Statement of the
National Council of State Housing Agencies
to the Senate Finance Committee's
Community Development and Infrastructure Working Group
in Support of Preserving and Strengthening the Low Income Housing Tax Credit and
Tax-Exempt Private Activity Housing Bond Programs

April 15, 2015

On behalf of our Housing Finance Agency (HFA) members, the National Council of State Housing Agencies (NCSHA) appreciates this opportunity to provide comments to the Senate Finance Committee's Community Development and Infrastructure Working Group for its consideration as it develops recommendations to inform the Committee's tax reform efforts. Our comments focus on the Low Income Housing Tax Credit (Housing Credit) and tax-exempt private activity Housing Bond (Housing Bond) programs, which HFAs administer in virtually every state. These programs are essential to our nation's ability to develop affordable rental housing and provide homeownership opportunities to people of modest means.

NCSHA's members are the HFAs of the 50 states, the District of Columbia, New York City, Puerto Rico, and the U.S. Virgin Islands. HFAs effectively employ the Housing Credit and Housing Bonds, entrusted by Congress to state administration, to advance their common public-purpose mission of providing affordable housing to the people of their jurisdictions who need it. These indispensable financing tools contribute more significantly to HFA efforts to create housing, community, and economic opportunity than any other federal housing resources.

Build on What Works to Address Growing Need

Congress is embarking upon one of the most significant and challenging endeavors of recent decades—reform of the federal tax code. There is bipartisan agreement that the current system is outdated, overly complicated, and inadequately structured to promote economic growth.

NCSHA understands the need to examine all aspects of the current tax system to determine which provisions work as Congress intended and continue to address pressing concerns and those that no longer belong in a 21st century, streamlined tax system.

The use of the tax code to provide affordable housing—both through the production and preservation of affordable rental properties with the Housing Credit and multifamily Housing Bonds and through the provision of lower-cost mortgages for working families with single-family Housing Bonds (under the Mortgage Revenue Bond (MRB) and Mortgage Credit

Certificate (MCC) programs)—has been one of the singular successes of the current system. The Housing Credit and Housing Bond programs are highly successful public-private partnerships that combine state HFAs' sophisticated underwriting and asset management capacity with private sector ingenuity, expertise, oversight, and vigilance. Without question, the Housing Credit and Housing Bonds are the most effective means of targeting limited affordable housing resources to the people and places that need them, while transferring risk to private sector investors.

Most importantly, the Housing Credit and Housing Bond programs make immeasurable investments in people and places. They transform lives by creating quality and sustainable living environments that lift up families; help children thrive; support seniors, people with special needs, and veterans; and permanently house persons experiencing homelessness. They contribute to community revitalization by inspiring business growth, infrastructure advances, transportation solutions, and much more.

Unfortunately, while the Housing Credit and Housing Bond programs are extraordinarily successful, the resources devoted to them are woefully insufficient to meet the nation's affordable housing need, which is great and growing. In fact, we are losing ground in this battle as needs grow and resources shrink at rapid rates.

Currently, 41 million U.S. households—more than one in three—pay an excessive share of their income for housing. The crisis is most acute for those earning the least. Of those households with incomes of $15,000 or less annually—approximately equivalent to working full-time at the minimum wage—four in five pay more than 30 percent of their income for housing. Two-thirds pay over 50 percent. This leaves little money left over for other critical necessities like food, transportation, childcare, healthcare, and utilities.

The housing crisis affects both homeowners and renters. Low- and moderate-income families face significant challenges as they seek to achieve homeownership. Even as the housing market strengthens, many creditworthy home buyers, especially first-time buyers, struggle to obtain mortgages they can afford. According to the National Association of Realtors, first-time home buyers currently account for just 33 percent of all home buyers, their lowest share of the market since 1987.

As more and more people turn to the rental market, they find a severe shortage of affordable homes. Those available to extremely low-income (ELI) households, those earning 30 percent or less of Area Median Income (AMI), are especially scarce. Since 2000, the rental housing shortfall for ELI renters—measured as the gap between the number of ELI renters and the number of units available and affordable to them—has grown by 55 percent. The rental shortage is exacerbated as hundreds of thousands of new renter households enter the market each year, while the nation loses countless affordable units from the housing stock due to conversion to market rate rentals or condominiums, demolition, or obsolescence.

Preserve and Expand the Housing Credit

As you consider changes to the current tax structure, NCSHA urges you to use this opportunity to build on what works, not only by preserving the Housing Credit and Housing Bond programs, but also by expanding Housing Credit resources so that we can better address the nation's severe affordable rental housing shortage. We know that Congress faces extraordinary pressure as it directs limited federal resources to so many priorities. However, we strongly believe that investing new resources in the Housing Credit makes sense, even in this time of budget austerity.

The Bipartisan Policy Center's (BPC) Housing Commission, after extensively analyzing all aspects of federal housing policy, recommended increasing Housing Credit authority by 50 percent in response to the significant and growing need for affordable rental housing. This politically diverse, well-respected Commission, chaired by two former U.S. senators, one former HUD secretary, and one who has held both of these distinguished roles, unanimously recommended this increase in Credit resources.

Congress last acted to increase Housing Credit authority 15 years ago. At that time, Congress instituted a phased-in cap increase and established an annual inflation adjustment factor. Unfortunately, the cap increase was insufficient then to meet the affordable housing rental need and annual inflation adjustments since have not kept pace with the ever-growing need for affordable rental housing.

Each year, state Housing Credit allocating agencies receive applications requesting nearly three times as much Housing Credit resources as the agencies have to allocate. Yet even this does not quantify the extent to which demand for affordable rental housing outstrips the supply of Credits, as many developers with worthwhile projects do not even bother applying because the competition for Credits is so fierce.

As the nation's HUD-financed affordable housing stock ages, even more demands are being placed on the Housing Credit to preserve these properties, in which the American taxpayer has invested considerable resources over decades. Just a few months ago, Congress tripled the size of the Rental Assistance Demonstration (RAD) program, which allows the conversion of targeted public housing and other HUD-subsidized rental housing to project-based Section 8, in the hopes of attracting private capital for critically needed repairs. The success of the RAD program is dependent on the Housing Credit as RAD's primary capital source. Yet these newly eligible RAD units will need to compete against much needed new construction properties and other preservation projects for a very limited pool of Housing Credits under current cap constraints.

State Housing Credit allocating agencies face difficult choices—not just whether to direct their limited Credit resources to preservation as opposed to new construction, but also whether to assign them to rural rather than urban areas or to neighborhood revitalization rather than to projects in high-opportunity areas. Agencies must balance whether to finance supportive housing for persons experiencing homelessness against assisted living for the elderly, housing for needy families, and projects for veterans—all of which serve populations with extraordinary housing and service needs. Housing Credit authority is simply inadequate to fund all of the worthy developments that are so needed.

To more effectively respond to the enormous affordable rental housing need, NCSHA recommends Congress increase Housing Credit authority by at least 50 percent annually, as the BPC's Housing Commission recommended. Given budget constraints, Congress could achieve this increase over time, on a phased-in basis. It could also provide a portion of this increase by allowing states at their discretion to convert some portion of their private activity bond authority to Credit authority, as the Administration has recommended. We caution Congress, however, that as Federal Reserve policies to suppress interest rates are lifted and interest rates rise, the demand for housing and other bonds will increase, making the conversion of bond to Housing Credit authority a far less attractive option for states. As Congress knows, Housing Bonds historically, like the Housing Credit, have been significantly oversubscribed and grossly inadequate to meet states' need for affordable homeownership and rental housing.

Protect and Strengthen the Housing Credit

The Housing Credit was born out of the last successful tax overhaul, the Tax Reform Act of 1986. Since then, the Credit has evolved significantly, as Congress has worked with the states and other industry stakeholders to strengthen and simplify its statutory regime. Tax reform presents another opportunity to make further changes to the program that could make it work even more effectively. NCSHA and our HFA members stand ready to work with Congress to adjust the Housing Credit program further, in ways that enhance its capabilities. As the administrators of the program, HFAs also have the on-the-ground experience and expertise to help Congress sidestep pitfalls and unintended negative repercussions that could accompany program simplification.

Set Minimum 9 percent and 4 percent Housing Credit Rates

NCSHA strongly urges Congress to set permanent minimum 9 percent and 4 percent Housing Credit rates so that state Credit underwriting would be no longer subject to the floating rate system. Under the current statute, Housing Credit rates change monthly based on Treasury rates. Low interest rate environments, like the one we are currently experiencing, drive Housing Credit rates down, reducing the amount of Housing Credit equity available for individual housing developments.

In 2008, in response to the need to provide flexibility to HFAs and give greater certainty to investors, Congress adopted a temporary change to the program to prevent the Credit rate from dropping below 9 percent. This modification improved the program by simplifying its administration and giving HFAs new flexibility to ensure that worthwhile projects could overcome a funding gap. Based on that success, Congress has twice extended the 9 percent minimum Credit rate. However, the change expired at the end of 2014, leaving the Housing Credit again subject to the floating rate system. Permanently setting a minimum 9 percent Credit rate would provide lasting benefit to the program at little to no cost. NCSHA further urges Congress to set a minimum 4 percent Credit rate for acquisition and for Credits used in tax-exempt bond-financed projects.

It is important to keep in mind that HFAs are mandated under the Housing Credit statute to provide no more Credit than necessary to make each development feasible over the long-term as affordable housing. Regardless of the amount of Housing Credit equity for which a property may be eligible, HFAs can only provide the amount necessary to ensure the property's financial feasibility. HFAs take this responsibility seriously, as it is the law and it is in their interest to stretch Credit resources as far as possible, while maintaining responsible underwriting standards and meeting priority affordable housing needs.

Provide States More Discretion to Employ Basis Boost

Over the years, Congress has made several modifications to the Housing Credit program to allow states greater flexibility to increase Credit amounts in individual developments to achieve their feasibility. First, Congress recognized the challenges of building affordable housing in certain areas and modified the Credit program to allow states to provide a basis boost to developments located in HUD-designated Difficult to Develop Areas and Qualified Census Tracts. In a later adaptation to the program, Congress gave HFAs the discretion to give a basis boost to 9 percent Housing Credit developments regardless of their location, so long as the state finds that the basis boost is necessary for the project's financial feasibility and to meet state-determined priority needs.

NCSHA encourages Congress to not only maintain this flexibility, but also to expand it by providing states the discretion to provide a basis boost to 4 percent Housing Credit properties financed with tax-exempt bonds, if they determine it is necessary to achieve their financial feasibility.

Broaden Access for Working Families and Extremely Low-Income Households

NCSHA encourages Congress to modify the Housing Credit's income eligibility rules to allow states at their discretion to expand access to Credit properties to low-income working families (with incomes no greater than 80 percent of AMI) in order to use the additional rental income generated from those units to cross-subsidize other units in the same property that are reserved for and affordable to ELI households. The average income limit for the property would be required to remain at 60 percent of AMI or less.

Currently, to be eligible for a Housing Credit apartment, a household must have an income of 60 percent of AMI or less. However, many Housing Credit tenants have incomes that are far below the program's income limits. Without rental assistance, which has become increasingly scarce, these households may pay more than 30 percent of their income for rent. By allowing cross-subsidization through income-averaging, states would have the ability to finance properties that include units reserved for and affordable to ELI households while maintaining an average income level of no more than 60 percent of AMI. In addition to serving more ELI households, this proposal would allow states to serve low-income households in need of affordable housing who earn too much to be eligible to live in Credit properties under the program's current income requirements. In some areas, for example, families with two full-time minimum wage workers exceed the 60 percent of AMI limit, making them ineligible to reside in a Housing Credit apartment.

Standardize Rural Income Limit Rules

NCSHA encourages Congress to standardize the tenant income limit rules for Housing Credit projects in rural areas, regardless of whether or not those projects are tax-exempt bond-financed. The Housing and Economic Recovery Act (HERA) of 2008 made Credit projects that do not use tax-exempt bond financing more feasible in rural areas by basing the income limit requirements for those properties on the greater of the area median gross income and the national nonmetropolitan median income. Prior to enactment of HERA, income limits for all projects, regardless of location and whether bond financing was used, were based on the median income for the area in which the project was located. Congress should extend the more flexible income limit standard adopted in HERA to tax-exempt bond-financed properties located in rural areas.

Retain Acquisition as an Eligible Activity

Congress wisely and with great foresight designed the Housing Credit to achieve a limited but important and appropriate set of federally established, public-purpose goals and imperatives, through, for example, income and affordability rules. It left to the states how to utilize their resources within these broad parameters to respond most effectively to their unique affordable housing needs. As such, HFAs have the flexibility to use the Housing Credit for various activities, ranging from new construction to substantial rehabilitation to the acquisition and rehabilitation of properties. In designing the Housing Credit, Congress recognized that acquisition can be an important use of finite resources, but it limited that activity to the 4 percent Credit. This system has worked well over the Housing Credit's nearly 30-year track record. NCSHA urges Congress not to restrict states' use of the Housing Credit by eliminating acquisition as an eligible activity. Acquisition is critical to preservation and community revitalization efforts, and in some cases, is the best use of scarce resources.

<u>Preserve the National Pool</u>

Lastly, NCSHA urges Congress to maintain the "National Pool," so unused Housing Credit resources are not lost and can be directed to states that can utilize them. In some years, a handful of HFAs do not allocate a small percentage of their Housing Credit authority for various reasons, such as isolated instances of reduced demand or disruptions in the construction cycle following natural disasters or other uncontrollable events. At the same time, the vast majority of their sister agencies have far more worthwhile proposals for developments than they are able to fund with their limited resources. Rather than lose the unallocated Credits, Congress designed a system under which any unallocated Credits are redistributed to other states that have used their entire allocation and apply to the national pool for additional resources. NCSHA encourages Congress to preserve this strategy for ensuring that Housing Credit resources are used for their intended purpose.

Preserve the Tax-Exempt Private Activity Housing Bond Program

For decades, the Housing Bond program—multifamily bonds for financing affordable rental housing and the MRB and MCC programs for financing affordable first-time, modest home purchases—has been essential and successful tool in our affordable housing efforts. While these bonds are private activity bonds, Congress deemed that the affordable housing they make possible is worthy of a tax exemption, not just because of the direct housing benefits these bonds provide but also because of the positive effects the housing opportunities they create have more broadly, on families, communities, and the economy.

Multifamily Housing Bonds finance a significant portion of all affordable rental housing produced annually, including Housing Credit developments. The Housing Credit program allows states to couple Housing Bond financing with 4 percent Credits; these Credits are not subject to the Credit cap, since the bond authority is capped. Developments financed with Housing Bonds and the 4 percent Credit account for approximately 40 percent of all Housing Credit production annually. Much of this activity supports the preservation of affordable rental homes.

HFAs also use multifamily Housing Bond financing on its own and in conjunction with other housing resources, such as project-based Section 8, HOME Investment Partnerships program funds, and homeless assistance, to construct and rehabilitate affordable rental housing.

For decades, MRBs have represented about the only hope for credit-worthy families with modest incomes and limited resources to achieve homeownership. HFAs have used MRBs to provide low-cost mortgages to millions of responsible low- and moderate-income first-time home buyers. HFAs often combine down payment assistance with MRB loans.

HFA single-family loan performance is strong, long noted for its low delinquency and default rates. HFAs have never engaged in subprime or other risky lending. Through a time-tested combination of low-cost, generally fixed-rate, long-term financing; prudent underwriting; careful credit evaluation; thorough loan documentation; home buyer counseling; down payment assistance; and proactive servicing, HFAs have proven over many years that homeownership for lower income families is achievable and sustainable.

HFAs apply the same rigor in their multifamily development evaluation and underwriting as they do in their single-family work with similar success. Default and foreclosure rates on Housing Credit and Housing Bond-financed rental housing developments are very low. In fact, a December 2012 study by CohnReznick LLP, a major accounting, tax, and advisory firm, found the Housing Credit property default rate to be less than 1 percent.

While the housing market is strengthening, stringent lending standards and competition from investors for lower-cost homes are preventing many lower income families from purchasing their first homes. Fewer entry-level home buyers will hold back the market's still fragile recovery by making it difficult for "move-up" buyers to sell their homes. In this tough market, MRB loans have a vital role to play in spurring the first-time home buyer and the overall housing markets.

Though the Housing Bond market has not fully recovered from the financial, housing, and broader economic crises of recent years, it is strengthening. However, if one thing is certain, it is that interest rates will not remain at the historic lows we have seen in recent years. As they begin to rise, the tax-exemption afforded to Housing Bonds will become more critical. Already, rates are inching back up, while incomes remain mostly flat. With that rise in rates, we are seeing the beginning of the recovery in the Housing Bond programs.

While still well below the highs seen before the recession, HFA usage of private activity bond volume cap for Housing Bonds has increased remarkably in recent years, rising by over 43 percent between 2009 and 2013. In multifamily issuance, for example, we are seeing a resurgence in the use of Housing Bonds to finance 4 percent Housing Credit developments, which adds significantly to Housing Credit production overall, as discussed earlier.

Finally, HFAs are working diligently with their partners to come up with creative and attractive new ways to utilize Housing Bond authority for the affordable housing purposes Congress intended, including using Housing Bonds to support mortgage-backed security lending platforms that use the latest homeownership financing techniques and respond better to today's investors' interests, including taking advantage of the To Be Announced market.

Modify the Housing Bond Program to Enhance Performance

NCSHA recommends Congress take a few modest steps to make the highly successful Housing Bond program even more effective. With tax reform, Congress has the opportunity to further strengthen Housing Bonds by making low or no cost changes to eliminate outdated rules and to give states more flexibility to respond to their unique needs and circumstances. For example, within the MRB program, the purchase price limit is no longer needed, as the income limits Congress later imposed much more effectively control the price of homes MRB borrowers can purchase. The considerable resources HUD and Treasury expend coming up with the purchase price limits annually could be deployed elsewhere.

In addition, the MRB home improvement loan program, especially important now given the repair needs of foreclosed properties and the home maintenance families were forced to defer during the recession, would be much more useful if Congress increases its loan limit of $15,000 by an amount at least adequate to reflect the rise in construction costs since it was first established in 1980 and indexes that limit to keep up with construction cost inflation annually. We also urge Congress, as it did on a temporary basis from 2008 through 2010, to allow state HFAs to use MRBs for refinancing, so state HFAs can help otherwise qualified borrowers.

We also urge you to adopt proposals that would improve investor interest in the Housing Bond program. For example, NCSHA supports exempting interest earned on refunding Housing Bonds from the Alternative Minimum Tax. Conversely, we urge you to resist proposals that would undermine investor interest in Housing Bonds. We are very concerned, for example, that the proposal the Administration has made again in its most recent budget to limit the value of tax deductions, including municipal bond interest, to the 28 percent tax rate would greatly diminish the value of Housing Bonds investments and, consequently, investor interest in them.

In addition, we have several suggestions for simplifying the MCC program, which the tax code provides as an alternative to MRBs and which states utilize more when the Housing Bond rate advantage is limited, as it is currently. MCCs help lower-income families afford homeownership by allowing first-time home buyers who meet the MRB program's income requirements to claim a dollar-for-dollar tax credit for a portion of the mortgage interest they pay each year, up to $2,000.

We also urge you to simplify the MCC calculation; permit HFAs to recycle MCCs, as you allow them to recycle Housing Bonds; provide HFAs the flexibility to shorten the MCC term and/or "front load" its benefits; eliminate the $2,000 annual credit cap on MCC benefits; and provide HFAs the flexibility to structure the MCC assistance to respond to diverse home buyer needs. We would be happy to provide further detail on any of these proposals.

Thank you for your commendable efforts to strengthen and simplify the tax code. NCSHA and our HFA members are pleased to have this opportunity to demonstrate to you the effectiveness of the Housing Credit and Housing Bond programs and provide to you our proposals for program improvements. We stand ready to assist you further with your evaluation in any way we can.