Council for Affordable and Rural Housing

Serving the Affordable Housing Needs of Rural America

TESTIMONY STATEMENT

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Hearing - America's Affordable Housing Crisis: Challenges and Solutions
Held on August 1, 2017

Chairman Hatch, Ranking Member Wyden and members of the Committee, as President of the Council for Affordable and Rural Housing ("CARH"), and on behalf of CARH and their membership, I would like to submit written testimony in support of efforts to address the affordable housing crisis, especially in rural America. CARH, the leading national trade association headquartered in Alexandria, Virginia, represents the interests of both for-profit and non-profit builders, developers, management companies, and owners, as well as financial entities and suppliers of goods and services to the affordable rural rental housing industry.

Among other organizations I am involved with, I am also President of Greystone Affordable Development, whereby I am responsible for the strategic growth and implementation of Greystone's affordable housing preservation efforts. In that role, I work closely with non-profit and for profit owners and developers in meeting the challenges associated with the preservation, recapitalization and rehabilitation of their affordable housing across the U.S. To date, we have successfully recapitalized and rehabilitated approximately 256 apartment communities (over 9,000 housing units) in the USDA Rural Development ("RD") Section 515 multifamily rural rental housing programs; and we are currently in the process of preserving an additional 85 Section 515 properties (approximately 3,700 units) across multiple states using Housing Bonds and the Affordable Housing Credit.

Rural Americans: Great Hardships Compared with Non-Rural Areas

During the August 1, 2017 Senate Finance Committee hearing, Senator John Thune (R-SD) accurately noted the affordable housing crisis is not just an urban community concern but also greatly affects rural communities across the country. Lower incomes and higher poverty rates often make housing options simply unaffordable for many rural residents, even though housing costs are generally lower in the rural communities. In fact, rural *renters* are more than twice as likely to live in substandard housing compared to people who own their own homes. USDA's 2016 Multi-Family Housing Occupancy Report published December 6, 2016 revealed the average household living in RD's Section 515 housing with rental assistance lives on only $10,732 per year of income and $12,960 for tenants that do not receive rental assistance.

While the demand for rental housing in rural areas remains high, the supply, particularly of new housing, has significantly decreased. According to a recent report published by the National Rural Housing Coalition ("NHRC"), the Section 515 Rural Rental Housing Loan program was once the principal source of financing for new rural rental housing development.[(1)] Since its peak in the mid-1980's, program levels have been cut by more than 96 percent from $954 million to just $35 million today (with further proposed cuts in the FY18 budget). Since 2012, the program has largely halted financing the construction of new rental housing; hence, the need for preservation of the existing (but aging) house stock is more critical today than any time in our nation's history. USDA reports a reduction of 271 rural rental properties in just the past year, representing a loss of 4,220 much needed apartment units.

Housing is particularly difficult to develop or preserve in the portions of rural America that are classified as "Persistent Poverty" - defined by the Economic Research Service at USDA as those counties where 20% or more of their population was poor over the last 30 years. Of the 353 persistently poor counties, 301 or an astounding 85.3% are rural counties.[(2)] The demand is there and the need is there, but too many Americans are simply unable to afford basic decent housing.Areas that are particularly persistently poor include middle Appalachia, the lower Mississippi Delta, the southern Black Belt, border Colonias areas, and Native American lands. In fact, 21 million people live in persistent poverty counties.[(3)] High poverty counties with 17% or more living in poverty essentially exist in nearly every state.

Housing instability has well-documented effects on the education and health of this country's greatest asset - our children. Neither the private nor the public sector can produce affordable rural housing independently of the other; it must be a collaborative partnership.

The Affordable Housing Credit—An Essential Tool

The low income housing tax credit ("Affordable Housing Credit") is a model of success, implemented through a federal-state model that utilizes federal economies of scale, state and local decision making, and partnership with the private non-profit and for-profit sectors to deliver new and rehabilitated quality housing to elderly and low income Americans. It has been noted that 90% of affordable housing constructed in recent years is done in partnership with the Affordable Housing Credit and has provided more than 2.5 million rental units since its inception.[(4)] The Affordable Housing Credit is likewise an essential tool for preservation of aging affordable housing that exist in high cost areas, or have been starved from the necessary capital to modernize.

When the Affordable Housing Credit program was enacted as part of the Reagan-era Tax Reform Act of 1986, it did not create a large new bureaucracy. Instead, it uses a small policy-setting staff at the Internal Revenue Service to coordinate funding to states, which in turn works with state Housing Finance Agencies or local agencies, depending on the local choices. These state and local agencies rigorously inspect and asset manage, but their job is made easier by the private investment system. Affordable Housing Credit investors are strongly motivated to require project owners and managers to consistently comply with housing requirements, even before government inspections.

CARH Strongly Supports S. 548, Housing Bonds and Other Proposals

CARH strongly supports S.548, the Affordable Housing Credit Improvement Act, as we agree with the bipartisan expression of concern and support to find solutions to the affordable housing crisis. It has always been difficult to attract investors to transactions in rural areas. While land costs in rural markets are typically less than urban areas, there are offsetting concerns caused by greater transportation costs and fewer vendors from which to choose. Housing assistance programs are generally geared toward urban areas, with programs like the Community Development Block Grant largely unavailable to rural areas. This is why the Affordable Housing Credit has been even more important to rural areas—because it is truly the single largest path to preserving existing housing and constructing new affordable housing. S. 548 would help facilitate preservation and new construction of this much needed affordable housing. Some of the key points we see in S. 548 are outlined below:

- Rural areas often compete with larger urban properties for the Affordable Housing Credit. This competition has grown intense and seems to be crowding out rural needs. In fact, between 1995 and 2009, only nine percent of Affordable Housing Credit financed rental properties were in rural markets utilizing Section 515 funding.(5) Congress has not increased Affordable Housing Credit authority in 17 years. This legislation would increase the Affordable Housing Credit by at least 50 percent. Such an expansion would support the preservation and construction of 350,000 to 400,000 additional affordable apartments over a ten-year period, undoubtedly many in rural areas.

- S. 548 would permit income averaging in Housing Credit properties. <u>However, to be fully effective in rural areas, there should be an added provision instructing Rural Development to permit income averaging in Section 514/515 rural rental multifamily programs. Currently, Rural Development does not permit such practices under their statutory authorities.</u> Rents that households with incomes above 60% AMI (up to the max of 80% AMI) could afford have the potential to offset lower rents than households below 40% or even 30% AMI could afford, allowing developments to maintain financial feasibility while providing a deeper level of affordability. Furthermore, the diversification of rents within a given property would broaden the marketability, providing more flexibility and responsiveness to local needs. As such, projects with tiered rents would be more attractive to Affordable Housing Credit investors, potentially attracting more capital to rural affordable housing projects.

- The legislation would base income limits in rural properties on the greater of area median income or the national non-metropolitan median income. This would make Housing Bond financed developments more feasible in rural areas while streamlining program rules. <u>Housing Bonds have been an important tool for preserving and financing multiple properties into one transaction, capitalizing on the economies of scale. Many existing small 515 properties have been preserved as part of a portfolio financing that otherwise would not have a means for recapitalization and modernization.</u>

- The bill simplifies the current Affordable Housing Credit student rule and better achieves the intended targeting by replacing it with a new rule that is aligned with the Department of Housing and Urban Development's ("HUD") rule, which would simplify multiple subsidy compliance. Many rural residents seek to re-tool and to improve their employment status by pursuing university, college, community college and vocational school. CARH has recognized this need for skilled training and has created a scholarship fund for residents of affordable housing to assist with college and vocational school costs.

- The proposed legislation would provide for a fixed floor rate for acquisition credits at no less than 4 percent and should similarly remove the uncertainty and financial complexity of the floating rate system, simplify state administration, and facilitate preservation of affordable housing at little or no cost to the federal government. Acquisition credits are currently set by the floating rate system just like new construction and substantial rehab credits were before the Housing and Economic Recovery Act (HERA) of 2008. A floating rate makes it very difficult to plan and assemble capital necessary for development. This fixed rate would potentially provide additional private capital to preservation transactions, greatly reducing the funding gap now being created from reduced credit pricing provided by investors.

- S. 548 provides up to a 50 percent basis boost of Affordable Housing Credits for developments serving extremely low-income families and individuals in at least 20 percent of the units, as well as allowing states to provide up to a 30 percent basis boost for Housing Bond-financed properties. This provision will provide parity between Housing Bond-financed developments and those that use allocated Housing Credits. As noted above, rural properties tend to serve very low and extremely low income persons with the average annual household income in unsubsidized Section 515 properties of only $12,960.

It is also important to note that Affordable Housing Credit properties can improve neighborhoods and property values. This very positive effect was discussed in *A surprising way to increase property values: Build Affordable Housing*, Washington Post, July 6, 2017 by Tracy Jan, which pointed to the November 2016 study by Rebecca Diamond and Tim McQuade at Stanford University. Their conclusion, based on their research, is that the Affordable Housing Tax Credit revitalizes low-income neighborhoods, increases housing prices 6.5%, lowers crime rates and attracts racially and income diverse populations.

Other Affordable Housing Credit Proposals

While not part of S. 548, it is worth noting that rural housing providers and developers have discussed additional ways to potentially bring in capital with the Affordable Housing Credit in rural areas:

(1) Affordable Housing Credits should be available to S Corporations, Limited Liability Companies, and closely-held C Corporations to the same degree Affordable Housing Credits are currently available to widely held C Corporations, to offset revenue with Affordable Housing Credits that would otherwise be taxable when passed through to the owners of these businesses. The Federal Internal Revenue Code restricts potential Affordable Housing Credit investors through passive loss limitations, limiting the ability of associations that are not real estate professionals from investing. To ensure high standards of oversight, such entities should have at least $10 million in annual gross receipts, be formed for reasons other than just avoidance of Federal income tax, and have an expectation of reasonable asset management. This proposal is aimed at accessing substantial investment capital available from sophisticated financial institutions and businesses that happen not to be widely-held Schedule C corporations. Indeed, this change would allow the 1,954 commercial banks and 55 savings institutions to invest in low-income housing tax credits in the communities in which they operate.

(2) Another barrier to preservation and tenant protection is an unintended one, resulting from a conflict between the tax code and market forces. Almost all Rural Development (RD) Section 515 properties were constructed through limited partnership arrangements whose structure makes it exceedingly difficult to introduce new capital into these properties, either through additional capital contributions from current owners or through the transfer of such properties to new owners. Most were also created before the 1986 Tax Reform Act. Because rent restrictions limit cash flow, new capital contributions would only generate additional passive losses that cannot be utilized by current investors. Yet, if the current owners sell a property it is almost impossible to generate sufficient cash to pay off the steep recapture taxes that would be owed. The best alternative for current limited partners is to hold the investment until death, enabling their heirs to acquire the property with a stepped up basis that avoids any recapture taxes. While that is a perfectly rational decision at the partner level, it is not consistent with sound housing policy and risks imposing far higher costs on the federal government, as these capital-starved properties either continue to deteriorate into substandard housing or are sold off as market rate housing as a means of generating cash on the sale to pay exit taxes for investors.

    A modest change in the tax rules must be adopted to preserve the stock of Section 515 affordable housing. This could be accomplished by waiving the depreciation recapture tax liability where investors sell their property to new owners who agree to invest new capital in the property and to preserve it as affordable housing for another 30 years. Since very few investors subject themselves to recapture taxes today, opting instead to pass the property to their heirs at a stepped-up basis, the cost of this proposal should be modest while the benefit to the federal government of extending the affordability restrictions will be far-reaching. During the 111th Congress, legislation was introduced, H.R. 2887, the Affordable Housing Tax Relief Act of 2009, which if enacted, would have embodied this concept.

Other Essential Tools Needed with the Affordable Housing Credit

Rural housing is dependent on several sources of funding for construction and preservation of the existing housing stock. While much focus deservedly is on the Affordable Housing Credit, there needs to be a tool box with a variety of tools. Just like needs and resources can differ in different places, there must be a broad set of tools to mix and match to get the most effective solution.

RD has the Section 538 guaranteed loan program, HUD has the HOME program, both widely used in rural rental housing. But the existing portfolio under stress is the Section 515 Rural Multifamily Housing and Section 514 Farm Labor Multifamily properties which are a lynchpin for affordable rural housing. These 514/515 programs supply mortgages to more than 14,000 apartment communities. However, RD calculates 74 projects with 1,788 units are maturing out of the program *each* year over the next 12 years. This not only means a loss to the program, the project based Section 521 rental assistance ("RA") provided to the tenant is also lost when the Section 514/515 mortgage matures because these programs are tied together by statute.

The RA program has been adjusted solely through the appropriations process for about two decades. While we appreciate the hard work of appropriators in both the House and Senate, we believe it is time for a thorough review through the Congressional authorizing committees (the House Financial Services and the Senate Banking, Housing and Urban Affairs Committees), and that hearings on the Agency programs and proposals should be a priority for the Congress.

Congressional review should also include program updates such as the ability to utilize flexible rents and longer term rent incentives to more efficiently occupy vacant units at turnover. Another simple improvement to make RA more efficient is to provide 20 year contracts, subject to annual appropriations. Not only would this reduce the costs associated with reprocessing contracts on an annual basis without increased appropriations, it would also create a more reliable subsidy. This will help attract potential investors and lenders to Section 514 and 515 properties. Most of these properties are 35+ years old and are ready for modernization.

Affordable Rural Housing is Part of a Healthy Economy and Provides Jobs

In 2002, RD estimated that 4,250 Section 515 properties with 85,000 units "will physically deteriorate to the point of being unsafe or unsanitary within the next 5 years." At that time, RD estimated it would need $850 million to maintain just this portion of the portfolio, and that as much as $3.2 billion will be required for portfolio-wide rehabilitation. Little progress has been made since 2002. Adjusted for inflation, the 2002 $3.2 billion estimate is now approximately $5.5 billion. Due to RD's policies over the past six years, the RD multifamily portfolio is under 15,000 projects for the first time in 20 years. In 2016, RD contracted for its own study, which confirmed the existence of significant deferred maintenance. At this rate of lost properties, we encourage preservation prioritization of existing properties ahead of new construction, as it is much more cost effective to complete a substantial rehabilitation compared to the cost of building new.

Providing for this portfolio will not only care for the extremely low income families and elderly residents, but will improve infrastructure and create jobs. For each 100 apartment units, 116 jobs (plus an additional 32 recurring local jobs) are created, generating more than $3.3 million in federal, state and local revenue. Moreover, many rural areas are facing worker shortages due to the lack of available affordable housing near rural jobs.

In conclusion, affordable housing plays a critical role in rural communities across America. There is not a single solution to this national affordable housing crisis. It takes a village. And thus, we encourage and support the continued Congressional efforts to do your part in prioritizing the protection of the essential housing stock in rural areas.

Thank you for this opportunity to provide written testimony to the Committee.

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(1) NRHC – A Review of Federal Rural Rental Housing Programs, Policy and Practices; April 2017
(2) Id.
(3) HAC Rural Research Brief, June 2012
(4) NY Times, A Tax Credit Worth Preserving, December 20, 2012
(5) Jill Khadduri, Carissa Climaco, and Kimberly Burnett, "What Happens to Low-Income Housing Tax Credit Properties at Year 15 and Beyond," U.S. Department of Housing and Urban Development, August 2012

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