we would have an administrable program from the tax administrator's perspective at the end of the day.

\*Mr. BLUMENAUER. I appreciate your observation. One of the things we have been working on, on this Committee, we've been in consultation with Chairman Frank in Financial Services. There's some of the work with the GSE and others that they're doing there and with the Global Warming Committee, is that there may be some way that we can synthesize this to make it less complex, to be more direct, to be more clear about what our priorities are in terms of affordable, sustainable housing that reinforces our goals of community development and energy independence.

I appreciate this may be a little off point in terms of what you were planning to talk about today, but I wanted to plant the seed, and, Mr. Chairman, invite observations that our witnesses here or on subsequent panels may have about ways that we can integrate this rather than have scattershot efforts, tax Code, housing, with two or three different Committees on energy, that the extent to which they can be integrated and focused, we may be able to start with the work that you've already been doing with some of the energy incentives.

I appreciate your courtesy and would welcome any observations that people may have upon subsequent reflection.

\*Mr. CABRERA. May I add one comment? When my colleague, Brian Hudson, comes up in a little while, he will note that when States develop qualified allocation plans and their competitive cycle, very often they will award points for precisely those things that you've just mentioned—proximity to public transportation, proximity to services, proximity—I'm sorry, use of energy-efficient appliances.

So—but that's something that is very much handled within the concept of each State's QAP, and you will see that pretty widely within all jurisdictions.

\*Mr. BLUMENAUER. We have entertained some of that in my State of Oregon. I'm not certain that it might not be an area that we could give some guidance and some uniformity so that it is applied more broadly to get the most of these investments.

Thank you very much.

\*Chairman NEAL. I thank the gentleman. The gentleman from Washington, Mr. McDermott, will inquire.

\*Mr. MCDERMOTT. Thank you, Mr. Chairman. I'd like to ask both of you, I chair the Subcommittee on Income Security and Family Support. And one of the programs that we deal with is the program of foster children in this country. Now when you get to be 18 years old, the system drops you out on the street with nothing.

You get a better deal coming out of the penitentiary than you do getting out of foster care.

And I would like to hear, what's the likelihood that a youngster could get a low-income housing situation in this country at 18? A single youth.

\*Mr. DESMOND. I could start off and let my colleague from HUD build on this, but I think one observation that people have made about both Section 42, the credit, and low-income housing bonds, is that they are not targeted to the very low-income individuals in-households. They are based on rental—average area house—or incomes, and rents are set to average area incomes. For individuals who have very low-income, it's more difficult for them to meet even those reduced income standards.

So that in a program like Section 42, the credits and the bonds, if it has an income-based component to it, oftentimes that works to the exclusion of very low-income households, and oftentimes I would suspect foster children may fit into that category and not benefit.

\*Mr. MCDERMOTT. Is that in the law? Did you have to do it that way? Or is that by rule and regulation?

\*Mr. DESMOND. I believe the law has in it the income-based calculation of the maximum rent that can be charged to tenants of these facilities. So that is part of the statute. There are other programs that my colleague from HUD can talk about, the voucher programs and other things, that may not be tied in their statutes to the income levels in the area. But the bonds and the credits we're talking about here are in fact keyed to income, area income levels.

\*Mr. CABRERA. Most of the units that you've just described, Congressman, are what serve a group of folks that we call extremely low-income people, people between 0 and 30 percent, vary in medium income. Things are not measured in terms of age as much as in terms of income.

And when those units are constructed, be they by a public housing authority or anybody else that's an applicant developing these units, when you aim to create units that serve that population, those become deep subsidy units. Those become units that require funding layers above that equity that is brought in by Section 42. Or if it's a debt deal that can survive above the debt that's created by the mortgage in the private activity bond program.

That money typically comes from a variety of sources, including the State, the local government. There are efforts that I am aware of, notably in my home State of Florida, to create demonstrate programs to serve that bandwidth. Those are generally done on a State-by-State basis.

\*Mr. MCDERMOTT. Let me add a further complication. This young 18-year-old foster kid is smart, gets himself a scholarship and is also a student. Now, can he qualify?

\*Mr. CABRERA. I want to—my first instinct is, this is a Code issue, and so I'd like to defer to Mike first.

\*Mr. DESMOND. Certainly there's nothing that precludes a student from being able to live in low-income housing. There are some rules that I mentioned in my testimony precluding housing units

from being occupied only by all full-time students. I think your question goes to something different if you are—

\*Mr. MCDERMOTT. Why—that's a regulation or that's in the law?

\*Mr. DESMOND. I think it's in the law, and there's some legislative history that speaks to students occupying Section 42 tax credit-financed units.

\*Mr. MCDERMOTT. So if they're living there with their girlfriend, they could qualify still? If there's somebody else who isn't in school living there?

\*Mr. DESMOND. Right. And for the bond finance program, there's actually a rule that requires you to be—if you are a full-time student, to file a joint income tax return with someone else. So it would have to be with a spouse who is not a student. But, again, I'd come back to the income requirements.

\*Mr. MCDERMOTT. You mean a single person cannot get into one of the units? They have to be married?

\*Mr. DESMOND. For the bond finance, a single student cannot. They would have to be filing—a single, full time student would have to be filing a joint return with a spouse in order to be eligible. There's a different rule under the tax credit provisions.

\*Mr. MCDERMOTT. Give me the justification for that. Why can't a single student not—he works 40 hours a week. He's going to school part-time at Seattle Community College, and he wants into a housing unit. Why is he—what's the justification for that? Just in the law. Is that it? We have to change the law to make that possible?

\*Mr. DESMOND. Right. And as I said, there's legislative history back in 1986 that speaks to that. I'd have to go back and review that. I think overall, the concern is that the tax, the Federal tax incentives not be used to subsidize all college students living in federally subsidized housing. I think what you're speaking to is certainly a much more narrower concern. It's not all college students. It's just a, you know, low-income individuals. So I'd have to go back and look at the legislative history to see what Congress's original concern was. But that is in the rules as they're currently written.

\*Mr. MCDERMOTT. Thank you.

\*Chairman NEAL. Let me thank the panelists for their testimony today, and I'd like to call up the second panel now.

Let me welcome the second panel.

Mr. Donovan.

**STATEMENT OF SHAUN DONOVAN, COMMISSIONER, DEPARTMENT OF HOUSING PRESERVATION AND DEVELOPMENT, NEW YORK, NEW YORK**

\*Mr. DOVONAN. Thank you, and good morning, Chairman Neal, Ranking Member English, and Members of the Subcommittee. I am Shaun Donovan, Commissioner of the New York City Department of Housing Preservation and Development, or HPD.

I want to thank you for inviting me to testify before the Subcommittee today, and I especially want to thank Chairman Rangel. New Yorkers are fortunate to have him representing us. He is a tireless advocate for his constituents and for affordable housing.

HPD is the nation's largest municipal housing development agency. As part of our responsibility, HPD directly allocates approximately \$12.5 million in 9 percent Low-Income Housing Tax Credits each year. In my capacity as Commissioner of HPD, I also serve as Chairman of the Housing Development Corporation, or HDC, New York City's Housing Finance Agency, which is the largest issuer of multi-family affordable housing bonds in the nation.

The crisis of abandonment that plagued many New York communities in the seventies and eighties was solved by rebuilding neighborhoods, driving down crime, and improving schools. Hundreds of thousands of people have moved back to New York to share in our success, and we are predicting that New York City's population will grow by close to a million by the year 2030. That population growth will add to our current challenge of housing affordability.

On Earth Day, Mayor Bloomberg unveiled PlaNYC 2030, which includes a commitment to create enough affordable and environmentally sustainable housing for our growing population. That pledge builds on the commitment made in Mayor Bloomberg's New Housing Marketplace Plan to fund the construction and rehabilitation of 165,000 affordable apartments by 2013.

We have already reached one-third of our goal—55,000 units of affordable housing have been created or preserved in New York City since 2004. But it has not been easy. The rapid rise real estate prices in New York, also experienced by many other cities around the country, has challenged us to find new and creative ways of doing business.

Through re-zonings, inclusionary housing initiatives and changes to our local tax incentive programs, we have been able to harness the strength of the private market to create affordable housing. This would not be possible without Federal partnership in the form of Low-Income Housing Tax Credits and tax-exempt private activity bonds. These two programs have created thousands of units of housing that otherwise would not be affordable to low- and moderate-income New Yorkers.

With the scale and ambition of the Mayor's housing plan, we now face a challenge caused by our success. We find ourselves needing more tax credits and private activity bond volume cap to be able to keep pace with our commitment to produce more affordable housing. Throughout New York State, demand for 9 percent credits outstrip supply by at least 3 to 1.

In addition to allocating more credits, we hope that the Subcommittee will consider changes to the program that have been championed by the National Council of State Housing Agencies and others, most notably, fixing the housing credit percentages at 4 and 9 percent; removing the prohibition on using 9 percent credits with other Federal subsidies; and synchronizing HOME and tax credit rules.

New York City is facing an immediate crisis in private activity bond volume cap, which we expect to deplete before the end of June this year. Without additional volume cap, almost 7,000 units of housing in our pipeline will not be built. We have shared with Chairman Rangel two possible solutions that we what hope you will consider.

The first is to allow for recycling or refunding of multi-family bonds after principal repayments or prepayments of the bonds. This is already permitted in the single-family program, and we believe that this proposal would free up millions of dollars in volume cap at little or no cost to the Federal Government.

Second, we hope you will consider raising the allocation of volume cap for high-cost areas. The tax credit program allows for a higher credit in difficult development areas, or DDAs, out of recognition that it is more expensive to build in some markets than others. Similarly, an additional allocation of volume cap to States with difficult development areas would help States where the current volume cap allocation is not sufficient to cover costs and demand.

We are also strongly supportive of Chairman Rangel's idea for a new tax credit to create housing for people earning between 60 and 80 percent of median income. In keeping with the current affordable housing bond and tax credit rules, the majority of new affordable housing development in New York using these programs follows an 80/20 model, in which 80 percent of the units are market rent and 20 percent of the units serve people with incomes below 50 percent of area median income.

But there is a real need for affordable housing for people higher on the income spectrum. Over half of the renters in New York City now spend more than 30 percent of their income on rent. We believe an additional credit could work in tandem with the Low-Income Housing Tax Credit and private activity bonds, and I have provided more details on this in my Statement for the record.

In closing, I'd like to thank you for the opportunity to testify, and for prioritizing the programs that we're discussing today. The Subcommittee's leadership has been crucial to the success we've had developing and preserving affordable housing in New York City and across the nation.

Thank you.

[The Statement of Mr. Donovan follows:]

**Statement of Shaun Donovan, Commissioner, Department of Housing  
Preservation and Development, New York, New York**

Good morning Chairman Neal, Ranking Member English, and Members of the Subcommittee. I am Shaun Donovan, Commissioner of the New York City Department of Housing Preservation and Development (HPD), the nation's largest municipal housing development agency. I want to thank you for inviting me to testify before the subcommittee today, and I especially want to thank Chairman Rangel. New Yorkers are fortunate to have him representing us—he is a tireless advocate for his constituents and for affordable housing.

HPD is the nation's largest municipal housing development agency. As part of our responsibility, HPD directly allocates approximately \$12.5 million in 9% tax credits each year. In my capacity as commissioner of HPD, I also serve as Chairman of the Housing Development Corporation, or HDC, New York City's Housing Finance Agency which provides bond financing for affordable housing projects.

The crisis of abandonment that plagued many New York communities in the 1970's and 80's was solved by rebuilding neighborhoods, driving down crime and improving schools. Hundreds of thousands of people have moved to New York to share in our success and we are predicting that New York City's population will grow by close to a million by the year 2030. That population growth will add to our current challenge of housing affordability. On Earth Day, Mayor Bloomberg unveiled PlaNYC 2030, which includes a commitment to create enough affordable and environmentally sustainable housing for our growing population. That pledge builds on the commitment made in Mayor Bloomberg's New Housing Marketplace Plan to

fund the construction and rehabilitation of 165,000 affordable apartments and homes by 2013.

We have already reached 1/3 of our goal—55,000 units of affordable housing have been created or preserved in New York City since 2004. It hasn't been easy. The rapid rise in real estate prices in New York, also experienced by many other cities around the country, has challenged us to find new and creative ways of doing business. Through rezonings, inclusionary housing initiatives and changes to our local tax incentive programs, we have been able to harness the strength of the private market to create affordable housing. This would not be possible without Federal partnership in the form of low-income housing tax credits and tax-exempt private activity bonds. These two programs have created thousands of units of housing that otherwise would not be affordable to low- and moderate-income New Yorkers.

With the scale and ambition of the Mayor's housing plan we now face a challenge caused by our success—we find ourselves in a position of needing more tax-credits and private activity bond volume cap to be able to keep pace with the demand and need for more affordable housing. Throughout New York State, demand for 9 percent credits outstrips their supply by 3 to 1.

In addition to allocating more credits, we hope that the Subcommittee will consider changes to the program that have been championed by NCSHA and others, most notably—fixing the housing credit percentages at 4 and 9 percent, allowing 9 percent projects in difficult development areas to use HOME funds and still be eligible for the 30 percent basis boost, and synchronizing HOME and tax credit rents and eligibility rules.

The actual percentages for the “4” and “9” percent tax credits fluctuate monthly and are consistently below those maximum amounts. For example, the May 2007 percentages are 3.47% and 8.11%. Fixing the credit percentages at 4 and 9 percent would increase the value of the credits, make the program easier to administer, and make the process more transparent.

Tax credit projects in difficult development areas are eligible for a 30-percent increase in the value of the credits. The additional 30 percent is lost if the project includes HOME funds. Difficult development areas are by definition areas that have high construction, land, and utility costs relative to the area median income. It is because the costs are high that additional subsidies are needed. Reducing the value of the credits because of the presence of HOME funds limits the flexibility needed in tight markets to create affordable housing.

Similarly, synchronizing HOME and tax credit rents and eligibility rules would make the combined use of these two programs much easier. Issuers would benefit from simpler and more predictable financial underwriting, and owners would be better able to stay in compliance with program rules after lease-up.

New York City is facing an immediate crisis in private activity bond volume cap, which we expect to deplete before the end of June. Without additional volume cap, 6,700 units of housing in our pipeline will not be built. We have shared with Chairman Rangel two possible solutions that we hope you will consider. The first is to allow for “recycling” or, “refunding” of multi-family bonds after principal repayments or pre-payments of the bonds. This is already permitted in the single family program and we believe that this proposal could free up millions of dollars in volume cap at little or no cost to the Federal Government. The second is to allocate additional volume cap to States with high cost areas.

A multi-family bond allocation penalty occurs through “burn-off” when tax credit equity proceeds pay off construction bonds after two to 3 years because affordable developments can not support the full amount of the bonds issued. Thus, through early principal repayments and unscheduled prepayments, a large portion of multi-family housing bond proceeds are lost via burn-off and bonds that could have otherwise been outstanding for as long as 48 years are used only for a few years. Bonds issued for single family homes and student loans are allowed to be recycled within their first 10 years of issuance. This proposal does not call for low income tax credits to be attached to the recycled bonds as they are in the initial issuance.

Two changes, one in regulation and one in statute are required to allow for the refunding of multi-family bonds. The first, Treasury regulation 1.150-1(d)(ii)(B), should be amended to specifically provide that the obligor of an issue used to finance qualified residential rental projects does not include the recipient of the loan. Under current regulations, if the issuer does not know who the borrower will be for the recycled project at the time of original issuance, then the bonds can not be re-used. Rental projects would thereby be treated like obligors of issuers financing qualified mortgage loans, qualified student loans and similar program investments. The second change needed is to Section 42 of the Code providing that recycling prepayments into other projects, either directly or through a refunding issue, satisfies the requirement of Section 42(h)(4)(A)(ii) that “principal payments on such financing

are applied within a reasonable period to redeem obligations the proceeds of which were used to provide such financing.” This broadening would permit recycling.

We also hope you will consider raising the allocation of volume cap for high cost areas. The tax credit program allows for a richer credit in difficult development areas (DDAs) out of recognition that it is more expensive to build in some markets than others. Similarly, an additional allocation of volume cap to States with difficult development areas would help States where the current volume cap allocation is not sufficient to cover costs and demand. This could be done either by making an additional allocation to States for the population living in a DDA, which would increase the allocation of volume cap for 37 States and by 17% overall, or by increasing the volume cap for States with more than half of their population living in a DDA. This would increase the overall allocation of volume cap by 13%.

We are also strongly supportive of Chairman Rangel’s proposal for a new tax credit to create housing for people earning between 60 and 80 percent of median income. We believe that such a proposal is especially needed, and would work especially well, in high cost areas. Should Congress allocate additional volume cap for high cost areas, it could be made in tandem with the flexibility to use tax credits to serve this income bracket.

In keeping with the current affordable housing tax credits, the majority of new affordable housing development in New York follows an 80/20 model, in which 80% of the units are market rent and 20% of the units serve people with incomes below 50% of area median income. But there is a real need for affordable housing for people higher on the income spectrum. Over half of the renters in New York City spend more than 30% of their income on rent. We believe an additional credit could work in tandem with the low-income housing tax credit and private activity bonds.

In New York City, residential rental buildings are eligible for tax exempt bond financing and 4% as-of-right tax credits if 20% of the units are rented to households earning less than 50% of area median income or 25% of the units rented to households earning less than 60% of area median income. This program has been widely utilized in Manhattan where there is extensive 80/20 development that includes 20% of the units at 50% area median income. Outside New York City, 20% of the units must be at 50% of area median income or a developer can provide 40% of the units to households earning less than 60% of area median income.

A “mixed income housing tax credit” (MIHTC) would reflect the same characteristics of the low income housing tax credit: utilize tax-exempt financing, be paired with the low-income housing tax credits, and target a small segment of overall tax credit unit production. Though project types and characteristics would vary by region, the following proposal characterizes a LIHTC/MIHTC structure that would be typical for the New York region.

A new MIHTC could be based on and coupled with the existing as-of-right 4% LIHTC credit. Coupling or linking the credits provides a structure that doesn’t compete with, but instead builds upon the existing program. A MIHTC program could modify the 80/20 structure into a 50/30/20 or 60/20/20 structure, making projects eligible to receive tax credits not only on the 20% low-income units (as in an 80/20 structure) but also on an additional percentage of units if they are occupied by households earning up to 80% of AMI. A new tax credit rate would be created for this structure and it would be applicable to all 40% of the affordable units. Our modeling shows that a tax credit rate between 6–8% would be the most effective.

In closing, I’d like to thank you for the opportunity to testify, and for prioritizing the programs that we’re discussing today. The Subcommittee’s leadership has been crucial to the success we’ve had developing and preserving affordable housing in New York City, and across the nation.

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\*Chairman NEAL. Thank you, Mr. Donovan.  
Mr. Lee.

**STATEMENT OF OLSON LEE, DEPUTY EXECUTIVE DIRECTOR,  
CITY OF SAN FRANCISCO REDEVELOPMENT AGENCY, ON BE-  
HALF OF NATIONAL ASSOCIATION OF LOCAL HOUSING FI-  
NANCE AGENCIES**

\*Mr. LEE. Good morning, Mr. Chairman, and Members of the Subcommittee. I am Olson Lee. I’m the President of the National

Association of Local Housing Finance Agencies and the Deputy Executive Director of the San Francisco Redevelopment Agency.

We appreciate the opportunity to share our views on refinements to the Low-Income Housing Tax Credit program. Supporting my testimony today are the U.S. Conference of Mayors, the National Association of Counties, and the National Community Development Association.

The Low-Income Housing Tax Credit program is the Federal Government's principal means of stimulating private sector investment in the production of affordable rental housing. With these credits, local and State housing finance agencies and their private and nonprofit partners produce an average of 110,000 newly constructed or rehabilitated units annually. It is the essential resource in the affordable housing tool kit.

In San Francisco, the Redevelopment Agency and the Mayor's Office of Housing has used the tax credit program to construct, acquire and rehabilitate over 20,000 units, including over 2,000 units of at-risk housing, housing for the formerly chronically homeless, workforce housing, as part of the San Francisco's redevelopment project areas, and public housing.

NALHFA and our partners urge the Subcommittee and Congress to adopt a number of refinements to the tax credit program. As local housing finance agencies, we share the responsibilities of providing the gap financing for most affordable housing projects in our communities. Our suggested refinements are organized as follows:

- Increase the effectiveness of the current credits;

- Provide for greater flexibility when credits are used with tax-exempt bonds.

Congress can increase the effectiveness of the credit by eliminating or modifying certain rules related to the use of credits with other funding sources. Many of these rules date to the earliest days of the credit program and were incorporated to prevent over-subsidizing a project. Even if the majority of these refinements are adopted, local housing finance agencies would still need to provide gap financing to make projects feasible. Our suggested refinements include:

- Exempting the Low-Income Housing Tax Credit from individual and corporate alternative minimum tax. And this would allow individuals to participate in the Low-Income Housing Tax Credit. And individuals would be a good source for additional equity for the program. But individual taxpayers that are subject to the AMT lose nearly all of the tax benefits they would otherwise receive from this investment. Because individual investors invest much smaller amounts than the corporations who currently are the largest investors in the credits, they base their decisions on characteristics such as the location of the project, the size of the project, or the population to be served by the project.

- Modify the tax credit Code to ensure the eligibility for 9 percent projects containing subsidies from all Federal programs. For example, as the earlier speaker said, Section 202 or Section 811 funds and the Federal Home Loan Affordable Housing Program funds trigger a reduction in value of the credit from 9 percent to 4 percent.

Remove the restriction in the tax Code that prevents tax credit projects from receiving the 9 percent credit and below-market-rate loans from HOME funds from getting the 30 percent tax credit bonus in designated low-income census tracts or difficult-to-develop areas. This would facilitate the development in high-cost areas.

As the earlier speaker said, set the value of the tax credit to 4 and 9 percent, again, a simplification.

My full Statement has a list of other changes that would further increase the effectiveness of the credit by, again, eliminating these unnecessary regulations, to increase the ease in which the credit is used, but clearly to increase the ability for the credit to bring capital to our low-income renters in our communities.

The next set—and I'll just read these, because they're part of the written record—is to talk about the greater flexibility:

Modifying the low-income credit to allow bond issuers to exchange a portion of tax-exempt bond allocation for the authority to issue a higher credit amount.

Modify the Low-Income Housing Tax Credit to allow housing bond issuers to forego 4 percent tax credits in exchange for additional bond volume cap.

Extend the eligibility for 4 percent credits to units with tenants up to 80 percent of median income after meeting the base project affordability requirements in communities with severe shortages of housing for this group.

And if I may just continue, I have three more items, then I'll wrap up:

Exempt tax-exempt bonds, again, from the AMT.

Repeal the mortgage revenue bonds tenure rule, which prevents the recycling of single-family mortgage payments.

And permit the recycling of multi-family bonds, as permitted for single family.

And provide exit tax relief to encourage owners of affordable housing to transfer such housing to non-profits who will maintain the long-term affordability of such housing.

Mr. Chairman, I thank you very much for the opportunity to present NALHFA's recommendations on these critical issues. And they're really in the spirit of using the existing resources and building more affordable housing.

**Statement of Olson Lee, Deputy Executive Director, City of San Francisco Redevelopment Agency, on behalf of the National Association of Local Housing Finance Agencies, San Francisco, California**

Mr. Chairman and Members of the Subcommittee:

On behalf of the National Association Local Housing Finance Agencies (NALHFA), thank you for the opportunity to testify today on refinements to the Low-Income Housing Tax Credit program. I am Olson Lee, President of NALHFA and Deputy Executive Director of the City of San Francisco Redevelopment Agency. NALHFA is a national non-profit organization of city and county government agencies and their partners that finance affordable housing through a variety of means including Federal tax incentives such as the Low-Income Housing Tax Credit (LIHTC). We appreciate this opportunity to share our views. Supporting my testimony today are the U.S. Conference of Mayors, National Association of Counties, and the National Community Development Association.

The Low-Income Housing Tax Credit program is the Federal Governments' principal means of stimulating private sector investment in the production of affordable rental housing for low- and very-low income Americans. The tax credit is available in two forms: a competitive 9% or 70% present value credit allocated by state and a handful of local governments and a non-competitive 4% or 30% present value

which is used with tax-exempt multifamily housing bonds. With these credits, local and state housing finance agencies, and their private and non-profit partners, produce on average 110,000 newly constructed or rehabilitated units annually. It is an essential resource in the affordable housing tool kit.

In San Francisco, the Redevelopment Agency and the Mayor's Office of Housing has used the tax credit program to construct, acquire, and rehabilitate over 10,000 units including over 2,000 units of housing at-risk of converting to market rate housing, housing for the formerly chronically homeless, workforce housing as part of the City's redevelopment project areas, and rebuilt public housing.

NALHFA urges the Subcommittee and Congress to adopt a number of refinements to the tax credit program. These suggested refinements come from a local housing finance agency's perspective. As local housing finance agencies, we share the responsibility of the gap funder for most affordable housing projects in our communities. But each local housing finance agency works in different markets and needs flexibility in the program to ensure that the credit can help address their particular local housing needs. Thus our suggested refinements are organized as follows: (1) increase the effectiveness of the current credits; and (2) provide for greater flexibility when credits are used with tax-exempt bonds.

#### **Increase Effectiveness for Current Credits**

Congress can increase the effectiveness of the credit by eliminating or modifying certain rules related to the use of tax credits with other funding sources. Many of these rules date to the earliest days of the credit program and were incorporated to prevent over subsidizing of a project. Even if the majority of these refinements are adopted, local housing finance agencies would still need to provide additional subsidy to make projects financially feasible. In California, the Tax Credit Allocation Committee conducts subsidy layering reviews which prevents such over-subsidizing of a project and makes these certain rules duplicative. The suggested refinements include:

- *Remove the restriction in the Tax Code that prevents tax credit projects which receive a 9% tax credit, and a below market rate loan from HOME funds, from getting the 30% tax credit bonus that is otherwise available to projects located in a designated low-income census tract or difficult to develop area.*

This change would facilitate development in high housing-cost areas.

- *Modify the Tax Code to ensure eligibility for the 9% credit projects containing subsidies from all Federal programs (e.g. Section 202 elderly and Section 811 housing).*

Currently, Section 202 or Section 811 funds and the Federal Home Loan Banks Affordable Housing program funds that are invested in LIHTC projects trigger a reduction in the value of the credit from 9% to 4%.

- *Other changes that would increase the effectiveness of the credit include:*
  - Not reduce basis for a Section 236 interest rate subsidy
  - Repeal the prohibition against project-based Section 8 Moderate Rehabilitation subsidy
  - Eliminate the 10-year ownership rule
  - Allow land and land leases as part of creditable basis for projects in high housing-cost areas where land constitutes a larger part of project costs
  - Allow the cost of a building as creditable basis at the 9% level for rehabilitation projects in high-housing cost areas, since the building has value
  - Allow incomes for existing tenants to go up to 80% of median income for "at-risk" projects

- *Set the value of the tax credits at 4% and 9%*

The current 30% and 70% percent present value causes uncertainty in the marketplace and makes project underwriting difficult.

- *Repeal the 10% expenditure rule*

We are asking for repeal of the requirement that 10% of a tax-credit assisted project's expected costs be incurred within 6 months after receiving a credit allocation (or by the end of the calendar year if later) with a requirement that housing credit allocating agencies ensure that projects are ready for implementation. The current rule adds unnecessary costs to the project.

- *Conform the rule for next available unit between the Low-Income Housing Tax Credit and tax-exempt multifamily housing bond program*

Under both the tax credit and multifamily bond programs, tenant income may increase up to 140% of the initial eligible income while still being qualified. If the tenant's income exceeds 140%, the landlord must rent the next available unit of comparable size to an income-qualified tenant. In the tax credit program, the rule applies to each building in a development, whereas in the bond

program it applies to the full development. In the interest of simplicity, the tax credit rule should conform to the bond rule.

- *Exempt Low-Income Housing Tax Credits from the Individual and Corporate Alternative Minimum Tax (AMT)*

Individual taxpayers subject to the AMT lose nearly all of the tax benefit that they would otherwise receive from these investments. AMT exemption would enable individuals to become a source of capital for the program. According to a study by the National Association of Homebuilders, “. . . corporations now provide more than 95 percent of all new capital. This in turn has affected the type, size, and location of LIHTC projects that receive funding. In general, corporations invest in large projects (\$5 million to \$10 million) . . . There is also some evidence that corporations are reluctant to invest in special needs projects or in projects designed to spur economic or community revitalization. As a result of these factors, corporations tend to invest in large urban and suburban developments.

Because individuals invest much smaller amounts . . . they are generally associated with smaller projects and base their investment decisions on idiosyncratic characteristics, such as the location of the project, the size of the project or the type of tenants.

The next set of refinements pertains to the need for greater flexibility in the use of credits with tax-exempt bonds. When 51% of the cost of a project is funded by tax-exempt housing bonds it is eligible for a non-competitive 4% credit for the affordable units which must equal 20% of the units for those at 50% of median income or 40% of units at 60% of median income.

- *After meeting the base project affordability requirement, extend eligibility for the 4% credit to units with tenants with incomes up to 80% of median income in communities with severe shortages of housing for this income group.*

In many high-housing cost urban areas, persons with incomes above 60% of area median cannot find suitable housing to rent. Under this proposal, housing credit allocating agencies would be permitted to award 4% credits to units in a project to be rented to those with incomes up to 80% of median income. However, the project must still target at least 20% of the units for those at 50% of median income or 40% at 60% of median income and demonstrate through a market study that there is a shortage of housing for those between 60% and 80% of median income and that the rents at 30% of 80% are below market. This proposal is intended to facilitate creation of mixed income housing.

- *Modify the Low-Income Housing Tax Credit to allow housing bond issuers to exchange a portion of a tax-exempt bond allocation for the authority to issue a higher tax credit.*

In recent years, Congress has increased the amount of Low Income Housing Tax Credits and the amount of private activity tax-exempt bonding authority. Until recently, when economic conditions led to renewed interest in single family mortgage revenue bonds, many state allocating agencies experienced a surplus of authority for tax-exempt bonds for private activity. With respect to affordable rental housing, however, there has not been an increase in secondary funding (such as CDBG and HOME) to complement the tax credits, which can only partially fund housing developments. This is particularly true of the tax credits generated by tax-exempt bonds.

While it is very attractive to use tax-exempt bonds and then generate tax credits, outside of the basic 9% program, these tax credits are 4% credits and consequently generate less than half the equity of the 9% credits. As a result, the funding gaps are larger, and without local sources of secondary funding, many projects cannot be done, and valuable resources tax-exempt bonds and 4% credits go unused. This proposal would permit local agencies to forego or trade in tax-exempt bonding authority in order to increase tax credits in a particular project, thereby reducing and possibly eliminating the need for secondary funding.

#### **Example:**

##### *Senior Housing Project*

- 100 units at \$150,000/unit
- Total development cost: \$15 million
- In a typical bond issuance, \$7.5 million of tax-exempt bonds would be issued with 4% credits and generating approximately \$5 million in equity.
- An alternative scenario would be to issue the \$7.5 million tax-exempt bonds but also trade in an additional \$15 million tax-exempt bond allocation to effectively use up \$22.5 million in bonding authority. If tax credits were permitted to be generated by the foregone bond cap, this would have the effect of issuing 12%

low income housing tax credits. It would generate an additional \$10 million in equity and eliminate the need for secondary funding.

The 12% tax credit scenario is used for illustration purposes only. It is attractive because it eliminates the need for other funding. But the essential idea is to permit the foregone bond cap (whatever the limits) to automatically generate tax credits at the same rate as the bonds used in a project. If properly structured, this concept would give greater flexibility to local issuers, would encourage more complete utilization of a resource that has already been allocated, and would not require any additional expenditure by the Federal Government.

- *Modify the Low-Income Housing Tax Credit to allow housing bond issuers to forgo 4% tax credits in exchange for additional bond volume cap.*

This proposal is essentially the reverse of the previous proposal. A project would get additional tax-exempt bond authority if it agreed not to take the 4% credit to subsidize its affordable units.

The preceding two proposals parallel the Mortgage Revenue Bond (MRB) program wherein issuers may trade in tax-exempt bond volume cap for the authority to issue Mortgage Credit Certificates.

- *Rename the Low-Income Housing Tax Credit, the Affordable Housing Tax Credit.*

This provision was in H.R. 4873 that was introduced in the 110th Congress. This change better describes the nature of the tax credit.

Although not the subject of this hearing there are several proposals affecting housing preservation and the tax-exempt Mortgage Revenue Bond and Multifamily Bond programs that NALHFA urges the Subcommittee to adopt:

#### **Housing Preservation**

- *Provide exit tax relief to encourage owners of affordable housing to transfer such housing to nonprofits who will maintain the long-term affordability of such housing.*

In 2002, the Millennial Housing Commission noted that “. . . [t]he stock of affordable housing is shrinking. Some properties are in attractive markets, giving owners an economic incentive to opt out of Federal properties in favor of market rents, and many owners have done so. Other properties are poorly located and cannot command rents adequately to finance needed repairs. In general, properties with lesser economic value are at risk of deterioration and, ultimately abandonment, unless they can be transferred to new owners. To remove an impediment to transfer, the Commission recommended . . . that Congress enact a preservation tax incentive [i.e. relief from exit taxes] to encourage sellers to transfer their properties to nonprofits.” Exit tax relief would be a tremendously helpful in preserving affordable housing in urban and rural areas.

#### **Tax-Exempt Bonds**

- *Exempt Tax-Exempt Bonds from the Individual and Corporate Alternative Minimum Tax (AMT).*

Taxpayers subject to the AMT lose all of the tax benefit that they would otherwise receive from these investments. General obligation bonds, Liberty Bonds for New York City’s recovery from 9/11, and the GO Zone bonds for Gulf Coast recovery are not subject to the AMT. According to testimony before the House Select Revenue Measures Subcommittee, a representative of The Bond Market Association stated that the AMT adds 15–25 basis points to the borrowing costs of issuers of private activity bonds. An exemption was included in H.R. 4873 that was introduced in the 110th Congress.

- *Repeal the Mortgage Revenue Bond’s “10 year” rule which prevents the recycling of single-family mortgage prepayments 10 years after the bonds were issued to make loans to additional first-time homebuyers.*

This repeal was included in H.R. 4873 that was introduced in the 110th Congress. It also passed the Senate in 2004, but it was rejected by a House-Senate conference Committee.

- *Permit the recycling of multifamily bonds as is permitted for single family bonds under the Mortgage Revenue Bond (MRB) program.*

Under the Mortgage Revenue Bond program, issuers may use mortgage prepayments or non-originations to make new mortgages as long as they are used within 10 years of the bond’s original issuance. Prepayments of tax-exempt multifamily

bonds are not able to be recycled into new mortgages. This would allow issuers to stretch limited bond volume cap thereby assisting additional lower income renters. The refunding bonds would be subject to a TEFRA hearing and would require corresponding changes in the tax credit program to permit projects to qualify for 4% credits.

- *Eliminate the current law requirement that issues designate a specific use for bond volume cap that is carried forward.*

This requirement has caused some NALHFA members to lose the amount carried forward because of a change in the housing market. As an example the City of Chicago lost \$80 million in volume cap that it carried forward for multifamily housing. There was insufficient demand for multifamily bond cap at the same time that the demand for single family bond cap was exploding.

- *Treat displaced homemakers, single parents, and homeowners who are victims of presidentially declared disasters as first time home buyers for purposes of the Mortgage Revenue Bond program.*

This repeal was included in H.R. 4873 that was introduced in the 110th Congress. In addition, Congress waived the first time home buyer requirement for victims of Hurricanes Katrina, Rita and Wilma, presidentially declared disaster areas.

Mr. Chairman, thank you for the opportunity to present NALHFA's recommendations on these critical housing issues.

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\*Chairman NEAL. Thank you, Mr. Lee.  
Mr. Hudson.

**STATEMENT OF BRIAN A. HUDSON, EXECUTIVE DIRECTOR,  
PENNSYLVANIA HOUSING FINANCE AGENCY**

\*Mr. HUDSON. Thank you. Good morning, Mr. Chairman, Representative English. I am Brian Hudson, Executive Director of the Pennsylvania Housing Finance Agency. Thank you for the opportunity to testify on behalf of the National Council of State Housing and Finance Agencies in support of proposals to modernize the Low-Income Housing Tax Credit program and tax-exempt private activity housing bond programs.

NCSHA's members allocate the housing credit and issue housing bonds in every State to produce affordable housing and ownership housing. NCSHA is deeply grateful to Chairman Rangel and for your support of the housing credit and bond programs. Without you, we would not be here today talking about how to make these extraordinary programs even better.

I'd like to share with you examples in Pennsylvania and what we have done. In Brentwood in West Philadelphia, long abandoned and decaying buildings now stand tall, proudly providing affordable homes to 43 families and older residents of the Parkside Historic District, thanks to the housing credit.

In before and after pictures in South Philadelphia, the housing and credit bonds work together to produce Greater Grays Ferry estates, a 40-acre mixed-income. The before picture shows a decaying neighborhood, in total decay, boarded-up homes, which was transformed into a mixed-income, mixed-use development that combines affordable housing, single-family homes, and apartments and a senior care center, and a community center onsite replacing dilapidated public housing, totally revitalizing the community. And this was done in a joint effort with the Housing Authority.

Moving to a world away in a small rural town of Edinboro, 29 affordable single-family homes stand among the older homes be-

cause of the housing credit. This initiative was undertaken by a local non-profit to provide these 29 homes, once again a major part in revitalizing this community.

And in Pittsburgh, many public housing and private hands reclaimed an aging federally assisted housing development in this neighborhood, using the housing credit to preserve 266 affordable rental apartments at Second East Hills. You created in the housing credit and bonds an unprecedented public-private partnership for affordable housing by unleashing the private sector, limiting Federal directives, and entrusting program administration to the States.

The States have lived up to your trust. We have established a long record of diligent and successful housing credit and bond administration. You have a chance now to eliminate program rules that made sense when you wrote them but have outlived their usefulness, rules that add unnecessary complexity and cost to the development process.

For example, it's time to eliminate the arbitrary limit on the amount of housing credits a State can allocate to federally subsidized developments. Allow States to determine when housing credit amounts higher than the law now allows are necessary to achieve development in places for people they want to serve. This would allow the States to target their resources in the hard-to-develop areas.

Allow housing bonds to finance single-room occupancy housing as the housing credit can.

Fix the housing credit and bond student rules so they don't inadvertently discourage lower income single parents from pursuing more education. We certainly believe that was not the intent of the law.

Repeal the Alternative Minimum Tax on housing credit and bond investments to attract more investor interest, increase dollars they supply affordable housing, and cut housing costs for the lower income families they serve.

We're asking for you to consider repealing the MRB tenure rule so States can recycle all MRB mortgage repayments into new mortgages for lower income families. In 2006 in Pennsylvania alone, that number was \$51 million.

Allow MRBs to give single parents a second chance at home ownership by easing the first-time home buyer requirement.

These are just a few mostly, we believe, low steps to empower States and our partners to respond more effectively to our affordable housing needs and priorities. I describe these changes and others we propose more fully in my attachments to our testimony. I ask that it be made part of the hearing record.

Demand for housing credits and bonds exceed supply by a great measure in Pennsylvania and all across the country. Again, that demand is 3 to 1 in Pennsylvania.

Finally, we commend you for reaching out across jurisdictional lines to the Financial Services Committee Chairman Frank, to make sure this housing credit and bond modernization effort includes a review of HUD programs on which the housing credit and bonds so heavily rely. We urge you to work with Chairman Frank to make sure any new housing programs his Committee proposes,

such as the GSE affordable grants that just passed the House, can be effectively combined with the housing credit bonds.

We understand you are faced with difficult decisions, with limited resources. I thank you for all you have done and will do to create affordable housing opportunity in this country. The States are honored to partner with you in this effort.

Thank you.

[The Statement of Mr. Hudson follows:]

**Statement of Brian A. Hudson, Sr., Executive Director and CEO, Pennsylvania Housing Finance Agency, on Behalf of the National Council of State Housing Agencies Harrisburg, Pennsylvania**

Mr. Chairman, Representative English, and members of the Subcommittee, thank you for the opportunity to testify on behalf of the National Council of State Housing Agencies (NCSHA) in support of proposals to modernize the Low Income Housing Tax Credit (Housing Credit) and tax-exempt private activity housing bond (Housing Bond) programs. I am Brian Hudson, executive director of the Pennsylvania Housing Finance Agency.

NCSHA is a national nonprofit organization that 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 allocate the Housing Credit and issue Housing Bonds in every state to produce affordable rental and ownership housing.

NCSHA is deeply grateful to Ways and Means Committee Chairman Rangel and you for your strong and consistent support of the Housing Credit and Bond programs. Many of you helped create these programs and extend them in their early years. You strengthened them and made them permanent. You restored their purchasing power and protected them against future inflation.

Just in the last few years, many of you have worked diligently to advance legislation to modernize them. Without your commitment and leadership, we would not be here today talking about how to make these extraordinary programs even better.

But, even you—some of the Housing Credit and Bond programs' strongest supporters—probably did not imagine the remarkable results these programs would achieve. All across the country, the Housing Credit and Bonds are turning around neighborhoods and transforming communities. They are bringing affordable housing to our inner cities and rural towns. They are building new housing and saving old. They are housing working families and the very poor. They are providing housing hope to people with special needs, the elderly, and persons who are homeless.

Here are just a few examples of the impact the Housing Credit and Bonds are making in Pennsylvania.

Not long ago, once magnificent buildings sat abandoned and decaying in West Philadelphia, as they had for more than 30 years. Today, thanks to the Housing Credit, these august buildings stand tall once more, proudly providing affordable homes to 43 families and older residents of the Parkside Historic District.

In South Philadelphia, the Housing Credit and Bond programs worked together to produce Greater Grays Ferry Estates, a 40-acre mixed-income, mixed-use development that combines affordable single-family homes and apartments, a senior care center, and a community center on one site. This development stands where dilapidated public housing once did, drawing retail and restaurant development to the surrounding community.

A world away, in the small town of Edinboro, Pennsylvania, 29 new affordable single-family homes are nestled among older homes. A local nonprofit knew just what kind of housing fit this rural community, and the Housing Credit made it possible.

With many public and private hands, Pittsburgh reclaimed an aging Federally assisted housing development and the neighborhood it plagued, preserving 266 affordable rental apartments at Second East Hills and driving out crime and vagrancy. Without the Housing Credit, this property and the Federal Government's investment in it would have been forever lost.

I could tell you hundreds more stories like these, as could my state HFA colleagues. We invite you all to come out and see what you have made possible. We hope you will.

Together, state HFAs and our affordable housing partners have produced nearly 2 million affordable rental homes with equity provided by the Housing Credit. About one-quarter of these homes are Housing Bond-financed. We have financed almost another million affordable rental homes with Housing Bonds alone. With the Hous-

ing Credit and Bonds, we add another 150,000 homes to our country's affordable rental housing inventory every year.

State HFAs have made home ownership a reality for 2.6 million working families with single-family Housing Bonds, probably known to you as Mortgage Revenue Bonds or MRBs. Another 100,000 families—teachers, firefighters, nurses, and service workers—join them each year with the help of MRB mortgages.

With the Housing Credit and Bonds, state HFAs and our partners are creating some of the highest quality, most innovative affordable housing ever produced with Federal assistance. With your help, we can do even more.

Congress got it right when it created the Housing Credit and Bond programs. By unleashing the private sector, limiting federal directives, and entrusting administration to the states, you created in these programs an unprecedented public-private partnership for affordable housing.

You have the opportunity now to reinvest in the Housing Credit and Bond programs' success. You can extend their reach to people and places they now struggle to serve by eliminating and rationalizing rules that have outlived their usefulness in these now mature and established programs.

When Congress created the Housing Credit, you took a bold new approach to affordable rental housing production. You let states and their local partners—not Washington—decide how best to respond to our unique and diverse housing needs with this new resource.

Recognizing the Housing Credit was an experiment, Congress built into it a number of safeguards. You limited, for example, the amount of Housing Credit states could allocate to developments financed with other Federal subsidies to insure against oversubsidization. Later, acknowledging even the maximum Credit amount states could allocate would not be enough to make development feasible in areas where incomes were especially low or low relative to construction costs, you allowed states to allocate more Credit to developments in these areas. But, even then, you had Washington, not the states, designate and limit those areas.

Over the years, you have entrusted the states with even greater responsibility to oversee the Housing Credit, requiring us to direct it to our most pressing housing needs under statewide allocation plans we and our partners devise. In addition, you have called on states to allocate through rigorous financial review and underwriting only the amount of Housing Credit necessary to developments' long-term viability as affordable housing.

The states have lived up to your trust. We have established a long record of vigilant Housing Credit allocation, underwriting, and compliance monitoring. We understand what a precious resource the Credit is and husband it carefully, squeezing every bit of affordable housing from it that we can.

In response, over time Congress has eased some rules that made sense at the program's outset, but proved no longer necessary. You, for example, made exceptions to the Federal subsidy rule for a number of Federal programs, like HOME and CDBG, commonly used with the Housing Credit.

A number of outdated Credit constraints still remain, however, that make it difficult—sometimes even impossible—for states and our partners to develop Housing Credit properties for people and in places that need them most. It is time to:

- Eliminate the 4 percent Housing Credit limit on properties financed with other Federal subsidies, allowing states to fully exercise the authority Congress gave us nearly two decades ago to determine appropriate Credit allocations;
- Permit states to determine when and where Credit amounts higher than the maximum the law now allows are necessary to achieve affordable housing goals we and our partners judge important in our states; and
- Eliminate the prohibition on the use of the Housing Credit in Section 8 Moderate Rehabilitation properties, as the Credit is necessary to their preservation and state underwriting will prevent their oversubsidization.

In addition, NCSHA urges you to fine tune the Housing Credit and multifamily Housing Bond statutes to eliminate other rules that made sense when Congress wrote them, but now add unnecessary steps and cost to the development process and throw up pointless barriers to the use of the Housing Credit and Bonds together. It is time, for example, to allow Housing Bonds to finance single-room occupancy housing, as the Housing Credit can, and to fix the student prohibition rules, which inadvertently discourage lower-income single parents from seeking more education.

We understand Chairman Rangel is also concerned that market rate rental housing is simply unaffordable in high-cost areas, like his own New York City district, to lower income families that earn more than 60 percent of area median income and so cannot access Housing Credit developments. We share the Chairman's concern

and want to explore with him and the Subcommittee mixed-income and possibly other solutions to this problem.

We urge the Subcommittee to seize this opportunity to also make a few modest changes to the MRB program to give states more resources and flexibility to respond to the nation's home ownership needs. Most notably, we ask you to finally repeal the MRB Ten-Year Rule, so states can recycle all payments on mortgages financed with MRBs into new loans for lower-income first-time home buyers. We also ask you to allow states to use MRBs to help single-parent households and respond to natural disasters.

Finally, we understand Chairman Rangel and many of you are committed to the repeal of the Alternative Minimum Tax (AMT) on middle-income taxpayers. We urge you, as part of that effort or this housing program modernization effort, to exempt Housing Credit and Bond investments from the individual and corporate AMT, as it limits investor interest in the Housing Credit and Bonds, reduces the dollars they supply for affordable housing, and ultimately increases housing costs for the lower income families they serve.

The changes I have just reviewed and others that would empower states and our partners to respond more effectively and efficiently to our affordable housing needs are described more fully in the attachment to our testimony. We ask that this attachment also be made part of the hearing record.

The changes we propose will allow us to do more with the Housing Credit and Bond resources we have. And, we must do more, as we do not begin to meet our states' housing needs with these limited resources.

Demand for the Housing Credit across the country exceeds supply by an average of two to one. In Pennsylvania, we receive three times the number of qualified Credit applications we can fund. The tax-exempt private activity bond volume cap, from which states draw their Housing Bond authority, is also oversubscribed in Pennsylvania and virtually every state. Many of the Housing Credit and Bond changes we are proposing will increase pressure on these resources by increasing demand for them and, in some cases, reducing the amount of housing they produce.

We deeply appreciate the Housing Credit and private activity bond cap increases Congress enacted in 2000 and the annual increases you have permitted since to offset inflation. However, the cap increases were not enough at the time to restore fully the purchasing power the Housing Credit and Bonds had already lost to inflation since first capped, and the inflation adjustments since have been outpaced by construction cost increases.

Meanwhile, our Nation's affordable housing need only grows. The Housing Credit and Bond programs account for most affordable rental housing developed in this country each year. But, their combined production does not even replace the affordable housing we lose annually to rent increases, conversion, deterioration, and abandonment.

At the same time, one in three families in this country spends more than 30 percent of its income on housing, and one in seven spends more than half, according to Harvard University's Joint Center for Housing Studies. Yet, only one in four families qualified for federal housing help receives it.

We want to work with you to find a way to increase the Housing Credit and Bond caps as soon as possible. We also want consider new ways to stretch the existing bond cap further, by exploring with you on the multifamily side recycling opportunities like we are seeking to expand on the single-family side with MRB Ten-Year Rule repeal.

Finally, we are heartened that Chairman Rangel and you have reached across jurisdictional lines to Financial Services Committee Chairman Frank to make sure this Housing Credit and Bond modernization effort includes a review of the HUD programs on which the Housing Credit and Bonds so heavily rely to reach lower income families than they can serve on their own. We have provided Chairman Frank's staff several suggestions for modifying HOME, voucher, and other HUD program rules to make these programs work more effectively with the Housing Credit and Bonds. We also urge you to work with Chairman Frank to make sure any new housing programs his Committee creates, such as the GSE affordable housing grant fund the House is considering and the trust fund his Committee will soon consider, can be effectively combined with the Housing Credit and Bonds.

In closing, I want to thank you again for all you have done and will do to create affordable housing opportunity in this country. State HFAs are honored to partner with you in this effort.

\*Chairman NEAL. Thank you, Mr. Hudson. We'll now proceed to inquiry.

Mr. Donovan, you advocate for a legislative change that would permit recycling of private activity bonds for multi-family housing within the annual cap. Can you explain why you think you need this change and whether current law allows for any such recycling of bonds that are redeemed early?

\*Mr. DOVONAN. Currently the problem is that with many low-income developments done with bonds and tax credits there is a requirement that at least 51 percent of the costs be financed by the bonds. Because of this, what ends up happening is that projects get financed with tax exempt bonds. But at the time of their completed construction those bonds get replaced by tax credit equity funds or other funding and are retired.

And so a resource that was intended and expected to be available for 15 or 30 years is only available for 3 years. But unlike on the single family side where those bonds can be recycled without requiring an additional volume cap, on the multi-family side there is a restriction.

We don't believe this was ever contemplated or intended by Congress, but it is an unintended consequence of other restrictions in the rules. So therefore we believe if we were given the ability to recycle those that it would allow us to make much greater and more effective use of that resource with little or potentially no additional costs because the original scoring didn't expect this short-term prepayment of the bonds.

So we believe that with that change there are two regulations which are specifically referenced in my testimony which we believe restrict our ability to recycle those bonds with either a legislative or potentially a regulatory change to do that. We believe it could be eliminated and there would be little or no cost on the scoring.

\*Chairman NEAL. Mr. Lee, part of our focus today is on the increasing need for affordable housing for middle-income as well as low-income families. What consideration has your agency given to this growing and acknowledged problem?

\*Mr. LEE. Our agency has really looked at the notion of providing housing across a very broad spectrum. We focus our credit on extremely low-income households, but we have tried to reach out to a higher income group through the development of our inclusionary housing as opposed to using the credits per se.

We have gone from 80/20 transactions in our community, which has fostered mixed-income housing, but in terms of our current real estate market, our market is such that the real estate developer community is going toward condominiums rather than affordable rentals and condominiums are priced at a very, very high level.

Our agency has also done affordable homeownership which has tried to reach the income level that is above that which is served by the Low-Income Housing Tax Credit. Our membership, as a whole, strongly supports the notion of increasing the access to the 4 percent credit for those at 80 percent of median income because that would provide for those other communities a much greater opportunity to serve a slightly higher group of individuals in their communities that they want to keep within the boundaries of their communities they are the teachers and the firemen that we all

want to serve and they are outside the income limits of the 60 percent program.

So for many, many of the membership in NALHFA, moving the bar from 60 to 80, but still meeting the principal project affordability requirements at 20 percent or 40 at 60 is a way of doing more mixed-income housing and making that mixed-income housing more financially feasible.

\*Chairman NEAL. Mr. Hudson, we've heard testimony that the States should have the authority to allow an additional basis boost in certain areas rather than the Federal Government. Do you think it's a good idea to take the 30-percent basis boost designation out of the hands of HUD and to put it in the hands of the State housing agencies?

\*Mr. HUDSON. We do. I mean we know what's happening in our States. For instance they would allow the States to target those hard-to-develop areas, for instance in inner-city urban areas or even rural areas, which we have in Pennsylvania. But we think it's an excellent idea to allow the States to make those determinations where is the best to use those resources.

\*Chairman NEAL. I thank you. The gentleman from Pennsylvania, Mr. English may inquire.

\*Mr. ENGLISH. Thank you. Mr. Hudson, it's a privilege to have you back testifying before this Subcommittee. And certainly from my own experience your agency does an extraordinary job, uses a great deal of creativity and is a model for how housing programs can be maximized nationally.

On that point, if we had the opportunity to deal with higher credit amounts, if we had the opportunity—and I think you heard the testimony of the HUD representative before. If this Committee had the opportunity to expand the current credit amounts, what could PHFA do if it had the flexibility to award higher credit amounts?

\*Mr. HUDSON. Our demand is three to one, quite truthfully. We get \$24 million in the State. We see applications totally \$60 million. But in just expanding the credit amount per property we could actually help more properties in hard-to-develop areas across the Commonwealth.

\*Mr. ENGLISH. We've heard similar testimony from other States to this effect, but when you say that you have three times the demand, what is the quality of the demand? Are most of those projects that you are ultimately comfortable that if you financed that they would yield positive benefits and benefits on the order that the program has traditionally achieved?

\*Mr. HUDSON. We believe so, that at least 90 percent of those projects would be financed. We have a scoring process, as do most of my counterparts in other States. So right now we're actually doing the highest ranking projects. But that ranking margin is very narrow. Projects that don't get done sometimes are within one, two points of each other.

So it's a very narrow band of those projects. So we do two funding rounds a year but the majority of those projects would get done if we had more credit.

\*Mr. ENGLISH. And as you set your priorities, what does PHFA do to ensure the credit properties are not over subsidized?

\*Mr. HUDSON. We're looking at the project three times, quite truthfully. When the application first comes in we're doing a review, we're scoring it. When we approve it it goes to initial closing, we're looking at it again. And if there's any adjustments that need to be made as part of that credit they're also made. And then we're looking at it one more time after construction, going through a complete cost-certification process to determine if it is the right amount of credit in this property.

And many times PHFA has some soft funds in that development also and we end up being the gap filler. So we're seeing it three times before it closes to make sure that the credit is not over-subsidized.

\*Mr. ENGLISH. On a related point, what impediments does PHFA encounter when combining Federal programs to build affordable housing?

\*Mr. HUDSON. Well, we think the regulations for instance on some of the home McKinney Act funds are not coordinated with the credit program. The credit is actually reduced when it is combined with those Federal funds.

And the example I can give you best is that years ago we refunded a deal that was insured and we could not use some of the savings from a refunded bond issue because it tainted the credit. So the credit had to be reduced. So we see that that needs to be changed so that other Federal sources coordinate with the credit so we can basically leverage those funds more down for the properties.

\*Mr. ENGLISH. On a narrower point, current law, we understand, prohibits households made up entirely of full-time students from living in Low-Income Housing Tax Credit apartments. I understand the rationale here, but it seems that this policy has had the unintended consequence for single parent families who fall outside the four narrow exceptions that are provided under the law because children in grades K-12 are counted as "full-time students" and because the tax dependent status of these children is considered, many custodial single parents who return to school full time become ineligible for Low-Income Housing Tax Credit housing, which it is fair to say is a bizarre outcome.

Working adults trying to complete the requirement for a high school education have also been adversely affected. In your view, what should Congress do cleanly to deal with this issue?

\*Mr. HUDSON. We think that definitely should be changed. We certainly believe not to discourage education. We support changing it to allow a single parent to pursue an education with regards to being eligible to live in a tax-credit unit, either eliminate the K-12 that the child is a full-time student or write specific language that allows that educated parent to go back to school, to live in that tax-credit unit. So we would support changes in legislation to do that in one or two of those ways.

\*Mr. ENGLISH. Thank you, Mr. Hudson. And again, I want to compliment the entire panel and especially you, Mr. Hudson and Mr. Donovan for some of the ideas that you've laid out here that I think are certainly meritorious and I think stimulating for our discussion.

Thank you, Mr. Chairman.

\*Chairman NEAL. Thank you, Mr. English. Mr. Blumenauer.

\*Mr. BLUMENAUER. Thank you.

Gentlemen, you may have heard an earlier question I had about energy efficient locations. I'm curious if your specific agencies as you are trying to allocate scarce dollars amongst worthy projects, if you evaluate the energy efficiency, the transportation efficiency and whether they have energy efficient appliances, whether they are located in a place that's access to mass transit, looking at the energy footprint. Do you evaluate them? Is that part of your criteria?

\*Mr. DOVONAN. Absolutely, and it's done on a number of different levels.

\*Mr. BLUMENAUER. Okay. What I'd like, because time is short and I have another question, actually for you, Mr. Donovan—if you could, supply the Committee with what that criteria would be relating to that.

Mr. Lee.

\*Mr. LEE. Yes, the city of San Francisco also can provide you written testimony but I could elaborate on what the city does if you would like.

\*Mr. BLUMENAUER. Energy efficiency, transportation location is a part of—

\*Mr. LEE. Yes.

\*Mr. BLUMENAUER. And Mr. Hudson?

\*Mr. HUDSON. Yes, we do the same. I can provide that information to you also.

\*Mr. BLUMENAUER. That would be great. Would any of you three gentlemen have objections if there were some minimum criteria for energy efficiency or transportation efficiency that were part of Federal regulations?

\*Mr. DOVONAN. No objection.

\*Mr. LEE. No objection, I guess I just would like to know what it would be.

\*Mr. BLUMENAUER. Well, we're the Federal Government. It would be very minimal, you know. And with your help it wouldn't be bureaucratic.

Mr. Donovan, I recently had a chance to have an exchange with your Mayor and be a part of the RPA's regional assembly where there was the presentation of this really exciting 127-point plan about greening New York, which I'm seeing in other cities around the country where innovative Mayors, local policy initiatives—we have what, 494 cities now that are deciding they're going to do something about global warming.

I'm curious if you have given some thought to what's going to happen here. We are going to have, I think most of the experts agree and even some politicians, a carbon constrained economy. There will be something that will come forward in the course of the next few years where there will be some significant value that will be realigned to reinforce what we want in terms of reducing the carbon footprint.

Have you given any thought to how your specific mission or the broader context of what the Mayor is proposing could be given credit as part of larger Federal legislation for reducing carbon emissions?

\*Mr. DOVONAN. Specifically as part of Federal legislation, you're saying? Well, I think one of the most important things that we are aiming to do in New York and with our partners nationally that could be replicated and perhaps incorporated into some of the Federal programs, we have been looking very closely at ways to incentivize private developers to incorporate sustainable elements into their projects.

\*Mr. BLUMENAUER. Right.

\*Mr. DOVONAN. And ultimately if we can assemble the information, the data, to demonstrate that these energy efficient improvements not only pay for themselves in the long run in terms of operating costs but in fact create more value than the up front cost, then we can figure out how to actually get the private sector to begin to finance in those improvements up front.

So I believe both incorporating certain standards cost effective, not all of the technologies are cost effective, but then also—

\*Mr. BLUMENAUER. My point is a little different. I understand what you're saying and I agree, and I hope you do it, and hopefully we can—I mean we're trying to do it in Portland, Oregon and elsewhere. My question or my observation I guess I would leave for all three of you, particularly relevant to New York because I think 70 percent of your energy use is building as opposed to transportation in other communities is that you folks get credit from the Federal Government under this scheme for the work that you're doing because some of it costs money and some of it needs to be jump started or incented that when the Federal Government comes up with what it's going to do with a carbon constrained economy that some of that comes back so that what you're doing in San Francisco, New York or Philadelphia you get advantage from some of that to help with your important work, that it might be another resource for housing.

If you gentleman could reflect on that and maybe give us some guidance it would be extraordinarily—at least of great interest to me. Thank you very much.

\*Chairman NEAL. Thank you, Mr. Blumenauer. Mr. McDermott.

\*Mr. MCDERMOTT. I have no questions.

\*Chairman NEAL. Thank you. I want to thank the panelists for your insights and we'd like to have the next panel step up now.

Welcome. Mr. Goldstein, would you begin please.

**STATEMENT OF JEFFREY H. GOLDSTEIN, EXECUTIVE VICE  
PRESIDENT BOSTON CAPITAL**

\*Mr. GOLDSTEIN. Mr. Chairman, Congressman English, Members of the Subcommittee, my name is Jeff Goldstein, and I'm Chief Operating Officer and the Director of real estate of Boston Capital.

Boston Capital is a privately held real estate firm founded in 1974 to raise equity for investment in and construction of affordable housing. Over the past 33 years, our investors have financed the new construction or the rehabilitation of over 157,000 units of affordable housing in 48 States, Puerto Rico and the District of Columbia.

Today we monitor the ongoing operations and compliance of these units on behalf of our investors. On behalf of the entire syndication industry I would like to thank you for giving me the oppor-

tunity to testify before you on the current economic and investment environment confronting the affordable housing marketplace as well as the opportunity to comment on the changes and the evolution to that marketplace which have led to the need for certain modifications to our housing program.

The Low-Income Housing Tax Credit is the most successful program ever created by Congress. This partnership between the public sector tax incentives and the private sector capital is responsible for producing over 1.9 million units of affordable housing since its inception in 1986.

The current program provides housing which serves residents earning 60 percent or less of the area median income. While area median incomes and the resulting per unit rental rates have not increased in many parts of the country, operating expenses are increasing.

Because of increased operating costs and specifically utility costs, taxes and insurance, there is less rental income available to pay the costs of debt service. Land costs, which are not includable in the calculation of the amount of low-income housing tax credits allocable to a property, have also grown to the point where proposed properties are no longer financially feasible in many high growth and high cost areas.

With such changes in economic conditions and many regulatory barriers in place when trying to combine the low-income credit with other sources of housing and development proceeds it is certainly time to modernize the credit and to simplify the program. We strongly support and encourage your effort.

As you know, the Low-Income Housing Tax Credit program works like a block grant to the States. States allocate credits under Federal guidelines to developers who then sell those credits to investors. Developers use the proceeds from the sale of the equity in the project to replace the funds that would otherwise have to be borrowed.

This reduction in debt translates into a reduction in debt service, which ultimately translates into a reduction in rents and thus keeps properties affordable. The following suggestions may seem complicated but they generally go to one of four goals, increasing the pool of investors available, giving the States more flexibility to use credits where they're most needed, making rents more accurately reflect increased utility costs and increasing the flexibility of the income ranges of tenants served.

I'd like to focus your attention on just a few things that I think would be particularly helpful. By exempting the Low-Income Housing Tax Credit from corporate Alternative Minimum Tax or AMT, this change would increase the market for the credit and ultimately increase the amount of equity into this marketplace. Allow projects with home funds to be used in difficult to develop and qualified census tracked areas; this change will facilitate the development of high cost areas.

Clarify the utility allowance formulas; we support removing the utility allowance from the gross rent equation and allowing the allocating State agency to determine maximum gross rent at the time of underwriting. This change ensures that the property can maintain financial feasibility.

Allowing residents earning up to 80 percent of area median income in projects in communities with severe shortages of housing for this income group; it's our experience that there is a tremendous demand in many areas for this income group and they are currently not being served.

Include land in allocable and eligible basis; this would support affordable housing in high cost areas. And lastly, amend the formula for determining the amount of credit allocable to a property to be the higher of the amount determined; under the present law, we're 9 percent for properties with no Federal subsidy; we're 4 percent if there is a Federal subsidy.

We support this change as it provides certainty for both investors and housing sponsors.

Again, thank you for the opportunity to testify. Please let me know if there's any additional information you'd like to receive. We're happy to help you and thanks again.

[The Statement of Mr. Goldstein follows:]

**Statement of Jeffrey H. Goldstein, Executive Vice President and Chief Operating Officer, Director of Real Estate, Boston Capital, Boston, Massachusetts**

Mr. Chairman, ranking Member, Mr. English, and other Members of the Subcommittee, my name is Jeffrey Goldstein. I am the chief operating officer and director of real estate for Boston Capital.

First, let me thank you for inviting me to testify. I am honored to have the opportunity to comment on the changes and evolution to that marketplace which have led to the need for certain modifications to our housing program. I am also grateful to the Subcommittee for recognizing the need to improve the effectiveness of the low income housing tax credit (LIHTC) program and for holding this hearing to provide a forum to discuss the current economic and investment environment confronting the affordable housing marketplace.

Next, let me give you a little background about our company. Boston Capital is a privately held real estate firm founded in 1974 to raise equity for investment in and construction of affordable housing. Over the past 33 years, our investors have financed the new construction or rehabilitation of over 157,000 units of affordable housing in 48 states, Puerto Rico, and the District of Columbia. Today, we monitor the ongoing operations and compliance of these units on behalf of our investors, while we continue to raise capital and invest in new properties.

While I am testifying on behalf of Boston Capital, we are also a coordinating member of the Housing Advisory Group, an organization with approximately 100 members from the affordable housing development, syndication, and accounting industry, who share our views and concerns.

The low income housing tax credit is the most successful housing program ever created by Congress. This partnership between public sector tax incentives and private sector capital is responsible for producing 1.9 million units of affordable housing since its inception in 1986. However, it is clear that over the last 21 years, economic circumstances have changed dramatically, making the credit less flexible than it could be.

For example, the LIHTC limits rent to a maximum of sixty percent of the area median income. Area median incomes have not gone up significantly in most of the U.S. for several years. As a result, income-limited rents have remained relatively flat. Operating expenses, however, have been moving upward nationally, and are very likely to continue to do so for the foreseeable future. Utility, insurance, taxes, and other operating costs have increased over the last several years. With the statutory ceilings on rents, there is less cash-flow available to pay debt service.

The amount of LIHTC that may be allocated to any property is based on the eligible basis of the property. Land costs, however, are not includable in "eligible" basis on which the amount of allocable credit is based. Yet, land costs have increased significantly, especially in high growth areas where affordable housing is greatly needed. As a result, the percentage of total project cost financed by the LIHTC has declined in many cases.

Exacerbating this problem of escalating operating costs and stagnant rents is the formula used to reduce rent to reflect the utility costs tenants have to pay. Under

present law, the formula is set by HUD and significantly overstates the rise in utility costs which results in lower rents. CPI would be a more accurate measure or, alternatively, the state housing agencies could set rent ceilings that reflect the actual costs.

Over the last quarter century, the nature of the investors in affordable housing has changed dramatically, as well. When the LIHTC began, the largest market for affordable housing investment was individuals. However, due in substantial part to the alternative minimum tax and passive activity loss limitations, the individual market has disappeared. Increased cost in raising equity, auditing properties and reporting to investors of publicly offered investments subject to SEC regulation have added to the inability of syndicators to offer an investment with an adequately attractive return for the individual market.

The LIHTC marketplace, nevertheless, has become more efficient since Internal Revenue Code Section 42 was made permanent. The vacuum left by the individual market has been filled by corporations, primarily banks, insurance companies, Fannie Mae and Freddie Mac. This concentration is due, in part at least, on the ability of financial institutions to use the LIHTC to satisfy Community Reinvestment Act (CRA) requirements, not solely on the rate of return realized. Thus, it is obvious that, while the investment base is solid, it is not as broad as it could be.

With the changes in economic conditions, and with many regulatory barriers in place when trying to combine the LIHTC with other sources of housing development proceeds, it is certainly an appropriate time to review the program with a view to modernization and simplification.

The most valuable change within the jurisdiction of the Committee on Ways and Means would be to allow the LIHTC to be used against the corporate alternative minimum tax. This would allow corporations that are now reluctant to invest in affordable housing out of concern that they may be subject to the AMT at some point during the credit period to invest with confidence. If Congress wanted to increase the likelihood that individuals would enter the marketplace again, LIHTC investments should be allowed to offset individual earned income and should also be creditable against the individual AMT.

It may be that changes to the corporate AMT to broaden the market for LIHTC investment could have some revenue impact. However, if you assume, as has been the case in recent years, that there is full utilization of credits, there should be little to no revenue impact other than taxpayers who thought that they would be able to use the credits over the 10-year period prescribed, but who turned out not to be able to use the full value of the credits because of the alternative minimum tax or, in the case of individuals, the passive activity loss limitations.

However, in addition to the AMT, there are a number of other modifications that would make the LIHTC usable in more situations. There is a consensus in the affordable housing industry on these suggestions, and we hope that the Subcommittee will carefully review and adopt them:

- Allow HOME-assisted properties in difficult development areas (DDAs) or qualified census tracts (QCTs) to use the 30-percent increase in eligible basis in calculation of the amount of LIHTCs allocable to those properties otherwise available for properties in DDAs or QCTs. This change will facilitate development in high-cost areas by reducing higher-cost debt financing.
- Clarify utility allowance formulas. As I mentioned earlier, the formula for reducing rent to account for utility costs, set by HUD, is flawed. Removing the utility allowance as a reduction in gross rent and allowing the allocating State Housing Agency to determine maximum gross rent at the time of the underwriting would help insure that the property can maintain financial feasibility over time.
- Allow a 30% increase in eligible basis for properties that meet state-specified geographic or income targeting requirements. Under present law, HUD has authority to determine which portions of a state are DDAs and high cost areas. The state agencies, however, have a better grasp on their affordable housing needs for high cost areas, rural areas and where deeper targeting may be necessary. As mentioned above, providing more equity into developments places less pressure on rising operating costs because the increased equity allows for much less debt service.
- Allow residents earning up to 80% of area median income (AMI) in projects in communities with severe shortages of housing for this income group. It is our experience that there is tremendous demand in many areas for this income group, and that this change would place the LIHTC in line with other existing affordable programs.

- Allow land to be included in eligible and allocable basis. Since the amount of the LIHTC allocable to a property is determined by reference to cost basis, this would support affordable housing in high-cost areas by increasing the percentage of equity financing provided via the LIHTC and reducing debt financing.
- Amend the formula for determining the amount of credit allocable to a property to the higher of (1) the amount determined under present law or (2) 9 percent for properties with no other Federal subsidy (e.g., tax-exempt bonds) or 4 percent if there is an additional Federal subsidy. A statutory formula limits the amount of credits allocated to any particular property to 70 percent of a property's qualified basis (essentially, depreciable basis minus Federal grants) over a 10-year period or to 30 percent of the property's qualified basis if there is another Federal subsidy (almost always, tax exempt bonds). The original legislation set the discount rates at 9 percent and 4 percent. The rates now float as a percentage of an average of the annual Federal mid-term and long-term interest rates, thus providing rates lower than 9 percent and 4 percent. Setting the rates at 9 percent and 4 percent as a floor would allow more equity into each property and place less pressure on debt servicing as operating costs increase. Setting the rate at a constant percentage allows more predictability for sponsors when layering other sources of capital and grants, while retaining the present law formula if it results in a higher credit amount will protect the credit's viability in a high inflation/interest rate environment.

In addition, I would like to mention two issues not specifically within the Committee's jurisdiction, but very important to the economics of the low-income housing tax credit program.

The first relates to Form 2530, a filing requirement promulgated by HUD that would limit investment in affordable housing. Thank you for your efforts to correct an attempt by HUD to over-regulate the affordable housing agency. On April 24th, the House passed H.R. 1675 the "Preservation Approval Process Improvement Act of 2007" by voice vote with no opposition.

The bill will reduce unnecessary and overly burdensome HUD filing requirements for purposes of participating in HUD programs. Specifically, the bill would exempt limited liability corporate investors from being required to file. Additionally, the legislation would allow for continued paper filings for those required to file until technical issues with the electronic filing system have been addressed.

The Senate Banking Committee reported H.R. 1675, without amendment, last week, and we are hopeful that this issue will be finally resolved shortly.

The second issue I would like to bring to your attention is a similar case of over-regulation by the Securities and Exchange Commission. Under U. S. securities regulations, an auditor of an entity regulated by the SEC cannot aid or assist in the preparation of financial statements. Last year, the SEC staff recognized that, while audits of public syndicated limited partnerships have been performed by auditors who meet the specific independence standards required under the securities laws, many audits of operating limited partnerships—in which the public funds invest as limited partners—did not meet these specific independence requirements. As a result, the SEC staff provided a temporary exemption from the Commission's independence requirements, in a letter dated April 21, 2006, for the filings of LIHTC registrants with limited partnership investments in operating partnerships for 2005 and prior years. However, the SEC staff has stated that they will not extend this exemption permanently.

The problem is that the auditor independence standards for nonpublic companies are not as restrictive as those established by the SEC. Most affordable housing developers and management agents do not have the in-house expertise and capacity required to prepare financial statements for their auditors and many operate in communities that do not support more than one accounting firm. It is far more likely that an accurate set of financial statements will be prepared if a professional, outside accounting firm prepares them under the generally accepted rules issued by the AICPA for privately held firms than if the general partners are forced to prepare financials in-house, assuming they can find the staff to perform these duties.

In some communities there may be several accounting firms available. However, experience has shown that splitting the accounting and auditing functions for even these financially simple businesses can increase costs beyond the ability of the business to pay. It is important to emphasize that these LIHTC investments are constructed assuming no free cash flow. In other investments, the price of the product or service produced might be increased to offset additional costs. However, in the case of an LIHTC property, the only source of income—rent—is strictly limited by Federal tax law.

It is also very important to understand that the applicable state housing agency is actively monitoring each property for compliance with the LIHTC requirements. Under the coordination of the National Council of State Housing Agencies, these state agencies provide comprehensive and ongoing independent review of the factors critical to LIHTC investors.

We urge Congress to address this issue, as it has in the HUD reporting problem, to maintain the efficiency of the LIHTC program and reflect the independent oversight role of the state housing agencies in protecting the interests of both tenants and investors in affordable housing.

Again, thank you for this opportunity to testify. Please let me know if there is additional information that you would like to receive from us. We are happy to help you in any way we can.

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\*Chairman NEAL. Thank you, Mr. Goldstein.  
Mr. Rose.

**STATEMENT OF JONATHAN F.P. ROSE, PRESIDENT,  
JONATHAN ROSE COMPANIES, LLC**

\*Mr. ROSE. Thank you, Congressman Neal, Ranking Member English and Members of the Subcommittee. I'm Jonathan Rose, president of Jonathan Rose Companies. Our firm is a for profit that collaborates with cities, community development corporations and academic and other institutions to repair the fabric of community.

We have seven tax credit projects currently underway in places ranging from Harlem to Connecticut to Albuquerque, New Mexico. And to answer a previous question, each is in a difficult to develop area. The 30 percent basis boost is very helpful and appreciated, but it is not sufficient to cover the costs of developing these areas, and we'd love to see that the basis boost be increased.

As a firm, we're also very committed to green building, environmentally responsible development, and absolutely agree that with climate change before us that every program needs to respond to climate change. And we make some suggestions on how to do that.

I'm not here today only as a businessman, but I'm also a trustee of the Enterprise Community Partners and a member of the Executive Committee. Enterprise actually pioneered the use of the tax credit to serve low-income and special needs populations and has been a leader in the movement to make affordable housing not only healthier and more energy efficient but to reduce climate impacts through it's the green communities guidelines.

And this initiative by the way has created a standard. And so earlier when you were asking about standards, it's an excellent, nationally approved standard that's been applied to projects all across the country that we know doesn't cost much more, one or 2 percent, and really works.

The time has come, if you add all these things that all of our requests and the demand, the time has come to increase the amount of tax credit available, and really by 50 percent at a minimum. At the same time we need to simplify and enhance the program because there's so much demand.

And as you know there are conflicts within it. We're seeing across the country both the supply of affordable housing shrink as more and more buildings are being taken off the market and rising energy and transportation costs that are cutting into the precious earnings of low-income families, and rising construction costs

which are making the credit smaller and it's essential, absolutely essential, a smaller portion of the housing that we're building.

So in addition to the 50-percent increase in total credit available we'd like to see that any Federal housing subsidies that enable residents or owners such as housing authorities to pay rent or pay operation expenses under credit properties does not reduce the amount of housing credits a building can receive, something that Representative McDermott is championing. We really appreciate that.

The second thing is that when you build a project that has non-housing space the credit does not apply to these uses. And so, Congressman McDermott, for example, we are building housing for youth aging out of foster care in Harlem. There is a youth construction trades academy on the ground floor and that is not considered housing space, so we can't apply the credit to it. So increasing the ability of the credit to fund or allowing the ability of the credit to fund support spaces would be very, very helpful.

We deeply believe there should be a 30 or a 50 percent basis boost in the housing credit for developments that incorporate cost-effective green criteria—this will help pay for the costs—and for projects that are adjacent to mass transit or in walkable locations. These we think are better for the residents, better for the owners of the buildings, the not-for-profits, public housing agencies, et cetera, and better for our country in terms of a climate change strategy.

We strongly recommend that Enterprise's green communities criteria be attached to the program. Many States are using it, many cities, some who have been here today, are using it as their criteria, but let's make it a consistent, nationwide program. Just attach it to the tax credit program. We know it works. We've used it in many, many States around the country.

As I mentioned, we'd love to see a basis boost for projects that are next to—in down towns and walkable locations next to transit. And one of the reasons is these are more expensive locations. For example, you cannot do surface parking in these locations, so they really need the basis boost to make them work. That's the only way we're going to get the density we need in these locations.

Same criteria, green criteria we recommend be attached to multi-housing finance bonds. And by the way one of the cheapest, actually a no cost way that Congress could respond to climate challenge is to take all taxes and bonds, whether they're for housing, hospitals, schools, et cetera, and just require them to comply with Energy Star. That costs you nothing and it will green every new project, lower the energy cost of every new project built under tax exempt bonds.

By the way, Representative English, I'm a former board member of the National Trust for Historic Preservation. I applaud your proposed legislation. And the trust, by the way, is also looking at how it can apply green building standards to its new work, its renovation work going forward.

And the last thing is Enterprise has recommended a new tax incentive to complement the housing credit, to fill the gap in housing finance system while encouraging greater energy efficiency and we support that too. Thank you very much.

[The Statement of Mr. Rose follows:]

**Statement of Jonathan F.P. Rose, President, Jonathan Rose Companies LLC, New York, New York**

Thank you, Congressman Neal, Ranking Member English and members of the Subcommittee for this opportunity to testify on strengthening the Low Income Housing Tax Credit and other tax incentives for affordable housing. I am Jonathan Rose, president of Jonathan Rose Companies.

Our firm collaborates with cities, community development corporations, academic and other institutions to help them solve complex development problems. Often this involves building affordable housing or institutional buildings, and all of our work aspires to be as green as it can be with limited budgets. We bring to this testimony a deep commitment to repairing the fabric of our communities and the practical experience of our long term engagement in this work. Affordable housing is at the core of our development work, often as part of larger mixed-use developments. Our firm is actively engaged in the development of a variety of mixed-use, urban infill, public housing revitalization and senior housing projects. We currently have seven Housing Credit projects in process in locations ranging from the heart of Harlem to downtown Albuquerque.

Among my volunteer affiliations I am a trustee of Enterprise Community Partners, which has been an active advocate of the Housing Credit since its founder Jim Rouse and chairman Bart Harvey helped Congress create the program in 1986. Enterprise Community Investment, a subsidiary organization, is a major participant in the Housing Credit program, having raised more than \$6 billion to support nearly 1,500 properties with more than 83,000 affordable housing units under asset management. Enterprise has pioneered use of the Housing Credit to serve special needs populations and advance healthier and more energy efficient development through the Green Communities initiative.

I will not go into exhaustive detail about the effectiveness, efficiency and importance of the Housing Credit program. Others from whom the Committee will receive testimony will likely cite the overwhelming evidence of the Credit's singular achievements among affordable housing programs.

Suffice to say that from my perspective as a socially motivated for-profit developer of affordable housing, and for my firm and many not for profit community partners, the Housing Credit is the single most important resource available to enable developers to create decent affordable homes for people who need them most. The Housing Credit elegantly joins private market discipline with public purpose and for the most part strikes the proper balance between flexibility and appropriate statutory requirements to help achieve a critical social objective.

**Worsening Affordable Housing Needs**

It is worthwhile to examine even the most successful public policy from time to time to determine whether market conditions, social needs and on the ground experience suggest modifications may be in order. The Housing Credit statute has not been significantly amended since 2000, when Congress made several important improvements while substantially expanding the program. The time has come to expand the credit again in the context of additional enhancements to further strengthen its ability meet pressing housing needs, for three central reasons.

First, affordability problems for low-income renters are worsening. The number of households paying more than half their incomes for rent increased by more than two million to a record 15.8 million between 2001 and 2004. Nearly two-thirds of this increase in severe cost burden was borne by households in the bottom income quartile, earning less than \$22,540.<sup>1</sup> We are now seeing large investment funds purchasing affordable housing, and investing in it, but raising rents beyond the reach of low-income families.

Second, the supply of affordable apartments available to these households is shrinking. More than one million units affordable to the very poor were lost between 1993 and 2003. According to the Harvard University Joint Center for Housing Studies, "the shortage of rentals available and affordable to low-income households was a dismal 5.4 million."<sup>2</sup> At the same time, construction costs have increased dramatically, raising the cost per unit built. Thus the credit itself is producing fewer units each year.

<sup>1</sup>Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 2006*, (Cambridge, MA: Joint Center for Housing Studies of Harvard University), p. 25.

<sup>2</sup>Ibid, p.24.

Third, rising energy and transportation costs are exacerbating the effects of housing challenges and are linked to detrimental health and environmental impacts. A recent national study documented the brutal choices that poor families make when faced with unaffordable home energy bills. The study found that during the prior 5 years, due to their energy bills: 57 percent of non-elderly owners and 36 percent of non-elderly renters went without medical or dental care; 25 percent made a partial payment or missed a whole rent or mortgage payment; and 20 percent went without food for at least one day.<sup>3</sup>

In addition, energy costs have increased much faster than incomes for low-income households in recent years. Today a family earning minimum wage pays more than four times as much a share of their income for energy as a median income household.

Transportation costs consume a large share of low-income family budgets as well. A study of 28 metropolitan areas found that families with incomes between \$20,000 and \$50,000 spend an average of 29 percent of their income on transportation and an average of 28 percent on housing.<sup>4</sup>

These sobering statistics and the severe human and community needs they reflect call for another expansion of the Housing Credit. Congress should act immediately to increase the program by at least 50 percent, with a priority for states and cities with the most acute housing supply shortages and the most innovative strategies for addressing them holistically and sustainably.

Even an expanded and improved Housing Credit cannot be expected to solve our country's affordable housing crisis on its own, however, especially with the huge projected increase in population—100 million over the next generation. We need much greater investment in rental housing assistance and other production programs and a more holistic housing policy that supports smarter land use, more sustainable development, greater transit access and healthier, higher performing buildings.

In fact, housing, transportation and environmental policy should be integrated and funded to a much greater extent at all levels of government. Smarter land use policies are part of the answer to global climate change, as well challenges faced by low-income people and communities. (For the Subcommittee's reference I have attached a list of policy recommendations in the area of transportation and affordable housing.)

Several improvements to the Housing Credit would make it a more effective resource in the context of broader policy changes.

#### **Recommendations for Improving the Housing Credit**

*Enable the Credit to better serve especially vulnerable populations.* The Housing Credit has proven to be an effective resource for creating affordable homes for extremely low-income families and people with special needs, such as the frail elderly, the homeless and individuals with HIV/AIDS, in part because the program generally works well with some other funding sources that help those members of our society pay their rent and enables building owners to keep properties in good shape. Internal Revenue Service rules are unnecessarily constraining the Housing Credit from achieving this purpose even more effectively. Some background is important to provide.

Section 42(d)(5)(A) of the Internal Revenue Code provides that the amount of Housing Credits awarded to a building is reduced to the extent of any grant of Federal funds made with respect to the building or operation thereof. Citing legislative history that "Congress did not intend to treat Federal rental assistance payments as grants" the Treasury Department issued regulations in 1997 [Treasury Regulations §1.42-16(b)] excluding from the definition of Federal grant certain rental assistance payments made to a building owner on behalf of a tenant.

Payments are excluded therefore if made pursuant to: (1) Section 8 of the United States Housing Act 1937 ("the Act"); (2) A qualifying program of rental assistance administered under Section 9 of the Act; or (3) A program or method of rental assistance as the Secretary may designate by publication in the Federal Register or in the Internal Revenue Bulletin.

Following up on that regulation, the Service has subsequently issued guidance excluding three other rental assistance programs from the definition of Federal grant, including: payments made to building owners under the Section 8 Assistance for the Single Room Occupancy Dwelling Program; the Shelter Plus Care Program; rental assistance payments under the Housing Opportunities for Persons with AIDS Pro-

<sup>3</sup>National Energy Assistance Directors' Association, *2005 National Energy Assistance Survey*, (Washington, DC: National Energy Assistance Directors' Association, 2005), pp. i-iv.

<sup>4</sup>Barbara J. Lipman, *A Heavy Load: The Combined Transportation Burden of Working Families*, (Washington, DC: National Housing Conference Center for Housing Policy, 2006) p.1.

gram; and rental assistance payments under the Section 236 program and under Section 101 of the National Housing Act.

Those rulings were based on specific requests by affected organizations. Meanwhile, a number of other federal housing programs providing rental assistance under substantially identical rules have not received clearance from the IRS, and there is some confusion whether they could be considered a Federal grant.

In addition, there are other programs that provide operating assistance to enable Housing Credit properties to rent units to the lowest income tenants at rates they can afford. These operating subsidies are economically equivalent to rental assistance payments and should be treated the same for purposes of determining whether they are Federal grants under Section 42(d)(5)(A). The purpose of the Federal grant rule is to prevent credits from being awarded on construction costs that are not paid by the owner of the property, but that are instead covered by a Federal grant. While that rule should not be changed, it should not apply to operating subsidies that are designed to make the property affordable to the lowest income tenants.

Congress should modify Section 42(d)(5)(A) to specifically provide that the following subsidies are not considered to be Federal grants: rental assistance payments, operating subsidies, interest subsidies and other ongoing payments to a housing property designed to reduce cash flow needs from rent to enable the property to be rented to the lowest income tenants. This seemingly “technical” change would dramatically improve the Housing Credit’s effectiveness in assisting families and individuals who are homeless, elderly, disabled, occupy older assisted housing where continued affordability is threatened or reside in Native American communities

*Enhance the Housing Credit’s capacity to help create community space.* Under the statute Housing Credits are provided for the cost of those units of a property that are rented to qualifying low-income tenants. Housing credits can also be claimed for the cost of common areas used by residents in the property, such as hallways and lobbies. In addition, under current law [Section 42(d)(5)(A)] Housing Credits can cover the cost of a limited amount of space known as “community service facilities.” This is space that can be used for such purposes as child care, Meals-on-Wheels, elderly care programs and other similar activities.

The law limits community service facilities to 10 percent of the eligible basis of the property. In addition it requires that the space be designed primarily to serve individuals who otherwise meet the income requirements for living in the property, even if they are not residents of the property.

The community service facility rule deals with a serious problem in many low-income communities: the lack of public space for activities that serve the community such as programs for the children and the elderly. The 10 percent limitation in current law is unduly restrictive and prevents the construction of sufficient space in many smaller Housing Credit properties.

To solve this problem, Congress should increase the space limitation in Section [42(d)(4)(C)(ii)] from 10 percent of eligible basis to 20 percent of eligible basis on the first \$5 million of eligible basis, and 10 percent on the basis above \$5 million.

*Encourage energy efficiency and transit access through the Housing Credit.* Current law allows a 30 percent higher credit amount (“basis boost”) for developments located in areas where at least half the households have incomes below 60 percent of area median income; where construction, land and utility costs are high relative to average incomes; or where the poverty rate is 25 percent or greater [Section 42(d)(5)(C)]. This policy recognizes that certain kinds of Housing Credit developments need additional funding to be feasible. (In fact, the House Credit must typically be supplemented by state and city subsidies to work in most parts of some large urban areas such as New York City.)

More affordable housing developers are recognizing that construction and rehabilitation practices that create healthier, more energy efficient developments and implement site planning that enhances access to transit can deliver significant economic benefits to properties as well as residents.

Achieving meaningful levels of energy efficiency or securing sites near transit can result in higher development costs. These costs are typically paid back from energy savings and result in better outcomes for tenants. However many affordable developers are unable to incur even marginally higher costs to realize these benefits, due to the scarcity of funds for affordable housing overall. Congress should allow a 30 percent basis boost and the necessary volume cap to pay for it for Housing Credit developments that incorporate cost-effective, comprehensive criteria resulting in healthier, higher performing and more environmentally sustainable developments.

A proven and workable reference standard Congress could use are the Green Communities Criteria. The Criteria are the only national standard for healthy, efficient, environmentally friendly affordable homes. The Criteria were specifically de-

signed to maximize the health, economic and environmental benefits of sustainable development for low-income people on a cost-effective basis for developers.

The Criteria were developed by Enterprise, the Natural Resources Defense Council, the American Institute of Architects, the American Planning Association, the National Center for Healthy Housing, Southface, Global Green USA, the Center for Maximum Potential Building Solutions and experts associated with the U.S. Green Building Council.

There are more than 180 Green Communities developments with more than 8,000 affordable units in various stages of development in 23 states. These include new construction, rehab and preservation developments; urban, small town and rural developments; and developments serving families, the elderly and people with special needs. Enterprise's initial assessment indicates that total development costs can be 2 percent to 4 percent higher on average for projects that meet Green Communities Criteria compared to projects that do not deliver the same health, economic and environmental benefits.

The Green Communities Criteria are also the basis for policymakers at all levels of government committed to more environmentally responsible housing and community development policies for low-income people. More than 20 states and cities have used the criteria to ensure their housing programs support healthier, more energy efficient and more environmentally responsible development.

By the way, similar criteria could be applied to Multifamily Housing Bonds, which are often used in combination with Housing Credits. More broadly, Congress should consider ways to increase energy efficiency in all facilities financed by Private Activity Bonds, such as ensuring projects meet the efficiency standard of the Federal Energy Star program and providing additional authority for projects that exceed a minimum standard.

There are a number of other worthy proposals for strengthening the Housing Credit that others have put forward. My suggestions are not intended to be exhaustive, but rather to reflect recommendations particularly designed to strengthen the Housing Credit's ability to meet the needs of some of our society's most vulnerable members and do so in ways that create healthier and more environmentally sustainable homes and communities

#### **A New Proposal to Increase Energy Efficiency in Affordable Housing**

My testimony concludes with a recommendation developed by Enterprise. While a new proposal, it is in the spirit of this hearing to improve tax policy to support affordable housing. The proposal would complement the Housing Credit and fill a gap in the housing finance system, and the Tax Code, while encouraging greater energy efficiency on a cost-effective basis.

Increasing energy efficiency in affordable multifamily housing delivers several important benefits. These include lower utility costs for low-income residents, more stable operating reserves for building maintenance, better building performance and reduced carbon emissions.

Significant improvements in energy efficiency are achievable for only slightly higher costs than would be the case for projects that do not deliver these benefits. Based on Enterprise's experience through a portfolio of more than 180 energy efficient affordable developments around the country, Enterprise estimates these costs to be between \$2,000 and \$3,000 per unit, on average, with some variability by location, project type, developer capacity and other factors.

As discussed, current affordable housing subsidies do not provide sufficient resources to cover the incremental costs of achieving high levels of energy efficiency in affordable multifamily developments. Current tax incentives for energy efficient buildings generally are not applicable or appropriate for affordable housing developments. In other words, while the Tax Code encourages energy efficiency in most other major building types, it offers no such incentive for affordable rental housing developments.

The solution is a one-year federal income tax credit to owners of affordable rental properties for eligible costs to achieve a significant reduction in energy in the building. The standard would be the American Society of Heating, Refrigeration and Air Conditioning (ASHRAE) Standard 90.1-2004 plus 20 percent or its equivalent. This is the standard for the Federal Energy Star for multifamily buildings program currently under development by the Environmental Protection Agency and Department of Energy.

To tie public subsidy directly to public benefit and to limit the cost to the Federal Government, *the tax credit would provide only enough subsidy to cover the incremental costs associated with energy efficiency improvements that would not otherwise be feasible*, i.e., only up to an additional \$3,000 per unit in costs.

Taxpayers would claim the credit the year the building was placed in service and its energy performance verified through a similar process for claiming the current law energy efficient home credit (Section 45L). The credit would not be allocated but could be subject to an overall annual cap on authority. The credit would not reduce eligible basis for the purpose of claiming Housing Credits or other available Federal tax benefits. Additional aspects of the proposals would ensure it could also support non-Housing Credit developments

I suspect that this proposal would have a very small revenue impact, yet generate significant benefits for low-income residents and operators of affordable rental housing. Enterprise and I would look forward to working with Members of the Subcommittee and full Committee to further refine and enact this proposal.

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\*Chairman NEAL. Thank you, Mr. Rose.  
Mr. Roberts.

**STATEMENT OF BENSON F. ROBERTS, SENIOR VICE PRESIDENT FOR POLICY AND PROGRAM DEVELOPMENT, LOCAL INITIATIVES SUPPORT CORPORATION**

\*Mr. ROBERTS. Thank you, Mr. Chairman and Members of the Committee. My name is Benson Roberts. I work for Local Initiatives Support Corporation. We are a national, not-for-profit organization, and have been around for 27 years. Our mission has been to help local residents to rebuild communities—low-income communities—into sustainable places to live, work and do business. Over the course of that period we've raised and invested about \$8 billion from the private sector into these low-income communities.

We've been involved with the Low-Income Housing Credit since its first conception in 1985 and enactment finally in 1986 and have been an active participant in the program ever since. We've raised and invested over \$5 billion over those 20 years in about 80,000 units of affordable housing in about 1,500 properties all around the country, focusing on community revitalization and stabilization as our primary theme.

We've all learned a lot. We agree with many of the comments others have made earlier. This is an outstanding program but it is time to review and update it in order to reflect changes in local communities, housing priorities and in the investment marketplace. I want to focus on just a few themes here.

One: let's simplify the way the housing credit coordinates with other Federal policies. We've heard about this from other panelists. These policies include below market loans that are used to develop the housing. They include the kinds of subsidies Jonathan Rose just mentioned for providing operating and rent subsidies to help these properties serve especially low-income people or to preserve existing affordable housing. And these policies includes tax incentives such as the historic credits. We think they're also very important. Right now there are penalties in the tax Code for doing all of those things and they ought to be removed.

Second: mixed-income housing. We've heard a little bit about that earlier. The Housing Credit does a great job of reaching tenants between about 40 and 60 percent of area median income. Typically that's between about, oh, \$24,000 to \$36,000 for a family of four. But it has a very hard time reaching to very, very low-income people, just because of the economics that are involved, and moderate income tenants are ineligible to generate tax credits.

There are at least four specific circumstances where we think there's a compelling public objective here.

The first is to revitalize low-income communities so that they serve really a mixed income population from the poor to moderate-income. Second would be in very high cost markets where moderate income tenants have very, very significant rental affordability obstacles. Third would be to preserve existing, federally assisted stock where some tenants' incomes have risen above the tax credit ceiling, and that means that you can't get tax credits to renovate those units.

And fourth is in rural areas. We haven't talked a lot about rural today but in many rural areas populations are so sparse that you simply can't put a deal together. If you could expand the income band that you're trying to reach to serve very poor residents as well as some moderate-income residents we could do a lot more rural housing than is possible today.

We'd like to maintain the overall income targeting. The 60 percent income targeting has been, I think, part of what has kept this program focused and strong, but we'd suggest that if sponsors are willing to go down and serve especially low-income tenants for some units that they also be able to go up correspondingly so that the overall balance is maintained.

Another theme would be community revitalization. Again, we very much agree with Jonathan's point about community service facilities. There is some provision in current law, but it is particularly difficult for smaller projects. Combining child care or primary health care resources that are critical to low-income communities and in very short supply would be very helpful.

Housing preservation is another key area. Here we agree that the so-called exit taxes that have to be paid upon a transfer of property does impede the preservation of affordable housing and we'd like to see that addressed. There is legislation to do that.

There is more detail that others have presented and also in our written testimony, but I will stop there and thank you very much.

[The Statement of Mr. Roberts follows:]

**Statement of Benson F. Roberts, Senior Vice President for Policy and Program Development, Local Initiatives Support Corporation**

Good morning, Mr. Chairman and Members of the Subcommittee. My name is Benson Roberts. I am Senior Vice President for Policy and Program Development at LISC, the Local Initiatives Support Corporation.

Since 1980, LISC's charitable mission has been to revitalize low-income urban and rural communities, principally by mobilizing private capital for and providing expertise to local community developers. We have invested \$7.8 billion—including \$1 billion last year alone—in 215,000 affordable homes, 30 million square feet of economic development space, 80 schools educating 28,000 children, 130 child care centers serving 12,300 children, and 155 playing fields for 150,000 youth. We have seen that low-income communities can be good places to live, raise families, and do business, and that community leaders can drive a revitalization process in partnership with the private sector and government. Former Treasury Secretary Robert Rubin chairs our board of directors.

For 20 years, the Low Income Housing Tax Credit has been central to LISC's work. Our affiliate, the National Equity Fund, has raised and invested \$5.5 billion in 1,500 properties with 80,000 quality affordable homes in 43 states. We have been part of a broad partnership that has helped the Housing Credit grow from a novel idea into the most successful Federal policy for producing affordable rental housing the U.S. has ever had. The Housing Credit has proven to be:

- *Productive*: It has created nearly 2 million homes, including about 130,000 annually, for low-income families at restricted rents for terms of at least 30 years. This production would not have occurred but for the Housing Credit.
- *Locally responsive*: It works for new construction, rehabilitation, and preservation of affordable housing. It works in cities, suburbs, and rural areas. It revitalizes low-income communities. It serves families, the elderly, the disabled, and the homeless. Each state sets its own housing priorities, and developers compete aggressively to meet these priorities.
- *Collaborative*: It creates partnerships among nonprofit and for-profit developers, private investors and lenders, and all levels of government.
- *Cost efficient*: It delivers about 90 cents at the start of a project for a stream of tax credits totaling one dollar over 10 years. Investors accept aftertax rates of return just above 5%, remarkably low for an equity investment in a form of real estate once seen as too risky without guaranteed rents and mortgages.
- *Market disciplined*: Investors receive their tax credits only if housing is built on time and on budget, operates successfully within local housing markets, and is well maintained over time. The annual foreclosure (failure) rate for Housing Credit properties is 0.02% annually, well below that for other housing or commercial real estate.<sup>1</sup>
- *Adaptive*: The way Housing Credits work continues to evolve, primarily to meet local needs and find more efficient ways to attract and manage investment capital.

As successful as the Housing Credit has been, it could benefit significantly from updating. When the Housing Credit was enacted in 1986, no one could know precisely how it would work. Many provisions written two decades ago have been essential to making the Housing Credit effective, while others have proven unnecessary and some have become obstacles to efficiency and flexibility. Markets and local needs have changed substantially. For example, before 1986 individuals had been the predominant investors in low-income housing; now corporations provide virtually all of the investment, and fewer than 20 provide most of it. Similarly, as housing costs have risen, many states and communities are focusing more on preserving affordable housing as well as developing new housing, and low-income community development strategies have become more sophisticated and comprehensive. Finally, the Housing Credit has become integral to many other federal housing policies and programs.

Accordingly, we strongly urge Congress to address the following objectives.

**Eliminate penalties for combining Housing Credits with other federal housing programs.**

We urge Congress to remove various restrictions that make it hard to coordinate Housing Credits with other Federal policies and programs. These restrictions frustrate efforts to address local needs and add unnecessary legal and accounting costs. In some cases these restrictions were set many years ago to prevent properties from receiving excessive subsidy. However, they are no longer needed because states examine each project at three points to ensure that it needs the amount of Housing Credits allocated to it. In addition, the high demand for Housing Credits and other subsidies motivates all subsidy providers to limit subsidies to the minimum amount necessary. Congress has lifted restrictions for some specified programs, and that has worked well in those cases, but Housing Credit policy has not kept pace with other policy developments and emerging local needs.

- *Ongoing governmental subsidies (e.g., rent, interest, and operating subsidies) should not be treated as grants, and instead treated similarly to Section 8 rental assistance.* For many years, most forms of Section 8 rental assistance have been used to help very low-income tenants who could not afford even the modest rents of Housing Credit properties. Over the years, the IRS has extended this policy to accommodate a limited number of similar Federal subsidies, such as public housing operating subsidies. However, there are still other comparable subsidies that the IRS has not affirmatively approved, leaving considerable confusion about their treatment, and interfering with the development of many important projects, mostly serving very needy populations. This change would facilitate the use of Housing Credits with numerous programs, including: homeless and other special needs housing under the McKinney-Vento Act and homeless veterans programs; preservation of older properties financed under HUD's Section 236 program and the Section 8 moderate rehabilitation program; HUD's

<sup>1</sup>Ernst & Young, *Understanding the Dynamics III: Housing Tax Credit Investment Performance*, Boston, MA: Ernst & Young, December 2005, page 3.

Section 202 elderly housing program; and HUD's Section 811 program for the disabled.

- *Eliminate penalties for below-market Federal loans except tax-exempt bonds.* Under current law, the available Housing Credit amount is reduced for projects receiving below-market Federal loans, a policy that complicates many projects and makes others unfeasible. This change would allow Housing Credits to be used without penalty in conjunction with below-market Federal loans in general, including those under the Section 202 elderly housing, Section 811 disabled housing, and HOPE VI public housing redevelopment programs, among others, as well as any future resources (e.g., under GSE legislation the House is considering this week). We are not seeking to permit the use of 9% (70% present value) Housing Credits with tax-exempt bonds.
- *Permit the "high cost area" basis increase on properties receiving below-market HOME loans.* The HOME program is a Federal block grant that states and localities use for the acquisition, development and preservation of affordable housing. In general, properties in areas where housing is especially hard to develop—markets where rents are very high relative to incomes and low-income communities—can get extra Housing Credits. However, these extra credits are not permitted if states and localities use HOME funds to make below-market loans. Not surprisingly, it is exactly these kinds of hard to serve areas where every possible resource is needed to make housing possible.

#### **Encourage mixed-income housing**

We recommend that the Housing Credit be modified to accommodate mixed-income housing, at least in certain circumstances. For 20 years the Housing Credit has done an excellent job of reaching low-income households at 40–60% of the area median, a national average of about \$24,000–\$36,000 for a household of four persons. However, it has been difficult to use the Housing Credit to build mixed-income housing: reaching *very* low-income tenants at reasonable rents without deep ongoing subsidies is financially all but impossible, and units serving moderate-income tenants are ineligible for Housing Credits. Nevertheless, many practitioners and policy experts agree that mixed-income housing is desirable social policy and conducive to the long-term financial sustainability of the housing.

More specifically, properties that serve some *very* low-income tenants at very low rents should also be able to serve a like number of moderate-income tenants at moderate rents, provided that the *average* income/rent ceiling for all Housing Credit units in a property does not exceed 60% of median. Under current law, the 60% standard generally applies to each unit rather than a building-wide average.<sup>2</sup> There are several circumstances for which there is a compelling policy justification for mixed-income housing:

- In high-rent markets where moderate-income renters face significant affordability problems.
- In low-income/high poverty areas as part of a mixed-income revitalization strategy.
- To preserve and revitalize Federally assisted rental housing, including the redevelopment of public housing. In many properties, some tenants' incomes have risen above 60% of AMI, and Housing Credits are unavailable to that extent.
- For rural areas. The population of many rural areas is too sparse for Housing Credit projects to work if the effective market is effectively limited to households between 40–60% of median income. Expanding the range of eligible incomes would make more rural developments financially feasible, especially in isolated areas with few other affordable housing opportunities.

We recommend that the maximum permissible income/rent for any unit should be based on 90% of area median. This level would enable another unit in the property to serve an extremely low-income household with an income below 30% of median. However, project sponsors should otherwise have flexibility, e.g., to balance a household below 40% of median income with another below 80%.

#### **Foster Low Income Community Revitalization**

The Housing Credit has played a driving role in revitalizing low-income communities. It has replaced blight with attractive assets, provided low-income families a solid foundation for upward mobility, helped community leaders take charge of their neighborhoods' future, forged multi-sector partnerships, and stabilized shaky neigh-

<sup>2</sup>In most cases Housing Credit properties serve tenants with incomes below 60% of area median. A smaller share of properties provides 20–40% of their units for tenants below 50% of area median; a comparable provision would apply to these projects.

borhood markets. Housing Credit investments frequently lead to other investments in home ownership and retail and other economic development activities.

Independent research confirms positive community effects. The most sophisticated study examined the effects of 13 Housing Credit projects on the quality of nearby neighborhoods in three different cities.<sup>3</sup> Projects produced upward shifts in nearby sales prices of 55 percent in Cleveland, 64 percent in Seattle, and 81 percent in Portland *compared to what they would have sold for otherwise*. (Most economists agree that property values are highly indicative of neighborhood quality, including such factors as crime rates and the physical attractiveness of the area.) Indeed, research has shown that nationwide, neighborhoods where Housing Credit properties are sited showed greater improvements in poverty, income and housing values than did all other metropolitan area neighborhoods.<sup>4</sup> LISC and Enterprise Community Partners have commissioned further research from New York University's Furman Center. Preliminary findings confirm those of other research and deepen our understanding of how Housing Credit projects create value. For example, developing larger projects up to a point produces correspondingly larger benefits. This is true mainly for projects involving rehabilitation of existing buildings, most likely reflecting the blighting influence of buildings in need of rehabilitation.

To further foster low-income community revitalization, we urge Congress to enact the mixed-income proposal discussed above and make two other modest changes:

- An important obstacle for families in low-income communities is the dearth of facilities for child care, primary health care, recreation and other community services that help families to grow strong and independent. Under current law, up to 10% of the eligible basis of projects in low-income or high poverty census tracts can support community service facilities. However, this allowance is too limited for smaller projects; for example, a child care center must be a certain size to function well. We recommend expanding eligible basis for these facilities to 20% of first \$5 million (indexed for CPI) and 10% thereafter.
- Incomes in rural areas are generally lower than in metropolitan areas, and in very low-income rural areas it is financially very difficult to make Housing Credit development work. To facilitate rural housing, we recommend basing rural rent/income ceilings on greater of: (1) current law or (2) 60% of national non-metro median. Since the national *non-metro* median income is significantly below the *metro* median, genuinely low-income households would still be served.

### Preserve Affordable Housing

Tighter housing markets and rising housing costs have prompted many governmental and community leaders to prioritize the preservation of existing affordable housing. Housing preservation is often faster, less costly, and more scaleable than constructing new housing, though each strategy is appropriate in different circumstances. In addition to the mixed-income housing proposal discussed earlier, we recommend three other changes.

- A modest number of older Housing Credit properties developed 15–20 years ago are starting to need additional capital improvements. Additional capital can be raised by transferring the property to new ownership. However, current law requires replacing at least 90% of the ownership for the cost of acquiring a building to qualify for new Housing Credits. This transfer requirement is far more stringent than the general related-party rules elsewhere in the Tax Code [Sections 267(b) and 707(b)], which generally require replacing only 50% of the ownership. The more stringent requirement is unnecessary, since states already allocate credits to only the highest priority projects and ensure that projects receive only the credits they need. Nor is it workable. Fewer than 20 corporate investors provide most Housing Credit investments, and most of these are banks that target only the communities where they have branch networks. The Section 42 requirement should be conformed to the Tax Code's general 50% related-party rule.
- In general, the cost of acquiring a building is ineligible for Housing Credits if the building changed owners within the previous 10 years. This rule made sense when the Housing Credit was enacted in 1986, following a surge of real estate sales in the early 1980s to take advantage of accelerated deprecia-

<sup>3</sup> Johnson, Jennifer E. and Beata Bednarz. 2002. *Housing Price Effects of the Low Income Housing Tax Credit Program*. Washington DC: United States Department of Housing and Urban Development.

<sup>4</sup> Freeman, Lance. 2004. *Siting Affordable Housing: Location and Neighborhood Trends of Low Income Housing Tax Credit Development in the nineties*. Washington, D.C.: The Brookings Institution, Center on Urban and Metropolitan Policy.

tion rules. These rules served little public purpose. However, since accelerated depreciation is no longer available, it makes no sense today, especially since preserving affordable housing has become so important and state administrative rules provide safeguards against abuse.

- Acquiring housing developed through HUD and USDA programs in the sixties through early eighties and preserving affordability is difficult in part because some current investors must pay depreciation recapture (“exit taxes”). Investors/sellers can avoid exit taxes by holding their ownership until death, when basis is stepped up as ownership is passed to their estates. However, properties in weak housing markets often deteriorate in the meantime, and properties in stronger markets are often converted to rents unaffordable to low- and moderate-income families. We urge Congress to enact H.R. 1491, the Affordable Housing Preservation Tax Relief Act of 2007, which would provide exit tax relief for housing that will remain affordable for an additional 30 years. This would facilitate the use of Housing Credits to preserve the affordability of Federally assisted housing. Relief for properties that have previously received Housing Credits is unnecessary.

#### **Eliminate Unneeded Inefficiencies**

Several requirements serve little public purpose but impose unnecessary rigidities or administrative burdens. We recommend that Congress make several changes to address these issues.

- A technical but important data problem is freezing rents in many Housing Credit properties, threatening their financial stability. Each year, HUD adjusts maximum incomes and rents as area incomes change, usually upward. HUD’s source of data was recently changed from the old census “long form”, which no longer exists, to the American Community Survey. The new income levels across the country are lower than previously reported. Under HUD’s “hold-harmless” policy, maximum incomes and rents were not reduced, but they were frozen, and in many areas it will be several years before rents will increase. Meanwhile, operating costs continue to rise, and energy and insurance costs rising steeply. The result will be to destabilize current properties and to create great uncertainty for future developments. We are working with other organizations to recommend a technical modification to the Housing Credit that will address this problem and serve low-income tenants.
- In general the income of each tenant in Housing Credit properties must be recertified annually. In Housing Credit properties where all units are income- and rent-restricted, this requirement serves no purpose, since tenants are not evicted if their incomes rise, rents cannot be increased, and all vacated units are reserved for low-income tenants. The IRS does accommodate a waiver process, but not all states participate. The result is that many project sponsors annually recertify all tenant incomes at substantial cost and for no real purpose. This requirement should be eliminated for such Housing Credit properties.
- We strongly support repeal of the recapture bond rule under the Housing Credit. It requires investors selling an interest in a Housing Credit property to purchase a guarantee bond from an insurance company to cover recapture liability in the event of noncompliance. This is a unique rule; no other part of the Tax Code requires taxpayers to post a recapture bond. It is particularly unnecessary in this program where a limited number of large financial companies account for almost all investor capital; there is no risk they will not pay a potential tax liability. Indeed, for the most part smaller, lower rated insurance companies are being paid to insure a potential tax liability of larger, higher rated Housing Credit investors. However, the bonds are costly; they make the secondary market less liquid; and they increase investor yields at the expense of program efficiency.
- Currently, 10% of expected project costs must be incurred within 6 months after receiving a Housing Credit allocation (or by the end of the calendar year if later). The current provision requires the expenditure of substantial legal and accounting costs, and does not achieve the desired policy result. We do support the purpose of this provision, which is to encourage projects to move forward expeditiously. However, we believe it would be more effective if Congress provided broader direction that states should ensure that projects are ready to proceed. It is also notable that other provisions require projects to be completed by the end of the second year after Housing Credits are allocated.
- That Housing Credits are subject to the Alternative Minimum Tax restricts the investor market, adds risks to those who do invest, and as a result reduces the efficiency of this tax incentive. We recommend that the AMT not apply to cor-

porate investments in Housing Credits, historic rehabilitation tax credits (which are often combined with Housing Credits), and New Markets Tax Credits.

- Currently the maximum Housing Credit amount is set based on prevailing interest rates so that its present value is 70% of eligible basis (30% for building acquisition costs and properties financed with certain below-market Federal loans). The actual Housing Credit amount will fluctuate with interest rates, making it hard for sponsors and other participants to plan developments reliably. We recommend that the Housing Credit percentages be set at the greater of current law or 9%/4% annually. Under most conditions, the 9%/4% rates would apply, but if interest rates were to rise substantially, the current rule would allow a somewhat larger tax credit.

#### **Expand the Volume of Housing Credits**

Although our testimony has focused on provisions that would require little or no cost, we would also urge the Committee to consider expanding the volume of Housing Credits. The need for affordable housing is far greater than the Housing Credit and other programs currently can address. The Housing Credit is already a proven success, and is well positioned for expansion.

#### **Conclusion**

This concludes my testimony. I would be happy to answer any questions.

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\*Chairman NEAL. Thank you very much, Mr. Roberts.  
Mr. Lawson.

#### **STATEMENT OF STEVE LAWSON, THE LAWSON COMPANIES, NATIONAL ASSOCIATION OF HOME BUILDERS**

\*Mr. LAWSON. Good morning, Chairman Neal, Ranking Member English and Members of the Subcommittee. My name is Steve Lawson and I'm a third generation builder and president of the Lawson Companies in Virginia Beach, Virginia.

For 35 years, our company has been active in the financing, development and management of single and multi-family housing, serving both affordable and market rate residents. It's my pleasure to be here today on behalf of the 235,000 members of the National Association of Home Builders.

NAHB applauds the Committee's effort to enhance the efficiency and effectiveness of the housing tax incentives. In an era of limited resources, increasing development and operational costs and a constant need for more affordable housing, maximizing the value of our existing tools is absolutely critical.

My written Statement contains a number of recommendations for fine tuning the Low-Income Housing Tax Credit, the private activity bonds and the historic rehab credit. It's worth noting that many of these recommendations are shared by several other organizations who are testifying here this morning.

I won't bore you by repeating those, but I think it is important to point out that this speaks very highly of the consensus in the industry about the specific ways to improve the affordable housing tax incentives.

In my brief time today I'll focus on one specific issue that affects Low-Income Housing Tax Credit properties. Namely, that is stagnant rents. This critical issue is one part of a significant challenge facing all tax credit properties today. That is balancing operating expenses versus revenue in order to maintain the long-term viability of a property.

Tax credit properties are facing stagnant rents because the changes in the system and the data used by HUD to establish income limits and thus rents for these properties. Most notably a shift to the American community survey data from the previous census data has resulted in a downward adjustment in income limits and rents in most areas of the country.

To HUD's credit, the Department established a very necessary hold harmless policy and did not reduce income limits or rents but instead froze them to blunt the impact of this trend. The strategy worked well in the context of smoothing over a temporary anomalous downturn in income data, but it cannot counter the effects of a systemic shift to the ACS data or other data changes.

In 2007, HUD's estimates show median family incomes actually declined in more than 75 percent of the country. This means more than two-thirds of the nation will be held harmless and see no increase in rents over the coming year. This follows several years where rents have already been frozen in many places.

Even worse, hundreds more localities will see no increases moving forward for several years because of the magnitude of these changes. Curiously, and I dare say tragically, while HUD's estimates show a widespread decline in incomes, the most recent ACS data, which is the data that all of this is based upon, actually shows the average median family income nationwide has increased by four percent.

In the context of trying to establish rents for tax credit properties, I believe this constitutes a complete disconnect between the statistical methodology and the real world. Even more, I think it begs the question whether income limits are the best way to establish annual rent increases for this program.

Compounding stagnant rents is a significantly increasing environment of operating costs. Utilities, insurance, real estate taxes, all of our costs are going up precipitously. Taken together, these issues create an ever widening gap between operating revenue and expenses. A tax credit property with such a critical gap could eventually be unable to meet its debt service obligations and default on its mortgage.

In the long-term, because of this fundamental weakness in the program, tax credit prices could fall, less equity would be available for each project and less affordable housing would be built.

Currently there's no good option for owners or property managers to address this situation. In order to cover the cash flow shortfall when expenses exceed revenues, properties must rob Peter to pay Paul by deferring needed maintenance or borrowing from capital reserves. This is not sustainable over the long-term and places properties at even greater risk because the maintenance and replacement costs become even greater as the property ages.

To address the rent side of the equation, NAHB has proposed indexing tax credits to a reasonable inflation factor such as the consumer price index after the initial rents had been set according to the income limits of the program. We believe this keeps rent increases at a modest level, ensures a stable increase in revenues over time and maintains the income targeting that is central to the program.

Whatever solution we do adopt here, something must be done to preserve the existing units and maintain production of new units. NAHB has crafted more detailed explanation of these issues, and we respectfully ask that these documents be included in the record. Thank you again for testifying, for allowing us to testify today. NAHB and its members look forward to working with the Committee and the rest of the industry and finding a solution.

[The Statement of Mr. Lawson follows:]

**Statement of Steve Lawson, The Lawson Companies, on behalf of the  
National Association of Home Builders, Virginia Beach, Virginia**

The 235,000 members of the National Association of Home Builders (NAHB) appreciate the opportunity to comment for the House Ways and Means Committee, Subcommittee on Select Revenue Measures, regarding tax incentives for low-income housing. This statement contains recommendations for improvements in several programs of the Internal Revenue Code (IRC) for low-income and historic housing, including the Low Income Housing Tax Credit (LIHTC), private activity bonds and the Section 47 historic rehabilitation credit. The primary focus of this statement, however, is on the LIHTC.

In the last 20 years, the LIHTC has facilitated the construction or preservation of nearly 1.4 million affordable housing units for individuals and families making less than 60 percent of area median income (AMI) and, oftentimes, much lower than that. It has evolved into the foremost tool for the production and rehabilitation of affordable housing. For-profit developers and builders have been and continue to be integral partners in that effort. However, the need for affordable housing greatly outpaces even this significant level of production and the existing supply of units. NAHB looks forward to working with the Members of the Committee as they craft legislation to maximize the efficiency and effectiveness of the LIHTC and other tax incentives for affordable housing to help meet this need.

NAHB's statement is organized into five parts. The first section discusses two critical issues in the LIHTC program that need resolution to ensure the continued vitality and success of the program. The second section proposes several technical improvements to the LIHTC to make it more efficient and effective while minimizing the economic impact on the federal budget.

The third section of this statement sets forth recommendations for reducing barriers to using the LIHTC with the U.S. Department of Housing and Urban Development's (HUD) Federal Housing Administration (FHA) multifamily mortgage insurance. NAHB strongly supports the FHA multifamily mortgage insurance programs and believes that these two important housing production programs should work together as efficiently as possible. The fourth section recommends ways to improve coordination between the LIHTC and other HUD programs. The fifth and final section makes recommendations in regards to the historic rehabilitation credit and private activity bond programs.

**I. Critical Issues in the LIHTC Program**

As legislation is crafted to improve the efficiency and effectiveness of the LIHTC NAHB urges Congress to address two critical issues that, unless resolved, will undermine the long-term success of the program. The first issue deals with the financial viability of existing and new LIHTC properties that are in jeopardy because of recent changes in the data used to establish their rents. These rents are being artificially frozen—and have been in many areas for several years—while operating expenses like utilities and insurance are rising precipitously. The second issue is inextricably tied to the first and deals with utility allowances for LIHTC units that must be deducted from gross rent to establish the amount of rent chargeable to the tenant. Taken together, these two issues present an unsustainable long-term financial scenario for the LIHTC program.

***Income Limits and Rents*<sup>1</sup>**

Each year, HUD estimates median family income for metropolitan and non-metropolitan areas of the country and publishes a list of "income limits" based on these

<sup>1</sup>NAHB recently published a detailed analysis of this issue entitled; *New Income Estimates Freeze Tax Credit Rents in Hundreds of Areas* in the April 2007 edition of the NAHB Multifamily Market Outlook. While the article was too lengthy to include as part of this statement,

Continued

estimates. These income limits determine eligibility and allowable rents for the LIHTC program, in addition to other Federal housing programs. The system and underlying data sources that HUD uses to establish income limits, however, have changed, most notably by shifting to data from the American Community Survey (ACS), which has replaced previous census reports. As a result of this data source change, in most areas, incomes and rents were adjusted down. Under its “hold-harmless” policy, HUD did not reduce LIHTC income and rent ceilings, but instead froze them. In 2007, two-thirds of the nation will be “held harmless” and see no increase in income limits or LIHTC rents. Hundreds more will see no increases going forward for several years.

NAHB stresses its commitment to serving low-income households, with reasonable rent adjustments over time. The concern here arises solely from the unintended impact of data changes. Indeed, data from the ACS indicate that incomes have actually risen in a notable number of these areas, but under HUD’s “hold harmless” policy it will take several years or more in some areas before these increases will result in higher LIHTC rents.<sup>2</sup> The “hold harmless” policy was designed to smooth over a temporary, anomalous downturn in income data, and it has worked well in that context. However, it cannot accommodate the effects of a systemic shift to the ACS or other data methodology changes. The spike in the number of areas with flat income limits in 2007 follows several years during which the limits had already been frozen in many places. Thus, tax credit properties have seen little or no increase in rent for the past 5 years in some areas.

Flat rents for LIHTC properties mean rent reductions in real terms, given even ordinary inflationary increases in expenses. This creates an ever-widening gap over the long-term, which is unsustainable, despite efforts by developers, owners, managers, syndicators, state and local housing finance agencies, and investors to fill the gap. Ultimately, it could lead to a loss of existing LIHTC properties and significant negative impacts on financing for future affordable housing development.

An LIHTC property with a critical gap in revenue versus expenses could eventually fail to meet its debt service requirements and default on its loan, at which point foreclosure occurs and the tenants lose their housing. In the long-term, because of this fundamental weakness in the program, investors will demand higher yields for their tax credit dollars. Consequently, credit prices go down, less equity will be available for each LIHTC project, and less affordable housing will be constructed. This will be especially hard on projects serving the elderly, those with special needs and very low income populations, because these properties typically operate on extremely thin margins of expense versus revenue. In the case of future projects serving these populations, many will not meet the underwriting criteria required by lenders and, therefore, will not be built.

There are no simple solutions to this problem. It is critical to protect the low-income tenants the LIHTC program serves while ensuring the long life of the nation’s supply of affordable housing units. As noted above, properties can currently go for years without any increase in their rents, but because of the erratic nature of the current data and system used to establish these rents, tenants can also be faced with higher-than-usual increases in rent in a single year. What both the properties and their residents need is a level of reasonable and modest predictability in what the increase in rent will be from year-to-year.

Indexing LIHTC rents to a reasonable inflation factor such as the Consumer Price Index (CPI) would create more consistency for owners and tenants. In practical application, a developer would set rents according to the income restrictions for the project at underwriting and each year following those rents would increase by the change in CPI.<sup>3</sup> This maintains the income-targeted nature of the program while allowing for a modest increase in revenue over time to operate the property. Most importantly it would provide a much more reasonable and predictable growth in rent over time for residents and property owners.

Certainly, the effect of this type of proposal would be a built-in rent increase every year for the resident; however, increasing by the change in CPI annually is certainly more reasonable than potentially larger increases that could occur under the existing system. Ultimately, a reasonable annual increase in rent for residents annually has to be considered against the outright loss of affordable housing units in the immediate term and decreased production of new affordable housing in the long-term.

we can provide it along with property-specific examples of the issue to any interested Members of the Committee.

<sup>2</sup>NAHB estimates that over 300 counties across the country will have frozen income limits and LIHTC rents for 3 years or more. Over 100 will be frozen for 4 years or more.

<sup>3</sup>CPI was 3.2% for 2006.

### ***Utility Allowances***

The second critical issue faced by LIHTC owners, which is occurring at the same time that income limits have been stagnant, is that operating costs—especially utility expenses—have continued to escalate. Property owners are required to calculate a utility allowance annually and subtract that from gross rent to arrive at the net rent that is charged to the tenant. As utility costs rise, upward pressure is placed on the utility allowance, thus reducing net rent and overall revenue to operate the property.

Operating costs, particularly utilities, are never completely predictable, but in general, owners feel secure assuming a reasonable increase in costs over time. While underwriting assumptions vary, a two to 3 percent increase in operating expenses per year is fairly typical. In polling NAHB members that build and own LIHTC properties around the country, utility costs have increased significantly more than this.

While developers always assume some rate of increase in annual operating expenses, they also always assume a steady increase in income over time—income necessary to keep pace with increasing expenses and to maintain the property's positive cash flow position. This has been very difficult in recent years as volatile utility costs and stagnant income limits severely limit owners' ability to project accurately the property's cash flow. When expenses like utility costs overtake income, property owners and managers are often forced to cover cost increases by deferring other important expenses, such as maintenance or replacement for reserves. Eventually, these dollars run out which does even more damage to the viability of the project in the long term since maintenance and replacement costs only increase as a project gets older.

Allowing state HFAs to convert the utility allowance into a percentage of maximum gross rent at the time of underwriting would help address this problem. Regardless of the level of future rents, an owner could estimate more accurately their cash flow over the life of the project, which improves their ability to cover unanticipated spikes in operating costs and attract private equity into the project. In the example below, the maximum allowable gross rent at the time of underwriting for a two-bedroom unit is \$500. The LIHTC allocating agency sets the utility allowance at 20 percent or \$100. Therefore, the maximum allowable net rent to the owner is \$400.

#### ***Year 1 (Underwriting) 2005***

Maximum Allowable Gross Rent	\$500
Documented Utility Allowance	\$100
Max Allowable Net Rent	\$400

In Year 2, the Maximum Allowable Gross Rent increases to \$520 and the utility allowance increases as well to \$104.

#### ***Year 2 2006***

Maximum Allowable Gross Rent	\$520
New Utility Allowance	\$104
Max Allowable Net Rent	\$416

In theory, utility expenses could increase by more or less than the percentage assumed at underwriting; however, having a relatively constant utility allowance is the trade off for any potential significant drop in utility costs. Like the proposal offered above for stagnant LIHTC rents, we believe this not only serves the property but the residents themselves. They will have more predictability in their utility expenses and are guaranteed an increased utility allowance if their rent increases.

## **II. Improving the Efficiency and Effectiveness of the LIHTC Program**

### ***Conform the LIHTC and Tax-Exempt Bond Next Available Units Rules***

One central inconsistency between the LIHTC and tax-exempt bond programs is on the issue of the "next available unit" rule. This rule requires that once a tenant exceeds 140 percent of AMI, the next available unit must be rented to an income-qualified tenant. For the LIHTC program this rule is applied on a building-by-building basis, while in the tax-exempt bond program it is applied on a project-wide basis. Currently, both rules must be followed for properties financed with both LIHTCs and tax-exempt bonds, creating an extremely complex management process. Applying the more restrictive LIHTC requirement to these properties would simplify project compliance.

### ***Reform the Full Time Student Occupancy Rules***

Current law prohibits households made up entirely of full-time students from living in LIHTC apartments. Exceptions exist for families who are: receiving Temporary Assistance to Needy Families (TANF); enrolled in a federal, state or local job training program; single parents and their children, provided that such parents and children are not claimed as dependents of another individual; or married full time students who file a joint return. While well-intentioned, full time student occupancy prohibitions are an obstacle for low-income families trying to make a better life for themselves.

Often, child support agreements allow noncustodial parents to claim their children as dependents on tax returns. Because children in grades K–12 count toward the determination of whether family is a full-time student household, many custodial single parents who returned to school full-time become ineligible for LIHTC housing. Working adults trying to complete the requirements for a high school education have also been adversely affected.

Education enables low-income families to expand their economic opportunities and NAHB supports specifying that minor children in grades K–12 should not count toward the determination of who is a full time student household. NAHB also supports striking the requirement that a single parent and their children must not have been claimed as dependents of another individual to qualify for the single parent with children exemption and exempting working adults who are full-time students pursuing a high school diploma or GED.

### ***Fix the LIHTC Percentages at 9 and 4 Percent.***

Actual credit percentages for the LIHTC have rarely ever been at four or 9 percent and are typically well below those figures (3.47 and 8.11 percent, respectively for May 2007). Not having the full amount of the credit available requires project sponsors to secure more debt or scarce soft financing. Fixing the tax credit percentages would increase LIHTC resources available for each project, simplify the Tax Code and provide certainty for project sponsors.

### ***Remove Federal Subsidy Restrictions***

Currently, LIHTC transactions utilizing grant sources such HOME or Federal Home Loan Bank AHP funds must reduce eligible basis unless they are structured as loans to the project. However, this process is costly and reduces funding available for bricks and mortar. Allowing grants like HOME and AHP to be included in eligible basis would decrease transaction costs and increase funds available for developing affordable housing.

NAHB also believes that other sources of Federal subsidies, such as the interest rate reduction payment (IRP) connected with Section 236 properties (of the Housing Act 1937), should not be treated as such for purposes of determining eligible basis. In years past, the IRP was not treated as a Federal subsidy for purposes of determining eligible basis in a LIHTC project. More recently, the treatment of the IRP has changed and is being deducted from eligible basis, thus reducing the amount of LIHTCs available to the property. Allowing the IRP to be includable in eligible basis would facilitate the preservation of these older affordable housing properties.

### ***Enlisted Military Personnel and LIHTC Housing***

In order to qualify for LIHTC housing, individuals and families must meet specific income limits. Property managers collect information on a potential resident's income but are allowed to exclude certain items from the income calculation. Among those items that can be excluded is rental assistance provided by the Section 8 Housing Choice Voucher program (of the Housing Act 1937). However, the Basic Allowance for Housing (BAH), which is a similar housing subsidy, cannot be excluded from the calculation of income and typically puts enlisted families over the income limits for LIHTC-financed housing. Ultimately, enlisted families are needlessly shut-out of quality, affordable housing around the military posts and bases where they are assigned. NAHB supports excluding the BAH from the determination of income for purposes of qualifying for an LIHTC unit.

### ***Streamline the Inspection Process***

There are multiple inspection requirements for properties developed with LIHTCs and other Federal programs, such as HOME, Section 8 project-based and Section 8 tenant-based vouchers. Streamlining of the inspection process would help cut overall costs while allowing quicker move-ins by tenants. NAHB recommends the following: In the case of a LIHTC property with a Section 8 tenant-based voucher holder, if the unit has been inspected within the last 12 months under any Federal program with inspection requirements equivalent to Housing Quality Standards (HQS), the tenant should be allowed to move in immediately and housing assistance pay-

ments (HAP) should also begin immediately. A PHA would have 60 days to complete an inspection.

***Repeal 10-Year Rule for Existing Properties***

One roadblock in the LIHTC program for acquisition/substantial rehabilitation of affordable housing is the “10-year rule.” The IRC requires that for an existing building to be eligible for LIHTCs there must have been a period of at least 10 years between the date of the developer’s acquisition of the building and the date the building was last placed in service or substantially improved. The purpose of the 10-year rule is to prevent “churning” of properties for tax benefits by individual taxpayers. However, the Tax Reform Act 1986 eliminated the benefits of property “churning” and eliminates the need for this rule. The 10-year rule inhibits investments in existing properties. There are many vacant, blighted properties that could provide affordable housing if they received an allocation of LIHTCs. Repeal of the 10-year rule would assist state housing finance agencies (HFAs) in meeting their preservation goals. NAHB supports repeal of this rule.

***Repeal the Recapture Rule for LIHTCs***

The Internal Revenue Code (IRC) requires that when an investor disposes of an interest in a LIHTC property, a recapture bond must be purchased to guarantee payment to the Treasury of any potential recapture tax liability. This imposes significant unnecessary costs on investors and can even prevent some properties from obtaining critical recapitalization resources. Further, according to the IRS, this process is “administratively difficult” to support. It represents excessive protection against a negligible risk (the IRS has never collected on a recapture bond), and repealing this rule would improve the secondary market for LIHTCs and bring more resources into affordable housing.

***Change the Name of the Program***

While awareness has grown of the need for more affordable housing, local resistance remains a significant issue. Although nearly all LIHTC units are rented to working families, many communities react negatively to the term “low-income.” Opposition to proposed LIHTC properties can dramatically slow the development process, increase transaction costs and ultimately result in properties not being constructed at all. One option for addressing this issue would be to change the name of the program to the “Affordable Housing Credit.” This would help reduce program stigma and diffuse “Not In My Backyard” (NIMBY) challenges making it easier to develop affordable housing.

***Allow State Agencies to Designate QCTs and DDAs***

LIHTC properties located within Qualified Census Tracts (QCTs) or Difficult to Develop Areas (DDAs) are eligible to receive a 30 percent boost in tax credit basis. However, there also are LIHTC properties outside of QCTs and DDAs that would benefit from a boost in tax credit basis. In some cases, these properties are located literally across the street from projects within the QCT or DDA boundary. Allowing state HFAs more flexibility to award the basis boost to projects in other areas would help alleviate this problem. State authorities have detailed information regarding local market conditions and can ensure that only the minimum amount of credit needed is awarded to a particular project.

***Streamline Compliance Monitoring and Subsidy Layering Requirements***

Although the affordability rules (percentage of income that must be served and term of the affordability period) differ among programs, the rules do not pose a significant problem for NAHB’s members. However, compliance monitoring could be streamlined when multiple sources of financing are included in a transaction. For instance, a single agency could be responsible for overall monitoring (income targeting and eligibility, rent restrictions and compliance periods). A good model to follow is the recent action taken by the Federal Home Loan Banks related to the Affordable Housing Program (AHP). A bank may now rely on another agency for compliance monitoring if the project’s financing (e.g., LIHTCs) include affordability rules substantially equivalent to those of the bank’s.

Similarly, a single agency could be responsible for subsidy layering. NAHB recommends that state HFAs take over that responsibility from HUD, when LIHTCs and other federal funds, such as HOME or FHA financing, are used. Since the HFAs already underwrite LIHTC projects, this change would streamline the subsidy layering process.

### ***Allow LIHTCs to Offset Alternative Minimum Tax Liability***

The role of individual investors in the LIHTC has changed from being significant investors in LIHTC properties to that of supplying very little capital through this housing tax program. The increasing impact of the alternative minimum tax (AMT) on individuals is likely to further erode the already attenuated role of individual investors. The impact of this decline in individual investors will potentially be felt most acutely in the mix of types of affordable housing properties that are developed.

Corporations tend to invest in large urban and suburban developments. Moreover, there is evidence that some corporations are reluctant to invest in special needs projects or in projects designed to spur economic or community revitalization. In contrast, individual investors tend to invest much smaller amounts and so are naturally attracted to smaller projects (including rural projects). Also, compared to corporate investors, individuals are more likely to take a personal interest in their investment projects and so may have more of a preference for projects aimed at particular types of renters in their communities, such as unwed mothers or the mentally disabled. As a result, any success in increasing individual investor demands for LIHTC projects is likely to increase demand for smaller projects, rural projects, and special needs projects. To insure that individual taxpayers maintain an active role in this important housing program, NAHB supports allowing LIHTCs to be fully applicable against AMT liability.

### **III. Reducing Barriers to Using LIHTCs with Federal Housing Administration (FHA) Multifamily Mortgage Insurance**

#### ***Adjust Rules Related to Use of Equity***

FHA multifamily mortgage insurance rules also require that LIHTC equity be used first, before any proceeds insured by FHA. LIHTC investors pay less for the credits if the equity contribution cannot be phased in over the course of construction and lease-up. The end result is less equity for the project. Allowing the phasing-in of the LIHTC equity would be a significant improvement.

#### ***Improve Processing Time***

A significant issue for LIHTC developers using FHA insurance is that the approval process for FHA insurance, even using Multifamily Accelerated Processing (MAP), is too long to meet the time deadlines accompanying the allocation of LIHTCs. A large part of this problem is the lack of expertise on the part of HUD staff related to the LIHTC program. Solutions could include the creation of a special office to process LIHTC/FHA deals, along with more technical training and the hiring of experts in LIHTC transactions.

#### ***Develop New Financing Tools***

FHA also does not offer an array of financing options for developers. For example, NAHB has encouraged HUD to develop a variable rate (or lower floater) option, as well as improve its small projects processing. Although HUD now has a pilot underway for a more streamlined small projects program, it does not include LIHTC projects. HUD needs to be more innovative in its product offerings.

#### ***Revise Rules on Use of Insurance Proceeds***

HOPE VI projects often include LIHTCs, FHA financing, HOME funds, tax exempt bonds and other funding. Currently, HOPE VI contracts include a provision that requires insurance proceeds to be returned to the public housing authority (PHA). In the event of a disaster, those insurance proceeds should be used to pay legitimate financial obligations of the property, not returned to the PHA. If the insurance proceeds are not returned to the affected development, the developer may face default on the mortgage obligations or may not be able to fund rebuilding of the property. This requirement is a significant deterrent to private sector investment in public housing.

#### ***Revise HUD's 2530 Previous Participation Requirements for Investors***

One significant barrier to the development of LIHTC projects is the HUD 2530 Previous Participation rule. This rule is intended to ensure that HUD does business with reputable persons and organizations that will honor their legal, financial and contractual obligations. This applies to participants wishing to use certain HUD programs, including FHA mortgage insurance, who must first be cleared through the 2530 process.

For many FHA-insured projects that also include LIHTCs, the requirements are burdensome and, in some cases, discourage investment in such properties. For example, HUD currently requires a 2530 review of individual officers of any corporation directly investing as a limited partner in a FHA-insured tax credit transaction.

All officers and directors three levels below the mortgagor entity must be listed with their social security numbers and a listing of their personal project undertakings. In the case of syndications, this often means 2530 clearance must be obtained for the officers, directors and stockholders who hold more than 10 percent of a corporation's shares. If Microsoft made such an investment, for example, HUD would require Bill Gates and his fellow officers to go through the 2530 review process and to personally sign 2530 forms.

NAHB applauds the passage of H.R. 1675 by the House of Representatives and hopes the Senate will do the same soon. Reducing the burden from the Section 2530 requirement would ensure a stable pool of investors for future LIHTC development.

#### **IV. Ways to Better Coordinate the LIHTC with Other HUD Programs**

##### ***Remove Caps on Voucher Rents in LIHTC Properties***

Section 8 voucher rents and HOME rents should be permitted to be at least as high as the LIHTC rent. If units with voucher or HOME tenants must have lower rents than the tax credit rent, the total revenue to the project is decreased. This places additional financial pressure on the project and increases the difficulty in meeting operating expenses.

##### ***Remove Prohibition on Using LIHTCs with Section 8 Moderate Rehab***

Another conflict between a HUD program and the LIHTC is the restriction in the IRC against using tax credits with Section 8 Moderate Rehabilitation (Mod Rehab) properties. This restriction was enacted in the late eighties after revelations that some Mod Rehab properties were being over-subsidized. Over-subsidization no longer exists in the LIHTC program because tax credit allocating agencies conduct extensive underwriting analyses of each LIHTC application. No funding has been provided for the Mod Rehab program for many years and these properties are in great need of rehabilitation. Raising capital to do this is very difficult without the LIHTC program and lifting this restriction would help preserve these affordable housing units.

##### ***Provide Consistent Underwriting Standards for Federal Programs***

LIHTC properties with multiple financing resources, from both the private and Federal sectors, will almost always require multiple underwriting standards. NAHB would strongly support consistent underwriting standards and processes for federal programs utilized in a transaction. This would help reduce both the complexity of LIHTC projects and transaction costs, which translates to more dollars for bricks and mortar. However, NAHB would caution against adopting a uniform set of underwriting standards for private capital investment sources. Imposing a fixed system on the market would increase regulatory burdens and reduce the incentive for investment in affordable housing.

##### ***Repeal the Mortgage Revenue Bond Ten-Year Rule***

Current law requires Mortgage Revenue Bond (MRB) issuers to use payments on MRB-financed mortgage loans to retire the existing MRB obligations rather than make new mortgages for more lower income families, once the MRB has been outstanding for ten or more years. Commonly referred to as the "Ten-Year Rule," this requirement costs states billions of dollars each year in lost MRB mortgage loan money and is administratively burdensome. A survey of state Housing Finance Agencies that was conducted by the National Council of State Housing Agencies estimates the Ten-Year rule will cost states \$11.8 billion in MRB mortgage money between 2005 and 2008. These funds could finance nearly 115,000 mortgage loans for first-time home buyers.

##### ***Repeal the First-time Home Buyer Requirement for MRB-funded Mortgage Loans.***

Without MRB-funded loans, teachers, first responders, municipal workers, service sector employees, and military veterans may not be able to purchase homes in or around the communities in which they work, even if these families previously owned homes elsewhere. Under the IRC, borrowers who receive MRB funded loans may not have owned a home during the preceding 3 years, except homes purchased in targeted areas suffering from chronic economic distress. In addition, the Code requires that a borrower's family income not exceed 115 percent of the median income for a family of similar size, and the purchase price of a home may not exceed 90 percent of the average price for homes in the area. NAHB believes that the family income and home-price eligibility requirements serve as sufficient constraints to maintain the focus of the MRB program on serving buyers of modest homes.

***Increase the Mortgage Revenue Bond Home Improvement Loan Limits***

State HFAs are currently authorized to sell MRBs or Mortgage Credit Certificates (MCCs) to fund home improvement loans to low- and moderate-income homeowners. The existing limit of \$15,000 for loans that can be funded by MRBs or MCCs was established by Congress in 1980 and is too low to be economically justifiable for state HFAs to offer home improvement loans.

***Revise the 50 Percent Test on Tax-Exempt Bonds***

It is increasingly difficult to use tax-exempt bonds and 4 percent tax credits together, especially in rural areas. Under current law, at least 50 percent of eligible basis of a development must be financed with tax-exempt bonds. This means there is a relatively large mortgage on the property. In areas with very low median incomes, it is often not possible to generate enough revenue from rents to cover debt service and operating expenses, given this constraint. NAHB suggests that the 50 percent test be reduced to a lower percentage to permit projects that are able to obtain significant subordinate debt to still take advantage of 4 percent tax credits.

***Expand the Section 47 Historic Rehabilitation Credit to Owner-occupied Housing***

NAHB supports the important role that the Section 47 Rehabilitation Credit plays in preserving historic communities across the country while also helping in the provision of affordable housing. Like the LIHTC, there are also ways in which the historic rehabilitation credit can be improved to maximize its efficiency and effectiveness. NAHB applauds the introduction of H.R. 1043 the "Community Restoration and Rehabilitation Act" by Representatives Stephanie Tubbs-Jones (D-OH) and Phil English (R-PA). This legislation provides for improvements to the historic rehabilitation credit that will enhance its value for smaller rural and urban projects and strengthen it as a tool for both affordable housing and community revitalization efforts.

NAHB also believes that the preservation of historic housing would be increased significantly by expanding the credit to include owner-occupied housing. Doing so would help revitalize older neighborhoods and historically important properties while retaining the private and social benefits of home ownership for those homes and local areas. This is a particularly important issue for inner suburbs in large metropolitan areas and small towns in non-metropolitan areas, for which the aging owner-occupied housing stock defines the character of a neighborhood.

***Conclusion***

NAHB appreciates the opportunity to comment on ways to improve the efficiency and effectiveness of tax incentives for low-income housing. Programs like the LIHTC, the Section 47 historic rehabilitation credit and private activity bonds have proven themselves invaluable to the production and preservation of safe, decent and affordable housing. Enhancing their positive impact even further is critical to continuing to meet the needs of low-income families.

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\*Chairman NEAL. Thank you, Mr. Lawson.  
Mr. Tetrault.

**STATEMENT OF JOHN LEITH-TETRAULT, PRESIDENT  
NATIONAL TRUST COMMUNITY INVESTMENT CORPORATION**

\*Mr. LEITH-TETRAULT. Thank you, Chairman Neal, Ranking Member English and Members of the Subcommittee. My name is John Leith-Tetrault and I am President of the National Trust Community Investment Corporation. And as such I can speak about housing rehab in historic and older buildings from both the tax creditor syndicator and developer perspectives.

Before I begin I'd also like to thank Representatives Stephanie Tubbs-Jones and again Phil English for introducing the national trust's leading bill, H.R. 1043, the Community Restoration and Revitalization Act. This legislation provides for a wide range of amendments to the 20 percent historic and 10 percent old building rehab credits.

These changes would enhance the existing linkage between historic and Low-Income Housing Tax Credits, unlock more of the historic credits potential for neighborhood reinvestment and make the credit easier to use for smaller rural and main street projects.

My written Statement explains in detail the technical changes the legislation makes to the Historic Tax Credit, but in the interest of time I will briefly outline the changes and showcase two projects that would benefit from these modifications. Congress amended the Historic Tax Credit in 1986 to allow it to be combined with the Low-Income Housing Tax Credit.

Since that time, based on National Park Service statistics, about 86,000 affordable housing units have been created through the combination of the Low-Income Housing and Historic Tax Credit. While this accomplishment is noteworthy, we believe that through the enactment of H.R. 1043 much more could be done

What most don't realize is that a large percentage of older and historic building stock is located in economically depressed areas. This is evidenced by research conducted by my company which showed that in 2006, two thirds of all Historic Tax Credit transactions approved by the National Park Service were located in high poverty census tracts that met the requirements of the new market's tax credit program.

The nexus between historic rehab and community development is indeed broad. The affordable housing provisions of H.R. 1043 are as follows. H.R. 1043 eliminates the low-income housing basis adjustment that's required when combining two credits. The basis adjustment, under current law, lowers the value of the Low-Income Housing Tax Credit by at least 25 percent and as much as 33 percent in difficult to develop areas. The bill provides a 130 percent basis boost for the Historic Tax Credit.

Thirdly, it would make housing an eligible use for the 10 percent provision of the Historic Tax Credit. Broadening the use of the 10 percent credit to include housing would open the potential to twin the 10 percent credit with the Low-Income Housing Tax Credit.

I have a couple of case studies, the first of which is Parkside Commons, the renovation of the former Meadville Junior High in Crawford County, Pennsylvania into 56 affordable housing units and 3,000 square feet of commercial space.

The school was built in 1921 and was threatened with demolition until the current developer, Tom Kennedy of Prudential Real estate of Erie, Pennsylvania stepped forward with a historic rehab plan. The project is currently under construction and has experienced serious cost overruns. The developer has addressed the situation by reinvesting his entire developer fee into the property, cutting the scope of work by \$600,000 and delaying the commercial phase of the project.

Parkside Commons has utilized both the Low-Income and Historic Tax Credits. The mandatory Low-Income Housing Tax Credit basis reduction cost the project \$781,000, more than enough to restore the \$600,000 in project enhancements that were abandoned due to the cost overruns.

The second case study involves the Worthington Commons apartments located in Springfield, Massachusetts. This property was formerly known as Summit Hill apartments and was acquired in fore-

closure by Mass Housing. Subsequently Mass Housing selected First Resources Companies to be the new developer. The redevelopment plan calls for the rehab of 12 buildings into 149 apartments and a community center.

This \$19 million project is in a qualified census track and therefore qualifies for the 130 percent Low-Income Housing Tax Credit basis boost. If H.R. 1043 were enacted, the additional historic credit basis boost would result in an additional \$900,000 for this project. Also, \$400,000 in equity would be generated by eliminating the low-income housing basis adjustment.

So in total there would be \$1.3 in additional equity available, which would have virtually eliminated the need for the \$1.6 million in soft debt provided by the Massachusetts Housing Partnership freeing those scarce resources to be used on other similar projects across the State.

Alternatively, the extra funding could have been used to establish a much needed maintenance reserve. It was the lack of maintenance reserves, among other things, that contributed to Summit Hill's original downfall.

Chairman Neal and Ranking Member English, Members of the Subcommittee, thank you for this opportunity to testify and I'd be happy to answer any questions you have.

[The Statement of Mr. Leith-Tetrault follows:]

Testimony of John Leith-Tetrault  
President, National Trust Community Investment Corporation  
Ways and Means Committee  
Subcommittee on Select Revenue  
Chairman Richard Neal  
Hearing on Tax Incentives for Affordable Housing  
10:00 a.m. – Thursday, May 24, 2007 – 1100 Longworth Building

Thank you Chairman Neal, ranking member English, and members of the Subcommittee for the opportunity to testify before you today on ways to simplify and amend the tax code to make affordable housing more available. My name is John Leith-Tetrault and I am President of the National Trust Community Investment Corporation. As such, I can speak about housing rehabilitation in historic and older buildings from both the tax credit syndicator and developer perspective. Before I begin, I would also like to thank Representatives Stephanie Tubbs Jones and – again – Phil English in particular for introducing the National Trust for Historic Preservation’s leading bill, HR 1043, the Community Restoration and Revitalization Act, which provides for a wide range of amendments to the federal historic rehabilitation tax credit. These changes would enhance the existing linkage between historic and low-income housing tax credits, unlock more of the historic tax credit’s potential for neighborhood reinvestment, and make the historic credit easier to use for smaller, main street projects.

Four of these amendments would positively impact the economic feasibility of projects that rehabilitate existing buildings for reuse as affordable housing. HR 1043 now has 53 co-sponsors from both sides of the aisle. Senators Gordon Smith and Blanche Lincoln have introduced an identical bill, S 584 which currently has 3 Republican and 2 Democratic co-sponsors.

My organization, the National Trust Community Investment Corporation (NTCIC) – a wholly owned for profit subsidiary of the 1949 Congressionally chartered National Trust – has invested \$185 million in historic and new markets tax credit (NMTC) equity in housing and commercial properties over the past six years. NTCIC is a certified Community Development Entity and a recipient of \$180 million in NMTC allocations since 2003. Rehabilitation, neighborhood reinvestment, and economic development are integral components of historic preservation, since the majority of the nation’s National Register historic districts overlap census tracts where there are high percentages of people living in poverty.

My testimony today will focus on the four affordable housing-related provisions of HR 1043, and provide two case studies of how subsidy amounts from both the federal low-income housing (LIHTC) and historic tax credits would increase under this bill to create a more favorable financing structure and to better achieve affordable rent structures for these transactions. The many endorsers of this bill in the affordable housing and rehabilitation tax credit industries hope the Subcommittee will consider the provisions of HR 1043 in its effort to put together a Low-Income Housing Tax Credit amendments bill.

1. ***The Nexus between Affordable Housing and Historic Rehabilitation*** – Affordable housing developers have always viewed historic and older buildings in low-income communities as an important resource for decent and affordable housing. Congress anticipated the rehabilitation of historic buildings for affordable housing in 1986 by allowing the combination of these two credits as part of the Tax Reform Act of 1986. Since the inception of the historic tax credit program, combining the LIHTCs and historic tax credits has created, based on National Park Service estimates, about 86,000 affordable housing units nationwide. Despite popular belief, most older and historic building stock is located in economically depressed low-income census tracts as evidenced by research conducted by the NTCIC. That research shows that in 2006, 67 percent or two-thirds of all historic tax credit transactions approved by the National Park Service were located in high-poverty census tracts. A prime acknowledgement of this demographic reality is the 2002 IRS ruling that allows new market tax credits and historic tax credits to be combined on certified historic commercial projects benefiting low-income businesses.
  
2. ***The Impact of HR 1043 on affordable housing development*** – Among HR 1043's broad set of provisions to improve the effectiveness of the historic tax credit, the following four are aimed at the historic tax credit's compatibility with affordable housing transactions:
  - a. **Elimination of the basis adjustment** - Section 2 of HR 1043 asks Congress to treat the historic tax credits the same as the LIHTC and NMTC by eliminating the reduction of a property's depreciable basis that is required when combining the historic and low-income housing tax credits. Since the LIHTC is calculated as a fraction of the depreciable basis, the reduction of LIHTC basis by 100 percent of the amount of the historic tax credit significantly diminishes the value of combining these incentives. At today's pricing for both LIHTC and historic tax credits – \$.95 on the tax credit dollar – the reduction in low-income tax credit value is a full 25 percent over the ten-year vesting period of the credit.

In a so-called Difficult to Develop Areas (DDAs) or Qualified Census Tracts (QCTs), the impact of reducing the LIHTC basis by 100 percent of the historic tax credit amount is even more severe. Due to the 130 percent basis boost provided to LIHTC developers of properties in these severely distressed areas, every \$1.00 of historic tax credit reduces the LIHTC basis by \$1.30. The net effect is to reduce the average value of the Low-Income Housing Tax Credit by nearly 33 percent. These provisions have the perverse impact of providing less combined credit subsidy to projects in communities with the greatest economic need. While this provision may be seen as a way to prevent double dipping, no such treatment is required by the tax code on LIHTC-only transactions, nor does the IRS require such an adjustment to the historic tax credit basis when combining

the historic tax credit and the new markets tax credits. Furthermore, the legislative history of the LIHTC and historic tax credit indicates two different purposes that act independently on historic buildings used for affordable housing. The historic tax credit's purpose is to offset the higher cost of rehabilitation over the less expensive option of demolition and new construction. The LIHTC is meant to lower conventional debt service loads on rent restricted buildings. Allowing the full benefits of twinning these two credits therefore addresses the twin impediments to using historic properties for affordable housing.

- b. Providing a 130 percent basis boost for the historic tax credit – HR 1043 asks Congress to treat the historic tax credit the same as the LIHTC by providing a 130 percent basis boost in DDAs and QCTs. By definition, these are areas where incomes are especially low and the cost of development is high. The basis boost for the LIHTC is meant to help defray higher costs such as security, insurance, materials and labor so that these added costs do not force up targeted affordable rents. The same logic should apply to the special costs of historic and old building rehabilitations that are also proportionately higher in these designated areas. The net effect of this provision of HR 1043 would increase the value of the historic tax credit by about 25 percent on a twinned transaction.
- c. Making housing an eligible use for the 10 percent "older building" portion of the historic tax credit – for reasons that are unclear from legislative history, the 10 percent portion of the historic tax credit program (the portion that accrues to non-certified historic structures) may not be used for housing. Whatever the reason was for this exclusion, it seems to be an anomaly in the context of the current national affordable housing need. Broadening the use of the 10 percent portion of the historic tax credit to include housing would open up the potential to twin the 10 percent portion of the historic tax credit with the LIHTC. This new combination of federal housing subsidies would have several valuable applications. Since the 10 percent credit is for non historic buildings only, this provision would potentially impact a much larger number of buildings eligible for both credits. The lack of historic design guidelines for the existing 10 percent portion of the historic tax credit would provide affordable housing developers with more flexibility in addressing compromises between preserving a building's architectural character and overall construction costs. This measure would also add additional subsidy to transactions aimed at preserving existing affordable units as previously awarded HUD subsidies expire.

A related change to the 10% credit, Section 6 of HR 1043 would index the eligibility date for older buildings to correspond with Congress' intent that these building be at least 50 years old. The current law requires that

10 percent portion of the historic tax credit properties must have been built before 1936. The indexing of the 10 percent tax credit eligibility date would make buildings built before 1957 eligible, adding approximately 225,000 post war multifamily properties to the stock of units that can receive the 10 percent portion of the historic tax credit.

### 3. Case Studies on the Impact of HR 1043 on Low-Income Tax Credit Transactions

- a. Parkside Commons, the renovation of the former Meadville Junior High School in Crawford County, PA into 56 affordable housing units and 3,000 sq. ft. of commercial space, is an example of a project that might have benefited from the enactment of HR 1043. The school is located on North Main Street in Meadville and shares prominent frontage on Diamond Park with the Crawford County Courthouse. It was built in 1921 and was threatened with demolition until the current developer, Tom Kennedy of Erie, stepped forward with a historic rehabilitation plan. The project is currently under construction and has experienced cost overruns. The developer has addressed the situation by reinvesting his developer fee into the property, cutting the scope of work by \$600,000 and phasing the project. According to the developer, Meade Junior High's conversion has gone from "feasible to marginally feasible."

Parkside Commons has utilized both the LIHTC and historic tax credits. The LIHTC contributes \$3 million and the historic tax credit provides \$1 million in equity to a total development cost of \$5.5 million. Unfortunately it is situated across the street from a Qualified Census Tract and therefore could not apply for the 130 percent LIHTC basis boost nor benefit from the proposed basis boost for the federal rehabilitation credit. The mandatory LIHTC basis reduction by the amount of the historic tax credit cost the Meade Junior High project \$781,000 dollars, more than enough to restore the \$600,000 in project enhancements abandoned due to the cost overruns. HR 1043's proposed elimination of the LIHTC basis reduction would have meant a great deal to Mr. Kennedy, the developer, and to the future tenants of the building.

- b. Worthington Commons Apartments is located on Summit, Federal and Worthington Streets in Springfield, Massachusetts. This property was formerly known as Summit Hill Apartments and was acquired in foreclosure by MassHousing. Subsequently, MassHousing selected First Resource Companies to be the developer. The redevelopment plan, which utilizes the LIHTC and historic tax credit calls for the rehabilitation of nine buildings into 111 apartments, rehabilitation of two abandoned buildings into 38 apartments, and the rehabilitation of a third abandoned building into a management office and resident community center. All of the units will be affordable.

This \$19 million project is in a Qualified Census Tract and therefore qualified for the 130 percent LIHTC basis boost. If HR 1043 were enacted, the additional 130 percent historic tax credit basis boost would result in an additional \$932,210 to the project. Additionally, \$413,000 in equity could be generated by eliminating the reduction of the low-income housing tax credit basis by the amount of the historic tax credit. If available, this additional \$1,345,210 could have been used by the developer to reduce the soft debt on the project provided by the Massachusetts Housing Partnership, (freeing these funds to be utilized for other projects in the state). Alternatively, the extra funding could have been used to establish reserves to fund operating deficits and maintenance for the property, the lack of which contributed to Summit Hill's original downfall.

Chairman Neal, ranking member English, and members of the Subcommittee, thank you again for this opportunity to discuss how the enactment of HR 1043, The Community Restoration and Revitalization Act, would allow historic tax credits to make an even more significant financial contribution to the production of affordable housing that also relies on the low-income housing tax credit. I would be happy to answer any questions members of the Subcommittee may have.

\*Chairman NEAL. Thank you, Mr. Tetrault. Your description, certainly in the closing words, was entirely accurate.

Mr. Goldstein, one of the problems you've highlighted is that the credit limits the amount of rent allowable to 60 percent of area median income and though operating costs, utilities and taxes have increased over time, median income has not. Do you know why incomes have not kept pace with other rising costs?

\*Mr. GOLDSTEIN. Well, I think a number of people here have testified to some of the issues that we've run up against. There are formulas involved whereby even when, in fact, incomes are rising, our rental rates are not rising.

\*Chairman NEAL. That's the second question, but go ahead.

\*Mr. GOLDSTEIN. It also is somewhat geographically based. In other words, there are certainly places along the coasts in high growth areas that are much different than the middle of the country in areas that haven't experienced that same level of growth.

\*Chairman NEAL. Having said that, that was the tease. Now here's the next follow up. If we allow the rents to increase would some families with stagnant wages no longer be able to afford such housing?

Let me get this out. You got a big job ahead of you here in Washington.

\*Mr. GOLDSTEIN. Well, I think there are a number of ways to answer that. Certainly, perhaps first and foremost is that, again, as one of the other panelists has testified, if in fact they're not allowed to rise in some manner, properties can't support themselves. And if properties can't support themselves, in fact we will lose units, not gain units.

That being said, I think there have been a lot of creative suggestions today both orally and in written testimony with respect to things that we can do that in fact wouldn't have a tremendous burden on the tenants themselves but would allow the properties themselves to realize greater revenue.

\*Chairman NEAL. Thank you.

Mr. Lawson, you heard my discussion earlier with Mr. Desmond of Treasury about the utility allowance regulation expected later this year. Should Congress, do you think, legislate in this area if in fact new regulations are on their way?

\*Mr. LAWSON. I do think Congress should step in. Rising utility costs are one of the main factors that we've experienced. Those hit us both on the expense side of our ledger and also affect utility allowances, which thereby decrease the revenue side of our ledger. Both put pressure on a property.

But utility costs are just one of the significant increases we've found. Insurance since—starting with 9/11, insurance went up significantly, again with Katrina. We work in a primarily coastal environment and we have seen just outrageous increases in expense costs.

Real estate taxes with the housing boom, the housing boom has benefited many homeowners but by the same token assessors always look to apartments to pay their fair share. That has put more pressure on our bottom line as well.

\*Chairman NEAL. Mr. Tetrault, that reference you made to Summit Hill earlier, there have been many announcements, many

ground breakings, many demolition projects and kind of back on the treadmill again, time and again. It's not, I think, friendly to children, concentrating poor people, and there's not a lot of open space nearby. In fact, there's minimal sunlight in some of the back streets there. And there are parts of that initiative—I shouldn't say that initiative but nearby that have worked. Why hasn't that worked?

\*Mr. LEITH-TETRAULT. Well, I think that the—for many of the reasons you've mentioned, when we over-concentrate poverty, put too many units together, we create a stigma for the families living there. I would say that all of those work together to increase the challenges that these projects have. I think one of the things that we hope is part of this equation in the future more often on other projects is the added cache, if you will, that historic preservation brings to a project that provides a visual anchor to the neighborhood and preserves buildings that people can relate to.

I think that preservation by itself doesn't answer all the questions you've raised. Certainly there are questions of security, of proper property management. I think large projects can be managed well, but there's also room for thinning out projects when it's appropriate.

\*Chairman NEAL. Mr. English.

\*Mr. ENGLISH. Thank you, Mr. Chairman. This has been a particularly stimulating panel. And Mr. Tetrault, in your testimony, touching on real life examples, you've touched a great one in my district in Parkside Commons, which not only highlights I think the potential of the credit to have a transforming effect and create opportunities for affordable housing but also some of the particular struggles in the current applications of the credit and particularly in a smaller community, the difficulty of making the credit available within a certain census track.

In your testimony you I think offered two cases for how improvements in the tax Code could have been used to make projects function better. Isn't the point that under current law both of these projects still got done?

\*Mr. LEITH-TETRAULT. They got done, although I would say in the case of Parkside the project can't be finished. I spoke to Tom Kennedy as recently as yesterday. Because of the cost overruns, he doesn't have funding left to do the commercial part of the project and so he has the difficulties now of leasing apartments above vacant storefronts.

The projects get done. The question I have—and I guess I'm old enough to have seen projects get rehabilitated more than once. The question—and when we go—I'm a syndicator and I go to all the ground breakings and all the ribbon cuttings, they all look great on the first day. The question is what do they look like 5 years later.

I think that what 1043 speaks to is long-term sustainability. The additional funding that I described that could have gone to the Parkside apartments could have provided an operating reserve, could have helped close that \$600,000 gap and provided a project for that downtown area that is more sustainable over time.

\*Mr. ENGLISH. Thank you. Are you aware of similar deals that did not get done for the reasons that you outlined in your testimony?

\*Mr. LEITH-TETRAULT. Well, we at National Trust Community Investment Corporation were working with a group in Little Rock, Arkansas. The name of the group is Arc of Arkansas. They do group housing for physically disabled households. And they, similar to the Parkside project, are renovating an old high school in Little Rock. They've finished phase one. Phase one is struggling to pay its mortgage, and for that reason and others they're having difficulty raising financing for phase two.

The funding gap, and this is after exhausting all Federal, State and local resources that they can find, is about \$500,000. And when we ran the numbers and we looked at the fact that it was in a difficult to develop area, it would also, under 1043, benefit from the reduced or the elimination of the basis adjustment, that would close the gap for that project and that project would be under construction today were we to enact 1043.

You know, it's hard to find case studies of projects that didn't go forward. People don't write articles about what didn't work as much as they do about success stories. But I can tell you from my own professional background, and I've worked in affordable housing much longer than I worked in historic preservation, there are dozens of projects that don't go forward for all the ones that do.

And I think often the gap is in that \$500,000 to \$1 million dollars range where you get to the point of passing the hat or doing bake sales to get those final dollars in the door. And those are the marginal projects that I think 1043 would assist, you know, that the cost of these two provisions that I focused on are not that great but they can close small gaps.

\*Mr. ENGLISH. And on that point, I guess a two part question, if I could wrap up my time. You had mentioned that those buildings which are only eligible for the 10 percent credit, built before 1936, cannot be used for housing. Two part question, Congress had to have had a rationale for putting in this prohibition. Can you identify it for us? And what would happen if we changed the law to allow the 10 percent credit to be combined with the Low-Income Housing Credit?

\*Mr. LEITH-TETRAULT. Well, we have looked at the legislative history of the 10 percent credit. We've talked to Members of various pertinent Committees. We've posed the question to joint tax. No one seems to know why housing was prohibited. And I think in the context of today's affordable housing need it seems to be an anomaly and an unfortunate one in the tax Code.

It's a bit speculative to say exactly what would happen if we make the 10 percent credit eligible for housing. Certainly I think Low-Income Housing Tax Credit investors would see the opportunity to look again at rehab, developers that may have been drawn more in the direction of new construction. It might take some pressure off the 9 percent credit and we might see developers using the 4 percent credit, lifetime credit and the 10 percent rehab credit.

There are I think interesting upper floor housing applications. One of the features of this bill, which I haven't talked about, is the small deal applications. The tax driven real estate is very awkward and clumsy for small transactions because the transaction costs on

a million dollar deal are the same as the deal that's a \$20 million deal.

So when the benefits get under a million dollars, particularly on Main Street where typical shop owners are only willing to give the Federal Government so much control over the cash register, there's a reluctance to take on these tax credit programs as a way to renovate their properties.

So I think the small deal provisions of this credit I think will—and particularly the 10 percent used for housing will encourage store owners who have vacant upper floor housing to renovate it and augment their revenues.

\*Mr. ENGLISH. Thank you very much. Thank you, Mr. Chairman.

\*Chairman NEAL. Thank you, Mr. English. Mr. Blumenauer.

\*Mr. BLUMENAUER. Thank you. And I must say Mr. Chairman the way the panel is coming together really covered a wide range of areas that I found extraordinarily useful, and I appreciate what you and the staff have done to make it a very worthwhile morning.

Mr. Rose, you referenced an additional cost of one or 2 percent with the projects that you're involved with to make them very energy efficient. What's the payback period to recoup that one or 2 percent?

\*Mr. ROSE. I want to add that it's not just to make them more energy efficient. It's the total greening. It's also to make them healthier, lower toxic and better places to raise our children. And the payback period is certainly often less than 5 or 7 years. Some of the investments actually—I'll give you a very simple example.

When we take a boiler and we—some of the investments are just cheaper, they're actually just smarter ways to do things and save money day one.

\*Mr. BLUMENAUER. And I appreciate your clarification. I understand that you are attempting to have a totally green environment. I didn't mean to unduly concentrate on energy and water, but those are things that are quantifiable. But you're saying some of these improvements actually are net savings, they're not—there isn't a payback period?

\*Mr. ROSE. Yes.

\*Mr. BLUMENAUER. And others it may be 5 to 7 years?

\*Mr. ROSE. Yes. So my point was that actually the energy and water savings, the 5 to 7 year payback includes the paying for the one—the health savings that don't have a direct dollar payback. And this is all, by the way, under the Enterprise Green Community Program, which was designed for affordable housing. So it is what we call practical green. It's not pushing the limits. It's a very—that's why we can do it for one to 2 percent, because it was really designed for this particular need.

\*Mr. BLUMENAUER. And if you would, take a step with me beyond practical green, you may have heard an earlier question to one of our witnesses about ways to tie this into a broader vision of a carbon constrained economy that we're going, the business community, the environmental leadership seem to be linking, and visionary local leaders are involved with it.

If, in theory, the Federal Government catches up with you all and has a series of Federal policies dealing with the carbon con-

strained environment, have you given some thought to ways that, of the value created and transferred, that benefit could flow back to these efforts at practical green communities so you get credit for it as well as maybe a little boost to make it easier?

\*Mr. ROSE. If there—I have several thoughts, but if you're talking about if there's a cap-and-trade carbon system, if that could bring benefits back to low-income communities and actually that would be of enormous benefit—so for example one could imagine if you could retrofit boilers in existing low-income housing, make them more efficient and have that paid for by a cap-and-trade system, you would lower the operating costs that we've heard so much about and you would be reducing climate change impacts.

But the other key thing is that when we look—we look at energy from a total budget of both the building itself and the energy getting to and from it. Particularly low-income people we think it's so important they get the jobs, they get the education, they get the opportunity to really move up. We think that's very important.

And so what happens is when you have low density sprawled development, the transit, the amount of energy used in transit is often higher than the energy used by the building itself. And so what we have found is as we bring affordable housing closer to walkable main streets, next to community colleges, next to mass transit, et cetera, we're not only saving the total energy picture, we're actually improving the ability of the family to move upward by giving them better access to jobs and education and daycare.

\*Mr. BLUMENAUER. Thank you. Mr. Chairman, I guess I would close by just asking to Mr. Rose or others of our panelists if they have some thoughts based on their experience about practical problems, the way these programs are currently structured, to building complete communities that probably—the reference that was made to a—I forget the social service agency in the bottom floor, problems occasionally in terms of the vacant first floor. If there are thoughts that panelists might provide to the Committee about statutory or regulatory difficulties in their being able to realize their vision of mixed use, sustainable community where we're kind of in the way, that would be very helpful I think as we're looking at the bigger picture in the future.

\*Mr. ROSE. As my time is short, I'll just refer you to my written testimony where I call for a whole series of those. One other thing that's not called for, if you could, create a mixed-use credit enhancement program. We currently do not have one, a Federal, mixed-use credit enhancement program. It would be extraordinarily helpful.

\*Mr. BLUMENAUER. Thank you.

\*Chairman NEAL. Thank you, Mr. Blumenauer. I want to thank our witnesses—the testimony was very helpful—and without objection the record will remain open for a few days for any additional material that needs to be included. And I would urge you to submit it and it really will be vetted by the Subcommittee and staff members.

So thank you very much. This was very helpful and this hearing is adjourned.

[Whereupon, at 12:23 p.m., the Subcommittee was adjourned.]

[Submissions for the record following:]

Council of Large Public Housing Authorities  
June 7, 2007

The Honorable Richard E. Neal, Chairman  
Subcommittee on Select Revenue Measures  
Committee on Ways and Means  
U.S. House of Representatives  
1135 Longworth House Office Building  
Washington, DC 20515

Dear Chairman Neal:

On behalf of the Council of Large Public Housing Authorities (CLPHA), I am pleased to provide our comments as a submission for the record in regard to the Subcommittee's recent hearing on Tax Incentives for Affordable Housing.

CLPHA is a national non-profit public interest organization dedicated to preserving, improving and expanding housing opportunities for low-income families, elderly and disabled. CLPHA's 60 members represent virtually every major metropolitan area in the country; on any given day, they are serving more than one million households. Together they manage almost half of the nation's multi-billion dollar public housing stock, and administer 30 percent of the Section 8 voucher program; they are in the vanguard of housing providers and community developers.

The 1.2 million public housing units serve the very lowest income households, whose median income is less than \$12,300 and more than half of those households are elderly and persons with disabilities. Public housing is home to more than one million children, and, as you know, a recent study found that children who grow up poor cost the economy \$500 billion a year because they are less productive, earn less money, commit more crimes and have more health-related expenses. While housing authorities are daily meeting the challenges of serving the lowest income residents they are also facing an aging housing stock that has been chronically underfunded and is in need of additional capital investment.

Over the years, CLPHA members have grown increasingly sophisticated in their use of the low income housing tax credit program (LIHTC) to augment funds available for the revitalization and redevelopment of their public housing developments. Public housing authorities (PHAs) have coupled the tax credit program with other federal, state, local and private financing mechanisms to improve, expand and renew their housing stock. More recently, PHAs have borrowed private market funds in order to raise capital for major repairs by pledging their future capital funds toward the repayment of bonds or loans. Some of these transactions have also used low-income housing tax credits to further leverage scarce public housing funds in creative ways to make large-scale comprehensive improvements to their developments.

***Unmet Public Housing Capital Needs***

Public housing capital needs accrue at more than \$2 billion per year; yet, recent annual appropriations for the Public Housing Capital Fund have been barely adequate. There are over 189,000 public housing units that are most likely distressed and the most recent comprehensive study of public housing capital needs found a backlog of more than \$20 billion. Even if appropriations improved so that at least the accrual needs are met, it is unlikely that sufficient federal funding resources will be available to address the significant backlog in capital needs for viable public housing developments. This does not even begin to address the need for units to replace the public housing stock lost to demolition.

To effectively address these challenges in a comprehensive, sustainable way, public housing agencies need:

- a dedicated source of capital to supplement Federal funding
- debt-financing tools to unlock the value of existing assets

***Public Housing Tax Credits***

As noted above, for more than a decade, PHAs have been using the Low-Income Housing Tax Credit to leverage significant amounts of private equity for the redevelopment of public housing. PHAs have experience using tax credits, forming and participating in ownership entities with tax credit investors, and managing or contracting for management of redeveloped properties under tax credit rules. HOPE VI projects now typically leverage tax credits, while other public housing redevelopment projects are often financed with tax credits and other resources. The existing LIHTC has broad market acceptance and an existing administrative and regulatory infrastructure.

Given the overwhelming level of public housing capital needs, public housing appropriation levels, and the need for replacement housing in many jurisdictions, a targeted resource for public housing redevelopment is needed. A dedicated public housing tax credit could raise significant amounts of equity for this purpose. For example, an annual allocation of \$100 million in public housing tax credits would generate approximately \$1 billion in equity, assuming a 10-year credit period. After 20 years, a public housing tax credit program would generate the roughly \$20 billion in equity needed to address the existing public housing capital needs backlog.

In addition to an increase in tax credit allocations for public housing redevelopment, there are various modifications to the tax credit that would benefit these projects. (See the attached *CLPHA Public Housing Tax Credit Proposals and CLPHA Public Housing Funding Reform Proposals*.) An alternative to increasing the LIHTC for public housing would be to design a tax credit tailored to the redevelopment of public housing properties, and that might address the broader community development and resident self-sufficiency mission of public housing agencies and their partners. A recent example of this approach is the New Markets Tax Credit (NMTC), enacted by Congress in 2000 to encourage investment in low-income communities.

#### ***Public Housing Debt Financing***

A recent study by Econsult Corporation found the value of existing public housing assets to be approximately \$162 billion. Gaining access to this value through debt financing would help PHAs meet current capital funding needs. Indeed, a Harvard study found that a significant number of public housing developments could support their capital needs through debt underwritten at market rent levels, meaning that lenders would see these properties as a sound investment. However, many properties could only finance a portion of their capital needs at market rents. These developments would need an upfront capital subsidy, such as tax credit equity or a HOPE VI grant, in order to be feasible under a debt-financing model. The Millennial Housing Commission also proposed debt-financing of public housing capital improvements.

PHA pledges of public housing funds for debt service could also be enhanced by a Federal loan guarantee or other credit enhancement. This approach is similar to that proposed by HUD several years ago in the Public Housing Reinvestment Initiative (PHRI). Current pledges of public housing Capital Funds to debt service are limited to roughly one-third of a PHA's annual Capital Fund receipts. A loan guarantee would increase this ratio. FHA insurance might be another alternative to a new loan guarantee program.

Another approach to financing the renewal, revitalization and redevelopment of public housing is through bond financing similar to the Qualified Zone Academy Bond (QZAB) program for educational facilities. Such a program could provide zero-interest debt financing for the borrowing housing authorities and a tax-credit or other incentive to lenders supplying the financing. The bonds could be used for either the redevelopment or replacement of deteriorated public housing. CLPHA also seeks to explore methods of combining QZAB financing with the low-income housing tax credit in order to maximize the leveraging of public housing funds.

In conclusion, CLPHA believes there is an urgent need for additional financing mechanisms to support a comprehensive preservation program for the nation's public housing stock. Such a program would utilize a variety of funding sources, including annual appropriations, low-income housing tax credits, debt financing, and innovative approaches such as QZABs.

We appreciate the opportunity to share with the Subcommittee many of our ideas for improving and expanding the LIHTC and approaches to new financing tools for preserving and revitalizing public housing. We look forward to working with you and the Subcommittee staff as you continue to develop your affordable housing proposals.

Thank you for your consideration. With best wishes, I am,  
Sincerely,

Sunia Zaterman,  
*Executive Director*

May 14, 2007

#### ***CLPHA Public Housing Tax Credit Proposals***

##### **1. Incremental Tax Credits Dedicated to Public Housing Revitalization**

- Additional tax credits allocated to States, reserved (or prioritized) for affordable public housing redevelopment projects

- Allocate to States based on
  - overall number of public housing units in State, or
  - backlog need through a proxy such as average age of units under ACC, or
  - specific projects identified nationally through pre-determined criteria.
  - Alternatively, establish a set-aside for public housing revitalizations similar to the 10% set-aside for nonprofits
- 2. Tax Credits Linked to HOPE VI Awards**
- Public housing developments which are awarded HOPE VI grants, and therefore have been determined by HUD to be “severely distressed” but also to have feasible redevelopment plans, would receive automatic awards of tax credits
  - Subject to compliance with standards established by State allocating agencies, similar to requirements for bond-financed projects under Sec. 42(m)(1)(D)
  - Permits smaller HOPE VI grants to go farther through leveraging
  - Expedites HOPE VI projects by avoiding timing problems associated with coordinating HOPE VI and tax credit application process
- 3. Add-On Tax Credits for Public Housing Revitalization**
- Add-on credits awarded to public housing redevelopment projects which successfully compete for LIHTCs
  - Similar to State tax credits that piggyback on Federal tax credits
  - Rewards unique characteristics of public housing, including deeper income targeting, greater number of rent restricted units, and longer use restrictions.
- 4. Below Market Federal Loans**
- Modify Sec. 42(i)(2)(E)(i) to treat public housing funds (including HOPE VI and Capital Funds) in the same way as HOME and NAHSDA funds.
  - Since these funds are used similarly in transactions, there seems to be no rationale for treating public housing funds differently in this context.
  - Public housing transactions now require involved negotiations with the investor so that loans of public housing funds are not treated as a “federal subsidy”, which would reduce the credit from 9% to 4%.
- 5. Qualified Census Tracts/Difficult Development Areas**
- Distressed public housing developments often have dramatic negative effects on surrounding neighborhoods and discourage other investment. Similarly, redeveloping these developments has equally dramatic impacts in stimulating neighborhood revitalization.
  - Therefore, public housing developments, perhaps above a certain size, should be deemed to be in qualified census tracts or difficult development areas under Sec. 42(d)(5)(C), thereby providing a 30% increase in tax credit basis.
- 6. Public Housing Loans Collateralizing Tax-Exempt Bonds**
- Some public housing transactions are now structured using tax-exempt bond financing to trigger 4% tax credits. Public housing funds (HOPE VI or Capital Funds) are used to fully collateralize the bond proceeds. As bond proceeds are drawn down for construction costs, commensurate amounts of public housing funds are drawn from HUD and escrowed. After project completion, the public housing funds repay the bondholders.
  - This structure allows PHAs to access 4% credits, but involves significant additional fees and expenses.
  - Transaction costs would be reduced and projects would be completed sooner if loans of public housing funds from PHAs to owners/investors were simply treated in the same manner as tax-exempt bonds for purposes of Sec. 42(h)(4).
- 7. Exception from Volume Cap for Bonds Secured by Public Housing Funds**
- A number of PHAs have been using creative tax credit/bond financing structures to rehabilitate viable, but at-risk, public housing developments.
  - These structures involve the PHA’s pledge of its future public housing formula funds, subject to appropriation, as security for a tax-exempt bond issue and the use of 4% tax credits through an allocation of volume cap.
  - While it varies by State, some PHAs have had considerable difficulty getting the volume cap allocation necessary to make these deals work.
  - This problem could be solved by modifying Sec. 42(h)(4) to provide that projects with tax-exempt financing secured by a pledge of public housing funds does not count against the State tax credit ceilings even if they do not receive volume cap. The same exception should apply to the public housing loan collateralization model described in item 6, above.

May 14, 2007

**CLPHA CONCEPT PAPER ON PUBLIC HOUSING FUNDING REFORM  
PUBLIC HOUSING REVITALIZATION TAX CREDITS, DEBT FINANCING,  
AND DEREGULATION**

**1. Current Status of Public Housing Funding and Regulation**

- **Backlog Needs.** The most recent comprehensive study of public housing capital needs found a backlog of more than \$20 billion. While a significant number of high cost units have been demolished, it is reasonable to assume that continued under-funding of the Operating Fund, Capital Fund, and HOPE VI has resulted in an offsetting increase in capital backlog needs.
- **Public Housing Capital Fund.** Additional public housing capital needs accrue at more than \$2 billion per year. Yet, recent annual appropriations for the public housing Capital Fund have been barely above that. Even if appropriations improved in the new Congress, so that at least these accrual needs are met, it is unlikely that resources will be available to address the significant backlog in capital needs for viable public housing developments. This does not even address the need for units to replace public housing units lost to demolition.
- **HOPE VI.** The HOPE VI program has been very successful in revitalizing severely distressed public housing developments and has helped to establish the mechanisms through which public housing funds and private funds can be combined to accomplish redevelopment goals. However, HOPE VI funding has fallen dramatically in recent years, from a high of approximately \$500 million per year to \$99 million last year. The current authorization for the HOPE VI program sunsets on September 30, 2007.
- **Public Housing Operating Fund.** The public housing Operating Fund has been seriously under-funded for a number of years. According to a benchmark established by Harvard's Public Housing Operating Cost study, the Operating Fund is now funded at only approximately 83% of need. The resulting deferral of maintenance work adds to the level of capital backlog needs.
- **Regulatory Environment.** PHAs have the worst of both worlds, operating in a highly-regulated environment, but without adequate operating or capital funding to comply with these rules. A more reliable funding contract and a less intensive regulatory environment, such as that applied to project-based Section 8 assistance, would address these issues and would be more consistent with asset management.
- **Asset Management.** While HUD and PHAs are still in conflict over the final rules and timing for implementing asset management, it is clear that asset management in some form is on the horizon. PHAs have generally endorsed the concept of asset management as a tool for managing their public housing portfolios. However, asset management is infeasible without adequate funding and may cause viable properties to appear to be non-viable, potentially subjecting them to HUD rules on mandatory conversion and demolition.
- **Value of Public Housing Assets.** A recent public housing economic impact study conducted by Econsult found that existing public housing assets are valued at \$162 billion (including land and buildings). PHAs need financing tools that enable them to unlock this hidden value to support current capital funding needs.
- **Solutions.** To effectively address these challenges in a comprehensive, sustainable way, public housing agencies need:
  - a dedicated source of capital to supplement Federal funding
  - debt-financing tools to unlock the value of existing assets and an enforceable contract for Federal operating subsidies
  - a rational, streamlined regulatory environment

**2. Public Housing Revitalization Tax Credits**

- **PHA Tax Credit Experience.** For more than a decade, PHAs have been using the Low-Income Housing Tax Credit to leverage significant amounts of private equity for the redevelopment of public housing. PHAs have experience using tax credits, forming and participating in ownership entities with tax credit investors, and managing or contracting for management of redeveloped properties under tax credit rules. HOPE VI projects now typically leverage tax credits, while other public housing redevelopment projects are often financed with tax credits and other resources, but without HOPE VI funds.
- **Need for Public Housing Tax Credits.** Given the overwhelming level of public housing capital needs, public housing appropriation levels, and the need for replacement housing in many jurisdictions, a targeted resource for public hous-

ing redevelopment is needed. A dedicated public housing tax credit could raise significant amounts of equity for this purpose. For example, an annual allocation of \$100 million in public housing tax credits would generate approximately \$1 billion in equity, assuming a 10-year credit period. After 20 years, a public housing tax credit program would generate the roughly \$20 billion in equity needed to address the existing public housing capital needs backlog.

- **Targeting Public Housing Developments.** Different types of public housing developments could be targeted for the tax credit, such as distressed developments that receive or are eligible for HOPE VI grants. Alternatively, the targeted developments might be those that need a significant level of rehabilitation, but are not distressed and therefore would not be competitive for a HOPE VI grant. These developments are particularly in need of alternative financing in order to remain viable.
- **Expanding the Existing Tax Credit.** Using the existing LIHTC rather than designing a new tax credit makes sense given its broad market acceptance and the existing administrative and regulatory infrastructure. The most direct approach would be to increase the State tax credit ceilings and target the increase to public housing redevelopment projects. A less direct mechanism would be to increase the ceilings and mandate a preference for public housing projects.
- **Modifying the Tax Credit.** In addition to an increase in tax credit allocations for public housing redevelopment, there are various modifications to the tax credit that would benefit these projects. (See CLPHA Public Housing Tax Credit Proposals.)
- **Designing a New Credit.** Although it would likely be more difficult to achieve, an alternative to increasing the LIHTC for public housing would be to design a tax credit tailored to the redevelopment of public housing properties, and that might address the broader community development and resident self-sufficiency mission of public housing agencies and their partners. A recent example of this approach is the New Markets Tax Credit (“NMTC”), enacted by Congress in 2000 to encourage investment in low-income communities.

### 3. *Debt Financing*

- **Value of Public Housing Assets.** A recent study by Econsult found the value of existing public housing assets to be approximately \$162 billion. Gaining access to this value would help PHAs meet current capital funding needs. Implementing asset management principles also puts PHAs in a better position to consider debt financing of capital improvements.
- **Feasibility of Debt Financing.** The Harvard Public Housing Operating Cost Study found that a significant number of public housing developments could support their capital needs through debt underwritten at market rent levels, meaning that lenders would see these properties as a sound investment. However, many properties could only finance a portion of their capital needs at market rents. These developments would need an upfront capital subsidy, such as tax credit equity or a HOPE VI grant, in order to be feasible under a debt-financing model. The Millennial Housing Commission also proposed debt-financing of public housing capital improvements.
- **Loan Guarantees or Other Credit Enhancement.** PHA pledges of public housing funds for debt service would be enhanced by a Federal loan guarantee or other credit enhancement. This approach is similar to that proposed by HUD several years ago in the Public Housing Reinvestment Initiative (PHRI). Current pledges of public housing Capital Funds to debt service are limited to roughly one-third of a PHA’s annual Capital Fund receipts. A loan guarantee would increase this ratio. FHA insurance might be an alternative to a new loan guarantee program.

### 4. *Reliable Funding and Deregulation through ACC Reform*

- **Reliable Funding.** PHAs would be able to use tax credits and debt-financing more effectively and efficiently if public housing properties had reliable funding streams. This is difficult to achieve under the existing program structure, since the public housing Annual Contributions Contract (“ACC”) does not provide adequate assurances of future funding levels.
- **ACC Reform.** For this reason, the Millennial Housing Commission, the Harvard cost study, and HUD’s PHRI proposal all advocated converting public housing properties from ACCs to contracts more like those used in the project-based Section 8 programs, which have more enforceable and reliable funding provisions.
- **Deregulation.** In addition to greater funding certainty, converting to a Section 8-type contract has the advantage of moving PHAs into a regulatory environ-

ment that is generally less burdensome and more market oriented than the current public housing program.

Mortgage Bankers Association  
*June 4, 2007*

The Honorable Richard Neal  
Chairman, Select Revenue Measures Subcommittee  
Committee on Ways and Means  
U.S. House of Representatives  
Washington, DC 20515

Dear Chairman Neal:

The Mortgage Bankers Association (MBA)<sup>1</sup> appreciates the opportunity to submit comments for the hearing record in follow up to the Subcommittee on Select Revenue Measures' Hearing on Tax Incentives for Affordable Housing, held on May 24, 2007. MBA is the trade association representing virtually all of the lenders that participate in the FHA multifamily insurance programs. Our members are very familiar with the difficulties arising from financing properties with low income housing tax credits (LIHTCs) and tax exempt bonds utilizing the FHA insurance programs as a credit enhancement.

MBA has been working with a number of other associations to identify key concerns that undermine the value of the LIHTC and tax exempt bond programs and restrict the use of these programs with FHA insurance. Attached is a list of issues, most of which require legislative changes, but many of which could be accomplished by HUD. In fact, we are working with HUD to adjust FHA program requirements, where possible, to make the FHA programs a viable financing vehicle.

The National Association of Home Builders (NAHB), in its testimony, addressed many of the issues in the attached list. However, we would like to elaborate on one area of NAHB's testimony, that is "Improve Processing Time." Without some adjustment in the FHA review and processing requirements to expedite their approval process, FHA will never be an effective tool for financing properties with LIHTCs. The time deadlines in the allocation of the credits and, quite frankly, the demands of today's real estate and capital markets, have made FHA a niche player, not only for tax credit-assisted properties, but for all but a small percentage of rental properties.

MBA has recommended to HUD, and suggests that Congress consider, a pilot program for processing applications for FHA mortgage insurance that involve low income housing tax credits. Under this pilot program, HUD would not undertake detailed reviews of the loan application in a multi-step process as is currently required. Under the existing process, mortgagees that make project loans that are underwritten and ultimately insured using FHA's Multifamily Accelerated Processing (MAP) procedures, are responsible for obtaining and facilitating all required FHA documentation including market studies, appraisals, architectural, cost and environmental reports from qualified FHA-approved third-party professionals. The approved MAP lender, through an underwriter approved by FHA, ensures that the proposed loan meets all of FHA required program requirements and the market, appraisal, environmental and credit associated with the proposed loan meet sound underwriting standards that are necessary for a successful credit-worthy development. A detailed narrative from the mortgagee's underwriter is included in the mortgagee submittal package that makes a recommendation for loan insurance. FHA, using long-established procedures, then reviews the mortgagee's proposed loan submittal in a multi-step process. The application package is first reviewed by an FHA architectural and cost reviewer, then reviewed by an FHA appraiser, and then reviewed

<sup>1</sup> The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 3,000 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: [www.mortgagebankers.org](http://www.mortgagebankers.org).

by the FHA loan specialist. The Firm Commitment is subsequently circulated through the HUD field office for each discipline to sign and then signed by the program director or his/her designee. From the submittal date until closing it can take as long as six months to one year. This is an antiquated system of approvals that is contrary to industry norms that use a single Chief Underwriter to approve a loan.

Under the proposed pilot program, in lieu of existing FHA processing procedures, a "Chief Underwriter" position would be established in the HUD field offices to review multifamily loan insurance applications submitted by approved mortgagees. The position of Chief Underwriter would be solely responsible for the review of the mortgagee submittals and would rely upon all third-party reports, including environmental, submitted by the approved lender who will use procedures established for mortgagees under FHA program standards. This approach would be similar to that which conventional lenders use when they underwrite loans for their own portfolios or for sale in the secondary market. As an additional check on loan quality, HUD lender monitoring and oversight associated with this program would be a post-closing review process, utilizing procedures currently established by the Department.

We do not anticipate that this new process will have an adverse affect on loan quality or on the FHA insurance fund. Developments with LIHTCs generally have an extremely low loan-to-value ratio and seldom go into default. All incentives for the lender and the investor are to keep the property viable and the loan performing.

We urge you to include such a pilot program in any legislation amending the National Housing Act and also to encourage HUD to implement as much of this approach as possible, pending any necessary legislative changes. The legislative and regulatory proposals on the attached list are also important to facilitating financing of properties with LIHTCs and tax exempt bonds; however, without these process changes FHA will remain, at best, a niche player in this market.

We appreciate this opportunity to submit the comments of the Mortgage Bankers Association on improving the financing of affordable rental housing, and would be delighted to furnish any additional needed information.

Sincerely,

John Robbins, CMB  
Chairman

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**Statement of National Affordable Housing Management Association,  
Alexandria, Virginia**

Thank you, Chairman Neal and Ranking Member English for this opportunity to present the views of National Affordable Housing Management Association (NAHMA).

NAHMA represents individuals involved with the management of privately-owned affordable multifamily housing regulated by the U.S. Department of Housing and Urban Development (HUD), the U.S. Rural Housing Service (RHS), the U.S. Internal Revenue Service (IRS), and state housing finance agencies. Our members provide quality affordable housing to more than two million Americans with very low and moderate incomes. Executives of property management companies, owners of affordable rental housing, public agencies and vendors that serve the affordable housing industry constitute NAHMA's membership.

I would like to bring three key affordable housing issues to the Subcommittee's attention. My testimony respectfully requests reasonable updates to the tax laws governing the full time student occupancy rule for Low Income Housing Tax Credit (LIHTC) properties, the LIHTC utility allowance, and exit taxes on affordable properties.

***Full Time Student Households***

Correcting the unintended consequences of the current LIHTC student occupancy restrictions for single parents and adult GED students is among NAHMA's highest advocacy priorities.

As you know, current law prohibits households made up entirely of full-time students from living in LIHTC apartments. Only four narrow exceptions exist for families who are:

- Receiving Temporary Assistance to Needy Families (TANF);
- Enrolled in a federal, state or local job training program;
- Single parents and their children, provided that such parents and children are not claimed as dependents of another individual; or

- Married full time students who file a joint return.

If the tenant or applicant was enrolled as a full-time student for any of five months during the calendar year, she is considered a full-time student for LIHTC purposes. The five calendar months need not be consecutive. Also, please be aware that the educational institution determines what constitutes “full-time” based on credit hours.

The occupancy prohibitions for full time student households have become an obstacle for low-income families trying to make a better life for themselves. Often, child support agreements allow non-custodial parents to claim their children as dependents on tax returns. Because children in grades K–12 count toward the determination of whether family is a full-time student household, many custodial single parents who returned to school full-time become ineligible for LIHTC housing.

Here is a common example of how single-parent families are disqualified under current law:

Mrs. Jones has lived in a LIHTC unit for two years. She works during the day, and is also attending night school (full-time) to qualify for a promotion. Her oldest son is in the sixth grade. Her youngest son was not in school when they moved into their LIHTC unit, so the Jones family was not a full-time student household at that time. The youngest began kindergarten in September. Children in K–12 are counted as full-time students. The Jones family is a full-time student household now that both children are in school. But they no longer fall under the single-parent exemption because Mrs. Jones’ ex-husband claimed the children as dependents on his tax return. The family does not meet any of the other exemptions to the full-time student occupancy rule provided by the Internal Revenue Code. The Jones family is no longer qualified to live in their LIHTC unit. They have to move.

Senator Charles Grassley introduced a bill (S. 1241) that would address the unintended consequences of this policy for single-parent families. NAHMA supports S 1241 as a very positive step in the right direction. It allows the child to be a tax dependent of “a parent,” as opposed to just the head of household.

While NAHMA is pleased that S. 1241 has generated interest in the Senate, we respectfully request a more comprehensive solution. The problem for single-parent families occurs when the child attends school (K–12) and is a tax dependent of the non-custodial parent. S. 1241 addresses this issue, but we believe the fact that a child is attending school (as required by state law) should not be a factor which disqualifies otherwise qualified single-parent families from living in a LIHTC unit. Our members feel that counting children in grades K–12 as full time students for LIHTC purposes is contrary to the No Child Left Behind Act. State law, quite properly, requires that children be educated. It is simply unfair that sending children to school should play any role at all in excluding otherwise-qualified families from LIHTC housing.

NAHMA also believes adults who are completing their GED requirements should be commended, rather than disqualified, from living in LIHTC apartments. This change would be particularly helpful for full-time GED students who are the sole members of the household. Because of the restrictions under the current law, our members must sometimes deny housing to these applicants, who would be otherwise qualified to live in the LIHTC unit. The current law is contrary to good public policy, since achieving a high-school education helps create economic opportunity that enables LIHTC tenants to eventually own a home or move to market rate apartment.

As the Subcommittee considers changes to the LIHTC program, please support legislation which removes the unintended consequences of the current student rule by:

- Specifying that minor children in grades K–12 should not be counted as full-time students for LIHTC purposes;
- Removing the tax-dependent status of a single parent’s minor children as factor to determine whether the family qualifies for the single parent with children exemption; and
- Adding a new exemption for working adults who are full-time students pursuing a high school diploma or GED.

Furthermore, we request that these changes also extend to multifamily housing financed under the tax exempt mortgage revenue bond program. The only exemption provided for full-time student households to live in apartments developed under this program is for students who are entitled to file a joint tax return.

#### ***Low Income Housing Tax Credit Utility Allowance***

Escalating energy costs are placing severe financial strains on affordable properties. This situation is particularly challenging in the LIHTC program, because the

tenants' utility allowance (UA) is part of the gross rent formula. Also, maximum tax credit rents can not exceed 30 percent of 60 percent of area median income. When energy costs rise and the UA increases, the rent to the owner decreases. A number of approaches could be used to ensure LIHTC developments remain financially viable as they struggle to deal with escalating utility costs.

As a short-term solution, NAHMA looks forward to the IRS' publication of a proposed regulation for determining a more accurate utility allowance. This rule change was requested by a coalition of trade associations which represent owners and management agents involved with the Section 42 program. We agree that having a more accurate UA will often result in a lower UA for newer, energy efficient properties. We believe this change will improve the financial outlook for many struggling properties, and we look forward to the opportunity to submit comments.

In the long-term, NAHMA believes Congress should seriously examine statutory changes to the LIHTC program to help properties deal with increasing utility costs. Ideally, our members would like Congress to consider removing the UA from the rent equation. Other possible solutions could result from examining the overall rent structure of the LIHTC program, or increasing cash flow to properties operating in areas where income limits are stagnant. NAHMA looks forward to working with the Subcommittee to address this challenging issue.

***Encouraging Preservation of Affordable Rental Housing through Exit Tax Relief***

The "exit tax" problem results from the financing structures used to build affordable housing many years ago. Today, owners face large tax bills if they sell the property, and there is no incentive to make any additional investment in the property. Under the current policy, owners can avoid recapture taxes by holding onto the property until death and leaving the property to their heirs at a stepped up basis or convert the property to market rate housing at a sufficient price to cover exit taxes.

The Affordable Housing Preservation Tax Relief Act of 2007 (HR 1491) offers a win-win alternative to the status quo. This legislation, and a similar Senate bill, S 1318, would waive the payment of depreciation recapture taxes if the affordable housing property is transferred to a qualified housing preservation entity that agrees to maintain the rent affordability restrictions for 30 years. In essence, these bills accelerate the stepped up basis that the property would receive upon the death of the investor in exchange for an agreement to keep the property affordable for another thirty years.

NAHMA respectfully asks Subcommittee members to cosponsor and support HR 1491.

***Conclusion***

In closing, please allow me to express NAHMA's sincere appreciation for the Subcommittee's interest in affordable housing. Our members are proud to provide communities of quality for low-income families to call home. I look forward to working with you and your staff to improve the tax-related affordable housing programs. Thank you for your consideration.

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**Statement of National Association of Realtors**

On behalf of its 1.3 million members, the NATIONAL ASSOCIATION OF REALTORS® (NAR) salutes Chairman Neal for convening hearings on affordable housing. NAR has a long and ongoing commitment to affordable housing and looks forward to working with Congress to find solutions to this growing problem. We agree with Chairman Neal's view that there is a great need to modernize existing incentives under Internal Revenue Code Sections 42, 47 and 142. NAR believes that, in addition to these important existing provisions, two additional housing issues merit the Subcommittee's consideration. One has implications for the long-term sustainability of homeownership; the second addresses the shortage of entry-level and workforce housing.

***Sustaining Homeownership in a Fragile Marketplace***

Recent media reports have noted an anticipated wave of foreclosures on homeowners who are unable to make payments associated with some adjustable rate mortgage products. In addition, some markets have experienced more than one quarter of declining home prices, thus putting some sellers in the unenviable position of having to sell their homes for less than the outstanding amount of the mort-

gage. (These transactions are typically identified as “short sales,” i.e., the seller is “short” of cash at settlement.) The news reports have not mentioned the tax problem that sellers in short sales and foreclosures will face if lenders forgive (i.e., do not require payment on) some or all of a mortgage debt at the time of disposition. *These sellers just might get a visit from the IRS.*

*Current Law.* Any lender that forgives debt is required to provide a Form 1099 information report to the borrower and to the IRS stating the amount of the forgiven debt. The Form 1099 is required in any circumstance when a debt is forgiven, whether it is a short sale, foreclosure, deed in lieu of foreclosure or any similar arrangement that relieves the borrower of the obligation to pay some portion of a debt. Many home sellers have been alarmed at real estate settlements when they have learned that the IRS will receive this report and that they will, in many cases, be required to pay tax on this non-cash or phantom income. We believe that the taxation of phantom income is fundamentally unfair.

The incidence of taxation on home sellers reinforces the fundamental unfairness of taxing phantom income. The overwhelming majority of sellers will never pay any income tax at all on the sale of their principal residence. Code Section 121, enacted in 1997, permits an exclusion of up to \$250,000 (\$500,000 on a joint return) of *gain* on the sale of a principal residence. As less than half of the existing housing stock has even a *value* of \$250,000, the number of sellers who experience a *gain* in excess of \$250,000 is small, indeed. (The current nationwide median sales price of an existing home is \$212,300.) Those who do have taxable gains are taxed at capital gains rates (currently 15%). This group might fairly be characterized as the truly fortunate.

The other individuals who pay tax on the sale of a principal residence are the truly *un* fortunate. These are the individuals who find themselves in a short sale or in foreclosure or similar loss circumstance. This group will experience what, for most, will be the most cataclysmic economic loss of a lifetime. These individuals will be required to pay tax on phantom income. Moreover, they will pay income tax at *ordinary* rates. This seems a remarkably heavy burden.

The Section 121 exclusion has proven to be a great benefit to taxpayers, particularly when they relocate from high cost areas to more moderately priced communities and as they downsize in anticipation of retirement. Section 121 is straightforward and is not riddled with the kinds of exceptions that create complexity. To undermine that provision would be a true burden for taxpayers who are changing their living circumstances. The provision does, however, underscore the anomaly of requiring that phantom income on the sale of a principal residence be taxed at ordinary rates when the only gains ever taxed are taxed at low capital gains rates.

*Who's Affected: Short Sales.* During the first quarter of 2007, the median sales price of a residence nationally and in every region was lower than it had been in the first quarter of 2006. The national decline is 1.8% over last year. Those national figures are based on local data provided to NAR as it tracks existing home sales in 159 Metropolitan Statistical Areas (MSAs). Of the 159 MSAs, in the first quarter of 2007, sixty had declining median sales prices compared with a year ago, ranging from a negligible decline of 0.1% (Columbus, Ohio and Corpus Christi, Texas) to a maximum decline of 14.9% (Elmira, New York). Data was not available or was unchanged for twelve MSAs. Thus, 41% of MSAs experienced declining prices over the past year (60 / 147).

Those who have owned their homes only for a short period are particularly exposed to the possibility of short sales. In a declining market, sellers are not necessarily at “fault” when they are unable to realize even the amount of their outstanding mortgages at sale. In addition, sellers in declining markets are not necessarily those who have been preyed upon in the subprime loan marketplace. They are not responsible for the declining home values around them, but they are certainly affected by the phenomenon. The most vulnerable are those who made low or zero downpayments. Often individuals in this class are first-time homebuyers. If they are wiped out financially on the sale of their first home, achieving the goal of homeownership a second time is substantially more difficult. Tax burdens on those transactions make the climb even steeper.

*Who's Affected: Foreclosure.* The most extreme predictions of foreclosures are that more than 2.4 million homeowners will lose their homes over the next 18 months. Often foreclosure occurs when economic conditions in a community change or when one wage earner in a family unexpectedly loses a job. However, in the current situation, the bulk of those who face foreclosure are those who are unable to keep up their payments on adjustable rate mortgages and similar products with floating interest rates.

Most of these adjustable mortgages were issued during the past 2–3 years at relatively low “teaser” interest rates that were to be adjusted after 2 to 3 years. Bor-

rowers were sold on the idea that they would never be subject to the above-prime, above-market interest rates these products carried because borrowers would be able to refinance before the adjustment period arrived. In fact, these products were generally viable *only* if housing prices continued to escalate. Hot markets began to cool at the end of 2005, exposing these individuals to rising mortgage payments. Often these borrowers were less-sophisticated individuals with blemished or impaired credit ratings.

These products are generally known as “subprime” loans. A significant majority (about 80% of subprime borrowers) has fared well with their loans, but the remaining minority has been unable to make their payments. Mortgage brokers and lenders made subprime products available both as original purchase money and as mechanisms to “cash out” and have funds available for a variety of uses, including debt consolidation, home improvements, vacations, cars and other consumption.

The Ways and Means Committee does not have jurisdiction over the business practices of subprime lenders, but the Committee does have control over the tax treatment of borrowers who were harmed by shenanigans in that market. Significant numbers of these borrowers were first-time homebuyers. Many are members of minority groups or are immigrants. It is unthinkable that individuals who were subjected to sharp practice by lenders should have to pay tax when they lose their homes to foreclosure.

Subprime borrowers are not necessarily the working poor buying their first house. A recent *Wall Street Journal* article explored the impact of subprime loans on one middle class African American neighborhood in Detroit. In that community, the subprime products were sold as ways to put an owner’s equity to a so-called better use. (See “The Debt Bomb,” *Wall Street Journal*, May 30, 2007, page A1.) The neighborhood is described as “a model of middle-class home ownership, part of an urban enclave of well-kept Colonial residences and manicured lawns.” But dandelions began to appear and the foreclosure rate in that neighborhood rose to 17%. Neighbors are concerned that “nobody’s going to want to buy into a neighborhood with 20% foreclosures.” A death spiral begins that can defeat even the well-employed and educated residents who remain. When a neighborhood is subject to high rates of foreclosure, even the most creditworthy and financially conservative are harmed. Home values fall along with property maintenance; the dandelions start to grow.

*Corrective Measures.* To mitigate the harm that sellers and borrowers are experiencing, NAR seeks enactment of H.R. 1876 or relief that is similar to it. H.R. 1876 (and a Senate companion, S. 1394) provides that borrowers will not be subject to taxation when a lender forgives mortgage debt on a residence. The legislation provides safeguards so that owners cannot load up their debt level and then bail out. The bill provides that relief will not be granted to those who have added debt in excess of acquisition indebtedness. (Code Section 163(h)(3)(B) defines interest on acquisition indebtedness as debt used to acquire, construct or substantially improve a residence. The debt must be secured by the residence.) NAR advocates this relief because it believes that individuals who have experienced a substantial economic loss should not become indentured at the time of the loss. If they must pay tax on phantom income, it will be that more difficult to repair their credit and acquire new housing either through purchase or lease.

NAR looks forward to working with the Committee to refine this legislation and secure taxpayer relief at the earliest possible opportunity.

*Precedents for Relief.* The residential real estate market has not been subject to the combined pressure of waves of foreclosure and declining property values in recent memory. There is precedent for declining real estate values, however. Historically, residential real estate has almost always appreciated in value. However, in some limited situations, values in some neighborhoods fall, often through no fault of the owners. In the early 1980’s, sky-high interest rates put significant downward price pressure on sellers. During that same period, markets in the “oil patch” of Texas and Oklahoma experienced declining values because of declines in the oil and gas economy. In the early 1990’s, the collapse of the aerospace industry caused significant property value declines in Southern California. During that period, 16% of all sales in California were “short sales.” Similar experiences affected New England during a high-tech recession in the early 1990’s. Denver and Phoenix were particularly vulnerable during the so-called credit crunch of that era, as well.

Other circumstances might put downward pressure on prices in limited circumstances. For example, a major employer might leave an area, a military base could close or environmental problems might emerge. In other circumstances, a homeowner might be in a situation where they need to sell in a down market to relocate, or because of job loss or health reversals.

Today, the decline in property values is not isolated to small geographic areas as it has been previously, but is rather experienced nationwide. The scope of fore-

closure is substantial. Imposing heavy tax burdens in such a context seems unwise and sure to make a fragile housing environment even more vulnerable. Further, it seems particularly unfair to tax phantom income at a time when a taxpayer is in reduced economic circumstances.

In 1999 and in 2000, the House and Senate passed several separate bills that each included mortgage cancellation tax relief identical to that found in H.R. 1876. Those bills were never in conference, however, so the provision was not enacted. In 2005, the Hurricane Katrina relief package included a provision identical to H.R. 1876. Its application was limited to debt forgiveness on mortgages secured by properties in the so-called GO Zone. The GO Zone relief was available only between September 2005 and January 1, 2007. NAR believes that it is time for that relief to be extended nationwide.

Finally, during the commercial real estate collapse of the early 1990's, Congress provided debt cancellation tax relief to owners of commercial real estate as part of the 1993 tax bill. The relief provision allows owners of commercial/investment real estate (i.e., real estate other than owner-occupied personal residences) to defer the recognition of income when debt is forgiven. The deferral takes the form of an adjustment to the basis of other real property.

While not all owners of commercial real estate owned other properties that permitted them to utilize the deferral, the 1993 provision does set a precedent for tax relief for owners of real estate during periods of market failure. As most home owners have only one residence, no analogous basis adjustment relief would be available. Further, it is extremely unlikely that individuals in short sales or foreclosures would be purchasing a replacement property immediately following either the economic loss of a short sale or the literal loss of a home in foreclosure. Thus, very few would have any property to which a basis adjustment might be applied.

*Answers to a Few More Questions:*

- What if a property declines in value, but is not sold? The mere fact of declining property values would not trigger the provision, as there is no yearly mark-to-market requirement for homes or other real estate assets. Tax relief should be extended when triggering events occur, however. These might include short sales, foreclosures, deed-in-lieu of foreclosure and workout arrangements with lenders that are intended to prevent a disposition.
- Do all lenders forgive mortgage debt when property values decline? No. In states with applicable laws, the lender may work out a repayment arrangement, particularly if the borrower has other assets.
- How many transactions would be affected by relief provisions? The figure is difficult to quantify. Between 2001 and 2005, virtually every residential real estate market in the U.S. was healthy and profitable and property values increased, often by double digit amounts. NAR has been unable thus far to identify a data source that would indicate how many sales in any market are short sales. Foreclosure data is available, but the fact that the marketplace anticipates a growing number of foreclosures makes it difficult to evaluate the impact.
- What is the revenue effect of the proposal? In 2000, the revenue estimate for an identical bill was a loss of \$27 million over 5 years and a loss of \$64 million over 10 years. It has not been scored since 2000.

*Homeownership in the Future—An Adequate Supply of Housing*

If one were to ask young people in their 20's or 30's to identify the most pressing housing problem in their communities, a majority would likely note the diminishing quantity of entry-level housing and the shortage of so-called "work force" housing. (Work force housing is usually thought of as housing that is priced so that school teachers, fire fighters, policemen and similar essential public sector professionals and young people can find housing in the communities where they work.) Realtors in those communities would also note that it is far easier to find financing for a home than it is to find entry-level or work-force housing in many communities.

Developers, financiers and tax professionals in older, inner-ring suburbs, central cities or rural areas might answer the same question from a different direction. They would note that the cost of land and/or the availability of capital make it impossible to construct or rehabilitate owner-occupied housing at a price that is affordable in the community. The tax professionals might note, as well, that while there are incentives that make the construction or rehabilitation of rental housing financially feasible in these types of communities, there is no incentive or mechanism available that would equalize the costs and likely prices for developing or rehabilitating housing that would be available for purchase.

Community development activists would note that the New Markets tax credit has been effective in bringing business development capital into communities that

need redevelopment. They would go on, however, to note that community development would move more quickly and be more vibrant if the capital available for new businesses could be matched with incentives to bring decent housing to those neighborhoods.

One solution was proposed in both the 108th and 109th Congresses. A bipartisan majority of Ways and Means Committee members sponsored legislation that had the backing of a wide variety of real estate and housing advocacy organizations. Those bills were H.R. 839 in the 108th [a Portman-Cardin bill with 303 cosponsors] and H.R. 1549 in the 109th [a Reynolds-Cardin bill with 200 cosponsors.] Entitled the "Renewing the Dream Tax Credit Act," the legislation's stated goal was "to allow an income tax credit for the provision of homeownership and community development." The proposed tax credit was designed on the model of the successful Section 42 low-income rental credit that equalizes the cost of providing rental housing with the amount of rent that can be charged.

NAR urges the Committee to consider the Renewing the Dream Tax Credit act at an appropriate time as part of any discussion of affordable housing. The need for entry-level and work-force housing continues to become more intense. The current challenges in residential real estate and lending have not eased the difficulties that moderate and low-moderate individuals face in finding decent housing.

#### *Supporting Affordable Housing Programs*

Finally, NAR wishes to inform the Committee of some of its efforts to advance the cause and elevate the profile of affordable housing through its state and local Realtor organizations. NAR has created a Housing Opportunities Board, made up of 35 Realtors, Realtor association executives, developers, and Housing Finance Agency leaders from around the country. The Board is a clearing house for a variety of local affordable housing initiatives. Primary among these are two grant programs: Ambassadors for Cities and the State and Local Initiative Fund.

NAR and the U.S. Conference of Mayors (USCM) created the Ambassadors for Cities program, which brings together local REALTORS® and mayors to increase home affordability and rental opportunities within a town or city. The goal of the Ambassadors program is to highlight successes in which REALTORS® and cities have played significant roles. The initiative provides models that REALTORS® and mayors can adopt in other cities. Each year, several highly successful REALTORS® and mayors receive the Ambassadors for Cities designation and \$5,000 grants to foster their initiatives. Twenty-three cities have participated in the Ambassador for Cities program. Grants have totaled \$115,000.

NAR also supports its State and Local Initiatives Fund to provide grants for a wide range of housing opportunity programs. Grants of up to \$4,000 are awarded in April and October. By the end of 2007, the Fund will have made grants totaling \$179,000.

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### **Statement of National Trust Community Investment Corporation**

Thank you Chairman Neal, ranking member English, and members of the Subcommittee for the opportunity to testify before you today on ways to simplify and amend the tax code to make affordable housing more available. My name is John Leith-Tetrault and I am President of the National Trust Community Investment Corporation. As such, I can speak about housing rehabilitation in historic and older buildings from both the tax credit syndicator and developer perspective. Before I begin, I would also like to thank Representatives Stephanie Tubbs Jones and—again—Phil English in particular for introducing the National Trust for Historic Preservation's leading bill, HR 1043, the Community Restoration and Revitalization Act, which provides for a wide range of amendments to the federal historic rehabilitation tax credit. These changes would enhance the existing linkage between historic and low-income housing tax credits, unlock more of the historic tax credit's potential for neighborhood reinvestment, and make the historic credit easier to use for smaller, main street projects.

Four of these amendments would positively impact the economic feasibility of projects that rehabilitate existing buildings for reuse as affordable housing. HR 1043 now has 53 co-sponsors from both sides of the aisle. Senators Gordon Smith and Blanche Lincoln have introduced an identical bill, S 584 which currently has 3 Republican and 2 Democratic co-sponsors.

My organization, the National Trust Community Investment Corporation (NTCIC)—a wholly owned for profit subsidiary of the 1949 Congressionally char-

tered National Trust—has invested \$185 million in historic and new markets tax credit (NMTC) equity in housing and commercial properties over the past six years. NTCIC is a certified Community Development Entity and a recipient of \$180 million in NMTC allocations since 2003. Rehabilitation, neighborhood reinvestment, and economic development are integral components of historic preservation, since the majority of the nation's National Register historic districts overlap census tracts where there are high percentages of people living in poverty.

My testimony today will focus on the four affordable housing-related provisions of HR 1043, and provide two case studies of how subsidy amounts from both the federal low-income housing (LIHTC) and historic tax credits would increase under this bill to create a more favorable financing structure and to better achieve affordable rent structures for these transactions. The many endorsers of this bill in the affordable housing and rehabilitation tax credit industries hope the Subcommittee will consider the provisions of HR 1043 in its effort to put together a Low-Income Housing Tax Credit amendments bill.

1. ***The Nexus between Affordable Housing and Historic Rehabilitation***—Affordable housing developers have always viewed historic and older buildings in low-income communities as an important resource for decent and affordable housing. Congress anticipated the rehabilitation of historic buildings for affordable housing in 1986 by allowing the combination of these two credits as part of the Tax Reform Act of 1986. Since the inception of the historic tax credit program, combining the LIHTCs and historic tax credits has created, based on National Park Service estimates, about 86,000 affordable housing units nationwide. Despite popular belief, most older and historic building stock is located in economically depressed low-income census tracts as evidenced by research conducted by the NTCIC. That research shows that in 2006, 67 percent or two-thirds of all historic tax credit transactions approved by the National Park Service were located in high-poverty census tracts. A prime acknowledgement of this demographic reality is the 2002 IRS ruling that specifically considers the overlap of historic properties and high poverty areas by allowing New Markets Tax Credits (NMTC) and historic tax credits to be combined on certified historic commercial projects benefiting low-income businesses.

2. ***The Impact of HR 1043 on affordable housing development***—Among HR 1043's broad set of provisions to improve the effectiveness of the historic tax credit, the following four are aimed at the historic tax credit's compatibility with affordable housing transactions:

a. ***Elimination of the basis adjustment***—Section 2 of HR 1043 asks Congress to treat the historic tax credits the same as the LIHTC and NMTC by eliminating the reduction of a property's depreciable basis that is required when combining the historic and low-income housing tax credits. Since the LIHTC is calculated as a fraction of the depreciable basis, the reduction of LIHTC basis by 100 percent of the amount of the historic tax credit significantly diminishes the value of combining these incentives. At today's pricing for both LIHTC and historic tax credits—\$.95 on the tax credit dollar—the reduction in low-income tax credit value is a full 25 percent over the ten-year vesting period of the credit.

In a so-called Difficult to Develop Areas (DDAs) or Qualified Census Tracts (QCTs), the impact of reducing the LIHTC basis by 100 percent of the historic tax credit amount is even more severe. Due to the 130 percent basis boost provided to LIHTC developers of properties in these severely distressed areas, every \$1.00 of historic tax credit reduces the LIHTC basis by \$1.30. The net effect is to reduce the average value of the Low-Income Housing Tax Credit by nearly 33 percent. These provisions have the perverse impact of providing less combined credit subsidy to projects in communities with the greatest economic need. While this provision may be seen as a way to prevent double dipping, no such treatment is required by the tax code on LIHTC-only transactions, nor does the IRS require such an adjustment to the historic tax credit basis when combining the historic tax credit and the new markets tax credits. Furthermore, the legislative history of the LIHTC and historic tax credit indicates two different purposes that act independently on historic buildings used for affordable housing. The historic tax credit's purpose is to offset the higher cost of rehabilitation over the less expensive option of demolition and constructing anew. The LIHTC is meant to lower conventional debt service loads on rent restricted buildings. Allowing the full benefits of twinning these two credits therefore addresses the twin impediments to using historic properties for affordable housing.

b. ***Providing a 130 percent basis boost for the historic tax credit***—HR 1043 asks Congress to treat the historic tax credit the same as the LIHTC by providing a 130 percent basis boost in DDAs and QCTs. By definition, these are areas where incomes are especially low and the cost of development is high. The basis boost for the LIHTC is meant to help defray higher costs such as security, insurance, mate-

rials and labor so that these added costs do not force up targeted affordable rents. The same logic should apply to the special costs of historic and old building rehabilitations that are also proportionately higher in these designated areas. The net effect of this provision of HR 1043 would increase the value of the historic tax credit by about 25 percent on a twinned transaction.

*c. Making housing an eligible use for the 10 percent “older building” portion of the historic tax credit*—for reasons that are unclear from legislative history, the 10 percent portion of the historic tax credit program (the portion that accrues to non-certified historic structures) may not be used for housing. Whatever the reason was for this exclusion, it seems to be an anomaly in the context of the current national affordable housing need. Broadening the use of the 10 percent portion of the historic tax credit to include housing would open up the potential to twin the 10 percent portion of the historic tax credit with the LIHTC. This new combination of federal housing subsidies would have several valuable applications. Since the 10 percent credit is for non historic buildings only, this provision would potentially impact a much larger number of buildings eligible for both credits. The lack of historic design guidelines for the existing 10 percent portion of the historic tax credit would provide affordable housing developers with more flexibility in addressing compromises between preserving a building’s architectural character and overall construction costs. This measure would also add additional subsidy to transactions aimed at preserving existing affordable units as previously awarded HUD subsidies expire.

A related change to the 10% credit, Section 6 of HR 1043 would index the eligibility date for older buildings to correspond with Congress’ intent that these building be at least 50 years old. The current law requires that 10 percent portion of the historic tax credit properties must have been built before 1936. The indexing of the 10 percent tax credit eligibility date would make buildings built before 1957 eligible, adding approximately 225,000 post war multifamily properties to the stock of units that can receive the 10 percent portion of the historic tax credit.

#### **Case Studies on the Impact of HR 1043 on Low-Income Tax Credit Transactions**

*a. Parkside Commons*, the renovation of the former Meadville Junior High School in Crawford County, PA into 56 affordable housing units and 3,000 sq. ft. of commercial space, is an example of a project that might have benefited from the enactment of HR 1043. The school is located on North Main Street in Meadville and shares prominent frontage on Diamond Park with the Crawford County Courthouse. It was built in 1921 and was threatened with demolition until the current developer, Tom Kennedy of Erie, stepped forward with a historic rehabilitation plan. The project is currently under construction and has experienced cost overruns. The developer has addressed the situation by reinvesting his developer fee into the property, cutting the scope of work by \$600,000 and phasing the project. According to the developer, Meade Junior High’s conversion has gone from “feasible to marginally feasible.”

Parkside Commons has utilized both the LIHTC and historic tax credits. The LIHTC contributes \$3 million and the historic tax credit provides \$1 million in equity to a total development cost of \$5.5 million. Unfortunately it is situated across the street from a Qualified Census Tract and therefore could not apply for the 130 percent LIHTC basis boost nor benefit from the proposed basis boost for the federal rehabilitation credit. The mandatory LIHTC basis reduction by the amount of the historic tax credit cost the Meade Junior High project \$781,000 dollars, more than enough to restore the \$600,000 in project enhancements abandoned due to the cost overruns. HR 1043’s proposed elimination of the LIHTC basis reduction would have meant a great deal to Mr. Kennedy, the developer, and to the future tenants of the building.

*b. Worthington Commons Apartments* is located on Summit, Federal and Worthington Streets in Springfield, Massachusetts. This property was formerly known as Summit Hill Apartments and was acquired in foreclosure by MassHousing. Subsequently, MassHousing selected First Resource Companies to be the developer. The redevelopment plan, which utilizes the LIHTC and historic tax credit calls for the rehabilitation of nine buildings into 111 apartments, rehabilitation of two abandoned buildings into 38 apartments, and the rehabilitation of a third abandoned building into a management office and resident community center. All of the units will be affordable.

This \$19 million project is in a Qualified Census Tract and therefore qualified for the 130 percent LIHTC basis boost. If HR 1043 were enacted, the additional 130 percent historic tax credit basis boost would result in an additional \$932,210 to the project. Additionally, \$413,000 in equity could be generated by eliminating the reduction of the low-income housing tax credit basis by the amount of the historic tax

credit. If available, this additional \$1,345,210 could have been used by the developer to reduce the soft debt on the project provided by the Massachusetts Housing Partnership, (freeing these funds to be utilized for other projects in the state). Alternatively, the extra funding could have been used to establish reserves to fund operating deficits and maintenance for the property, the lack of which contributed to Summit Hill's original downfall.

Chairman Neal, ranking member English, and members of the Subcommittee, thank you again for this opportunity to discuss how the enactment of HR 1043, The Community Restoration and Revitalization Act, would allow historic tax credits to make an even more significant financial contribution to the production of affordable housing that also relies on the low-income housing tax credit. I would be happy to answer any questions members of the Subcommittee may have.

