Testimony On
"The Role of Tax Incentives in Affordable Housing"
Before the
Senate Finance Committee
by
Andrea Bell,
Director, Oregon Housing and Community Services

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Mr. Chairman, Ranking Member Crapo, and members of the Committee, thank you for this opportunity to testify on the vital role tax incentives—specifically the Low-Income Housing Tax Credit (Housing Credit) and tax-exempt private activity Housing Bonds—play in our nation's affordable housing delivery system. These programs are by far the most important tools we have to finance affordable rental housing and help low- and moderate-income families become home buyers.

I am Andrea Bell, director of Oregon Housing and Community Services (OHCS), which is the State of Oregon's Housing Finance Agency (HFA). HFAs are state-chartered, mission-driven agencies that address the full spectrum of affordable housing need, from homelessness to homeownership. For more than 50 years, HFAs have played a central role in the nation's affordable housing system, delivering more than $500 billion in financing to make possible the purchase, development, and rehabilitation of more than 7.5 million affordable homes.

OHCS administers the Housing Credit and Housing Bond programs, as well as other federal housing programs from the Department of Housing and Urban Development and state-level resources for affordable housing. During the Covid-19 pandemic, OHCS and many other HFAs also stood up federal emergency assistance programs, such as Emergency Rental Assistance and the Homeowner Assistance Fund. HFAs were able to do this because we are nimble and high-capacity organizations that have a strong track record of meeting multifaceted housing challenges.

I want to begin by thanking you, Mr. Chairman, for being a steadfast champion of the Housing Credit and Housing Bonds for many years and for continuously elevating the housing needs of Oregonians. In particular, we appreciate your vision for solving the affordable housing crisis, as outlined in the Decent, Safe, Affordable Housing for All (DASH) Act. I also want to thank you, Senator Crapo, for always being a supporter of state HFAs, and in particular for your support of tax-exempt Housing Bonds. Lastly, I want to acknowledge Senators Maria Cantwell (D-WA) and Todd Young (R-IL) for their leadership as the sponsors of the Affordable Housing Credit Improvement Act, S. 1136, passage of which is the most important thing Congress could do to address the imbalance between supply and demand for affordable rental housing.

The Central Role of the Housing Credit and Multifamily Housing Bonds

While HFAs administer various federal and state affordable housing programs, the Housing Credit and Housing Bonds are by far our most essential production tools. Few people who are not deeply entrenched in affordable housing policy understand that the federal government's most important housing supply programs are authorized under the tax code and not part of the annual appropriations process.

The Housing Credit is a highly successful public-private partnership that draws on state HFAs' sophisticated underwriting, asset management, and oversight capacity, as well as private-sector experience and investment. It is the most efficient means of increasing rental housing supply, while transferring risk to private-sector investors rather than taxpayers. Since the Credit's establishment in the Tax Reform Act of 1986, it has financed more than 3.6 million affordable rental homes for low-income families, seniors, veterans, and those with special needs.[1]

In recent years, more than half of Housing Credit homes have been financed with the help of multifamily Housing Bonds. In Oregon, multifamily Housing Bonds play an even more outsized role, as nearly 70 percent of all units we have financed in the state over the last five years are bond-financed. The Housing Credit and multifamily Housing Bonds are inextricably linked because of the role bonds play in triggering the 4 percent Credit.

While the Housing Credit program generally serves low-income working households earning 60 percent of area median income (AMI) or less, with congressional direction to serve the lowest income households possible, in practice the program reaches families with incomes much lower than its top-most statutory limits. In fact, 53 percent of households living in Housing Credit apartments are extremely low-income, meaning they earn 30 percent or less of AMI, and another 31 percent are very low-income, earning between 30 and 50 percent of AMI.[2]

There is a fundamental market failure when it comes to affordable housing supply. It simply costs too much to build housing to rent it at rates low-income people can afford absent a federal incentive such as the Credit. Developers will tell you that it is economically infeasible for them to build rental housing without the equity derived from the Credit unless they charge rents that are well out of the reach of low-income families.

Affordable Rental Housing Need in the Post-Pandemic Economy

America has been in the midst of a housing crisis for a long time, but never has the need been more acute than it is today. In particular, and especially since the Great Recession when many developers left the industry, our nation has drastically under-produced both rental and for-

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[1] *State HFA Factbook: 2020 NCSHA Annual Survey Results*, National Council of State Housing Agencies.
[2] *Tenants in LIHTC Units as of December 31, 2019*, U.S. Department of Housing and Urban Development, Office of Policy Development and Research.

sale housing. We are currently seeing the repercussions of the extreme mismatch between supply and demand.

Meanwhile, in the two-year period from early 2020 to early 2022, the number of households that rent grew by 1.1 million to 44.2 million.[3] With rising interest rates and escalating home prices, would-be homeowners are stuck renting at the same time millennials, many of whom put off household formation, are now entering the rental market.

The sheer number of new renters, without corresponding housing production, has driven historically low vacancy rates and skyrocketing rents, with rents in most major markets spiking by double digits between 2021 and 2022.[4]

While these market dynamics create hardships for renters across the income spectrum, low-income households are by far the most vulnerable. There is currently a shortage of more than seven million affordable rental homes for extremely low-income renters, with only 37 affordable and available units for every 100 extremely low-income renter households nationwide. Moreover, more than 70 percent of extremely low-income renters spent more than half their income on housing in 2021.[5] Sadly, Oregon is even less affordable than the national average.

The housing market in Oregon clearly demonstrates the challenges renters face due to basic supply-and-demand economics. Since the Great Recession, Oregon has underproduced at least 140,000 homes. More than 584,000 homes are needed to meet our state's population growth over the next 20 years. Even more telling, nearly half of those homes must be built affordable to low-income Oregonians. The data is staggering: Oregon must increase housing production two-fold to address supply shortfalls and three-fold to address affordable housing supply needs.[6] Without action to increase or improve affordable housing production resources, Oregon and other states will continue to see rates of homelessness rise.

Barriers to Affordable Housing Production

Unfortunately, the economic fallout of the Covid-19 pandemic has made it even harder to produce affordable rental housing. The costs of many commodities necessary for construction have gone up drastically, while supply chain disruptions create development delays that further increase costs, and developers struggle to find skilled workers and subcontractors.

According to the National Association of Home Builders, since Spring 2020, prices have gone up for lumber by 75 percent, steel by 107 percent, gypsum and drywall by 32 percent, ready-

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[3] *The State of the Nation's Housing 2022*, Joint Center for Housing Studies of Harvard University, June 2022.
[4] Ibid
[5] *The Gap: A Shortage of Affordable Homes*, The National Low Income Housing Coalition, April 2022.
[6] *Building on New Ground: Meeting Oregon's Housing Need*, Oregon Housing and Community Services and ECONorthwest, February 2021.

mix concrete by 11 percent, interior paint by 33 percent, exterior paint by 48 percent, aluminum by 61 percent, and copper by 57 percent.[7]

Despite the vast and growing need and the escalating costs of production, the Housing Credit has actually suffered a cut to resources. A hard-won increase in Housing Credit resources, which Senator Cantwell was instrumental in achieving in 2018, expired at the end of 2021. That means state HFAs have fewer Credits to provide to developers this year, at a time when their costs have gone up so substantially and demand is unprecedented.

Costs are rising so quickly that projects in the pipeline must be re-underwritten, sometime several times, before completion to address financing gaps. This has caused tremendous problems as states and their developer partners try to find creative ways of filling these unexpected, gaping holes in project financing.

In some cases, developers of projects that were initially provided Credits in prior years are coming back to the HFA asking for a subsequent allocation of Credits from the state's 2022 authority. But by backfilling older deals, it means the state will have far less Credit authority with which to fund new proposals.

Unfortunately, sometimes the gaps are too large or additional resources are not available, forcing many quality developments to scale back unit production.

Another reason cost increases are particularly problematic is that bond-financed projects that see significant cost increases risk missing the threshold requirement for maximizing Housing Credit resources. A bond-financed property must have at least 50 percent of its costs financed with tax-exempt multifamily bonds to access a sufficient amount of Housing Credit authority as an equity source. We typically provide some cushion to those deals to account for potential cost increases. However, with prices going up as quickly as they are, some projects risk failing this threshold test, which is devastating, even if the developer is fortunate enough to be able to assemble other financing sources to fill the gap. This is particularly problematic in states like Oregon where bond cap is in very high demand and we often do not have excess bond cap to provide a project if its costs go up too much.

Congressional Action to Address the Rental Housing Crisis

The federal government has delayed far too long in taking the steps our nation needs to address the housing crisis. We are now seeing the repercussions of that delay in rapidly escalating rents, and it is our most vulnerable residents who pay the price.

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[7] Eye on Housing blog post: "Rapidly Rising Building Materials and Freight Prices Push Construction Costs Higher," National Association of Home Builders, June 2022.

Many states, including Oregon, have already stepped in with significant investments in affordable housing. I am proud that our state has nearly tripled affordable housing investments biennium over biennium, investing in proven and promising practices to support the stabilization of families making low wages. But states cannot solve this problem without the help of the federal government.

The good news is, we know what works and we have the right tools in hand. By far, the most impactful thing Congress could do to meet the need is to pass Senator Cantwell and Senator Young's Affordable Housing Credit Improvement Act (AHCIA). Half of this Committee has already cosponsored the bill, and I urge all who have not yet done so to do it now.

The AHCIA is comprehensive legislation that would expand and strengthen the Housing Credit. While it includes many policy changes—some of which are no-cost, commonsense, good governance improvements based on over three decades of program administration—I'd like to focus on how the bill would expand the Housing Credit, as these are the provisions that add supply.

The AHCIA would make a significant increase in Housing Credit allocation authority for what we call the 9 percent Housing Credit. The 9 percent Credit is the component of the program that provides the more substantial subsidy to developments. These Credits are highly competitive, and states often use them to finance the most challenging and needed properties for the highest-risk populations. For example, last week in Oregon, we celebrated the opening of River Bend Place in rural Ontario, a new development funded with the 9 percent Credit. Fifty-six new doors are open, and 16 homes will have wrap-around services to help permanently house Oregonians experiencing chronic homelessness.

The other major provision in this legislation that would substantially increase supply is the reduction of the bond financing threshold, sometimes called the 50 percent test. For Oregon, this is probably the most impactful action Congress could take to increase supply as we continue to leverage historic state resources and locally funded housing bonds approved by Metro voters. As I mentioned previously, developments that are funded with tax-exempt multifamily Housing Bonds can generate what we call 4 percent Housing Credits. The 4 percent Credit provides less subsidy than the 9 percent Credit, but is an essential tool for financing affordable housing. In fact, in 2020, nearly 60 percent of Housing Credit homes nationwide were financed with 4 percent Credits.

To maximize the 4 percent Credit equity available to an individual deal, multifamily bonds must be used to cover at least 50 percent of the cost of the development. That means states need to make a significant investment of their finite Private Activity Bond (PAB) resources in individual developments in order to unlock the 4 percent Credits. More and more states are like Oregon, which has far more demand for PAB cap than we have available. According to research by Novogradac and Tiber Hudson, 22 states were oversubscribed for PAB cap as of May 2022.

Moreover, covering at least 50 percent of a project's total cost with multifamily bonds makes no sense from a financing perspective. Bonds provide debt, but these projects cannot support that much debt over the long run. What happens in practice is that we provide bonds sufficient to meet the 50 percent test just to trigger the 4 percent Credits. Then, the developer must refinance the project, paying off the bond debt, to put in place permanent financing with a much lower debt level that the project can reasonably support. This practice is inefficient, adds cost, and prevents states from spreading bond resources to more quality affordable housing projects.

The AHCIA would lower the bond financing threshold to 25 percent, which is much more in line with the amount of debt these projects could support. According to an estimate by Novogradac that considered the time-limited reduction in the bond financing threshold included in the Finance Committee's initial proposal for the Build Back Better Act, Oregon would be able to finance 11,200 more homes over a 10-year period if Congress made this change. It is this type of commonsense reform to Housing Credits that will allow Oregon and other states to dramatically scale production to address supply challenges.

The AHCIA also includes other provisions that would increase production by providing basis boosts for properties in rural areas, those benefiting tribal populations, and those housing extremely low-income households, as well as expanding the number of areas where basis boosts are allowed because the area qualifies as a Qualified Census Tract or Difficult Development Area. The AHCIA also gives states discretion to provide a 30 percent boost to 4 percent Credit properties as needed for financial feasibility.

Another step Congress should take to address the immediate housing cost challenges we face is passing the bipartisan LIHTC Financing Enabling Long-term Investment in Neighborhood Excellence (LIFELINE) Act, S. 4181, introduced by Senators Patrick Leahy (D-VT) and Susan Collins (R-ME).

Approximately half of states and countless local governments have turned to the Coronavirus State and Local Fiscal Recovery Fund (FRF) as a source of funds that could be used to fill financing gaps in Housing Credit developments, but there are significant challenges to using FRF money effectively for long-term loans to Housing Credit developments due to unintended statutory barriers. The LIFELINE Act would fix the problem by allowing these funds, which Congress has already allocated to states and local governments, to be used for loans with maturities of at least 30 years.

While FRF is not a tax incentive, the Finance Committee has jurisdiction over these funds, and I strongly encourage all Committee members to join Chairman Wyden as cosponsors of this bill and to press for its enactment.

The Housing Crisis Is Impacting Homeownership Opportunities, Too

Our nation's critical affordable housing shortage is not limited to rental housing. According to a recent analysis by Freddie Mac, the United States would need to construct nearly 3.8 million for-ownership homes to meet demand.[8] Insufficient supply has substantially increased sale prices of single-family homes, pricing many working families out of the market. Moreover, recent dramatic increases in mortgage interest rates have exacerbated affordability challenges. It now costs a home buyer 50 percent more to buy a home than it would have to purchase the same home a year ago,[9] putting homeownership out of reach for many households.

Another significant challenge facing low- and moderate-income households seeking to become homeowners is the lack of starter homes on the market. For some time, builders have reported that building smaller homes is cost prohibitive, therefore most new construction is of larger luxury homes because that's the only way for developers to make the economy of scale work. The average sale price for a new home in May was $511,400, up 15 percent from just a year ago.[10] Only nine percent of new homes sold that month were priced under $300,000, compared to around 30 percent in January 2021.[11] Moreover, development costs for single-family homes are also subject to the same market dynamics as multifamily production, including significant inflation of common construction materials, supply chain delays, and workforce disruptions.

These market developments have made it harder to address the long-standing homeownership gap between white households and households of color. In 2020, 72.1 percent of white households owned their home, compared to 61.7 percent of Asian American households, 51.1 percent of Hispanic American households, and 43.3 percent of African American households.[12]

A recent study found that, in each of the nation's 50 largest metro areas, African American residents own a disproportionately small share of homes compared with their population.[13] One of the biggest factors historically preventing minority families from purchasing a home is a lack of accumulated wealth compared to white households, a legacy of our nation's discriminatory redline policies. The current surge in pricing has worsened these disparities by making it even harder for minority households to amass the necessary savings to pay for the upfront costs of purchasing a home. While state HFA down payment assistance programs offer an affordable and sustainable option for such borrowers, we need a more comprehensive solution that helps increase supply and improve other homeownership tools.

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[8] *One of the Most Important Challenges Our Industry Will Face: The Significant Shortage of Starter Ho*mes, Sam Kater, Freddie Mac, April 2021.

[9] *The Cost of Buying a Home Is Up 50% From a Year Ago—But Here's Where You Could Get a Break*, Clare Trapasso, Realtor.com, May 16, 2022.

[10] *Monthly New Residential Sales, May 2002*, US Census Bureau, June 24, 2022.

[11] Ibid

[12] *2022 Snapshot of Race and Home Buying in America*, National Association of REALTORS®, February 2022.

[13] *Black Americans Own Disproportionately Small Share of Homes in 50 Largest U.S. Metros*, Jacob Channel, Lending Tree, April 5, 2022.

A healthy and affordable home purchase market is crucial for economic growth. Homeownership is many working families' primary means of building generational wealth. Further, an active home purchase market would open up more rental opportunities for those wishing to rent as new home buyers leave their apartments.

Congressional Action to Address the Needs of Homeowners

While addressing these issues will take concerted and multifaceted action, there are two legislative proposals the Finance Committee can take up in this Congress to expand the supply of affordable homes and improve access to homeownership for low- and moderate-income home buyers. These are the Affordable Housing Bond Enhancement Act, S. 4445, and the Neighborhood Homes Investment Act, S. 98.

I want to thank Committee member Senator Catherine Cortez Masto (D-NV) for introducing the Affordable Housing Bond Enhancement Act (AHBEA) last month. This important bill would enact simple and impactful improvements to two essential tax incentives that help first-time low- and moderate-income home buyers: the Mortgage Revenue Bond (MRB) and Mortgage Credit Certificate (MCC) programs.

MRBs historically have been HFAs' primary tool for financing low-interest mortgages for low- and moderate-income home buyers. Investors are willing to accept a lower rate of return for Housing Bonds than they would get on other investments because the interest on the bonds is exempt from federal income tax. The lower rate is then passed on to lower the interest rate paid by lower-income home buyers.

In total, MRBs have helped more than 3.3 million working households become home buyers. The median income of MRB loan borrowers in 2020 was two-thirds of the national median income. OHCS utilized MRBs to help more than 430 Oregon families across 29 counties achieve the dream of homeownership in calendar year 2021, supporting more than $116 million in loans for low- and moderate-income home buyers.

In addition, HFAs can use their MRB authority to issue Mortgage Credit Certificates, which provide a nonrefundable federal income tax credit for part of the mortgage interest qualified home buyers pay each year. State HFAs have used MCCs to provide critical tax relief to more than 365,000 families.

AHBEA would improve MRBs and MCCs by, among other changes:

- Increasing the MRB home improvement loan limit;
- Allowing MRBs to be used for refinancing loans;
- Providing HFAs additional flexibility in how they utilize housing bond authority;
- Simplifying how a borrower's MCC benefit is calculated;

- Reducing the time period for the MRB and MCC recapture tax from nine years to five;
- Extending the amount of time HFAs can use converted MCC authority from two years to four; and
- Allowing HFAs to reconvert MCC authority back into MRBs two years after the conversion, rather than one.

This legislation is a cost-effective way to improve the MRB and MCC programs. I urge all Committee members to cosponsor this legislation.

Lastly, I'd like to express our support for the Neighborhood Homes Investment Act (NHIA), introduced by Committee members Senators Ben Cardin (D-MD) and Rob Portman (R-OH). In many census tracts and rural areas, developers cannot sell homes for what it costs to construct or substantially rehabilitate them, known as the "value gap." This is a problem for which we currently do not have a solution. We need a new tool in our arsenal.

The NHIA would establish a new tax credit, the Neighborhood Homes Credit, modeled after the highly successful Housing Credit. It would incentivize developers to construct new or substantially rehabilitate housing by closing the value gap, up to 35 percent of eligible development costs. It is estimated that the equity raised by the Neighborhood Homes Credit would finance the building and substantial rehabilitation of 500,000 affordable homes for low- and moderate-income homeowners over the next 10 years.

Thank you, Chairman Wyden, for including the Neighborhood Homes Credit in your DASH Act and working with OHCS to allow the credit to more effectively be used to assist homeowners impacted by natural disasters.

I encourage the Committee to take up and advance both of these bills as quickly as possible.

The housing crisis will not get better unless Congress acts. Enactment of the four bills I've addressed in this testimony—The Affordable Housing Credit Improvement Act, the LIFELINE Act, the Affordable Housing Bond Enhancement Act, and the Neighborhood Homes Investment Act—would truly address the affordable housing crisis for both renters and homeowners. OHCS and all HFAs, through our national association, the National Council of State Housing Agencies, urge the Committee to act on these bills and Congress as a whole to enact them this year.

Thank you for your commendable efforts to support affordable housing. I am honored to have had this opportunity to testify before the Committee.