Council for Affordable and Rural Housing

Serving the Affordable Housing Needs of Rural America

Written testimony by the Council for Affordable and Rural Housing for the House Financial Services Committee Hearing, April 30, 2019: "Housing in America: Assessing the Infrastructure Needs of America's Housing Stock."

Chairwoman Waters, Ranking Member McHenry, and members of the Committee, on behalf of the Council for Affordable and Rural Housing (CARH) we would like to submit written testimony in support of efforts to increase investment in rural America's infrastructure. CARH is a trade association with headquarters in Alexandria, Virginia. CARH represents the interests of 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 rental housing industry in rural America.

CARH is pleased to be part of the Rebuild Rural Coalition which has been organized in order to bring focus to the infrastructure needs of rural America. We support the efforts of the Coalition and agree that infrastructure legislation by Congress should specifically address the unique needs of agriculture and rural communities. We applaud efforts to increase broadband in rural America. Broadband will do much to increase rural American's access to health care and business opportunities. However, an overlooked aspect of broadband development is how it will also increase the livelihood of residents to access the internet from their homes. Roads and other infrastructure needs that have been identified by other committees are important, but without housing for rural Americans to live in, Congress is not addressing all of rural communities' needs.

Affordable rental housing issues affect residents and a broad array of local government, non-profit, and for-profit participants working together in partnership. Rural renters are more than twice as likely to live in substandard housing compared to people who own their own homes. With lower median incomes and higher poverty rates than homeowners, many renters are simply unable to find decent housing that is also affordable. While the demand for rental housing in rural areas remains high, the supply, particularly of new housing, has decreased. 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 needs to be a partnership. There are several areas within the rural housing arena that Congress and the Administration should consider as discussion continues on the infrastructure needs of rural communities.

The United States Department of Agriculture's (USDA)/Rural Development (RD) Section 515 rural multifamily housing and Section 514 farm labor multifamily properties are a lynchpin for affordable rural housing. Poverty rates in rural areas are substantially higher than in urban areas. Therefore, rental assistance under the Section 521 Rental Assistance (RA) program is essential for many family and elderly households residing in rural America. At the same time, most federally supported multifamily properties are 35+ years old and are ready for modernization. These properties have suffered from federal funding shortages and statutory and regulatory barriers that make recapitalization difficult or impossible.

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Rural housing is dependent on several sources of funding for construction and preservation of the existing housing stock. The Low-Income Housing Tax Credit (Housing Credit) program is a vital source for this important housing. The Housing Credit program has worked successfully since its creation in 1986. It bridges the gap between what the market provides and what the market demands. In short, America's elderly, working families, civil servants, and working poor seek to live in or near their jobs, families, and communities. In much of America, this need cannot be met. Homeownership is out of reach or not financially viable. Indeed, the cost of providing any new housing or rehabilitating existing housing to current standards without public-private assistance is too expensive for most low-income Americans. The Housing Credit program allows multi-family housing providers to utilize cost-effective, energy-efficient housing developments to meet this need. The program also allows non-profit and for-profit companies to work together with local and state governments to raise private equity and put it to use bridging the financial gap. The savings are passed on to the residents in the form of affordable rental housing.

When the 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. Housing Credit investors are strongly motivated to require project owners and managers to consistently comply with housing requirements, even before government inspections.

The Consolidated Appropriations Act, 2018, created a new occupancy threshold by allowing income averaging. In sum, this allows flexibility to new Housing Credit properties by varying income limited at 10 percent increments between 20 percent and 80 percent. Section 515 and 514 properties already permit this income range and certain existing properties will benefit from this program to help lower rents for certain units, permitting unsubsidized units that remain vacant for extended periods to be reoccupied more quickly in very low-income areas. But the income averaging is prospective only and RD policy limits projects to one rent per unit type, and when incomes vary that much, rents need to also vary to accommodate the tenants. A statutory change is needed to both make income averaging available for existing properties as well overcome this RD limitation. Of course, any such proposal will need to be implemented protecting existing residents and existing use restrictions.

The Section 521 RA program is an essential component of the Section 514/515 programs. The average annual income of residents in rural housing properties is approximately $12,960. RA provides deep subsidy to very low-income residents by paying the difference between 30 percent of a resident's income and the basic rent required to operate the property; 63 percent of Section 515 units are subsidized with RA. The RA program must continue to provide sufficient funds for both current levels of RA and sufficient additional RA to support increasing program costs. RA budgets have been constrained for at least four years, even before the sequestration issues impacting the program at the end of Fiscal Year (FY) 2013. Historically, RA budgets on a per unit basis are about half of other rental subsidy programs. Much of that has been achieved by delaying needed repairs and restricting operating funds.

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. We applaud the April 2nd hearing by the

Housing, Community Development and Insurance Subcommittee of the House Financial Services Committee, at which a witness testified on behalf of CARH. This hearing was the beginning of your committee's oversight of the Rural Development (RD) housing programs and discussion of how to improve the agency's current rural housing programs.

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.

A substantial portion of Section 515 properties also have project-based Section 8 subsidy and residents with tenant based Section 8 housing choice vouchers. CARH also supports a strong project-based and tenant-based set of Section 8 programs.

The rural multifamily programs were never intended as a one-time capitalization of low-income housing. The original intent was to allow properties to refinance out of the program, and provide a market centric nucleus of decent housing in rural areas—indeed USDA originally required owners to refinance out of the program at the first opportunity. The federal government changed the laws, rules, and basic operations when it changed the federal tax code, withdrew prepayment rights, and reduced Section 515 funding without any replacement mechanism.

In order to save the $11.5 billion Section 515 program, and its sister Section 514 farm labor housing program, RD's current demonstration efforts have shown preservation can be successful but the number of properties able to be preserved with current resources will not achieve portfolio preservation in any reasonable time period.

The Section 514 and 515 programs under Section 514 and 515 of the Housing Act of 1949, operates through a successful public-private partnership. The 514 and 515 portfolios reportedly consist of 13,766 apartment complexes containing 421,816 rental homes, a staggering decrease of 14,234 properties and over 111,000 apartment homes since the program inception in 1963 - an approximate 51% reduction in the housing stock. According to RHS, they have not financed any new affordable rental units since 2011. Section 515 properties are geographically dispersed across all rural America.

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 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.

Maturing mortgages have overtaken prepayments as the most pressing issue. According to Rural Development, approximately 77 properties with 1,759 units are maturing out of the mortgage programs over the next 18-24 months, and that number will only significantly increase past 2027. When a 514/515 mortgage ends, whether through prepayment or foreclosure or maturity, the Section 521 RA also ends, exposing below-market residents to market rents and turning assisted properties into market-rate properties. In 300 counties, Section 515 properties are the majority of project-based federally subsidized units and 90 percent of all Section 515 properties are in counties with persistent poverty.

CARH also has several legislative proposals that, working with RD and Congress will help expand tools available to RD in preserving this housing. The traditional rural rental housing and rent subsidy programs work and work as a program that can attract other forms of public and private assistance. But Congress needs to be clearer and instruct RD to use financing on hand, specifically Section 521 RA for preservation. In past years when Congress specifically provided funding for preservation, RD processed that specific amount. Without that clarity, the last two Administrations have allowed other priorities, including holding on to reserves of RA, to take priority over preservation transactions. While we welcome a greater appropriation of RA, more important than even that is a specific direction to RD to spend all funds on hand each fiscal year.

We believe that existing escrows required by RD can serve a dual purpose of capitalizing a new revolving loan fund: using deposits in the Rural Housing Insurance Fund, not needed in the current fiscal year, to loan to eligible properties at the applicable federal rate of interest; and, to pay for asset management costs and offset loan risk. The proposed loans also would be backed by a voluntary guaranty or pledge of Section 515 reserve funds from owners of participating properties. Another long neglected tool is Section 515(t), which USDA has not implemented but should, because it could guarantee equity loans to provide a fair return and further recapitalization resources for properties that are 20 years old or older, attracting new owners and new private capital.

Congress should consider creating a Loan Risk Sharing Program for lenders to increase credit to rural areas. This program would provide additional funding authority for rural areas that would support and encourage the production and preservation of affordable housing. In addition, the program would provide insurance and reinsurance for multifamily housing projects whose loans are originated, underwritten, serviced, and disposed of by a local housing agency (LHA) or a lender.

A LHA and/or its approved lender would originate and underwrite affordable housing loans. If there is a default, the LHA would pay all costs associated with loan disposition and would seek reimbursement from USDA. The USDA risk share would be 50 percent pro-rata. The program would enable USDA to provide alternative forms of Federal credit enhancement to increase affordable multifamily housing lending. USDA would selectively invite LHA to participate in a variety of mortgage options to assess the effectiveness of the various credit enhancements. The LHAs and USDA would enter into Risk-Sharing agreements to implement the program. A LHA or its lender, in turn, would make loans to investors, builders, developers, public entities, and private nonprofit corporations or associations. Eligible mortgagors include investors, builders, developers, public entities, and private non-profit corporations or associations.

We greatly appreciate the support shown both in Congress and the current Administration for a fee-based, revenue neutral Section 538 Guaranteed Rural Rental Housing program. We believe that the

Section 538 is proving to be an important housing tool, at no cost to the government or taxpayers. CARH has recommended to RD, and we understand RD is reviewing a variety of administrative adjustments to the 538 program that would allow even more units to be preserved or produced, with increased cost efficiency. We would encourage a statutory chance to make it easier to refinance existing rural housing not already in the 538 program.

Also, key to rural housing recapitalization is maintenance of the HOME Partnerships program administered by the Department of Housing and Urban Development (HUD). HOME uniquely empowers state and localities to respond to the housing needs they judge most pressing, allowing them to serve the whole spectrum of need from homelessness to rental to disaster recovery assistance. HOME is flexible and can be used in rural or non-rural areas. The program is a vital piece in financing numerous affordable housing developments, many of which would not be able to go forward, which in turn, would mean not providing housing for low-income families. HOME does not replace resources committed to rural areas, but is an important gap financing program. States and localities leverage HOME by generating almost four dollars of other public and private funding.

Since its inception in 1986, the Housing Credit program has created homes for approximately 2.4 million families. As indicated earlier in this testimony, for each 100 apartment units, 116 jobs are created, generating more than $3.3 million in federal, state and local revenue. This important housing resource creates a positive, broad-based economic benefit that includes jobs (particularly construction jobs), income and taxes in industries such as manufacturing, trade, and services, in addition to construction. Income includes business profits as well as wages and salaries paid to workers. Affordable housing not only creates jobs directly, but also facilitates job growth. Affordable housing shortages prevent workers from meeting job demand in rural areas with limited housing options.

Rural housing construction and preservation projects have access to only a few funding sources. The Housing Credit program is a vital source for this important housing. The Housing Credit is narrowly targeted and represents the best of the public-private partnership between government, local communities, and the private sector. The program is the most successful affordable rental housing production program and its place in the tax credit code is an essential part of its long-term success. Indeed, the Housing Credit has been so successful that it has become the model for subsequent programs.

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CARH believes it is critical that both the Housing Credit and Housing Bond programs continue. Reforming, simplifying, and flattening the Internal Revenue Code (Tax Code) is a centerpiece to many efforts to spur economic growth. However, the Tax Code has proven to be an efficient way to incentivize private sector to meet affordable housing needs that the private sector alone is not able to meet. We support legislative changes that would both strengthen and expand these two important programs so rural housing preservation and new construction can continue. During the last Congress H.R. 1661 was introduced and many of its provisions remain important to preserve rural housing. Efforts are currently underway to have legislation reintroduced in this Congress. While the legislation is under the jurisdiction of the Ways and Means Committee, all members of this Committee should cosponsor this important bill when introduced.

The federal Internal Revenue Code restricts potential Housing Credit investors through passive loss limitations, limiting the ability of associations that are not real estate professionals from investing. Housing Credits should be available to S Corporations, Limited Liability Companies, and closely-held C Corporations to the same degree Housing Credits are currently available to widely held C Corporations, to offset revenue with Housing Credits that would otherwise be taxable when passed through to the owners of these businesses. 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.

Another barrier to preservation and tenant protection is an unintended one, resulting from a conflict between the tax code and market forces. Almost all 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 as affordable 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 the property as affordable housing for another 30 years. Since very few investors subject themselves to recapture taxes today, opting instead to pass on 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.

Again, we support the efforts of the Rebuild Rural Coalition and agree that infrastructure legislation by Congress should specifically address the unique needs of agriculture and rural communities. We recognize that a private-public partnership is needed. The various housing programs outlined in this testimony are evidence of the success of this partnership. However, we know that more can and must be done so that the housing and infrastructure needs of rural America can successfully be achieved. In this regard, we thank you Chairwoman Waters for proposing the recommended funding level for RD's Multifamily Preservation and Revitalization (MPR) program in the draft legislation entitled "Housing is Infrastructure Act of 2019." We would urge the Committee to expedite consideration of this legislation as drafted.

Thank you for this opportunity to provide written testimony to the Committee. We thank the Committee for bringing housing into the conversations surrounding infrastructure initiatives.