Statement in Response to the Senate Finance Committee's Request for Comments on Comprehensive Tax Reform

July 17, 2017

The Local Initiatives Support Corporation (LISC) is pleased to provide recommendations for the Committee's consideration as it begins the process of reforming the nation's tax code; recommendations which we believe will help to strengthen businesses, create jobs, remove impediments for investments, and put the economy on a better growth path.

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. Two of the most critical federal tools that support our efforts are the Low Income Housing Tax Credit (the Housing Credit) and the New Markets Tax Credit (NMTC). Since these programs were established in 1986 and 2000, respectively, they have become an integral component of efforts to support affordable housing development and, as importantly, the revitalization of economically distressed neighborhoods. Driven by the private sector, the federal investment in these programs by way of tax expenditures has paid strong dividends by sparking private sector investment in geographic areas that would otherwise be overlooked. Congress must act to preserve and strengthen these successful programs; to avoid doing so would have devastating and potentially irreversible effects on some of the nation's most underserved populations and communities.

In addition, and as described further below, Congress should 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. This is a critical market failure that cannot otherwise be addressed through either the LIHTC or NMTC programs.

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.

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

Background on the New Markets Tax Credit

Building off the success of the Housing Credit, the NMTC was launched in 2000 as the next generation community recovery tool. The NMTC provides an incentive in the form of a tax credit for investors to make equity investments in U.S. Treasury-certified Community Development Entities (CDEs), which in turn deploy the capital to support operating businesses, commercial real estate projects (including mixed-use, industrial, retail, manufacturing and office space), community facilities and for-sale housing in low-income communities throughout the country. The credit totals 39 percent of the investment amount and is claimed over a period of seven years. The Treasury Department awards these credits to CDEs annually through a national competition.

To date, over $44 billion has been invested in low-income communities through the NMTC Program. Through 2014, the NMTC Program has created or retained an estimated 275,000 jobs. It has also supported the construction of 37 million square feet of manufacturing space, 80 million square feet of office space, and 61 million square feet of retail space. For every $1 invested by the Federal government, the NMTC Program generates over $8 of private investment. Over 74 percent of New Markets Tax Credit investments have been made in highly distressed areas.[2]

LISC has placed $895 million of NMTC investments in 108 different businesses and real estate projects, supporting $2.5 billion in total project costs. These funds have helped to develop or rehabilitate 440 units of housing and 9 million square feet of commercial and community space, and have supported the creation or retention of 20,000 jobs.

NMTCs are the perfect tool to complement the work LISC has been doing in support of affordable housing. LISC believes that housing is just one component of vibrant communities; that residents also need to have access to good jobs, a thriving retail environment, and critical community services such as childcare, education, and health care. With NMTCs, LISC has revitalized commercial corridors and fueled commercial and retail jobs; funded new and expanded community facilities supporting jobs in the fields of education, healthcare and childcare; and redeveloped industrial brownfields to return land to productive use for offices, warehouses and new manufacturing ventures. There is also a wide range of construction jobs connected to developing all of these projects, which has been particularly critical given the decline of the building industry during the recent recession.

Success of the Tax Credits

The Housing Credit and the NMTC share similar design features, and have achieved tremendous success in financing housing, small businesses, commercial properties and community facilities in low income rural and urban communities throughout the country. Some of the more noteworthy characteristics that have led to the success of these credits include:

[2] "New Markets Tax Credit Program: Fact Sheet", CDFI Fund, Department of the Treasury

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.[3] A similar dynamic occurs with most NMTC projects, which are located in the nation's most severely distressed communities, and cannot access traditional sources of financing (e.g., former industrial sites in need of significant environmental remediation, community facilities with limited revenue streams). The GAO reported that an estimated 88 percent of NMTC investors said that they would not have made the same investment without the NMTC, and that 69 percent of investors had not previously made any investments in these communities.[4]

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.

   NMTCs support a broad range of community revitalization efforts, including: health care centers in medically underserved areas; public charter schools and childcare facilities; grocery stores in food deserts; athletic facilities that help restore dangerous, deteriorating parks; and manufacturing facilities that return good jobs to disinvested areas. LISC has funded these types of projects and many more office, retail and mixed-use facilities, as well as small and mid-sized businesses. Whatever the needs of the low-income community, LISC has used NMTCs to respond.

3. **The competition for credits produces better outcomes.** Both programs are dramatically oversubscribed. In 2014, NMTC applicants requested close to $20 billion in total allocation authority, though only $3.5 billion was available. 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 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.[5]

---

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

[4] "New Markets Tax Credit Program: Progress Made in Implementation, but Further Actions Need to Monitor Compliance", GAO 04-326, January 30, 2004

[5] U.S. Department of Housing and Urban Development, Office of Policy Development and Research, "Data on

- All NMTC investments must be made in qualifying low-income communities, but due to priorities instituted by the Treasury Department in the application process, approximately 74 percent of investments have been made in communities characterized by severe economic distress.

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.[6]

   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.** Treasury Department data demonstrates that at a minimum, NMTCs leverage $8 of investment for every one dollar of foregone tax revenue. 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.

The Credits are Unique within the Tax Code

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

1. **They spur 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. The Housing Credit and NMTC are unique in that they direct 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.

Tenants in LIHTC Units as of December 31, 2013" (2016)

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

2. **The benefits of the credit extend far beyond the investors to fulfill a broader public need.** The Housing Credit and NMTC directly fulfill 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 Credits or NMTCs does achieve a financial benefit in the form of reduced tax payments. However, the Housing Credit and NMTC are unique in that they are among the 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. 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; the business in the low-income community that can now get capital to expand its operations; and the community residents that now have access to health care, childcare or other important community services.

These factors, when taken in combination, suggest that were these credits to disappear, the consequences would be felt immediately and would likely be irreversible, because there would not likely be any kind of substitution for these investments. It is no exaggeration to say that:

- The market for developing affordable housing nationwide would crumble.
- There would be significant job losses, particularly in the construction and manufacturing industries.
- Homelessness would increase.
- Seniors on limited fixed incomes, low-income veterans, people with disabilities, farmworkers, entry-level retail employees, and many other populations would be much less likely to find an affordable home.
- Families would be forced to pay considerably more in rent, leaving far less available to be invested back into the economy.
- Many projects in low-income communities – including community facilities such as charter schools and health clinics – could not move forward.
- Catalytic development which often results from these investments would not occur, keeping low-income communities in economic distress.

Tax Reform Priorities

Housing Tax Credit

Protect and expand the current program. 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 hosing 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.

New Markets Tax Credit

The NMTC must be made a permanent part of the tax code. The NMTC will expire in 2019. As Congress considers making changes to the tax code, it needs to place a high priority on ensuring that this critical program is permanently authorized. With the certainty of permanent authorization, the competition for tax credits will become even stronger, as more CDEs invest the time and energy into participating in the program. This will lead to an even higher quality of business strategies and funded projects. Similarly, program permanency will also draw more investors to the program, which will result in higher pricing for the credit and, consequently, greater subsidy available for NMTC projects. This will enable more projects to be financed in distressed communities. Finally, with a permanent authorization, the Treasury Department could consider additional program improvements (such as larger, multi-year awards) that will add stability to an application process that currently cannot guarantee awards beyond a single year.

NMTC allocation authority should be increased to at least $5 billion annually. The program is dramatically over-subscribed at $3.5 billion. As a result, many highly qualified applicants to not receive awards, and many of those who receive awards receive amounts that are significantly lower than their requested amount. Increasing the allocation pool will enable more organizations to receive awards and/or to increase the size of awards made – both of which provide paths to spreading the benefits of the awards to more areas in the country.

Investors that are subject to the Alternative Minimum Tax (AMT) should be allowed to use NMTCs to offset tax liabilities. Unlike other investment tax credits –including the Housing

Credit and the Historic Tax Credit (HTC) – NMTC investments are not available to investors subject to the AMT. Providing an AMT exemption for NMTC investments would bring the NMTC in line with those other credits and open up the NMTC investor market to new investors, including high net worth individuals, community banks and corporate investors who are currently restrained by the AMT. Broadening the NMTC investor base would increase competition and efficiency, leading to better pricing, and driving even more subsidy to businesses operating in NMTC qualified communities.

All of these changes are included in The New Markets Tax Credit Extension Act (S.384), the bi-partisan legislation that has been introduced by Senator Blunt and Senator Cardin.

Neighborhood Homes Tax Credit

LISC, along with many other organizations, is calling for the creation of 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 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 that 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).[7]

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.[8] 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.[9]

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 and NMTCs. However, neither the Housing Credit, which was designed to create affordable rental housing for low- and very-low income families, nor NMTCs, which require investments of long-term patient capital, can 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.

---

[7] "One in Four U.S. Foreclosures are "Zombies" Vacated by Homeowner, Not Yet Repossessed By Foreclosing Lender." RealtyTrac. Feb 5 2015.
[8] http://www.communityprogress.net/filebin/CCP_BaltimoreTASP_Final_Report_102616.pdf
[9] 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.

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 and NMTC have a proven track record of success in producing affordable housing and spurring investments in the most distressed communities in the country and are unique fixtures 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 these tax incentives 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.

Matt Josephs
Senior Vice President for Policy, LISC
mjosephs@lisc.org