Senate Finance Committee Hearing
"America's Affordable Housing Crisis: Challenges and Solutions"
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The Local Initiatives Support Corporation (LISC) is pleased to provide a statement for the record with respect to the Committee's hearing on "America's Affordable Housing Crisis: Challenges and Solutions," held on August 1, 2017.

As one of the largest national nonprofit housing and community development organizations in the country, LISC often relies upon public-private partnerships to engage in the type of comprehensive community development work that is needed in low-income communities. The Low Income Housing Tax Credit (Housing Credit) is the single most important federal resource available to encourage private sector investments in the development and rehabilitation of affordable housing for low, very-low and extremely low-income renter households. As discussed further below, Congress must act to preserve and strengthen this successful program; and should also consider enacting a new tax incentive, the Neighborhood Homes Tax Credit, to spur investments in single family homes in communities characterized by high rates of vacancy and low property values.

Background on LISC

Established in 1979, LISC is a national non-profit Community Development Financial Institution (CDFI) that is dedicated to helping community residents transform distressed neighborhoods into healthy and sustainable communities of choice and opportunity — good places to work, do business and raise children. LISC mobilizes corporate, government and philanthropic support to provide local community development organizations with loans, grants and equity investments; technical and management assistance; and policy support.

LISC has local programs in 31 cities, and partners with 77 different organizations serving over 2,000 rural counties in 44 states throughout the country. LISC focuses its activities across five strategic community development goals:

- Expanding Investment in Housing and Other Real Estate
- Increasing Family Income and Wealth
- Stimulating Economic Development
- Improving Access to Quality Education
- Supporting Healthy Environments and Lifestyles

Background on the Housing Credit

Supported on a broad bipartisan basis, the Housing Credit was enacted as part of the Tax Reform Act of 1986, the last major overhaul of the tax code. The Housing Credits are allocated to the states through a formula allocation, and then awarded through competition to developers of qualified projects. Developers sell the property to investors to raise equity capital for construction of their projects, thus reducing the debt service and allowing the projects to provide affordable rents to low-income families. Investors claim the credits over a 10-year period, and are at risk of tax credit recapture for an additional five years if the property does not remain in compliance with the rules.

To date, the Housing Credit has financed the development of approximately 3 million affordable homes across the nation with projects in every state, leveraged more than $100 billion in private capital, and helped to create well over 3 million jobs in the construction and property management industries.[1] It is the country's most successful affordable housing production program.

LISC, through its subsidiary the National Equity Fund (NEF), is one of the nation's largest syndicators of Housing Credits. To date, NEF has invested $13.3 billion in close to 2,500 housing properties, creating approximately 159,000 affordable homes for low-income families in 46 states, and spurring the creation of an estimated 194,000 jobs. In recent years, LISC has been able to use the credit to support disaster recovery efforts, a veterans housing initiative, and an initiative to link housing to critical community health services.

Successful Attributes of the Housing Credits

The Housing Credit has achieved tremendous success in financing affordable housing in rural, urban and suburban communities throughout the country. Some of the more noteworthy characteristics that have led to the success of these credits include:

1. **The credits correct market failures.** The potential financial return achieved via the tax credit enables investment in projects that would not otherwise produce profitable returns. This is clearly evidenced with respect to Housing Credit investments, where it's been demonstrated that a typical housing project would have to reduce its construction costs by 72 percent to be able to serve a low-income family at an affordable rent.[2]

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[1] "Low Income Housing Tax Credit Impacts in the United States", Affordable Rental Housing ACTION Coalition

[2] Harvard University Joint Center for Housing Studies (JCHS), "America's Rental Housing" (2011)

2. **The credits are responsive to locally determined needs.** The Housing Credits are allocated by state housing finance agencies, which determine the state's affordable housing priorities in annual funding rounds. Based on the needs within the states and localities, priorities in any given year could include elderly housing, veterans housing, units serving homeless families, workforce housing, rural housing, etc.

3. **The competition for credits produces better outcomes.** Applications for the Housing Credit typically outpace availability by 3 to 1, and in some states this ratio is as high as 7 to 1. This competition drives applicants to achieve better outcomes than are minimally required in program regulations. Most notably:

    - Housing Credit properties must satisfy affordability requirements for 30 years after completion, but state allocating agencies often require much longer affordability periods as a condition of allocation.

    - Housing Credit units must be affordable to persons making less than 60 percent of area median income (AMI), but states set higher goals to achieve deeper income targeting. As a result, the most recent Department of Housing and Urban Development (HUD) data indicate that 48 percent of Housing Credit units are occupied by families making less than 30 percent of AMI and 82 percent are occupied by families making less than 50 percent of AMI.[3]

4. **The tax credit structure allows for more efficient program administration.** Investors – with their own capital at risk – impose underwriting and asset management oversight. The investor due diligence leads to a more robust and efficient compliance monitoring system, and results in projects that are financially strong. For instance, Housing Credit properties far outperform other real estate classes, with occupancy rates topping 96 percent nationwide and a cumulative foreclosure rate of just 0.66 percent over the program's history.[4]

    In addition, investors and developers – not taxpayers – assume the financial risks of these projects. If projects are not in compliance with statutory requirements, tax credits are forfeited back to the Treasury. In the case of the Housing Credit, investors cannot even begin claiming credits until the apartments are occupied by low-income families at affordable rents. This is in stark contrast to most federal grant-making programs, in which grants are advanced and an agency must seek a return of funds (often after they are already spent) in the case of program noncompliance.

5. **The credits provide a great return on investment for the Federal government.** The National Association of Homebuilders estimates that, on an annual basis, the Housing Credit produces 95,000 new, full-time jobs, adds $6.8 billion into the economy, and generates approximately $2 billion in federal, state and local tax revenues.

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[3] U.S. Department of Housing and Urban Development, Office of Policy Development and Research, "Data on Tenants in LIHTC Units as of December 31, 2013" (2016)

[4] "The Low-Income Housing Tax Credit at Year 30: Recent Investment Performance (2013-2014)"

Uniqueness within the Tax Code

The Housing Credit is distinct from almost every other type of tax credit, in at least two critical ways:

1. **It spurs activity that would not occur but for the tax incentive.** Most federal tax benefits reward business behavior that already directly aligns with their operational interests. While these tax benefits may have some effect on business behavior, it is likely on the margins of activities in which they are already likely to engage even in the absence of the tax incentive. Conversely, the Housing Credit directs investments to activities in which companies would not otherwise invest in because: (a) it does not further their normal business operations; and/or (b) if not for the benefits provided in the tax code, they would not be profitable for the company. So if these credits were to disappear, so too would the investments.

2. **The benefits of the credit extend far beyond the investors to fulfill a broader public need.** The Housing Credit fulfills a fundamental public purpose that most other credits do not. As with all tax credits and deductions contained within the tax code, the entity claiming the Housing Credit does achieve a financial benefit in the form of reduced tax payments. However, the Housing Credit is among one of very few tax benefits provided in the corporate tax code that focus exclusively on improving the lives of low-income persons and low-income communities (the New Markets Tax Credit being the other most notable one). In other words, unlike most other provisions in the tax code which solely benefit a corporation's bottom line, the ultimate beneficiaries of these credits are the end users: the low-income family that is paying significantly below-market rent, thus freeing up more resources for the family to cover other critical expenses and to save for education, retirement, homeownership or other activities that will better enable the family to escape the cycle of poverty.

Priorities for Tax Reform

Protect and expand the Housing Credit. The Housing Credit is a permanent part of the tax code, enacted in 1986 as part of the last major tax reform effort. However, despite its longevity and its track record of success, there may be some who would seek to scale back or even eliminate this credit to help offset a reduction to the overall corporate tax rate. To do so would put the future of the country's strongest program for affordable housing development in great jeopardy at a time when demand for affordable housing continues to increase.

It is noteworthy that the Bipartisan Policy Center's Housing Commission, which was co-chaired by two former Secretaries of HUD (one a Democrat and one a Republican) and two former Senators (one a Democrat and one a Republican), released a report in 2013 not only citing the critical role of the Housing Credit in supporting affordable housing, but also calling for an expansion of the Housing Credit by fifty percent over current funding levels. While LISC recognizes the importance of fiscal restraint as part of the tax reform exercise, we also believe that tax reform presents an opportunity for reflection on what truly has worked in the tax code, and every consideration should be given to expanding this vital initiative.

In considering additional measures to protect and strengthen the Housing Credit, the best starting point is The Affordable Housing Credit Improvement Act (S. 548), the bi-partisan legislation introduced by Senator Hatch and Senator Cantwell which would, among other things:

- Increase the formula for allocating the credit by 50% over five years;
- Streamline program requirements and provide states with additional flexibility;
- Facilitate Housing Credit development in challenging markets, including rural and Native American communities;
- Increase the Housing Credit's ability to serve extremely low income populations;
- Better support the preservation of existing affordable housing;
- Enhance the "4% credit" and multifamily housing bond portion of the program.

In addition, as the Committee undertakes efforts to reform the broader tax code, it needs to consider making adjustments to the applicable housing credit rate (i.e., the 9% or 4% rate) to offset the impact that a lower corporate tax rate and/or changes to depreciation would have on utilization of the Housing Credit. It also needs to retain the multifamily housing private activity bonds, which are used in conjunction with the 4% credit and account for about 40% of all Housing Credit production annually.

Create a new Neighborhood Homes Tax Credit. LISC, along with many other organizations, is calling for the creation of a Neighborhood Homes Tax Credit (NHTC). The NHTC is designed to attract private capital to support investment in single family homes in communities where the costs of developing and rehabilitating homes for sale exceed the appraised value of the home. The NHTC would provide the developer or investor with a tax credit to cover this "appraisal gap." The tax credit would work as follows:

- State allocating agencies (most likely the state Housing Finance Agencies) would be allocated a new tax credit authority and/or be given the flexibility to convert unused private activity bond authority or mortgage credit certificate authority into NHTCs.

- The credits would be awarded by the state agencies to eligible entities through an annual competition. The eligible entity would identify a strategy for developing or rehabilitating properties in eligible communities, either for new homes, existing owner-occupied homes, or for homes that are vacant and will be brought to market. The eligible entities could be developers or financial institutions, including non-profit CDFIs or other entities looking to capitalize a loan pool.

- States would allocate only the tax credits reasonably needed for financial feasibility, determined both at the time of application and again when homes are sold or owner-occupied rehabilitations are completed.

- Program limitations would ensure the credit is benefitting the right projects and communities.

    - The maximum value of the credit would be 35% of construction, substantial rehabilitation, and building acquisition and demolition costs.

- The maximum cost basis for calculating the tax credits could not exceed the national median existing home sales price or four times the area MFI, whichever is higher.

- The credits would generally only be available to support homeownership by low-income and middle-income homebuyers.

- Only those neighborhoods characterized by some combination of high poverty, low median family income and low home values would be eligible for investments. In addition, the states would be required to further define neighborhood eligibility requirements to ensure that the program is not targeting neighborhoods where there has been a recent influx of investment marked by improving property values, higher rents or a displacement of lower-income families.

The NHTC addresses the need for neighborhood revitalization in communities hit with blocks of home foreclosures and vacant properties. Vacant properties inflict heavy costs on American communities: blight, crime, lowered home values, and decreased property tax revenue. There are mounting costs and difficulties associated with vacant and abandoned properties, especially when concentrated within neighborhoods. There are negative spillover effects ranging from crime and safety to reduced property values and increased costs for municipal governments. RealtyTrac found that 142,462 U.S. properties in the foreclosure process were vacant, representing 25 percent of all properties in the foreclosure process. The states with the most owner-vacated foreclosures were Florida with 35,903 (25 percent of the national total), New Jersey (17,983), New York (16,777), Illinois (9,358), and Ohio (7,360).[5]

Part of the reason property abandonment becomes contagious is because it lowers nearby home values making it more difficult to attract mortgage capital to an area. This makes it harder for people to sell their homes, in turn causing lenders to lower appraisals or to deny loans entirely. Vacant properties deteriorate and the underlying value of the property declines, causing neighboring property values to also decline.[6] These neighborhoods are trapped in a cycle where low property values prevent the construction of new homes and the renovation of attractive of existing homes, and where the absence of these investments keeps property values unsustainably low. Declining homeownership rates, property abandonment, the erosion of family assets, and concentrated poverty are too often the result. Studies attempting to quantify the effect of foreclosures on surrounding property values find that foreclosures depressed the sales prices of nearby homes by as little as 0.9 percent to as much as 8.7 percent.[7]

The NHTC would provide an effective and necessary tool for revitalizing blighted neighborhoods. As noted above, the NHTC would fill the gap between cost of construction and the appraised value of the property, with the private market bearing construction and marketing risks – much as is done with the Housing Credit. However, the Housing Credit, which was

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[5] "One in Four U.S. Foreclosures are "Zombies" Vacated by Homeowner, Not Yet Repossessed By Foreclosing Lender." RealtyTrac. Feb 5 2015.
[6] http://www.communityprogress.net/filebin/CCP_BaltimoreTASP_Final_Report_102616.pdf
[7] W. Scott Frame. "Estimating the Effect of Mortgage Foreclosures on Nearby Property Values: A Critical Review of the Literature." Federal Reserve Bank of Atlanta, Economic Review. Nov 3 2010.

designed to create affordable rental housing for low- and very-low income families, cannot readily be utilized to support homeownership housing. And while tax exempt private activity bonds and mortgage credit certificates (MCCs) do support homebuyers by reducing mortgage interest costs, these incentives cannot fill the gap between development or renovation costs and appraised home values.

Only those neighborhoods characterized by some combination of high poverty, low median family income, and low home values would be eligible for NHTC investments. In these neighborhoods, where inventory is high and appraisals are low, it is simply not possible for the private sector to invest in these properties without additional subsidy. By creating this incentive through the tax code, financial companies will now be able to participate in the recovery of these communities.

Although legislation authorizing the NHTC has not yet been introduced in the 115th Congress, similar legislation was proposed by the George W. Bush administration and was introduced in the 108th Congress and received tremendous bi-partisan support. The Senate legislation (S. 875) had 46 co-sponsors, and the House legislation (HR 839, introduced by then Congressman Portman and Congressman Cardin) had 304 co-sponsors.

Conclusion

The Housing Credit has a proven track record of success in producing affordable housing, is a unique fixture within the tax code that cannot readily be replaced by other public or private sources of capital. The corporate investors who will benefit from lower tax rates will not be negatively impacted by the elimination of these tax incentives, but lower income individuals and communities will. The scaling back or loss of this tax incentive would be felt immediately and could be irreversible. To this end, it should be the priority of Congress to preserve and strengthen these invaluable credits, and to support a new Neighborhood Homes Tax Credit to provide a needed incentive to spur homeownership in many of these same blighted communities.

Thank you for your consideration of our comments.

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