STATEMENT FOR THE HOUSE WAYS AND MEANS COMMITTEE
APRIL 25, 2013 HEARING ON TAX REFORM AND RESIDENTIAL REAL ESTATE

Submitted on May 9, 2013

As the largest national nonprofit support group in the country, LISC often relies upon support from federal programs to engage in the type of comprehensive community development work that is needed in low-income communities. The two most critical 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 the surrounding neighborhoods. Driven by the private sector, the federal investments made into these programs by way of tax expenditures have paid strong dividends by sparking equity investment in 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.

Background on LISC

Established in 1979, LISC is a national non-profit 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; local, statewide and national policy support; and technical and management assistance.

LISC has local programs in 31 cities, and partners with 58 different organizations serving rural communities 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

Both the Housing Credit and the NMTC are absolutely critical to our work in community development.

Background on the Housing Credit

Supported on a broad bipartisan basis and signed into law by President Reagan, 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 more than 2.5 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 1 million jobs in the construction and property management industries. It is the country's most successful affordable housing production program – currently financing approximately 90 percent of all affordable housing development.

LISC, through its subsidiary the National Equity Fund (NEF), is one of the nation's largest syndicators of Housing Credits. To date, NEF has secured over $10 billion of financing through the Housing Credit, leading to the development of 131,500 affordable rental homes in 45 states and spurring the creation of 160,000 new 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.

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 $31 billion dollars have been invested in low-income communities through the NMTC Program. Through 2011, according to the Treasury Department, $26 billion of NMTC investments supported the construction of 7,500 housing units, the development or rehabilitation of 109 million square feet of commercial real estate and community facilities, and the creation or preservation of close to 360,000 jobs.

LISC has placed $723 million of NMTC investments in 79 different businesses and real estate projects, helping to develop or rehabilitate 390 units of housing and 8 million square feet of commercial and community space, and supporting the creation or retention of 17,000 jobs.

With NMTCs, we have found the perfect tool to complement the work we've 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 very 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:

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. A similar dynamic occurs with most NMTC projects, which are not only located in the nation's most severely distressed communities, but also are projects that 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.

2. **The credits are responsive to locally determined needs.** The Housing Credits are allocated by state finance agencies, which determine 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 2012, NMTC applications topped $21.9 billion in requests for only $3.5 billion of investment authority. 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 at least 15 years after completion, but state allocating agencies generally do not approve projects unless they commit to at least 30 - 60 years of affordability.

    - Housing Credit units must be affordable to persons making less than 60 percent of area median income (AMI), but 42 percent of Housing Credit units are occupied by families making less than 30 percent of AMI and 80 percent are occupied by families making less than 50 percent of AMI.

    - All NMTC investments must be made in qualifying low-income communities, but due to priorities instituted by the Treasury Department in the application process, over 70 percent of investments have been made in communities characterized by <u>severe</u> 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 0.62 percent over the program's history.

    In addition, investors and developers – not taxpayers – assume the financial risks of these projects. If projects do not meet performance benchmarks over time, 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 fully occupied by low-income families with affordable rents and at federal property quality standards. 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 is not further their normal business operations; and (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 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 NTMCs does achieve a financial benefit. 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 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

Priorities for the 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 Secretary's of HUD (one a Democrat and one a Republican) and two former Senators (one a Democrat and one a Republican), recently released a report 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.

Make permanent the fixed rates for the 9% and 4% credits. There are two types of Housing Credits available to investors, both taken over a 10-year credit allowance period: the "9 percent credit", used for construction and substantial rehabilitation, which covers 90% of the project financing costs; and the "4 percent credit", used for acquisition of properties, which covers 40% of project acquisition costs. However, these credit rates of 9 percent and 4 percent are not fixed rates. They are based on a floating rate system that is tied to the US Treasury's borrowing rates, which are at historic lows. For May 2013, the 9% credit was worth 7.41%; and the 4% credit was worth 3.18%. These low rates reduce the credits that can be awarded to a property, resulting in less equity available for properties. This means that properties will have larger financing gaps to fill. As a result, some properties may not get funded at all, and others may not be able to target the very low income populations that require the deeper subsidies.

In response to the declining rates, the Housing and Economic Recovery Act of 2008 (HERA) set a temporary floor of 9 percent for the "9 percent credit", and this temporary floor has since been extended for allocations made through 2013. However, nothing has yet been done to provide a floor for the 4% credit. In order to preserve the value of the credits and to provide certainty to Housing Credit investors and developers, Congress should make a permanent fix to set a floor for both the 9% and 4% credits.

Priorities for the New Markets Tax Credit

The NMTC must be made a permanent part of the tax code. The NMTC is set to expire in 2013. 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.

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 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 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.

<u>Additional Consideration: Tax Subsidies for Homeownership</u>

The goals of tax reform are generally focused on simplifying the tax code, reducing tax rates, and encouraging economic growth, In order to achieve the goal of reducing tax rates, many credits and deductions would have to be scaled back significantly or eliminated altogether. For the reasons cited throughout, we are making the argument here that the Housing Credit and NMTC should not be scaled back, but rather should be preserved and strengthened.

However, much of the discussion at the April 25th hearing focused not on these credits, but on tax incentives for homeownership, such as the mortgage interest deduction. Unlike the Housing Credit and NMTC, these benefits are not targeted to low-income persons, and the beneficiaries in fact tend to be higher income tax filers. Given the increasingly widening gap between the demand for and supply of affordable housing units (according to the Joint Center for Housing Studies at Harvard University, the number of US households paying more than half of their incomes for housing rose by 2.3 million between 2007 and 2010, bringing the total to 20.2 million), and consistent with the recent findings of the Bipartisan Policy Center's Housing Commission, LISC believes that a portion of any revenues obtained by scaling back or otherwise modifying homeownership tax preferences should be devoted to expanding resources for rental housing programs for low-income populations. Such resources could be targeted, for example, to expanding the formula for allocating Housing Credits to state agencies; expanding the availability of Section 8 housing vouchers, or capitalizing the National Housing Trust Fund at HUD and the Capital Magnet Fund at the Department of the Treasury.

<u>Conclusion</u>

The Housing Credit and NMTC have proven invaluable to LISC's work around building sustainable communities. 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.

Thank you for your consideration of our comments.

Sincerely,

Matt Josephs
Senior Vice President for Policy

Local Initiatives Support Corporation (LISC)
Suite 1100, 1825 K St NW, Washington D.C. 20006
Telephone: (202) 739-9264
Email: mjosephs@lisc.org