Testimony of

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On Behalf of the

National Association of Home Builders

Before the

United States Senate

Committee on Finance

Hearing on

America's Affordable Housing Crisis: Challenges and Solutions

August 1, 2017

On behalf of the approximately 140,000 members of the National Association of Home Builders (NAHB), I appreciate the opportunity to testify today.

My name is Granger MacDonald, and I am CEO of the MacDonald Companies based in Kerrville, Texas. I am a proud second-generation builder with 40 years of experience in real estate development. I run the business my parents founded in the mid-1950s to meet post-war demand for affordable housing. My son Justin serves as president of our business, continuing our family legacy.

Our company specializes in the construction and management of affordable rental housing, and we currently own and manage 4,700 units in 41 communities in 25 Texas cities. I have constructed affordable rental housing with the Low-Income Housing Tax Credit (LIHTC) since 1997. I am proud to have committed my life's work to providing safe, decent, affordable housing to thousands of Texans.

NAHB is a Washington, D.C.-based trade association focused on enhancing the climate for housing, homeownership and the residential building industry. We represent builders and developers who construct many types of housing — including single-family for-sale homes, affordable and market-rate rental apartments, and remodelers. About one-third of our members are builders and remodelers; the other two-thirds work in closely related specialties, such as sales and marketing, insurance, and financial services.

NAHB is a member of the A Call To Invest in Our Neighborhoods (ACTION) Campaign, a grassroots coalition of over 2,000 national, state, and local organizations and businesses calling on Congress to protect, expand and strengthen the Low-Income Housing Tax Credit.

While the housing industry continues to recover slowly from the Great Recession, housing affordability in both the single and multi-family markets has become a rising challenge in the industry. Multifamily housing affordability has reached crisis proportions. The number of renter households considered "severely cost burdened," meaning they spend more than half of their monthly income on rent, is at an all-time high of 11.4 million.[1] That translates to more than one in four of all U.S. renters.

I am grateful to the Committee for focusing today's hearing on this important issue. The tax code plays a major role in multifamily development, most visibly through the Low-Income Housing Tax Credit.

The best solution to this crisis is to pass S. 548, the *Affordable Housing Credit Improvement Act of 2017*. This bipartisan bill provides needed additional resources and includes other reforms to promote the construction of affordable housing nationwide.

Affordable Housing Development Requires Policy Support

To understand what is needed to address the affordable housing crisis, you need to understand the challenges facing the development community.

Let me be direct. Where there is housing demand, as a businessman, I want to supply that demand. But there is no magic wand to erase basic development costs. Fees, regulatory compliance, modern building and energy codes, building materials, land and labor costs determine whether a project is financially

[1] Harvard University Joint Center for Housing Studies (JCHS), "The State of the Nation's Housing 2016"

viable. If we want to provide affordable rental housing for lower-income households, it is financially impossible to do so without a subsidy.

A 2011 study from the Harvard University Joint Center on Housing Studies reiterates this point: "[t]he rising costs of construction make it difficult to build new housing for lower-income households without a subsidy."[2]

In 2009, the median asking rent for new unfurnished apartments was $1,067; for minimum-wage workers, an affordable monthly rent using the 30-percent-of-income standard is just $377.[3] The study calculated that to develop new apartments with rents affordable to households with incomes equivalent to the full-time minimum wage, the construction costs would have to be 28 percent of the current average.[4]

Without federal assistance, it is financially infeasible to construct new, unsubsidized affordable rental units. The LIHTC is a critical program, and as noted in the study, "[a]t present, the Low-Income Housing Tax Credit (LIHTC) program is nearly alone in replenishing the affordable stock, supporting both new construction and substantial rehabilitation of existing properties including older assisted developments."[5]

We also need to recognize the important role affordable housing plays in our communities. There are meaningful social effects, which can be seen as middle and lower-income Americans try to make ends meet. I see how affordable housing creates stability for my tenants and their families. My properties help to revitalize neighborhoods. Breaking the cycle of poverty starts with access to stable and affordable housing.

The housing affordability crisis affects our economy as well. It costs us jobs, productivity and economic growth. I challenge everyone in this room to ask the owners of the small businesses you frequent about labor shortages. Housing affordability is critical in areas of the country experiencing robust economic growth. As the number of open, unfilled jobs grows, the operation of the housing market plays a key role in allowing individuals to relocate to areas where jobs need to be filled. And if we don't address this issue, where do our employers find their workers? How do we grow the economy?

And for our fellow citizens who want to realize the American dream, if they cannot afford to live where the economic opportunities are, we are just creating an economic divide based on housing "have's" and "have nots."

[2] "America's Rental Housing: Meeting Challenges, Building on Opportunities" Joint Center for Housing Studies of Harvard University, 2011. Pg 23
[3] Page 23 and 21
[4] Page 24
[5] Page 5

This isn't complicated economics here. Simple supply and demand. To address it, we need to commit to increasing supply. That is why I respectfully ask you to support and pass S. 548.

Development Costs are Increasing: Factors Driving up Costs

Regulation

Increasing costs due to regulation are a significant challenge for the residential construction industry. For example, regulatory costs at all levels of government now make up roughly 25 percent of the price of a home and have increased by one-third since 2011.[6] Costs incurred in the development stage alone account for over half of the cost of a finished site sold to a builder. At the local level, jurisdictions may charge permit, hook-up, and impact fees, and establish development and construction standards that either directly or indirectly increase costs to builders and developers. The federal government can also affect the price of a home. For example, the government may require permits for stormwater discharge on construction sites, which may lead to delays in addition to permit costs.

Building Materials

Building material price increases continue to outpace inflation by a wide margin, significantly increasing development costs nationwide. For example, since the start of this year, the industry average price of framing lumber has increased 18 percent. The cost of many softwood lumber products has risen well over 30 percent in the same period, and lumber futures suggest that prices are expected to keep climbing. The increase in softwood lumber prices adds nearly $500 to the development and acquisition cost of a typical multifamily unit.[7]

The costs of other materials used in residential construction have also risen significantly. Oriented strand board (OSB), commonly used as sheathing in walls, flooring, and roof decking, is nearly 30 percent more expensive than in August 2016. The price of drywall has also increased 9 percent over the same period.

Labor Shortages

Labor costs and availability remain large problems. In 2012, only 21 percent of builders reported labor cost or availability problems. That figure rose to 46 percent in 2014 and increased to 56 percent in 2016. The rate of construction job openings has risen substantially in the past year, meaning builders have available jobs but cannot find people to fill them.[8] This translates into higher prices and/or construction delays, both of which increase project costs.

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[6] http://eyeonhousing.org/2016/12/top-posts-of-2016-regulation-is-24-3-percent-of-the-average-new-home-price/

[7] http://eyeonhousing.org/2017/06/duties-on-lumber-now-enough-to-threaten-thousands-of-u-s-jobs/?_ga=2.116462790.1957391554.1501190622-192765943.1501190622

[8] http://eyeonhousing.org/2016/06/more-builders-report-laborsubcontractor-shortages/

Lot Shortages

Another significant problem is the availability and supply of sites ready for construction. In a recent NAHB survey, 64 percent of builders cited site availability as "low" or "very low." Unsurprisingly, the price of sites has gone up as well, with 65 percent of builders saying prices were "substantially" or "somewhat" higher than they were a year ago. Taken together, the cost and availability of sites was cited as a significant problem by more than 60 percent of builders in 2016, a nearly threefold increase from 2011, when only 21 percent of builders identified site supply as an issue.

There are many inputs that go into developing a multi-family project, and they have all increased in price in the past few years. This adds to the strain of the existing affordable housing resources. Put simply, projects require additional financial support, yet financial resources remain either flat or have been significantly reduced, as in the case of federal programs like HOME.

The LIHTC is a Success Story, But Demand Exceeds Resources

The Low Income Housing Tax Credit (LIHTC) was created during the Reagan Administration as part of the Tax Reform Act of 1986 as a more effective mechanism to produce affordable rental housing. It is the most successful affordable rental housing production program in U.S. history. Since its inception, the LIHTC has produced and financed more than 2.9 million affordable apartments. As LIHTC properties must generally remain affordable for 30 years or longer, they provide long-term rent stability for low-income households around the country. But the demand for affordable housing is acute and exceeds the availability of financing through the LIHTC program.

The LIHTC is a unique private-public partnership. The benefits of this structure are evident in the quality of the projects. Moreover, NAHB estimates that the LIHTC program in a typical year supports 95,000 new, full-time jobs, adds $7.1 billion to the economy, and generates approximately $2.8 billion in federal, state, and local tax revenue. Unfortunately, the supply of private, affordable housing stock is rapidly shrinking. According to a 2011 Harvard study:

> … the private low-cost stock is rapidly disappearing. Of the 6.2 million vacant or for-rent units with rents below $400 in 1999, 11.9 percent were demolished by 2009. Upward filtering to higher rent ranges, conversions to seasonal or nonresidential use, and temporary removals because of abandonment added to the losses. On net, more than 28 percent of the 1999 low-cost stock was lost by 2009.[9]

And the private marketplace needs a subsidy to build new construction to replace those lost units.

[9] "America's Rental Housing: Meeting Challenges, Building on Opportunities" Joint Center for Housing Studies of Harvard University, 2011. Page 6.
http://www.jchs.harvard.edu/publications/rental/rh11_americas_rental_housing/AmericasRentalHousing-2011.pdf

While no program is perfect, the LIHTC works incredibly well. Its public-private partnership model is one that frankly should be replicated in other government programs. When I start a LIHTC project, my investors and I assume all the risk. If the project fails, the taxpayer is protected, as the IRS can and will reclaim the tax credits. Since the investors cannot claim the credits until after the project is placed in service, it is the rare public program where the taxpayer gets what they are paying for, or the taxpayer does not pay.

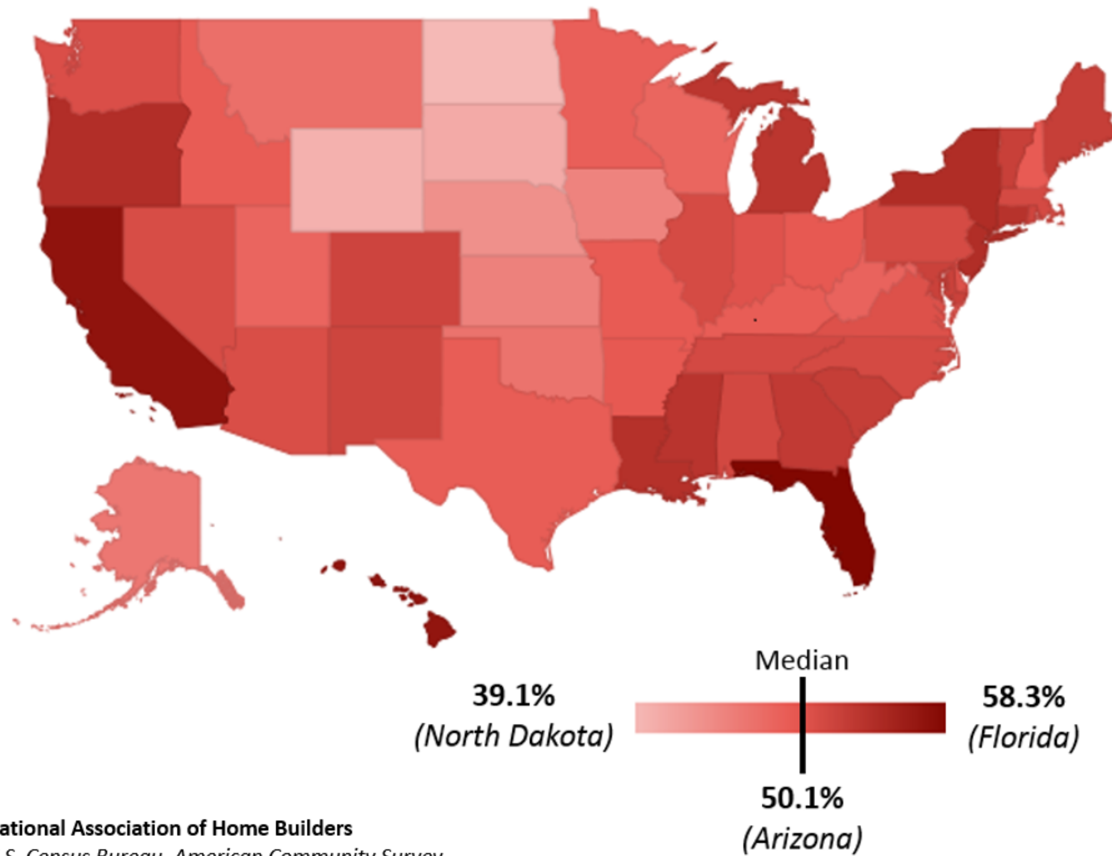
A key component to the LIHTC's success is the flexibility the state agencies have to target specific types of affordable housing developments. For example, a state with a large population of seniors may offer a developer bonus points on an application for focusing on senior housing. Nationally, in 2014, approximately 27% of LIHTCs were directed to senior housing.[10] Other targeted projects include assisted living; family housing; homeless; and housing for the disabled. This flexibility allows each state to determine what types of affordable housing are best suited to the demographics of their state, rather than applying a single, national standard. Ultimately, however, a lot of needs are not being met as demand simply outstrips the availability of credits.

As the map below shows, every state has a large population of rent-burdened households. Correspondingly, demand for credits greatly outstrips the resources available. According to the most recent annual survey released by the National Council of State Housing Agencies (NCSHA), state housing finance agencies generally receive more than $2 in requests for every $1 in LIHTCs available. In 2014, state agencies received applications for $1,836,172,240 in credits. Total allocations were $775,844,195. This means that for every tax credit allocated, there was a demand for approximately 2.4 tax credits[11].

But this does not tell the whole story. As an experienced developer, I will not submit applications for viable projects when there are inadequate resources to support it. So there is a shadow demand for credits not reflected in the above data.

[10] 2014 NCSHA State FHA Factbook, Pg. 111

[11] Pg. 94



Nationally, demand varies somewhat from year to year but generally remains high. It is useful to compare the 2014 national numbers against 2008. 2008 was the height of the financial crisis, and multifamily development was at a low point. Many traditional LIHTC project investors were not investing, which made putting together deals much more challenging. Nationally, there were applications for $1,873,311,018 in credits. Credits allocated were $939,924,853.[12] Even in one of the most challenging times for real estate development, demand was still double the amount of available credits.

Looking back to better times in 2006, there were applications for $1,509,779,928 in credits. Credits allocated were $691,073,326.[13] 2006 had approximately $2.20 in credit requests for every $1 available. We can see over several years and in different economic environments, demand for tax credits remained steady at double or more of the available credits.

LIHTC development remains stable because the need for affordable housing is significant. Consistent demand for credits also reflects the advantage of creating this credit in the tax code. Investors have

[12] State HFA Factbook: 2008 NCSHA Annual Survey Results, pg 92

[13] State HFA Factbook: 2006 NCSHA Annual Survey Results, pg 88

confidence in the predictability of the tax code, which allow LIHTC developments to continue even during economic downturns. The LIHTC enables a fairly constant supply of affordable housing, as well as a financing mechanism that ensures long-term operation of affordable housing. In fact, LIHTC tax credit projects outperform the rest of the multifamily housing sector in one key measure: the annualized foreclosure rate. This rate is less than one tenth of a percent[14] and a third of the rate for other multifamily properties. The success of these projects partially reflects the ever-present threat that the government can recapture tax credits if the project fails.

To start meeting the growing and significant demand for affordable rental housing, we must increase resources supporting production. S. 548 takes a significant and needed step to boost supply by increasing LIHTC allocations by 50 percent. NAHB estimates that based on the estimates of the bill's sponsor that enacting S. 548 would result in an additional 400,000 LIHTC units over the next 10 years, the economic effects from that construction would increase federal tax revenue by $11.4 billion and state and local revenues by $5.6 billion over 10 years.

Failure to take action now will only deepen the crisis. Rental housing demand remains solid, and more housing is needed to help address growing affordability challenges. For example, the peak age of the Millennials is approximately age 27. While historically the typical age of a first-time home buyer is just above age 30, we can expect continued demand for rental housing in the years ahead. Absent new supply, this demand will increase rents and worsen existing affordability issues.

Cost Containment: Effectively Utilizing Existing Resources

Reducing and containing LIHTC development costs is a critical, yet difficult, balancing act. For starters, there are simply more fees associated with LIHTC development, which can account for ten percent of the cost of a project. These fees are associated with compliance and necessary to ensure that the program is fulfilling its intended goals. Other trends which have understandable policy goals, such as locating affordable housing near transit hubs or in higher-income neighborhoods, result in higher development costs. Land costs tend to be significantly higher when constructing near transportation centers, and wealthier communities may require more expensive exterior architectural details to blend into the surrounding neighborhood.

But we have also seen a growing trend towards gold-plating Qualified Allocation Plans (QAPs). Every state housing finance agency develops a QAP, which establishes the criteria used by the state for awarding tax credits. States have significant latitude to write a QAP to ensure that resources are meeting the unique affordable needs of each state. As mentioned earlier, a state QAP may steer more investment into affordable seniors housing, for example. This flexibility is important, but should have some limits. One troubling trend we are seeing is QAPs pushing energy efficiency requirements significantly above the current code requirements, which can greatly increase project costs. Pennsylvania, for example, is pushing for "net zero energy" projects, which is not even common in high-end single-family homes.

[14]"The Low Income Housing Tax Credit: Assessment of Program Performance & Comparison to Other Federal Affordable Rental Housing Subsidies," by Novogradac & Company, LLP, 2011, Page 4
http://www.novoco.com/products/special_reports/Novogradac_HAG_study_2011.pdf

A more cost-effective means of promoting energy efficiency is through tax incentives. While a number of energy efficiency tax credits, such as Section 45L, the New Energy Efficient Home Tax Credit, have been allowed to expire, they were not utilized for LIHTC development because they required a basis adjustment. Because the total basis in a property determines the amount of LIHTCs a project can be awarded, using an energy tax credit that requires reducing basis in the project had the effect of reducing the amount of LIHTCs the project received—offsetting any gains from the energy efficiency tax credit. Section 311 would remove this barrier by eliminating the LIHTC basis adjustment requirement when using energy tax credit. NAHB strongly supports Section 311 and also urges the Committee to restore the Section 45L tax credit and Section 179D deduction.

QAPs should weigh the cost and benefit of various development requirements to produce as much affordable housing with the limited resources we have, but unfortunately that does not always occur. As an example, Texas briefly considered, and fortunately rejected, a proposal to require LIHTC projects to include a carport. At the time, it made me wonder if we were housing cars or people. The quality of affordable housing built under the LIHTC is part of the program's 31-year success story, but we cannot lose sight that this program's goal is to produce and preserve as much as affordable housing as possible. We must strike a reasonable balance between development requirements and cost.

Local governments may also impose costly requirements on development, which apply whether the project is market-rate or affordable. In one Texas community, I was required to plant 200 trees, which probably doubled the number of trees in this community. Sadly, the community also had water restrictions due to a drought, so while the trees were planted as required, I could not water them, and most died. This is simply the reality of developing housing in this country. While academics may offer assorted ideas on how affordable development should work, until you have actually done a deal, you cannot possible understand the challenges developers face.

Some criticize the program for not directing more affordable housing to higher-income communities. This is an interesting academic debate, but let me shed light on the challenges I face as a developer working in higher-income communities. The Texas QAP awards bonus points, without which receiving an allocation is nearly impossible, for LIHTC projects that are endorsed by the appropriate state legislator and the local community, even if that project is otherwise permitted under the municipality's comprehensive plan and zoning rules. In other words, if I was building a market rate project, I could simply pull the permits and start construction. But for tax credit projects, developers are subject to a special review process that oftentimes results in community opposition.

Any affordable housing developer in Texas has many stories of battling community opposition simply because the project would serve lower-income residents. The problem is so acute that the New York Times recently highlighted the challenges Texas developers face when building in higher-income areas.[15] The article quoted a resident who is opposing an affordable housing project in the Houston, Texas, area: "I will fight very hard before I give up that privilege and dignity to those who, either from lack of initiative or misfortune, don't deserve to be there." If we are going to break the cycle of poverty and

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[15] "Program to Spur Low-Income Housing Is Keeping Cities Segregated," New York Times, July 2, 2017

ensure all Americans have equal opportunity to succeed, we must reject the notion that only some people "deserve" to live in well-off communities. I can assure the Committee that this reaction is not unique and is often associated with racial undertones. Nonetheless, this is real-world challenge that developers of affordable housing across the country face on a daily basis.

Fortunately, relief is possible. Section 308 of S. 548 would prohibit state QAPs from requiring special local approval of LIHTC developments. This will ensure that if the zoning allows it, I will be able to develop affordable housing on the same terms as a market-rate project.

Improving Utilization of Existing Resources: Create a Minimum Floor for 4% credits

Under the Low Income Housing Tax Credit (LIHTC) program, affordable housing developments receive tax credits that are used to attract equity capital. There are two types of tax credits: one credit provides 70% of the financing cost and is used for new construction and substantial rehabilitation; and a second credit that provides 30% of the financing cost and is used to acquire an existing property for rehabilitation. These are often referred to as the 9% and 4% credits, respectively, because that was the original credit amount when the program was created in 1986.

The *Tax Reform Act of 1986* did not fix those credit rates at 9 and 4 percent, but rather created a floating rate system where the credit rates are adjusted on a monthly basis. The IRS calculates the monthly values of the credits based on the cost of borrowing by the federal government. As a result, today's low federal borrowing costs produce very low credit rates, which reduces the amount of private equity invested in LIHTC development. For August 2017, the 9% credit was only worth 7.52%; the 4% credit was worth 3.22%. These low rates reduce the amount of equity properties could receive by more than 15 percent, making it more difficult to do LIHTC developments, particularly as state and federal governments cut back on direct spending that is used to fill financing gaps for LIHTC properties. The "floating rate" system also creates uncertainty for owners and investors, and complicates state administration of the program.

In response to the declining rates, the *Housing and Economic Recovery Act of 2008* (HERA) set the rate for new construction and substantial rehab credits from each state's allocation at no less than 9 percent, which was the rate when the program was created. The provision was then extended for credits allocated by the end of 2013 through the *American Taxpayer Relief Act of 2012* (ATRA). The 9 percent minimum floor was made permanent in the *Protecting Americans from Tax Hikes Act of 2015 (PATH ACT).*

Unfortunately, while the Finance Committee has favorably reported legislation that included a minimum 4% credit floor for acquisition, the legislation enacted into law (HERA, ATRA and the PATH Act) failed to address the 4% credit. S. 548 will correct this by creating a minimum floor for 4% credits. Applying the minimum floor rate for 4% credits would similarly remove the uncertainty and financial complexity of the floating rate system, simplify state administration, and increase the number of units that can be preserved and developed into affordable housing. As our housing stock ages—the first LIHTC projects are now over 30 years old—preservation and rehabilitation is a cost-effective tool.

Income Averaging

The LIHTC serves tenants with an area median income (AMI) of no more than 60 percent. Many tax credit projects target significantly lower-income individuals. It is important to recognize that the tax credit only partially covers development costs. LIHTC projects also rely on other sources of financing, including a mortgage. The amount of debt a project can take on is determined by rental income. As rent is based on the tenant's income, projects targeting lower-income residents cannot assume as much debt, which may affect the financial viability of a project.

Section 201 of S. 548 would allow for income averaging, providing states with the flexibility to target lower-income tenants while also ensuring the financial viability of the project by allowing a limited number of units to serve tenants with incomes up to 80 percent of AMI. This is an excellent solution for achieving income targeting below the current 60 percent AMI minimum while ensuring that the project is viable and can be built. However, the entire project must still maintain an average income of 60 percent or below.

Improve Rural Affordable Development Opportunities

My company specializes in rural affordable housing development, which has unique challenges. Although housing costs tend to be lower in rural areas, these areas are often plagued with lower incomes and high poverty rates. Nearly half of rural renters are rent-burdened, paying more than 30% of their income in rent. Rural areas also often have limited rental options.

S. 548 includes a number of provisions that will enhance rural development opportunities. They include income averaging, discussed above, but also standardizing rural income limits. The bill also provides a basis boost for projects serving extremely low-income tenants. This is an important provision considering that rural residents' income tends to be lower than in urban areas. The bill would also encourage development in Native American communities, which are home to some of our most vulnerable rural residents.

Tax Reform and the LIHTC: Preserving Production Levels in the Next Generation Tax Code

NAHB believes that lower rates, simplification, and a fair system will spur economic growth and increase competitiveness. And that's good for housing, because housing not only equals jobs, but jobs mean more demand for housing. As the Committee moves forward on tax reform, NAHB wants to be a constructive partner and help the committee with this important issue.

Corporate tax reform poses a unique challenge to syndicated tax credits such as the LIHTC. Investor valuation of a tax credit is based on how much tax liability that credit offsets. As the Committee considers lowering the corporate tax rate, NAHB also recommends the Committee consider options to ensure that tax credit equity remains stable. We believe that a lower corporate rate and a robust LIHTC are both possible to achieve.

Earlier this year, we saw a significant drop in tax credit pricing throughout the country as investors began to assume a drop in the corporate tax rate. In some cases, projects were unable to move

forward. We believe the effects of the lower corporate tax rate on LIHTCs can be mitigated through two policy changes.

The first recommendation is to update the discount rate formula used to calculate the 9 percent and 4 percent credit rates. The basis of that formula reflects the cost of borrowing for the federal government, which is not a reflection of investor return in the private market. The formula can also be adjusted based on the final corporate tax rate to ensure that tax credit equity remains stable.[16]

The second recommendation is to expand the investor base. Greater demand for credits will increase pricing. Currently, most tax investors are financial institutions, as tax credits also help banks meet their Community Reinvestment Act obligations, as well as other large C-Corps with stable and constant profits. Individuals, pass-through businesses, and S-Corp banks are largely shut out of the tax credit market due to the current passive-loss rules. While C-Corps can fully claim passive losses, and are therefore willing to pay a higher price for tax credits, individuals and pass-throughs are limited to a $25,000 deduction. NAHB does not recommend a complete repeal of the passive loss rules, but rather suggests that additional flexibility for individual investors and pass-throughs investing in LIHTCs should be considered.

We believe a targeted tweak of the passive-loss rules would also enhance deals in smaller communities, particularly rural areas, where tax credits can be marketed to local professionals.

Conclusion

The challenges of housing affordability are increasing. In some communities, even middle-class households are feeling the financial strain of today's housing costs. The problem is simple: we lack enough affordable housing. The only effective, long-term solution is to increase supply. S. 548 would greatly enhance our ability to increase the supply of affordable rental units, and NAHB urges the Committee to mark up and favorably report out the bill.

We also must recognize that without a sizable investment in our housing stock, particularly as older units reach obsolescence, we risk a worsening problem for middle-income Americans. We commend Senator Wyden for recognizing this emerging problem and his legislation last Congress to create a Middle Income Housing Tax Credit (S. 3384), modeled on the LIHTC. NAHB would also urge the Committee to take up this legislation. Frankly, addressing these challenges now before they reach a national crisis point will be much cheaper in the long-run.

NAHB greatly appreciates the overwhelming bipartisan Senate support to solve our affordable housing crisis. In this era of increasingly partisan political discord, I hope we can all unite around this issue and

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[16] see: https://www.novoco.com/notes-from-novogradac/how-congress-could-offset-effects-affordable-housing-production-reduced-corporate-rate

take action. Shelter is a basic human need, and we have an opportunity to do something that not only makes good economic sense, but will uplift the lives of millions of Americans.

NAHB stands ready and willing to help.