LOW-INCOME HOUSING TAX CREDIT

HEARINGS

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

FIRST SESSION

APRIL 23 AND MAY 1, 1997

Serial 105–82

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

58–929 CC WASHINGTON : 1999

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-059769-2

COMMITTEE ON WAYS AND MEANS

BILL ARCHER, Texas, *Chairman*

PHILIP M. CRANE, Illinois
BILL THOMAS, California
E. CLAY SHAW, JR., Florida
NANCY L. JOHNSON, Connecticut
JIM BUNNING, Kentucky
AMO HOUGHTON, New York
WALLY HERGER, California
JIM McCRERY, Louisiana
DAVE CAMP, Michigan
JIM RAMSTAD, Minnesota
JIM NUSSLE, Iowa
SAM JOHNSON, Texas
JENNIFER DUNN, Washington
MAC COLLINS, Georgia
ROB PORTMAN, Ohio
PHILIP S. ENGLISH, Pennsylvania
JOHN ENSIGN, Nevada
JON CHRISTENSEN, Nebraska
WES WATKINS, Oklahoma
J.D. HAYWORTH, Arizona
JERRY WELLER, Illinois
KENNY HULSHOF, Missouri

CHARLES B. RANGEL, New York
FORTNEY PETE STARK, California
ROBERT T. MATSUI, California
BARBARA B. KENNELLY, Connecticut
WILLIAM J. COYNE, Pennsylvania
SANDER M. LEVIN, Michigan
BENJAMIN L. CARDIN, Maryland
JIM McDERMOTT, Washington
GERALD D. KLECZKA, Wisconsin
JOHN LEWIS, Georgia
RICHARD E. NEAL, Massachusetts
MICHAEL R. McNULTY, New York
WILLIAM J. JEFFERSON, Louisiana
JOHN S. TANNER, Tennessee
XAVIER BECERRA, California
KAREN L. THURMAN, Florida

A.L. SINGLETON, *Chief of Staff*
JANICE MAYS, *Minority Chief Counsel*

SUBCOMMITTEE ON OVERSIGHT

NANCY L. JOHNSON, Connecticut, *Chairman*

ROB PORTMAN, Ohio
JIM RAMSTAD, Minnesota
JENNIFER DUNN, Washington
PHILIP S. ENGLISH, Pennsylvania
WES WATKINS, Oklahoma
JERRY WELLER, Illinois
KENNY HULSHOF, Missouri

WILLIAM J. COYNE, Pennsylvania
GERALD D. KLECZKA, Wisconsin
MICHAEL R. McNULTY, New York
JOHN S. TANNER, Tennessee
KAREN L. THURMAN, Florida

Pursuant to clause 2(e)(4) of Rule XI of the Rules of the House, public hearing records of the Committee on Ways and Means are also published in electronic form. The printed hearing record remains the official version. Because electronic submissions are used to prepare both printed and electronic versions of the hearing record, the process of converting between various electronic formats may introduce unintentional errors or omissions. Such occurrences are inherent in the current publication process and should diminish as the process is further refined.

CONTENTS

	Page
Advisory of April 14, 1997, announcing the hearing	2

WITNESSES

U.S. General Accounting Office, James R. White, Associate Director, Tax Policy and Administration Issues, General Government Division; accompanied by Dennis Fricke, Assistant Director, Housing and Community Development; and Ralph F. Block, Assistant Director, Tax Policy and Administration Issues, General Government Division, San Francisco, CA	10
Internal Revenue Service, Thomas J. Smith, Assistant Commissioner for Examination	51

Affordable Housing Group, Saperston & Day, Steven J. Weiss	162
Affordable Housing Tax Credit Coalition, William E. Haynsworth	136
Associated Financial Corp., Ronald L. Platt	211
Barbolla, Patrick, Rural Rental Housing Association of Texas, Inc.	156
Bon Secours Baltimore Health Corp., Sister Nancy Glynn	115
Boston Capital Corp., Herbert F. Collins	200
Boston Financial Group, William E. Haynsworth	136
Collins, Herbert F., Boston Capital Corp	200
Connecticut Housing Finance Authority, Gary E. King	129
Cooper, Wilfred N., WNC & Associates, Inc., National Association of Home Builders, National Housing Conference, and U.S. Chamber of Commerce, Taxation Committee	206
Enterprise Foundation, F. Barton Harvey III	181
Glynn, Sister Nancy, Bon Secours Baltimore Health Corp	115
Harvey, F. Barton III, Enterprise Foundation	181
Haynsworth, William E., Affordable Housing Tax Credit Coalition, and Boston Financial Group	136
Hodel, Kathleen, Lake Havasu City Apartment Owners Association	120
King, Gary E., Connecticut Housing Finance Authority	129
Lake Havasu City Apartment Owners Association, Kathleen Hodel	120
Lewis, Terry, National Cooperative Bank, National Association of Housing Cooperatives, and National Cooperative Business Association	227
Local Initiatives Support Corp., Benson F. Roberts	189
Logue, James L., III, National Council of State Housing Agencies, and Michigan State Housing Development Authority	68
Metcalf, Hon. Jack, a Representative in Congress from the State of Washington	103
Michigan State Housing Development Authority, James L. Logue III	68
National Association of Home Builders:	
Wilfred N. Cooper	206
Larry A. Swank	144
National Association of Housing Cooperatives, Terry Lewis	227
National Cooperative Bank, Terry Lewis	227
National Cooperative Business Association, Terry Lewis	227
National Council of State Housing Agencies, James L. Logue III	68
National Housing Conference, Wilfred N. Cooper	206
Platt, Ronald L., McDermott, Will & Emery, and Associated Financial Corp	211
Rangel, Hon. Charles B., a Representative in Congress from the State of New York	107
Roberts, Benson F., Local Initiatives Support Corp	189
Rural Rental Housing Association of Texas, Inc., Patrick Barbolla	156
Sterling Group, Larry A. Swank	144
Stevens, Herbert F., Peabody & Brown	217
Swank, Larry A., National Association of Home Builders, and Sterling Group	144

Page
U.S. Chamber of Commerce, Taxation Committee, Wilfred N. Cooper 206
Weiss, Steven J., Affordable Housing Group, Saperston & Day 163
WNC & Associates, Inc., Wilfred N. Cooper 206

SUBMISSIONS FOR THE RECORD

Clark & Clark, Memphis, TN, William B. Clark, Jr., letter (forwarded by Hon. John S. Tanner, a Representative in Congress from the State of Tennessee) 246
National Apartment Association, and National Multi Housing Council, joint statement 248
Texas Department of Housing and Community Affairs, Austin, TX, Larry Paul Manley, statement 251

LOW-INCOME HOUSING TAX CREDIT

WEDNESDAY, APRIL 23, 1997

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The Subcommittee met, pursuant to notice, at 1:34 p.m., in room B–318, Rayburn House Office Building, Hon. Nancy L. Johnson (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
April 14, 1997
No. OV-5

CONTACT: (202) 225-1721

Johnson Announces Hearing on the Low-Income Housing Tax Credit

Congresswoman Nancy L. Johnson (R-CT), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a two-day hearing on the administration of the low-income housing tax credit. **The first hearing day will be conducted on Wednesday, April 23, 1997, in room B-318 of the Rayburn House Office Building, beginning at 1:30 p.m. The second hearing day will take place on Thursday, May 1, 1997, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

Oral testimony on April 23 will be received from invited witnesses, including representatives of the U.S. General Accounting Office (GAO), the Internal Revenue Service (IRS), and the National Council of State Housing Agencies. The Subcommittee will receive testimony from public witnesses on May 1. Also, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee or for inclusion in the printed record of the hearing.

BACKGROUND:

The low-income housing tax credit (LIHC) is the largest Federal program to fund the development and rehabilitation of low-income housing. According to GAO, if all the credits authorized over a 10-year period were awarded by the States to completed projects and used by investors, the annual cost to the Treasury would be over $3 billion.

As part of the Committee's oversight of the tax credit program, Chairman Bill Archer asked GAO to study the administration and operation of the credit to determine: (1) how efficiently the IRS is administering and monitoring the LIHC, (2) what controls exist at the State level to ensure that the credit is applied as intended and that costs are reasonable, (3) what controls exist to ensure that States do not certify buildings as eligible for the credit beyond the amount allocated by State housing authorities, (4) the characteristics of the individuals residing in the units produced by the credits (i.e., whether residents fit the characteristics of individuals and families for whom the program is intended), and (5) such other issues as may arise during the course of the examination. Chairman Archer asked Subcommittee Chairman Johnson to oversee the study. The study has been completed by GAO and was released by Chairman Archer on April 9, 1997.

In announcing the hearing, Chairman Johnson stated: "The GAO's work will be tremendously helpful to the Subcommittee in determining how well the low-income housing credit is being administered. It appears that there are several opportunities to improve enforcement, and it is my hope that these hearings will help the Subcommittee develop recommendations to strengthen oversight and monitoring of compliance."

FOCUS OF THE HEARING:

The hearing will focus on the issues addressed by the GAO study and the findings, including characteristics of the residents and properties that have benefitted from the LIHC, and the controls the IRS and the States are using to ensure that priority housing needs are being met, i.e., project costs (including tax costs) are reasonable, and that States and project owners comply with the program requirements.

(MORE)

WAYS AND MEANS SUBCOMMITTEE ON OVERSIGHT
PAGE TWO

DETAILS FOR SUBMISSIONS OF REQUESTS TO BE HEARD:

Requests to be heard on Thursday, May 1, 1997, must be made by telephone to Traci Altman or Bradley Schreiber at (202) 225-1721 no later than the close of business, Wednesday, April 23, 1997. The telephone request should be followed by a formal written request to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The staff of the Subcommittee on Oversight will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee on Oversight staff at (202) 225-7601.

In view of the limited time available to hear witnesses, the Subcommittee may not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are required to summarize briefly their written statements in no more than five minutes. **THE FIVE-MINUTE RULE WILL BE STRICTLY ENFORCED. The full written statement of each witness will be included in the printed record, in accordance with House Rules.**

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Subcommittee are required to submit 200 copies of their prepared statement and a 3.5-inch diskette in WordPerfect or ASCII format, for review by Members prior to the hearing. **Testimony should arrive at the Subcommittee on Oversight office, room 1136 Longworth House Office Building, no later than 48 hours before the hearing date.** Failure to do so may result in the witness being denied the opportunity to testify in person.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement and a 3.5-inch diskette in WordPerfect or ASCII format, with their address and date of hearing noted, by the close of business, Thursday, May 15, 1997, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments. At the same time written statements are submitted to the Committee, witnesses are now requested to submit their statements on a 3.5-inch diskette in WordPerfect or ASCII format.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

(MORE)

WAYS AND MEANS SUBCOMMITTEE ON OVERSIGHT
PAGE THREE

Note: All Committee advisories and news releases are available on the World Wide Web at "http://www.house.gov/ways_means/".

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-225-1904 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

*****

Chairman JOHNSON. The hearing will come to order.

Congresswoman Thurman will be along shortly, but I think since I have a longer than usual opening statement, that I will start.

The low-income housing tax credit is currently the largest program whose purpose it is to stimulate the production of housing for low-income households. According to the Joint Committee on Taxation, the revenue loss associated with the credit, that is, the cost to the taxpayers, is almost $18 billion over 5 years. Given the substantial cost of this program and its tremendous importance in the lives of people in New Britain, my hometown, Bristol and my district and other towns and cities throughout my district and the Nation, it is imperative that the program be administered effectively and that States be accountable for using these key dollars to produce the maximum number of high quality units in areas of need.

In July 1995, Chairman Archer asked that the GAO study the administration and operation of the credit. Specifically, GAO was asked to examine the characteristics of the tenants and the properties benefiting from the credit, to make sure the credit is helping the right people and the right developments. He also asked GAO to evaluate the controls that the Internal Revenue Service and the States are using to make sure that, first, State priority housing needs are being met, second, housing project costs, including tax credit costs, are reasonable and, third, States and project owners comply with program requirements.

Since we will be hearing from GAO shortly, I will not summarize their major findings and recommendations. However, I would like to comment briefly on several findings that are of interest to me.

The credit was originally intended to help the working poor. In practice, an estimated three-quarters of the households had incomes at or below 50 percent of median area incomes, with 50 percent of those benefiting having incomes below $15,000 and 80 percent below $20,000. This is truly impressive. Yet, it is difficult to examine the credit in isolation, because 71 percent of the households benefited directly or indirectly from other forms of government assistance, including rental assistance, government loans, loan subsidies and grants. Are we using the range of Federal housing subsidy programs to help the maximum number of our citizens?

Fully 43 percent of the households in tax credit properties were one-person households and another 24 percent were two-person households. About 29 percent were headed by a person aged 55 or older. I expected a larger percentage of the units to be rented to families with children. Are States not putting a priority on affordable family housing? If not, why not?

Many States do not appear to be fully using their existing tax credit allocations. For each year from 1992 through 1994, the value of the tax credits awarded to projects placed in service fell substantially short of the total annual per capita allocations. In fact, only half of the $315 million allocation was awarded in 1992. When I think of the rural and urban needs just in my district, I find this hard to understand.

I am concerned about the amount of money that is going to fees. The National Council of State Housing Agencies has recommended that developers' fees generally be limited to no more than 15 percent of a project's total development costs and that fees to builders and related parties be limited to 14 percent of a project's construction costs. Most of the States have followed the NCSHA's guidance with respect to developers' fees and about half with respect to builders' fees, but some have not. Syndication fees may consume from ten to 27 percent of the funds contributed by investors. Is almost 30 percent of the money going to developers' and builders' fees reasonable? We need to ask that question.

I am also concerned to read that, according to the IRS' Chief Counsel, if the Service determines that a State is not in compliance with its qualified allocation plan, the Code does not give the IRS the authority to levy sanctions against State agencies that would not affect taxpayers who have already received credits. The sanction that exists in current law is to disallow a State's entire allocation amount for the period of noncompliance. Surely, we can respond forcefully, but in a targeted fashion, to both gain a higher standard of performance and protect good projects from harm due to the actions of others.

Finally, I am surprised to learn that the IRS regulations do not require States to make onsite visits to ensure that the housing units are habitable. NCSHA, to its credit, has provided guidance in this area, but some States have fallen short.

The low-income housing tax credit has financed many fine projects, creating excellent homes for people of all ages. It is no secret that I have supported the credit since its inception and I am gratified by the overall tone of the GAO's findings. However, oversight is about overseeing, so we can know how public policy is serving us and how we can improve its ability to help us meet critical

needs. Nearly every feature of our tax law leaves room for improvement and the GAO has demonstrated that the credit is no exception. I believe the report provides us with an opportunity to strengthen the credit, review its goals and ultimately, to understand how it interacts with other housing subsidy programs in a more realistic way to assure the long-term interests of our constituents.

Today, we will be hearing from the General Accounting Office, the Internal Revenue Service and the National Council of State Housing Agencies, and on May 1, we will hear from a number of other stakeholders. The GAO has given us a good starting point, but I am looking forward to suggestions that other witnesses may offer us as to how to strengthen enforcement and compliance and better utilize this valuable program.

Upon completion of these hearings and the Subcommittee's review of the GAO's report, we will be recommending legislation to the Full Committee.

[The opening statement follows:]

Opening Statement
The Honorable Nancy L. Johnson
Low-Income Housing Tax Credit Hearing
Ways and Means Subcommittee on Oversight
April 23, 1997

The low-income housing tax credit is currently the largest federal program whose purpose it is to stimulate the production of housing for low income households. According to the Joint Committee on Taxation, the revenue loss associated with the credit -- the cost to the taxpayers -- will be $17.9 billion over the next five years. Given the substantial cost of this program and its tremendous importance in the lives of the people of New Britain, my home town, Britstol, and other towns and cities across America, it is imperative that the program be administered effectively and that states be accountable for using these key dollars to produce the maximum number of high quality units in the areas of need..

In July of 1995, Chairman Archer asked the U. S. General Accounting Office to study the administration and operation of the credit. Specifically, GAO was asked to examine the characteristics of the tenants and the properties benefitting from the credit, to make sure the credit is helping the right people and the right developments. He also asked GAO to evaluate the controls the Internal Revenue Service and the states are using to make sure that (1) state priority housing needs are being met, (2) housing project costs, including tax credit costs, are reasonable, and (3) states and project owners comply with program requirements.

Since we will be hearing from GAO shortly, I will not summarize their major findings and recommendations. However, I would like to comment briefly on several findings that are of interest to me.

- The credit was originally intended to help the working poor. In practice, an estimated three quarters of the households had incomes at or below 50 percent of median area income, with 50 percent of those benefitting having incomes below $15,000 and 80 percent below $20,000. This is truly impressive, yet it is difficult to examine the credit in isolation, because about 71 percent of the households benefitted directly or indirectly from other forms of government assistance, including rental assistance, government loans, loan subsidies and grants. Are we using the range of federal housing subsidy programs to help the maximum number of our citizens?

- Fully 43 percent of the households in tax credit properties were one-person households, and another 24 percent were two-person households. About 29 percent were headed by a person aged 55 or older. I expected a larger percentage

of the units to be rented to families with children. Are states not putting a priority on affordable family housing? If not, why not?

- Many states do not appear to be fully using their existing tax credit allocations. For each year from 1992 through 1994, the value of the tax credits awarded to projects placed in service fell substantially short of the total annual per capita allocations. In fact only half of the $315 million allocation was awarded in 1992. When I think of the rural and urban needs just in my district, I find this hard to understand.

- I am concerned about the amount of money that is going to fees. The National Council of State Housing Agencies has recommended that developers' fees generally be limited to no more than 15 percent of a project's total development costs and that fees to builders and related parties be limited to 14 percent of a project's construction costs. Most of the States have followed NCSHA's guidance with respect to developers' fees and about half with respect to builders' fees, and some have not. Syndication fees may consume from 10 to 27 percent of the funds contributed by investors. Is almost 30 percent of the money going to developers' and builders fees' reasonable? We must ask this question.

- I am also concerned to read that according to the IRS Chief Counsel, if the Service determines that a State is not in compliance with its qualified allocation plan, the Code does not give the IRS the authority to levy sanctions against State agencies that would not affect taxpayers who have already received credits. The sanction that exists in current law is to disallow a State's entire allocation amount for the period of noncompliance. Surely we can respond forcefully but in a targeted fashion to both gain a higher standard of performance and protect good projects from harm due to the action of others.

- Finally, I am surprised to learn that IRS regulations do not require States to make on-site visits to make sure the housing units are habitable. NCSHA, to its credit, has provided guidance in this area, but some States have fallen short.

The low-income housing tax credit has financed many fine projects, creating excellent homes for people of all ages. It is no secret that I have supported the credit since its inception, and I am gratified by the overall tone of GAO's findings. However, oversight is about overseeing, so we can know how public policy is serving us well and how we can improve it so it better serves our needs. Nearly every feature of our tax law leaves room for improvement, and the GAO has demonstrated that the credit is no exception. I believe the report provides us with an opportunity to strengthen the credit

and re-think our goals.

Today, we will be hearing from the General Accounting Office, the Internal Revenue Service and the National Council of State Housing Agencies, and on May 1st we will hear from a number of other stakeholders. The GAO has given us a good starting point, but I am looking forward to suggestions that the other witnesses may offer as to how to strengthen enforcement and compliance and to better utilize this valuable program.

Upon completion of these hearings and the Subcommittee's review of GAO's report, we will be recommending legislation to the full Committee. I'd like to recognize our ranking Member, Representative Coyne of Pennsylvania.

Chairman JOHNSON. I would like to recognize my Ranking Member today, Congresswoman Thurman, for any opening comments that she may have.

Ms. THURMAN. Thank you, Madam Chairman.

Let me just first state that Representative Coyne has been delayed in Pittsburgh and hopefully will be joining us later.

Today is the Oversight Subcommittee's first day of hearings on the effectiveness of the low-income house tax credit. I want to personally thank the U.S. General Accounting Office for the kind job in providing a comprehensive and thorough review of the LIHTC. The low-income housing tax credit is our Nation's most important program for funding the development and rehabilitation of low-income housing. Thus, it is important that the Ways and Means Committee conduct periodic oversight review of this program.

I know we are pleased that the Internal Revenue Service supports GAO's administrative recommendations for enhancing the IRS' and State's monitoring system. Also importantly, the GAO has concluded that all of the States have developed qualified programs, allocations plans and that the LIHTC is, in fact, providing housing to thousands of working families at the lowest income levels.

Finally, the GAO did not identify any noncompliance problems in operation of the LIHTC or recommend any statutory changes to the Internal Revenue Code. All those involved in the LIHTC should be proud of their participation in the program and commitment to providing affordable housing to thousands of low-income individuals and families. At our second hearing next week, we will have the opportunity to discuss the program with these experts and to evaluate the success of the LIHTC in more detail.

In short, though, I would also like to state that the LIHTC Program is a perfect example of the Federal Government's working in concert with the private sector. In a time when roughly 100,000 apartments are demolished, abandoned or converted to market rate use each year, it is important to give the private sector the means to stimulate the low-income housing market. In doing so, Congress has created a successful program which provides essential housing services to our lower income citizens. By administrating tax incentive block grants to the States, Congress is also giving the States the flexibility they need to meet their individual needs.

For example, in Florida, following the effects of Hurricane Andrew, the Florida Housing Finance Agency was able to refocus a substantial number of housing credits to meet the needs of those low-income residents whose properties were devastated by the hurricane. I would also like to note that I am quite impressed with the Florida Housing Finance Agency's oversight of the Low-Income Housing Tax Credit Program. Their extensive application forms, credit underwriting, record extensive use agreements and regular onsite visits surpass many of the current IRS regulations which govern low-income housing.

As a result, since 1987, the housing credit program has provided my home State of Florida with 45,692 safe, affordable apartment units, housing more than 68,000 people. There is room for improvement in any program, but I am encouraged by the cooperation between the State housing agencies and the IRS to work together to make the needed advances in the housing credit program.

I look forward to the hearing today and to the testimony that we are about to receive and certainly in our next week so that we can have even more discussion. Thank you.

Chairman JOHNSON. Thank you, Congresswoman.

As we start, let me say that I am not going to use the 5-minute light. I assume that you will understand there are panels to follow you and there is a limited time this afternoon. I also want to mention that I do have to leave promptly at 5, although I will be back in about 15 minutes. Unfortunately, there will be that interruption and the Subcommittee will proceed in my absence.

I have read your testimony. I am looking forward to having a chance to question you, along with the rest of the Subcommittee. I do want my colleagues to have time to really hear your report and to have the time they need to question. I am very pleased to have your report. This is an important oversight project. So, I am pleased to start this oversight review of the low-income housing tax credit with what I think is a very thorough report.

Mr. White.

STATEMENT OF JAMES R. WHITE, ASSOCIATE DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY DENNIS FRICKE, ASSISTANT DIRECTOR, HOUSING AND COMMUNITY DEVELOPMENT; AND RALPH F. BLOCK, ASSISTANT DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES, GENERAL GOVERNMENT DIVISION, SAN FRANCISCO, CALIFORNIA

Mr. WHITE. Thank you. Madam Chairman and Members of the Subcommittee, we appreciate being here this afternoon to discuss our report entitled "Tax Credits, Opportunities to Improve Oversight of the Low-Income Housing Program." I am Jim White, Associate Director of GAO's tax issue area. With me is Ralph Block, also from tax and Dennis Fricke, from our housing issue area. I have a written statement which I would like to summarize.

As you mentioned, Madam Chairman, the tax credit is the largest Federal program for funding development of low-income rental housing and could cost Federal taxpayers as much as $3 billion per year. Our report describes the tax credit projects and residents and

assesses IRS and State controls for insuring that State housing needs are met, costs are reasonable and tax laws are complied with.

Our report makes the following four main points. First, the households served had income levels considered very low by HUD. Second, although States had plans to direct tax credits to housing needs, we identified several factors, such as, credits not being used that could affect the housing actually delivered. Third, all States had cost controls, however, some States lacked complete cost and financial data for some projects. Last, IRS needs additional information to adequately monitor State and taxpayer compliance.

Our analysis was based on a survey of all State tax credit allocating agencies, a random sample of 423 housing projects and review of IRS procedures.

I would like to outline very briefly how the program works. Figure 1, this and other figures are attached to my prepared statement, is an illustration of a simple case of that. Starting in the lower lefthand corner of the figure, developers have to finance projects. Under the program, that is done partly using private-sector mortgages from lenders, shown above the developer and, partly using equity paid into the project by investors who receive the tax credits. I won't say anything else about the diagram in the interest of time. It is a quick outline of how the program works in a simple case.

What I would like to do now is to describe the housing delivered under the program and the tenants served. We estimated that about 4100 properties with 172,000 tax credit units were placed in service in the United States between 1992 and 1994. Those were the years of our sample. The average annual income in 1996 of the tax credit households was an estimated $13,300. The distribution of incomes is shown in figure 2.

About three-fourths of tax credit households met HUD's definition of very low income. That is, their incomes were below 50 percent of their area's median income. Many household benefited from other Federal housing assistance. Tax credit households are small. About two-thirds were one or two persons. A quarter of the projects were developed to serve the elderly. Tax credit properties are located throughout the country. Most common is a walkup garden-style building, but properties range from rowhouses to elevator buildings. Most projects are newly constructed.

The average monthly rent of a unit was about $450. Figure 3 shows the per unit costs of tax credits in present value terms. For the average unit, the present value of the cost of the credit to Federal taxpayers was an estimated $27,300. About 2 percent of the units had tax credit costs in present value terms of over $100,000 per unit.

Project development costs as opposed to tax credit costs are shown in figure 4. We estimated that the average cost of developing the units was about $60,000.

Now, I will discuss the State and IRS controls over the program. All the States have developed allocation plans required by the Tax Code, to direct tax credits to priority housing needs. Most use some sort of point system to rank project proposals. However, we identi-

fied several factors that could affect the housing actually delivered by the program.

First, nearly all the agencies reserved discretion for bypassing their plan. We recognized that discretion can be beneficial. It can target unforeseen needs, but it should be documented. A second factor affecting housing delivery is whether tax credits are used. Data from the States, IRS and HUD showed a significant gap between tax credits initially allocated and credits awarded the projects when completed. For example, projects proposed in 1992 got initial credit allocations of $322 million, but by the end of 1994, only about half had been used. This raises the question of whether the State agencies produced all the housing the Federal Government was prepared to fund.

A third factor affecting housing delivery is the economic viability of the tax credit projects after the 15-year compliance period. Whether these properties continue to provide low-income housing for tenants will depend on such factors as the economics of alternative uses and the need for additional subsidies.

Now, I will discuss controls to insure costs are reasonable. All States have some cost controls in place. However, we identified opportunities for the States to improve their controls. Figure 5, shows the aggregate development costs and financing for projects placed in service from 1992 through 1994. The height of the bar represents total development costs or the uses of funds. The height also shows the total financing needed or the sources of funds. There were three sources, equity paid into the project by tax credit investors, commercial mortgage loans and concessionary financing providing primarily by other Federal housing programs.

To control costs, many States relied on HUD cost standards and most also used competition among developers for credits. To determine the reasonableness of private financing, States reported that they reviewed projects' rents, operating expenses and mortgage terms. To determine the reasonableness of non-tax credit public subsidies, States also reported doing reviews. In the case of HUD financing, the evaluation is called a subsidy layering review.

Referring back to figure 5 again, the equity paid into projects in 1992 through 1994 was about $3.1 billion. This equity paid in was generated by about $6.1 billion in tax credits payable over 10 years. This works out to a yield of about 0.53 cents on the dollar. This tax credit yield or price has gone up over time from about 0.45 cents in 1987 to over 0.60 cents in 1996, according to several major syndicators and State allocating agency officials.

In controlling costs, allocating agencies are largely dependent on information submitted by developers. We found some control weaknesses in this area. For example, for the years 1992 through 1994, the scope of independent cost verifications varied and about 14 percent of the projects lacked complete information on the sources and uses of funds. This leaves States vulnerable to providing more or fewer credits than needed. Accordingly, we recommended in our report that the Commissioner of Internal Revenue establish clear requirements for insuring independent verification of the sources and uses of funds, information submitted to States by developers.

Now, I will discuss State and IRS oversight. We found several States had not completed their agreed upon monitoring of project

compliance with rent, income and habitability requirements for 1995. Also, IRS did not have the information to determine whether States did their monitoring. IRS' regulations did not require States to make onsite visits to projects and IRS did not have enough information from States about noncompliance to be able to determine the tax consequences for property owners.

Accordingly, we recommended that the Commissioner of Internal Revenue require, one, that States report sufficient information about monitoring inspections so that IRS can determine whether States have done their monitoring and, two, that States' monitoring provide sufficient information to insure the Code's habitability requirements are met. We also recommended that IRS explore modifying the form States use to report noncompliance, so that it can better determine any tax consequences for project owners.

In late 1995, IRS instituted an audit program to determine whether taxpayers are entitled to the credits they claim. IRS is relying on the results of its audit initiative to provide estimates on the extent and types of noncompliance. However, IRS' current audit program is not based on a random sample of returns and will not provide statistically reliable compliance data.

With respect to monitoring State use of tax credits, the IRS is currently developing a document-matching program, but still lacks information on return credits which is necessary for determining whether States stay within their ceilings. Accordingly, we recommended that the Commissioner of Internal Revenue explore alternative ways to, one, develop an estimate of tax credit compliance and, two, obtain better information to verify that States' allocations do not exceed authorizations.

Now, I will discuss independent oversight of the tax credit program. Unlike most programs operated by State and local governments that receive Federal financial assistance, the Low-Income Housing Tax Credit Program is not subject to independent audits under the Single Audit Act. The act, which is an important accountability tool for the Federal financial assistance administered by State and local governments does not apply the tax credits because credits are not considered Federal financial assistance by OMB. Subjecting the Low-Income Housing Tax Credit Program to the single audit process may be a more efficient, effective and less federally intrusive way of monitoring State agency controls than other types of independent audits.

Accordingly, we recommended that the Director of OMB incorporate the Low-Income Housing Tax Credit Program in the definition of Federal financial assistance, so that the program would be subject to the Single Audit Act.

That concludes my prepared statement and I would be pleased to answer any questions.

[The prepared statement follows:]

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

For Release on
Deliver Expected at
1:30 p.m., Wednesday
April 23, 1997

TAX CREDITS

Opportunities to Improve Oversight of the Low-Income Housing Program

Statement of James R. White, Associate Director, Tax Policy & Adminstration Issues, General Government Division

GAO/T-GGD/RCED-97-149

Madam Chairman and Members of the Subcommittee,

We appreciate being here this afternoon to discuss our recently issued report entitled Tax Credits: Opportunities to Improve Oversight of the Low-Income Housing Program (GAO/GGD/RCED-97-55, March 28, 1997). Currently, the tax credit is the largest federal program for funding the development and rehabilitation of rental housing for low-income households. Under this program, the states award tax credits that could cost federal taxpayers as much as $3 billion per year.

Our report, which is addressed to you, Madam Chairman, and the Chairman of the Ways and Means Committee, answers questions about the characteristics of tax credit projects and their residents and the controls the Internal Revenue Service (IRS) and the states have over the program. More specifically, with respect to controls we were asked to assess IRS and state controls for ensuring that (1) state priority housing needs are met; (2) housing project costs, including tax credit costs, are reasonable; and (3) states and project owners comply with program requirements.

In answering these questions, our report makes the following four main points:

–A substantial majority of the households served by the program had incomes considered "very low" by the Department of Housing and Urban Development and about three-fourths of all households benefited either directly or indirectly from other types of housing

assistance. We estimate the average tax credit cost per-unit, in present value terms, to be about $27,300.

–All the states had developed qualified allocation plans required by the Internal Revenue Code to direct tax credit awards to priority housing needs. Although the states met tax code requirements, we identified several factors that could affect the housing actually delivered over time. Some states reserve discretion for amending or bypassing the allocation process. In addition, many tax credits that were initially allocated may not have been used. Further, the long term economic viability of tax credit projects as low-income housing has not been tested.

–All states had cost control procedures in place that were intended to help ensure the reasonableness of project costs and tax credit awards. However, some projects lacked complete cost and financial data and some key data used in determining the basis for tax credit awards were not independently verified.

–While states had established compliance monitoring programs consistent with IRS regulations, the regulations did not provide adequate assurance that states perform agreed upon monitoring reviews. Also, IRS needs additional information to adequately monitor states' tax credit allocations and taxpayer compliance with credit requirements.

Before elaborating on these points I would like to describe our methodology and provide some background about how the low income housing tax credit program works and the responsibilities of the IRS and states for administration and oversight of the program.

Our analysis of the low-income housing tax credit program is based primarily on a survey of tax credit policies and procedures in 54 state tax credit allocating agencies, a review of state files for 423 randomly selected housing projects, and a survey of project managers for these projects. We also reviewed IRS' low-income housing tax credit procedures and programs.

HOW THE PROGRAM WORKS

The low income housing tax credit program is a joint federal, state and private sector initiative. Figure 1 attached to this statement illustrates for a simple case how tax credits help finance low-income housing development. Under the program, a developer finances a low income housing project in part using a private mortgage, with payments made out of rental revenues, and in part using equity paid into the project from investors who receive the credit. The greater the private financing, the smaller the amount of tax credit needed.

The process of awarding tax credits to private investors begins with IRS annually allocating tax credits to each state housing agency in an amount equal to $1.25 per state

resident. Developers proposing to build low-income housing apply to the state agencies for credits. Winning developers receive credits which they in turn offer, in effect sell, to private investors, often organized into partnerships by syndicators, who use the credits to offset taxes otherwise owed on their tax returns. In return for the credits, the private investors provide equity financing for the projects. This equity financing fills the gap between the development costs and the non-tax credit financing. The equity paid into a project is less than the sum of the tax credits. The difference provides the investors with a rate of return over 10 years as well as compensation for housing project evaluation and monitoring. A complication not shown in the figure is that many projects also receive other housing subsidies.

About $300 million in new credits are made available nationally each year for award to new housing projects. Assuming project owners remain eligible, they would be entitled to take the $300 million in credits each year for 10 years. Thus, if this occurred in any one year, 10 years worth of federal tax credits would be outstanding and the aggregate annual cost to the federal government would be $3 billion.

The states and IRS share responsibility for administering the tax credit program. Once projects have been placed in service, state agencies are responsible for monitoring the projects for compliance with federal requirements concerning household income and rents and project habitability. Noncompliance with these requirements may result in IRS recapturing or denying previously issued or used tax credits.

IRS is responsible for issuing regulations on state monitoring requirements, ensuring that taxpayers take no more tax credits than they are entitled to take, and ensuring that states allocate no more credits than they were authorized to allocate. In implementing these responsibilities, IRS requires annual reports from the states on the amount of tax credit allocations made in total and amounts awarded to individual projects. IRS also requires taxpayers to disclose tax credit information on their tax returns and requires the states to report findings of project noncompliance.

HOUSING DELIVERED UNDER THE PROGRAM

We estimated, based on our random sample, that about 4,100 properties with about 172,000 tax credit qualified units were placed in service in the continental United States between 1992 and 1994. We also estimated that, for these projects, the states annually awarded tax credits with a potential value over their 10-year lifetime of about $2 billion (about $1.6 billion in present value terms), or about $6.1 billion for the three years combined.

On the basis of information from our survey of property managers, we estimated that the 1996 average annual income of households in units qualifying for tax credits was about $13,300. The distribution of incomes is shown in figure 2, which is attached to this statement. About three-fourths of tax credit households met HUD's definition of "very low income"--that is, their incomes were below 50 percent of their area's median income.

About 71 percent of the tax credit households, benefited directly or indirectly from one or more types of housing assistance besides tax credits. One type of housing assistance, direct rental assistance, enabled the tax credit program to serve many households whose reported income was well below the qualifying limits established by the program. Overall, an estimated 39 percent of the households received direct rental assistance. The average income for these households was about $7,900.

Tax credit households were small--about two-thirds were one or two person households. About a quarter of the projects were developed primarily to serve the elderly.

Tax credit properties were located throughout the country. The most common type of property was a walk-up/garden-style apartment building but properties ranged from row houses to elevator buildings. Most of the projects were newly constructed.

The average monthly rent was about $450. For some tenants rental payments were covered in part by other federal housing assistance.

We estimated that for the tax credit properties placed in service between 1992 and 1994, the states had annually awarded tax credits with a potential value over 10 years of about $2 billion (about $1.6 billion in present value terms). Thus, the taxpayer costs for the tax credits attributable to these three years could be as high as $6.1 billion over the 10-year credit period. We also estimated that the present value of the average tax credit cost per

unit would be about $27,310. As shown in figure 3, which is attached to this statement, about 60 percent of the units had tax credit costs at or below the estimated average and about 2 percent had tax credit costs of $100,000 or more. The federal costs of the tax credits is a function of many factors, including property development costs and the market price of the tax credit.

Project development costs, including land and building acquisition outlays, construction costs, builders' profit, and financing costs, varied widely. We estimate that the average cost of developing the units was about $60,000. About two-thirds of these units cost less than or the same as the average unit. As shown in figure 4, which is attached to this statement, the per-unit costs of the properties varied widely. About 10 percent of the properties cost less than $20,000, and about 10 percent cost more than $100,000--including 3 percent whose costs exceeded $160,000 per unit. Development costs may vary because of differences in the physical characteristics of properties, broader community development needs, and the extent to which tax credit allocating agencies use various controls to limit costs.

STATE CONTROLS FOR ALLOCATING CREDITS TO HOUSING NEEDS VARY

All the states had developed qualified tax credit allocation plans required by the Internal Revenue Code to direct tax credit awards to meet priority housing needs. The plans generally targeted the credit to the priority housing needs identified by the states.

Consistent with the latitude given them in the Code, the states had defined and weighted the selection criteria for awarding credits in different ways. Most states used some sort of scoring system to rank project proposals. The states also used varying amounts of data and analyses in assessing housing needs.

Although all states had adopted required allocation plans for meeting state set housing priorities, we identified several factors that could affect the housing actually delivered over time.

- One factor involves the use of discretionary judgment. Nearly all of the agencies reserved some discretion for amending or bypassing their allocation process. We recognize that discretion can be beneficial –it can target needs resulting from unforeseen circumstances. But, unless the use of discretion is well documented and made public it could undermine the credibility of the allocation process. For example, in one recently completed allocation cycle in Texas senior managers overrode over half the decisions made through the allocation process without documenting their decisions.

- A second factor involves the timely use of tax credits. Data from the states, IRS, and a study contracted by HUD suggest that the states may not be fully using their tax credit allocations. The data show a significant gap between the amount of tax credits that have been allocated by the states to proposed projects and the tax

credits that have been awarded to projects when they were completed and been placed in service. For example, IRS data showed that the cohort of projects proposed in 1992 received tax credit allocations of about $322 million. However, by the end of calendar year 1994 only about half the credits had been actually used--that is, awarded to projects placed in service. These data raise the question of whether the allocating agencies produced the total amount of housing that the federal government was prepared to fund. From the available data, we cannot determine how much of the total federal allocation that has not been awarded may have lapsed and how much may have been reallocated for future use.

A third factor involves the long-term economic viability of the tax credit projects after the 15 year tax credit compliance period ends. Under the Code, projects receiving tax credits are required to have an extended-use agreement requiring that the property serve low-income tenants for 30 years, but with a contingency clause that allows for conversion to market rate housing after 15 years under certain conditions. Within the next decade, the first properties subsidized with tax credits will enter the period covered by extended-use agreements. Whether these properties convert to market rate housing, continue to provide high-quality housing for low-income tenants, or gradually deteriorate will depend on such factors as the economics of the alternative uses, the states' ability to find buyers willing to keep the properties in low-income use, and the need to obtain additional subsidies.

STATE CONTROLS FOR ENSURING THE REASONABLENESS OF PROJECT COSTS CAN BE STRENGTHENED

All states had some cost control procedures in place that were intended to help ensure the reasonableness of tax credit awards. However, we identified opportunities for the states to improve their cost controls. Figure 5, which is attached to this statement, provides an overview of the development costs or uses of funds and the financing or sources of funds for projects placed in service from 1992 through 1994. The height of the bars represents total development costs or the uses of funds. The financing of these development costs, the sources of funds, was provided by the three components shown:

- Equity paid into projects by tax credit investors, which was about $3.1 billion and which was generated by about $6.1 billion in tax credits investors can claim on their tax returns over 10 years.
- Commercial mortgage loans of about $3.8 billion.
- Concessionary financing of about $3.8 billion, which was provided primarily by other federal housing programs.

Controlling the amount of tax credits awarded to individual projects limits federal taxpayers' cost for the project and allows a state, with an overall tax credit allocation proportional to its population, to finance more projects. To do this the states should consider

- the reasonableness of a project's development cost;

- the extent of a project's financing gap, which is the difference between the cost of a project and the amount of non-tax credit financing that a project can raise to cover those development costs; and

- the yield obtained from a project's tax credit award, which is the amount of equity investment a project could raise for each tax credit dollar received.

All state agencies had controls over development costs. Many states relied on HUD cost standards, others believed their own standards were more effective in limiting costs, and some relied on their staffs' expertise because they said that differences in project types and location made setting standards impractical. These standards acted as a ceiling on costs. Additionally, most supplemented these practices by using competition among project developers to control costs, i.e., cost was a factor in ranking projects applying for tax credit awards. State agency practices for determining the reasonableness of the non-tax credit financing varied, but they generally included reviewing projects' rents and operating expenses, private mortgage terms, and non-tax credit public subsidies–in the case of HUD financing the evaluation is called a "subsidy layering review".

As already mentioned, the equity yield per dollar of tax credit is a factor influencing the federal cost of an individual project and the $3.1 billion in equity paid in by investors

during 1992 through 1994 was generated by $6.1 billion in tax credits. This works out to about $0.53 on the dollar. States generally relied on the market to determine the yield obtained from a project's tax credit award. The tax credit yield or price has gone up over time, from about $0.45 in 1987 to over $0.60 in 1996, according to several major syndicators and state allocating agency officials.

In controlling costs--that is, in evaluating the reasonableness of project costs, the financing gap, and the tax credit price--allocating agencies are largely dependent on information submitted by developers. To the extent that the agencies do not have complete and reliable information, they lack assurance about the effectiveness of their cost controls.

We found some control weaknesses in terms of the way states assured the reliability of information from developers about their sources and uses of project funds. For example, although all but one state required some form of independent verification of cost and financing data, the scope of the required cost verification work varied. It ranged from audits to more limited work, that did not require verification of costs included in the base for calculating the tax credit award. Overall, we estimated that for about 14 percent of the total projects, the states lacked complete information on the sources and uses of project funds. Without assurance of the validity of developer costs and without a complete and documented basis for determining equity needs, such as a detailed sources

and uses of funds analysis, states are vulnerable to providing more (or fewer) credits to projects than needed.

Accordingly, we recommended that the Commissioner of Internal Revenue amend regulations for the tax credit program to establish clear requirements for ensuring independent verification of key information on sources and uses of funds submitted to states by developers.

STATE AND IRS OVERSIGHT CAN BE IMPROVED

The Internal Revenue Code provides for dual oversight of the tax credit program by state tax credit allocating agencies and IRS. In general, we found that not all allocating agencies fulfilled the requirements of their compliance monitoring programs; and although IRS has been developing programs, it did not have sufficient information to determine state or taxpayer compliance.

State Monitoring Programs

In general states are responsible for monitoring project compliance with rent, income, and habitability requirements after the projects are placed in service and for reporting any noncompliance to IRS. In 1995, several states did not do the number of desk reviews and on-site inspections they had agreed to do. Because IRS' regulations do not require states

to submit annual reports to IRS on the number of monitoring inspections made, IRS was not in a position to readily determine whether states met their agreed-upon monitoring responsibilities. Also, IRS' monitoring regulations do not require states to make on-site visits to projects or obtain information from other sources, such as local government reports on building code violations, that would allow states to detect violations of the Code's habitability requirements. For IRS to better ensure that habitability problems are identified during monitoring reviews, states would have to do on-site inspections or obtain information on these types of problems from other sources. We also found that IRS was not collecting enough information from states on the number of units in each project where states found noncompliance for IRS to determine whether the noncompliance has a tax consequence for the project owners.

Accordingly, we recommended that the Commissioner of Internal Revenue amend regulations for the tax credit program to (1) require that states report sufficient information about monitoring inspections or reviews, including the number and types of inspections made, so that IRS can determine whether states have complied with their monitoring plans; and (2) require that states' monitoring plans include specific steps that will provide information to permit IRS to more effectively ensure that the Code's habitability requirements are met. We also recommended that IRS explore modifying the form states use to report noncompliance so that IRS can better determine whether the noncompliance has a tax consequence for the project owners.

IRS Compliance Oversight Activities

IRS is responsible for ensuring that taxpayers claim only those tax credits for which they are entitled and for ensuring that states do not exceed their annual tax credit ceilings.

In 1995, IRS instituted an audit program to determine whether taxpayers are entitled to the credits claimed on their tax returns. As of the end of fiscal year 1996, IRS had completed work on 35 audit cases and found 12 to be in noncompliance.

IRS is relying on the results of its audit initiative to provide estimates on the extent and types of noncompliance that exist in the tax credit program. It is important for IRS to have information on compliance so that it can determine how best to allocate its compliance resources. However, IRS' current audit program is not based on a random sample of returns and will not provide statistically reliable compliance data.

With respect to monitoring state use of tax credits, IRS is currently developing a document matching program using state tax credit reports to determine whether states have allocated more credits than allowed by law. However, the reports do not contain information on the allocation year of the tax credits that developers returned to the allocating agencies for reallocation to other projects. IRS needs this information in order to determine whether states stay within their tax credit ceilings. Collecting this additional data on returned credits would also allow IRS to determine whether the states are fully

using their tax credit allocations. As I indicated earlier, a significant gap exists between the amount of tax credits that have been allocated by states and the amount of credits that states and IRS records show were awarded to projects that were placed in service.

To supplement its tax credit audit initiative, IRS is exploring the possibility of computer-matching these data against tax credit amounts reported on housing project partnership returns. However, this match would not detect noncompliance at the partner level. But overreporting of tax credits by partners could be detected by matching tax credits reported on the Schedule K-1s, which shows the individual partners' credit allocations, to the partners' income tax returns. In a June 1995 report on partnership compliance, we recommended that IRS match Schedule K-1 to tax returns.[1] However, resource constraints have prevented IRS from transcribing all the Schedule K-1s reporting tax credits it receives so that it could have an effective matching program.

Accordingly, we recommended that the Commissioner of Internal Revenue (1) explore alternative ways to develop an estimate of tax credit compliance so that IRS can better determine the resources needed to address noncompliance and (2) explore alternative ways to obtain better information to verify that states' allocations do not exceed tax credit authorizations.

---

[1]Tax Administration: IRS' Partnership Compliance Activities Could be Improved (GAO/GGD 95-151, June 16, 1995).

INDEPENDENT OVERSIGHT OF THE TAX CREDIT PROGRAM

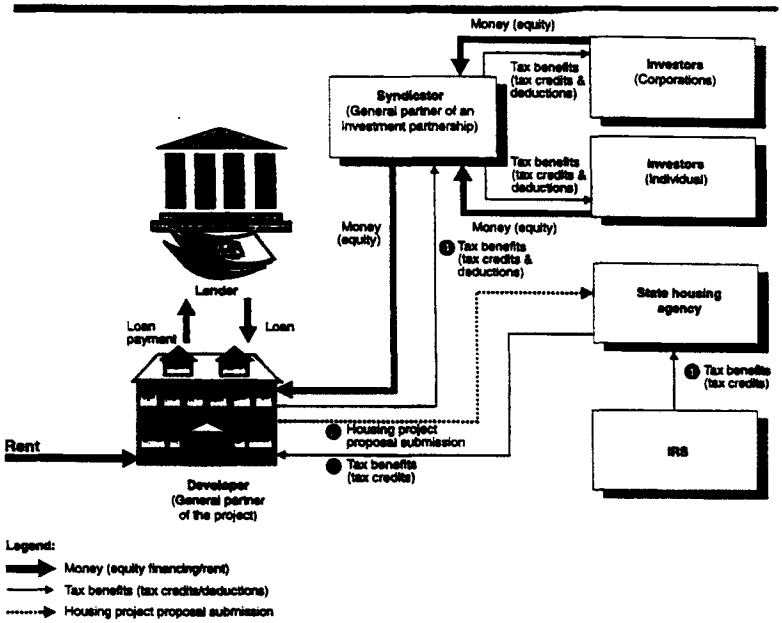
Unlike most programs operated by state and local governments that receive federal financial assistance, the low-income housing tax credit program is not covered by the Single Audit Act. The Single Audit Act, which is an important accountability tool for the hundreds of billions of dollars of federal financial assistance administered by state and local governments and nonprofit organizations, does not apply to tax credits because credits are not considered federal financial assistance under the Office of Management and Budget's implementing guidance. Subjecting the low-income housing tax credit program to the single audit process may be a more efficient, effective, and less federally intrusive way of monitoring state agency controls than other types of independent audits.

Accordingly, to help ensure appropriate oversight of state allocating agencies' overall compliance with tax credit laws and regulations, we recommended that the Director, Office of Management and Budget, incorporate the low-income housing tax credit program in the definition of federal financial assistance included in implementing guidance for the Single Audit Act so that the program would be subject to audits conducted under the Single Audit Act.

Madam Chairman, this concludes my prepared statement. I would be pleased to answer any questions.

268796

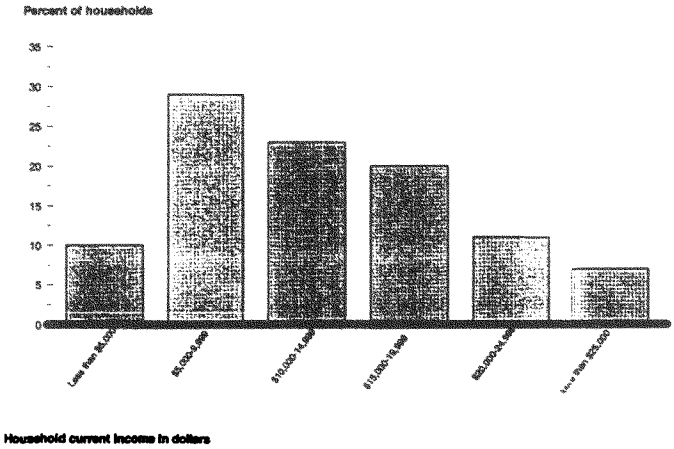
GAO Figure 1: Transferring Tax Credits From the Federal Government to the Private Sector



1

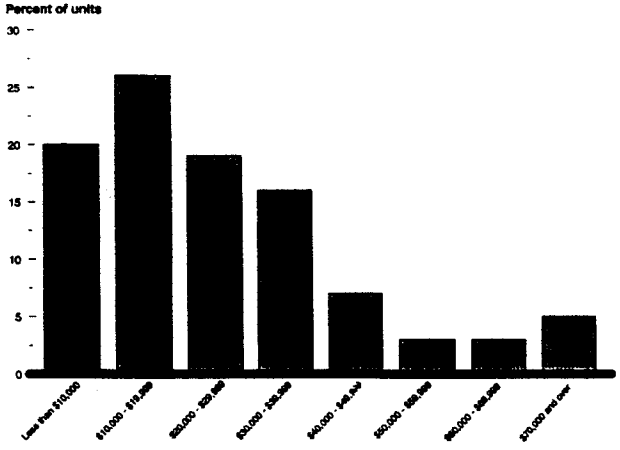
GAO

Figure 2: Estimated 1996 Incomes of Households in Tax Credit Units



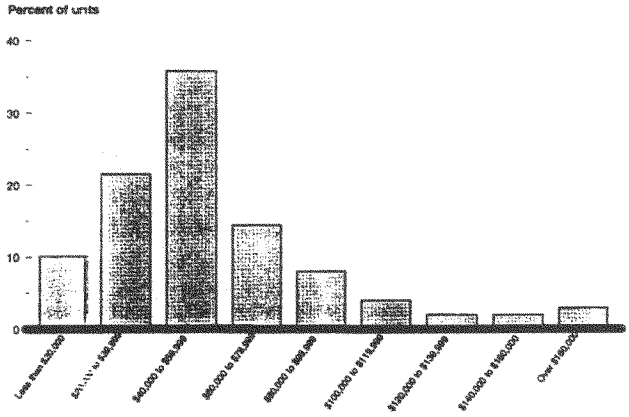
2

GAO Figure 3: Estimated Average Per-Unit 10 year Credit Costs of Properties Placed in Service, 1992-94

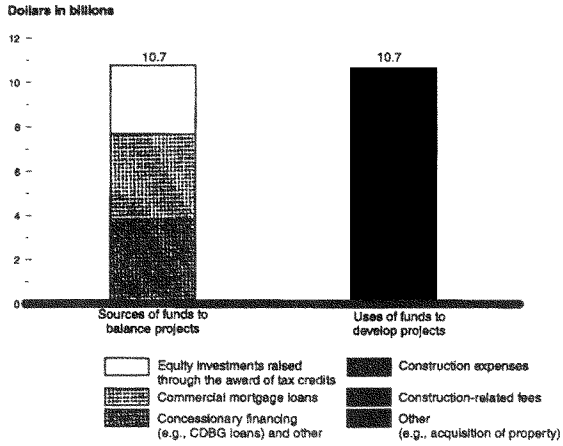


3

GAO Figure 4: Estimated Average Per-Unit Development Costs of Tax Credit Properties Placed in Service, 1992-94



GAO Figure 5: Estimates on Housing Project Sources and Uses of Funds



5

Mr. ENGLISH [presiding]. Thank you, Mr. White.

The Chair will recognize Dennis Fricke, Assistant Director of the Housing and Community Development Program at the U.S. GAO for your testimony.

Mr. WHITE. I have summarized our statement.

Mr. ENGLISH. I was misinformed. OK, apparently I have been given clearance. [Laughter.]

Mr. White, I wonder if you could elaborate on the difference between the development costs to the housing projects and the cost to the Federal Government?

Mr. WHITE. The cost to the Federal Government is less than the costs of the project as a whole. If we refer back to figure 5, the one on the right there—it is the last figure in the testimony. The sources of funds bar, the one on the left, the height of that bar shows the total development costs of the project and that is the total amount that has to be financed to fund project development.

Of that, some is coming from commercial mortgage loans. So, the middle part of that bar is coming from private, commercial mortgage loans. The rest of that bar is financed by government assistance and part of that, roughly half looking at the bar, is from tax credits. The rest is from other housing assistance.

So, the Federal part of the financing is smaller. What matters for Federal costs then is the overall height of the bar, holding this other financing constant. If you lower the height of the bar, you need fewer credits. What also matters is the price you sell the credits for.

Mr. ENGLISH. I appreciate you clarifying that distinction, following up and recognizing that, later, we are going to be hearing from Mr. Logue, on behalf of the National Council of State Housing Agencies.

You have made several recommendations which may have some impact on State costs. You recommended that States report additional information to the IRS; that States use validated cost and financing data when evaluating the financial viability of the housing projects and that States subject their allocating agency operations to a Single Audit Act coverage, which makes a great deal of sense to me.

Have you assessed the cost of these recommendations and specifically, why did you recommend that States be reviewed under the Single Audit Act rather than by direct IRS oversight?

Mr. WHITE. We did try to take costs into account when we were making our recommendations. In fact, in the wording of the recommendations, we tried to offer some flexibility to the States and to the IRS so that if there was a lower cost, a more cost-effective way of satisfying the recommendation, that would be an option. One example would be in terms of site visits. Right now, not all States are making site visits. It may be the case that State housing agencies will not necessarily have to visit every project. They may be able to get that information from other sources, for example, building inspectors. We wanted to leave that option open to them.

The Single Audit Act is another example. The Single Audit Act was designed to lower the cost of the independent audits. As the name implies, there's a single audit done of Federal money going to State programs and we thought that the lowest cost way of getting an independent audit done would be to include the program under the single audit that is already being done for these State housing agencies, because of the other Federal money they are getting.

Mr. ENGLISH. I have two other questions quickly and then I'm going to move this to my colleagues.

As you contemplate the integration and coordination of programs, how do the States control overall Federal costs when the tax credits are combined with other Federal subsidies?

Mr. WHITE. The States are required by the Tax Code to review combined Federal costs and all the States reported to us that they are doing so. As I mentioned, in the case of HUD financing, there is a review called the subsidy layering review that is done. Actually, what this means in this case is, there is an additional control. Not only does the tax credit program require that this review be done, but the other Federal subsidy programs also require their

own reviews to be done. So, in a sense, you have an additional control in this case.

I do want to make clear, however, we did not audit individual housing developments.

Mr. ENGLISH. I understand.

Mr. WHITE. So, the effectiveness of these controls at that level is not something we are able to speak to.

Mr. ENGLISH. Your point is well taken and I understand the scope of your audit. I was encouraged by some of your findings, because I think they make a very strong case for the permanence of the credit. I wonder in that regard, how great is the syndicators' risk in making these investments? I think that is very closely tied to the argument for keeping the credit permanent.

Mr. WHITE. There is a risk to the syndicators. We did not try to quantify it. It is very difficult to quantify how much risk is being transferred to the private investors under this program. It is the case that syndicators and investors spend resources monitoring and helping manage the program or manage individual projects. So, they have staff who visit projects in some cases and otherwise help monitor. So, there is money being spent, which is an indication that there has been some risk transferred.

As you probably know, credits can be recaptured or denied under the program if projects go out of compliance during the 15-year compliance period.

Mr. ENGLISH. Thank you again, Mr. White. This has been very enlightening. I would now like to turn this over to my colleagues. First, I would like to recognize the distinguished gentlelady from Florida, Ms. Thurman, for 5 minutes.

Ms. THURMAN. Thank you, Mr. Chairman.

Mr. White, in the GAO report you stated that, of the 431 tenant files reviewed by the GAO, there was evidence of ineligible tenant incomes or excessive rent charges. Also, you stated that in reviewing 253 project tax returns involving about $83.3 million, only 3 projects had overreported credits. At the same time, with what I would consider to be fairly high compliance, you actually make some recommendations for additional IRS oversight and more State reporting.

What do you think that would accomplish and why would you do that? There are other people that would be believed that flexibility and, where States are doing very well, that this could become cumbersome.

Mr. WHITE. Our recommendations were not focused on incomes or rents. Our recommendations were focused primarily on the controls at the State level and the IRS level, over costs and overall compliance with the requirements of the Tax Code. We tried to make, as I said, tried to leave some flexibility in terms of how the States and the IRS could respond to our recommendations to keep the costs as low as possible. Clearly, there is a cost.

What we aimed at primarily in our recommendation was insuring that there was better information at the State level about the cost information that was provided from developers to the States, in which the States then used, when making the credit allocations. Obviously, without reliable information on costs, on the developers'

true costs, the States cannot be assured of awarding the minimum number of credits.

Ms. THURMAN. Based on that conversation, let me just ask you a couple of questions, based on what we are going to hear in our next testimony. The National Council of State Housing will testify on the next panel and make a series of recommendations. Have you had an opportunity to look at any of those recommendations?

Mr. WHITE. I glanced just for a minute. I have not read their testimony through.

Ms. THURMAN. If you do not know, that is OK. Does the GAO agree that the $1.25 per capita cap should be increased?

Mr. WHITE. I guess I would respond to that by saying that, one of our findings was that it may be the case that right now, all the credits are not being used. We looked at data several different ways and the consistent finding was, we cannot find all the credits being used. In the case of the 1992 credit allocation, by the end of 1994 only about half of those credits had actually been awarded to projects that were placed in service, that is, construction was completed.

Ms. THURMAN. The IRS should be able to share noncompliance data with State housing authorities?

Mr. BLOCK. Actually, that is a taxpayer disclosure issue. I do not think we are in a position to answer to that. That is up to the Internal Revenue Service.

Ms. THURMAN. Fine. There should be more onsite compliance checks?

Mr. WHITE. We had a recommendation to that end, again, allowing some flexibility, so that if there is a more cost-effective way to do that, they could do that.

Ms. THURMAN. That possible legislation is needed for the States to more effectively use the national pool?

Mr. WHITE. Again, given our finding on the number of credits that are being used right now, it is hard to reach a conclusion right now about the need for legislation in that area.

Ms. THURMAN. Thank you, Mr. English.

Mr. ENGLISH. Thank you. The Chair recognizes Mr. Hulshof.

Mr. HULSHOF. Thanks, Mr. Chairman. Mr. White, in your prepared statement on page 8, you do make note that all States have adopted the required allocution plans for meeting State housing priorities. Is that right?

Mr. WHITE. Yes.

Mr. HULSHOF. Then you go on to talk about the use of discretionary judgment and you mention, I think, as anecdotal evidence, one State where senior managers overrode a certain percentage in those particular cases. What is the spectrum, I mean, just an example of the discretion that different States use? Can you give us just some examples of this spectrum as far as discretion was concerned?

Mr. WHITE. Yes, but the Texas finding was the result of an audit that was done in Texas.

Dennis, do you want to add to anything across the board on that?

Mr. FRICKE. I think, as Jim said, it was a particular State where really that issue came up as the result of an internal audit finding. For the most part, the States really were complying in terms of the

allocation of credits with their allocation plan. They were not deviating from the thresholds, set-asides or points that they used to really focus the program on what they have identified as their priority housing needs.

Mr. WHITE. The point in the Texas case that we wanted to make is, that the discretion that was used was not documented.

Mr. HULSHOF. Right.

Mr. WHITE. There was no documentation. That was the real problem there.

Mr. HULSHOF. Let me follow up, because you talk about how the public's confidence could be undermined in the absence of documentation. What is your recommendation as far as documentation is concerned?

Mr. WHITE. We did not make a recommendation in this case partly because the finding here was based on an audit in a single State case. We also did not do audit work at the project level to know whether the discretion that was being used was being used improperly or not.

Mr. HULSHOF. I think in the report, page 58, it talks about the Internal Revenue Code and calls on State agencies to determine the appropriateness, I think, is the word that is used, of a project or local conditions. It really does not talk about guidance as to what is appropriate for local conditions.

Now, keeping in mind that we all believe that States should be given the greatest flexibility possible to be creative, to be responsive to local needs, do you have a recommendation or suggestion as to whether or not the Code should be amended to provide greater guidance to States so that we can have more accurate information? Do you have any sense on that?

Mr. WHITE. We do not have a recommendation in this area. We recognize that the program delegates authority to award credits to the States and that the Code does not define appropriate to local conditions. That is left up to the States. It is a value judgment there and we do not have a recommendation.

Mr. HULSHOF. As a final generic question, would you characterize the low-income housing tax credit as a successful program?

Mr. WHITE. We did not compare the tax credit program to other housing programs. So, I cannot characterize it relative to other programs. We focused on the cost controls and compliance controls of this program alone. Overall, we found that the States do have controls in place. We found some weaknesses in some States and with respect to some projects.

Mr. FRICKE. I think I would also just add that the program, the visits that we did make to projects, basically without exception, the program is delivering a good product in the sense of quality housing. The price of that housing varies considerably. I think as Jim was just alluding to, what the study does not do is answer the question, could you build that housing cheaper through another government program. That was not clearly a part of this study and it would be a study that would require really considerable thought, I think, in terms of how you would approach it.

Mr. HULSHOF. Thank you, Mr. Chairman. I yield back.

Mr. ENGLISH. Thank you. The Chair recognizes Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Mr. White, the GAO recommends inclusion of the low-income tax credit in the Federal Government's Single Audit Act. Could you explain a little bit more what that act is and what it does?

Mr. WHITE. Yes. The Single Audit Act, as the name implies, allows for one audit of agencies, usually at the State level, State or local, or nonprofit organizations that receive Federal money. And rather than independent audits of every program that might be sending money, say, to a State housing agency, the Single Audit Act was passed to lower the burden of those audits.

Our thinking was that we would lower the cost of an independent audit of the tax credit program if it could be included under the single audits that are now being done. Again, the State housing agencies are subject to Single Audit Act requirements right now because they get Federal money.

Mr. COYNE. Well, as you know, OMB opposes including the Low-Income Housing Tax Credit Program in the Single Audit Act. Do you have any idea why they would be opposed to it?

Mr. WHITE. I do not know that they oppose it. I think they had a sense that conceptually this might be a good idea. One of their concerns—they did have some concerns. One of their concerns was about whether you should focus on a single credit and do this for a single credit or do a broader evaluation of tax credits generally and make a determination about whether you could do something more generally. And we do not object to that kind of approach.

Mr. COYNE. Have they suggested an alternative audit system?

Mr. WHITE. They have not suggested an alternative. They commented on our recommendation.

Mr. COYNE. OK. You had mentioned that you looked over 400 low-income housing tax credit projects. Could you comment on Pennsylvania's operation, specifically?

Mr. WHITE. Yes. I think Dennis can in a minute. Let me introduce it by saying that our methodology was aimed at giving us statistically reliable results for the country as a whole. Our sample was not large enough to give us statistically reliable results for an individual State.

Dennis, do you want to say anything more about Pennsylvania?

Mr. FRICKE. At least from the standpoint of visiting projects, I actually went out to several projects in Pennsylvania. Again, as I made the comment earlier, Pennsylvania, like other States that I visited, the projects were top-quality properties. They were revitalization projects, in the case of two properties I visited in Philadelphia, another one in Lancaster. All three properties were providing very affordable rents to low-income people, and like other projects that we describe in the report, costs really varied. And I can think of the two in Philadelphia. One project, the cost was over $100,000, and the other I believe was somewhere around $70,000. We really did get quite a cost variation, and also a variation in these two cases in terms of the tenant profiles of the people that were being served. The one project was serving larger families, and the other project was serving younger, smaller families.

So, again, it just kind of speaks to the program in general that we describe in the report. It really serves a lot of diversity in terms of needs and incomes.

Mr. COYNE. Thank you.

Mr. ENGLISH. Thank you, Mr. Coyne.

The Chair recognizes Mr. Weller.

Mr. WELLER. Well, thank you, Mr. Chairman, and I would like to direct my question to Mr. White.

I am interested in exploring the issue of full use of the tax credit allocations. Your audit analysis suggests that the States now may not be fully utilizing their allocation. In fact, data from both the States, the IRS, and a recent HUD study would suggest as much as $80 million out of the per year, the annual $315 million per capita allocation, are not being fully utilized to produce the housing that we hoped to have as part of this public-private partnership.

Number one, do you agree that these allocations are not being fully utilized, that they are being underutilized?

Mr. WHITE. Our conclusion is they may be underutilized. Our real conclusion here was we could not reconcile what was being awarded initially, what was being allocated initially to projects when they were in the proposal stage to what was actually being used and awarded when projects were completed. There is this large discrepancy, and we cannot account for the difference. It looks like credits may not all be used.

Mr. WELLER. If you are not able to account for the difference, is there an explanation of why you are unable to account for the difference?

Mr. WHITE. We discovered the difference with the methodology we had, once we developed the methodology and started sampling. I think to get an answer to that question you would probably have to track the credits for an individual State over time and, in effect, go back and do a retrospective audit, picking one or two States and track every credit in that State over several years.

Mr. WELLER. Would you recommend that this sort of tracking and reporting system be put in place as part of a better way of understanding utilization of the tax credit?

Mr. WHITE. I guess before thinking about a system, perhaps a study to determine if this is, in fact, what is happening. At this point we do not know for sure where these credits are going.

Credits can be—developers have 2 years to use the credits. If they do not use them within the 2 years, then they lose them. The credits can be returned to the States and be reallocated. If the 2 years pass, the credits lapse. And right now with the data that is available, we do not know how many of these credits have lapsed and how many credits have been returned to the States and have not been reallocated yet.

Mr. WELLER. Mr. Fricke.

Mr. FRICKE. I think in that regard, too, the question that may be appropriate to just pose to the National Council when they are here. They do track allocations of credits by year, and to really address maybe with them the feasibility of them tracking the credits as they are applied to the projects that are placed in service over time, at least there will be some centralized data source to really track the differences.

Mr. WELLER. I would also like to explore—of course, one of the goals of this program is to make sure that affordable housing lasts longer than the credit, that quality affordable housing is available in every community where it is needed. And one of my colleagues

on the Subcommittee started asking questions regarding the issue of layering of various subsidies, other subsidies that would affect those that are able to be served by low-income housing tax credit housing. And it is my understanding in the report from reading it that 71 percent of the households in these projects receive one or more types of housing assistance beyond that that is provided by the tax credit. With that, what some would call a high ratio of additional assistance, is it realistic to believe that this credit program, these types of projects can survive beyond the life of the credit?

Mr. WHITE. We do not know the answer to that. We raised the question in the report. What is clear is that the tenants served by this program have incomes that are so low that the rents they can pay are not high enough right now to cover the costs of developing and operating these projects. And, in fact, the incomes that many of the tenants who are actually being served have are so low that they are not high enough to cover the costs if the only subsidy the project got was the credit subsidy, because the credit only is allowed to cover part of the development costs. It does not cover any of the operating costs, and it does not even cover all of the development costs. And given the income levels served, that is the reason for the other subsidies being used.

Mr. WELLER. Mr. Fricke, would you like to comment on that?

Mr. FRICKE. Yes. I think just to make a little distinction, the layered subsidies that are used in the program in conjunction with the tax credits really make the properties themselves more affordable by just reducing the amount of debt that is associated with the property. In the report we pointed out that the rents in these projects, are generally anywhere from 13 to 23 percent below the ceiling imposed by this program. So by layering these subsidies, one of the benefits you are getting is lower rents, which translates into a lower population that is being served.

Part of the reason that you have the tenant population in terms of income being served is not only direct rental assistance but also the fact that rents are down, making the units more affordable to lower income people.

I think your other question, the question as far as long-term viability of these projects, that really gets to an issue of in 15 years and out, what the cash flow is going to look like for these properties, what kind of capital needs these properties are going to have, and do these properties have reserves set aside to meet those capital needs or will they be—will they have generally a high enough cash flow to borrow additional capital that together with any reserves they can make the needed repairs? Or will they come back to this program and look to it as a way of raising capital to make substantial rehabilitation of properties that may have fallen somewhat into disrepair. That is an issue that we will not know until sometime into the future.

Mr. WELLER. Of course, marketing studies are a way of determining long-term viability. Do you think that market study should consider the issue of layering to determine long-term viability of the project?

Mr. FRICKE. Well, again, layering is more—not so much the long-term viability as it is—layering goes more toward affordability ini-

tially. I mean, if you layer these subsidies initially, then you really just do not have to borrow the debt. Consequently, the rents basically only have to cover operating expenses and whatever debt that you have to borrow. So, again, the layering really has not a whole lot to do with the long-term viability of the property. That is more a function, again, of the cash flow of the property in the outyears and the reserves and such that have been set aside.

Mr. WELLER. Thank you, Madam Chair. I yield back.

Chairman JOHNSON [presiding]. Thank you.

Mr. Tanner.

Mr. TANNER. Thank you very much, Madam Chairman. Most of my questions have been covered, but I have one for Mr. White.

Did you all look at the urban-rural mix of the program? And is it being utilized in the rural areas to the extent that it is constructed?

Mr. WHITE. It is being used in rural areas. I think we have found about half the units are in urban areas, about a quarter of the units are in suburban areas, and about a quarter of the units are in rural areas right now.

Dennis, do you want to expand on that?

Mr. FRICKE. That is true. You have more than half the properties in rural areas, but because they tend to be smaller, they represent, as Jim said, only about a quarter of the units. Conversely, only about a third of the projects, I believe, are in urban areas, but because they tend to be larger, they constitute about half of the units.

Mr. TANNER. So you did not find any problem with the rural areas being able to participate in the program?

Mr. FRICKE. No, we did not.

Mr. TANNER. Thank you. Thank you, Madam Chair.

Chairman JOHNSON. Thank you.

Mr. Portman.

Mr. PORTMAN. Thank you, Madam Chair, and I thank GAO, Mr. White, for your recommendations and your good study. Many of the recommendations, of course, are focused on more State requirements, and I know you have already talked to Mr. English and others about that. My sense is that this Subcommittee will probably be putting together some legislation in response to your recommendations, and I would hope you would work with us to be sure those are as streamlined as possible and we are not just creating more bureaucracy at the State level and more red tape. I know you indicated your interest in that and, in fact, said you already had thought about the unfunded mandate issue. I think when you put together these recommendations, we do have that point of order on the floor, among other concerns. And I think it is important that we not just load up more regulations on the State side.

With that in mind, let me talk to you about the other side, which is the IRS. Mr. Coyne and I are very interested in looking at IRS restructuring right now on a commission, and one of the issues that has come up is low-income housing, how that is working. You have not, to my knowledge, really addressed that today, nor do you focus on that in your report, how the IRS is doing. I know we are going to hear from the IRS in a moment, and I am looking forward to that.

But if you could, just tell us briefly how you think they have done, particularly since 1994, 1995. I understand they have begun to audit these programs. They have sent out over 200 lead packages to their field offices recently about particular problems they have seen. But how do you think the IRS is doing in terms of this program? And do you have any recommendations for changing the relationship between the IRS and the State agencies?

Mr. WHITE. The IRS has clearly made a start in terms of providing oversight in this program. We have several recommendations, however, aimed at providing what we believe is sufficient information for the IRS to fulfill their role in ensuring compliance with the Tax Code.

Mr. PORTMAN. So more information will help them do that job?

Mr. WHITE. Yes. One example would be right now they do not have a good measure of noncompliance with the program, and because of that, they do not have a good ability to allocate their compliance resources. They need such a measure to be able to allocate compliance resources, obviously.

Mr. PORTMAN. We hear from Ohio, for instance—of course, Ohio's program is perfect. [Laughter.]

But we hear, as an example, that more interaction with the IRS could be helpful, that there may not have been over the years, particularly—and, again, this may be changing recently—as much focus on the compliance side. Is that the sense you got from looking at this?

Mr. WHITE. I think one thing we heard from the States is that the IRS has been doing a better job over time in terms of providing some guidance to the States, and the IRS is now considering revising the forms on which noncompliance is reported to make that process somewhat easier.

Again, we still have some concerns there about whether they will have adequate information.

Mr. PORTMAN. Because this is a tax credit, it necessarily involves the IRS because of the Tax Code. But do you think the IRS is the right entity to be, in essence, auditing this and monitoring what the State agencies are doing?

Mr. WHITE. You are raising the question, I think, of whether you want a housing program——

Mr. PORTMAN. We have section 8; we have other housing programs that are under HUD. And one of the issues, again, Mr. Coyne and I have looked at is the noncore functions of the IRS, whether it makes sense for an agency that has as its mission the collection of taxes to be focused on, whether it is child support or earned income tax credit or low-income housing. Do you have any thoughts on that?

Mr. WHITE. It is certainly the right question to be asking, one of the right questions to be asking here. We did not compare this program to housing programs operated by HUD, so we do not have a conclusion or recommendations on that point.

Mr. PORTMAN. And in terms of the bang for the buck we are getting—and I think others may have questions on this, but that is one of the concerns we have from a policy perspective. You focus more on how to administer this program and compliance. But apparently you did not look at other housing programs such as sec-

tion 8. Are we getting as much bang for the buck through the tax credit? I think the average, I am told, over the life of the credit in an assisted unit is $27,300 reduction in Federal revenues. How does that compare to other programs? Did you look into that at all?

Mr. WHITE. We did not do that comparison. One of the reasons that comparison is difficult to do is because there are very few pure credit projects out there. Most of the tax credit projects——

Mr. PORTMAN. Are mixed.

Mr. WHITE [continuing]. Are also getting other Federal housing money.

Mr. PORTMAN. OK. Thank you.

Mr. FRICKE. I think if I could just add to that particular point that Jim just made, this program, again, delivers basically a very new product, either through new construction or substantial rehabilitation. section 8 is really aimed at the 40th percentile in terms of the rental properties in an area. So you really are comparing somewhat of an apple and an orange in terms of the benefits, the housing benefits conferred on the low-income household, whether they receive a section 8 or they move into an apartment built under this program.

Mr. PORTMAN. Your site visits were very helpful to look at toward the back of your report. I guess, Mr. Fricke, you were involved in that. I would love to have seen also some comparison to rents, market rates, that are not part of the low-income housing credit. As you say, it is difficult because of the layering and because of other programs. But we talk about—on page 156, the Grand Rapids, Michigan, study. It is a $295 a month rental, and it is just hard for us to look at that and know what is the rent subsidy per year on that. How does that compare to other rental units? You talked about rents going down generally. The cost per unit was $48,800. What is the real cost to the Federal Government in terms of the value of the tax credit to that?

These are policy questions. You may not be in a position to answer today, but these are the bigger issues that we have to grapple with.

Mr. FRICKE. May I in part give you a little context? In this report, we talk about the average for the Nation of $453 a month, I think. And, again, I am going to generalize and say that is probably about a two-bedroom unit because that is about the average size in this particular program.

In mid-1993, I believe the average fair market rent nationwide was about $555, so about $100 more. And I think the median rent for a two-bedroom unit in the country was about $650, about $200 more. If you take just the fair market rent and say that if a family were to move into a tax-credit-supported property and receive section 8 rental assistance, as many families were receiving, or they moved into another market rate unit in the community that was renting at the fair market rent of $555, the government would have an additional $100 a month cost to subsidize that family in private rental housing.

But the government in the tax credit unit has already sunk in up front $27,300 in present value cost, and there are also some additional costs associated with other programs that may have gone into the developing of that particular housing. And, again, having

said all that, too, the benefits are different to the household. Again, the family—I will just say this very generally—is, under this program, going to receive more housing benefit in terms of quality housing than they generally will under a section 8 voucher or certificate program.

Mr. PORTMAN. Right, which is a whole other issue.

Mr. FRICKE. Right. It is just kind of like context, I think, when you start comparing programs to really consider.

Mr. PORTMAN. Thank you, Madam Chair.

Chairman JOHNSON. I would like to follow up on that, though. If we know that the tax credit over a 10-year period costs us on average $23,000, don't we have any ability to see whether over that 10 years we get $27,000 of rent subsidy?

Mr. WHITE. You have got a couple of issues there. One is: for what you have built with whatever amenities it comes with, have you done that at a minimum cost?

Chairman JOHNSON. Right.

Mr. WHITE. Then another issue is: Were the amenities that are provided with that housing proper? Are you providing too many amenities or not? So you have got two aspects to cost there.

We have got some recommendations on the former in terms of providing better information to the States about the costs that developers actually incurred and are reporting to the States in their proposals.

On the latter, on the issue of the amenities, the program, again, has delegated responsibility for making that decision to the States, and the States have made the decision to build under this program primarily new units, new construction rather than rehab. Rehab is generally cheaper than new construction, but part of the reason they are going with new construction is because of where they are locating the projects. Roughly 25 percent of the units, again, are in suburban locations where there is not a lot of housing typically to rehabilitate. If you are going to locate housing there, it is going to necessarily have to be new. So the States are making some decisions about amenities and location that have implications for costs.

Chairman JOHNSON. But, nonetheless, there are some pure tax credit projects. There are not a lot. But in those pure tax credit projects, where the credit is the sole subsidy provided by the taxpayers, are we getting back in rent reduction what we are putting in? Taking the average rent, not what the units in that complex would go for, because you are right, some of these units are associated with more amenities, considerably more amenities than a section 8 housing voucher would buy you. But ignoring that and looking at what the average rent—what the section 8 housing voucher would provide there—are we getting back $27,000 over 10 years in buydown of rent costs?

Mr. WHITE. It is a difficult question to answer definitively. Part of the reason is the way this program is structured, some of the risk is being transferred to these private investors who receive the credits. How much risk is being transferred is something that is not easily quantified.

Chairman JOHNSON. Still, can't we just do the math on a pure tax credit project and see what does it cost us over 10 years and what do we get for it?

Mr. WHITE. I think the problem is you have got an apples and oranges case, though. You are comparing a tax credit project where these private investors have some incentives to manage and monitor the project because they have assumed some risks. They have got money in it, and they are at risk of losing the credits if the project should go out of compliance to other projects that serve a different income level and are structured differently.

Chairman JOHNSON. I would see the risk issue as one reason that we would prefer this form of allocating dollars to housing; we have somebody onsite who really has a vested interest in keeping the property up and making the project run right. That is one of, the checks that says you are going to spend your housing dollars wisely.

But I should think that you could take a few of the projects that had no other subsidy involved and see what kind of subsidy you would have to provide for a family who is getting this tax credit in this unit, and what kind of subsidy you would have to provide for that same family under other housing project programs, and see what are we getting back.

But what I hear you saying is that it is hard because the rent that is being asked is based on the cost of a project that would be normally higher than the cost of a project that a section 8 voucher would generally support the rent. It seems to me you ought to be able to say here is a pure low-income housing tax credit project. It is going to cost us $27,000. Is this person getting 27,000 dollars' worth of rent subsidy?

Mr. FRICKE. The answer to that, real simply, is no, they are not, but the explanation as to why they are not, part of what Jim said, is that the government cost being $27,300 on average, that part of that cost is transaction cost, the syndication——

Chairman JOHNSON. Yes, but, see, that is not our problem.

Mr. FRICKE. Right.

Chairman JOHNSON. That is their problem, in a sense. What I want to know is from the taxpayer's point of view, we are investing $27,000. Are we getting $27,000 or are we getting less? And what I hear you saying is we are getting less. So the benefit we are getting is new units.

Mr. WHITE. But you have got costs and benefits here. You have got both sides. Again, you have structured—the tax credit projects are structured differently than others, given our sample, the small number of pure tax credit units in our sample, and therefore, the very small number in any one market, we probably only got a single pure credit project for doing this sort of comparison, even if you thought you were comparing apples to apples. So we did not do that kind of comparison.

Chairman JOHNSON. Mr. Portman.

Mr. PORTMAN. If you would yield just for a moment, let me just take Mr. Fricke's numbers. And I may be missing something in terms of the apples to grapefruit to oranges comparison. But you said the average rental unit costs for about a two-bedroom was $453 per month.

Mr. FRICKE. In our program, the average rent for a tax credit unit was $453.

Mr. PORTMAN. OK. And the average nationally is about $555.

Mr. FRICKE. That was the fair market rent that HUD sets for its section 8 certificate program.

Mr. PORTMAN. OK. So the difference is about $100, roughly.

Mr. FRICKE. Exactly.

Mr. PORTMAN. Let's take that $100 over a year, and this gets to Mrs. Johnson's question. That is $1,200. Multiply that by the 15 years, $1,200 by 15 years you get about $18,000.

Mr. FRICKE. Right.

Mr. PORTMAN. Which is the value of the rent subsidy. It is a zero discount rate, just $18,000.

Mr. FRICKE. Right.

Mr. PORTMAN. Why can't you compare that $18,000 to that credit, which is $27,000—$27,300 I think is the number in your report. That is a big difference.

Mr. FRICKE. It is a big——

Mr. PORTMAN. And what you are saying—let me just try to characterize what you are saying, and then you can tell me where I am wrong. You say there are basically two differences, as I understand it. One is transaction costs, which, as Mrs. Johnson said, really is not an issue. To the extent that we are comparing the public subsidy costs, the taxpayer cost to this, it probably should not be an issue we care about. The second is that they tend to be newer units. It is newer housing, maybe nicer housing, as a result, and, therefore, that would account for some of the difference. But we are talking about almost a $10,000 difference.

Mr. WHITE. That is right, and part of the answer to the question depends on what happens over time. If the ownership structure of this works, it could mean that over time these units are better managed than they would be under an alternative. That is part of what you are buying with the money.

Chairman JOHNSON. Right. What you are saying, then, is the public benefit is that you buy higher quality housing over a longer period of time. But you do not get your money back dollar for dollar.

Mr. WHITE. Well, or that you buy better managed public housing over time. That is part of what you are buying here.

Chairman JOHNSON. Let me do a follow-on question. It does seem to me that if you add up the fees that are charged—the syndication fees, the development fees, the construction fees, all that—a lot of this money is going to fees. I worry about, you know, 47 cents of every dollar not going in a sense directly to housing.

Now, I appreciate that it costs money to syndicate, but after all, private developers who compete with these units also have syndication fees. I mean, a lot of them finance their operations the same way. To what extent do States really look at the total number of fees in a project, as opposed to money for bricks and mortar and money for rent subsidies, to what extent do States really oversee that rigorously? And to what extent do States look at gold plating? I mean, are there amenities in this that are really not appropriately funded by a public program?

These are hard questions, and from reading your report, I do not know whether we just do not have the information or whether there is some suggestion that it does not matter. I think when only

53 cents of your dollar really goes in a sense to the program, that is, the bricks and mortar, I am worried.

Mr. WHITE. We do not want to leave the impression that this does not matter. It clearly matters a great deal. The States report that they consider fees and that they have controls, standards that they impose on fees. One of the problems we had is that when they impose percentage standards on fees, different States impose them on different bases. So it is difficult to tell.

We also did not do audits of projects so that at the project level we are unable to reach a conclusion about whether too much was going to fees or not. I mean, what you might imagine doing, if you could do it retroactively somehow, would in effect be to rebid the project and see if you can get a lower——

Chairman JOHNSON. I was truly surprised by the series of fees involved—syndication fees, State fees, so on and so forth. When you take out all the money that goes in the way of fees—and some of it is profit. I mean, I think what they call fees in the construction area must be the construction company's profits. At least I hope so. I hope that is not over and above what we already do at 47 cents on the dollar.

Do you have any comparison? Is 53 cents a lot? And is the remainder a little—for bricks and mortar and subsidies?

Mr. FRICKE. I will just try to answer that real quickly. The difficulty, of course, in comparing the 53 cents to the dollar is that 53 cents is paid in today, the dollar is a government cost over 10 years. So if you discount back that dollar over 10 years, it is basically 70 cents. And I think when you hear, you know, from the industry, you are going to hear that the 53 cents today is more like 60 or 65 cents.

Having said that, it is still not an apple to apple comparison to compare 60 or 65 cents against the 70-cent present value cost to the government because that 60 or 65 cents to the investors is not just for the tax credits, but it is for other depreciation that that property throws off.

The industry may estimate somewhere around 80 percent of the pay-in of the 60 or 65 cents is attributable directly to the credit.

Chairman JOHNSON. OK. Thank you.

Why do the development costs vary so widely? You say in your report they vary from $20,000 to $160,000.

Mr. WHITE. This gets partly to your gold-plating question. Again, it gets back to the decisions that States have made about which projects to fund. As I said, new construction costs more than rehabilitated housing. Most of the projects are new construction. The location of the projects matters. California is a very high cost area. Construction in California has to meet seismic standards. There are underground parking requirements. A number of the high-cost projects in California are elevator buildings. Elevator buildings are higher cost construction, than garden-style apartment buildings.

Chairman JOHNSON. And how much variance is there from State to State in the price of a tax credit?

Mr. WHITE. Again, our sample was not designed for us to be able to make estimates on that. There clearly are large differences across States. As I just indicated, California is a high-cost area to develop any type of housing.

Chairman JOHNSON. Do you have any idea what percentage of the tax credits have been taken back by States or what the primary reasons are?

Mr. WHITE. We do not have one. We can check. If we have got it, we will get it to you.

Chairman JOHNSON. Yes, I would be interested in that. I do not get any data that these projects are failing and the tax credits are being withdrawn. So if you have indication that that is the case, I am interested. We need to know the dimensions of that problem if it exists.

Mr. WHITE. Yes. My understanding is it has happened, but the magnitude right now, we do not have an answer. If we do, we will get it to you.

Chairman JOHNSON. And your report does clearly indicate that the States conduct fewer site visits or even desk audits than their plans require. Do you have any idea why this is?

Mr. BLOCK. No, we do not have any idea why. It could have been resources. There were several States that conducted no visits or did no monitoring reviews at all. But we do not know the reason for it.

Chairman JOHNSON. Did you ask?

Mr. BLOCK. We did not ask, but I guess we can go back and ask them for the information.

Chairman JOHNSON. I would be curious, mostly because you wonder whether it is because they considered it a less troubled program than some of the others, or whether they just have not done it and should do it.

Thank you very much for your testimony today. I appreciate it. I am sorry I could not be here for all the questions of my colleagues, but I do appreciate your good work, and I thank you for coming to brief the Members of this Subcommittee last week. That was extremely helpful in our gaining a better grasp of the work that you have done.

Thank you.

Next we will have Thomas Smith of the IRS, the Assistant Commissioner for Examination of the IRS.

Mr. Smith, please proceed.

STATEMENT OF THOMAS J. SMITH, ASSISTANT COMMISSIONER FOR EXAMINATION, INTERNAL REVENUE SERVICE

Mr. SMITH. Thank you. Madam Chairman and distinguished Members of the Subcommittee, my name is Thomas Smith. I am the Assistant Commissioner for Examination of the Internal Revenue Service. I am pleased to be here today to discuss the low-income housing tax credit.

I wish to commend the General Accounting Office for its thorough and comprehensive study of the low-income housing program. The Service worked closely with GAO throughout the course of their study to provide the necessary information regarding the Service's role in administering the credit.

My testimony today will provide a brief overview of the program, including existing compliance monitoring activities. I will also briefly discuss GAO's recommendations contained in their March 1997 report.

As you know, the low-income housing credit is available to owners of residential rental property which incur certain acquisition, construction and rehabilitation costs for property that are rented to low-income persons. Each State is authorized an annual amount of credit that it allocates to buildings throughout the State through its local housing credit agency. To be valid, credits must be allocated under a qualified allocation plan. The plan must provide: selection criteria that set out housing priorities; preferences for projects serving the lowest income tenants and those serving tenants for the longest period of time; and, procedures that the agency will follow in monitoring compliance with the various tax credit requirements and for notifying the Internal Revenue Service of noncompliance.

I am going to skip over a lot of the areas that may already have been covered by GAO regarding its decisions and try to concentrate mostly on our compliance activities which I think will be the areas of your concern.

Chairman JOHNSON. Thank you, I appreciate that, because I am sure we will have lots of questions. Thank you.

Mr. SMITH. Since 1995, the Service has made significant progress in its oversight of the program. A special unit at the Philadelphia Service Center processes and monitors the receipts of the various forms filed by the State agencies. Beginning with 1995, filings on Form 8610, which is the Annual Low-Income Housing Credit Agency's Report and Form 8609, Low-Income Housing Credit Allocation Certification, which are due on February 28 of each year are being reconciled to ensure that States are not exceeding their current year annual credit ceiling.

In 1993, State agencies began notifying the Internal Revenue Service of noncompliance with program requirements utilizing Form 8823, Low-Income Housing Credit Notice of Noncompliance. Prior to filing this form with the Internal Revenue Service, the State agency gives the taxpayer the opportunity to correct noncompliance. The nature and severity of the noncompliance may result in the disallowance or recapture of the tax credit that was claimed by the taxpayer.

In November 1996, we began utilizing a new letterwriting system to notify building owners that the Service had been informed by the State agency of their noncompliance with certain low-income housing credit procedures and provisions. Form 8823 which describes the noncompliant action is reviewed by our tax examiners and the type of error is coded into our database to use in selecting the appropriate notification to the owner. Owners are advised that their noncompliance may result in an examination. Form 8823 is used by the agencies to also advise the Service when noncompliance no longer exists.

The form is currently being revised, which is included in one of the recommendations by GAO, to incorporate a check block section, which should facilitate the agencies in determining the type of infractions and classifying those in a simpler format than the prior form.

The owner claiming a low-income housing credit must include certain forms as part of their annual filing requirement. Service Center return processing, excluding those pertaining to flow

through entities, are responsible for reviewing the forms when tax returns are filed. When forms are missing and the dollar amount of the credit is above a certain dollar threshold, taxpayers are contacted and their refunds could be reduced by the amount of the disallowed credits or balance due notices could be sent to taxpayers.

Bear in mind that, tax returns claiming these credits could incorporate both corporations, partnership and individual tax returns. An exact report of taxpayers claiming the credit should assist us in the process of matching the credits allocated by State agencies to amounts claimed on forms by owners. We are expecting, hopefully, an accurate run of the system to be done in July 1997. At that point, we should be able to validate how well we are able to match the credit allocations by the States to those actually claimed on tax returns.

We also have another compliance unit located in our Pennsylvania District Office. This compliance unit is responsible for training and ongoing technical support for our field examiners. Training began in July 1995 and was completed in April 1996. This unit also provides technical support to State agencies, property owners and practitioners to call in regarding taxpayer assistance questions relating to the low-income housing credit. People who participate in our unit in Pennsylvania, also attend the annual conferences of the National Council of State Housing Agencies and work with them on an outreach basis in terms of educating those who are involved with the credit.

We believe our outreach program has had a positive impact. For instance, after our initial meetings, we did experience an increase in the notifications to the Internal Revenue Service on Notices of Noncompliance that were sent to us. Fifteen States that had previously not supplied the necessary notices of noncompliance to us, did after our attendance and participation with the agency. So, we think the outreach efforts have had a positive impact.

As concerns were raised by our own internal audit and subsequently by GAO about the potential owner noncompliance, an audit program was developed. Beginning with information supplied to us by the States on noncompliance through Form 8823, we prepared 210 lead packages which have been assigned to our field examiners. The volume of audit closures at this point are relatively small and it is premature to comment on the overall compliance level of owners claiming the credit. However, early results do not suggest widespread abuse.

However, I must caution the Subcommittee, it is not really prudent to make judgments until we have a significant number of cases that have closed out from our audit activities. It is entirely possible that those cases with the least problems could tend to close out first, and the ones with more subsequent problems, could be a more difficult type of examination to conduct. They would be closed out at a later time.

In November 1995, our multiagency Low-Income Housing Credit Steering Committee was formed. The committee provides interagency coordination in the administration of the credit program when used with other housing programs. The committee includes the Department of Housing and Urban Development, the National

Park Service, rural housing representatives, the National Council of State Housing Agencies and the Internal Revenue Service.

Finally, in its report, the General Accounting Office makes certain recommendations for approving the Low-Income Housing Tax Credit Program through the regulatory process. Those recommendations will be considered as part of the regulatory process. Under this process, as you know, the Service would consult with the Treasury Department about proposing new or amending existing regulations with respect to those areas cited in the GAO report. Interested parties and stakeholders would have the opportunity to submit written comments on the areas under consideration for modification of the regulation.

After carefully reviewing these comments, we would further consult with Treasury on the development of the proposed regulations. Any proposed regulations would provide State agencies and taxpayers with an additional opportunity for comment. Those comments would be taken into account prior to issuing any final regulations. This is the normal regulatory process that the Service would follow with the Treasury Department.

That concludes my remarks and I will be happy to answer any questions that you may have.

[The prepared statement follows:]

Statement of
Thomas J. Smith
Assistant Commissioner for Examination
Before the
Subcommittee on Oversight
House Ways and Means Committee
April 23, 1997

Madame Chairman and Distinguished Members of the Subcommittee:

I am pleased to be here today to discuss the Low-Income Housing Tax Credit (LIHC). I wish to commend the General Accounting Office (GAO) on its thorough and comprehensive study of the low-income housing program. The Internal Revenue Service (IRS) worked closely with GAO throughout the course of the study to provide the necessary information on the IRS' role in the administration of the tax credit.

The Administration believes that the LIHC is an effective tool for the provision of rental housing to an underserved population. It represents an ongoing partnership between the Federal and State governments and the private sector to address critical housing needs. Within this partnership, the Federal government determines aggregate credit amounts and monitors compliance, State housing agencies allocate credits to projects that meet their local housing goals and needs, and the private sector provides the financing. When all three partners fulfill their roles, the LIHC addresses its intended goals in an efficient manner.

My testimony today will provide a brief overview of the program, including existing compliance monitoring activities. I will also discuss GAO's recommendations contained in its March, 1997 report.

Background

The low-income housing tax credit is available to owners of residential rental property who incur certain acquisition, construction, or rehabilitation costs for property that will be rented to low-income persons.

Each state is authorized an annual amount of credit that it allocates to buildings through a state or local housing credit agency. To be valid, credits must be allocated under a qualified allocation plan. A plan must provide (1) selection criteria that set out the housing priorities of the state agency, (2) preferences for projects serving the lowest income tenants and those serving tenants for the longest periods, and (3) procedures that agencies must use for monitoring compliance with the various tax credit requirements and for notifying the IRS of noncompliance. In addition, a state agency may allocate only an amount of credit that is necessary for the financial feasibility of a project and its viability as a low-income project over a certain period of time.

Claiming the Credit

To obtain the housing credit, an owner must apply to the appropriate agency. That agency then reviews the owner's application and, using criteria set out in the qualified allocation plan, ranks the owner's project against other applicants. If successful, the project will receive a credit allocation. Provided all other requirements relating to the allocation process are satisfied, the owner will be issued a Form 8609, Low-Income Housing Credit Allocation Certification, for each building in the project. No credit may be claimed without a Form 8609.

Various factors may affect the amount of credit that an owner may claim. These factors include the eligible costs incurred by the owner, whether federal grants or subsidies are involved, the percentage of qualifying tenants occupying a building, and the owner's personal tax circumstances. Generally, an owner is eligible to claim credit for each year of a 10-year credit period. Under certain circumstances, credit may be claimed over a 15-year compliance period.

Although an owner may claim credit for up to 15 years, the owner must generally maintain a certain percentage of low-income units for at least a 30-year period under a so-called "extended use agreement" with the state agency.

The ability of an owner to claim the housing credit each year depends upon the owner's compliance with statutory and regulatory requirements relating to the project and tenants. These requirements include the income eligibility of tenants, rent restrictions, health and safety standards, building dispositions, actual occupancy of units by qualified tenants, and whether an extended-use agreement is in effect. Failure to comply with these requirements could result in the recapture of a certain percentage of credits already claimed by the owner.

An owner is required to retain records that support the amount of credit claimed. In addition, an owner must make an annual certification of information to the state agency. For example, an owner must certify that (1) the project is occupied by a minimum number of qualifying tenants, (2) the owner has received all required annual income certificates from low-income tenants and documentation to support those certificates, (3) each low-income unit in the project is rent-restricted, (4) all units in the project are for use by the general public and are used on a nontransient basis, and (5) each building in the project is suitable for occupancy, taking into account local health, safety, and building codes. The owner must further certify that (6) there has been no change in the basis (upon which credits are calculated) of any building in the project (or the owner must describe any change), (7) certain tenant facilities are provided on a comparable basis without charge to all tenants, (8) reasonable attempts are being made to rent a vacant low-income unit or another comparable vacant unit to other low-income tenants, and (9) if the income of tenants of a low-income unit increases above a specified income limit, the next available unit of comparable or smaller size will be rented to tenants having a qualifying income.

State Agency's Responsibilities

Under the IRS' regulations, a state agency must monitor all buildings for noncompliance. An agency is required to notify the IRS of any noncompliance that it finds (whether or not the noncompliance is corrected) or any failure of the owner to make the required annual certifications.

In monitoring for noncompliance, a state agency must also review the annual certifications of information made by owners and choose one of three review procedures that target a certain percentage of projects for greater review of the income certifications of low-income tenants (including the documentation supporting the certifications) and the rent records for a percentage of low-income units in those projects. Only one review procedure requires an on-site inspection of a certain percentage of projects; however, the regulations give an agency the right to perform an on-site inspection of any project in its jurisdiction throughout the time that credits can be claimed for the project.

IRS Oversight

Since 1995 the IRS has made significant progress in the oversight of this program.

A special unit at the Philadelphia Service Center (PSC) processes and monitors the receipt of the various forms filed by the state agencies. Beginning with 1995 filings, Form 8610, Annual Low-Income Housing Credit Agencies Report, and Form 8609, Low-Income Housing Credit Allocation Certification, which are due February 28 each year, are being reconciled to ensure that states have not exceeded their annual credit ceiling.

In 1993, state agencies began notifying the IRS of noncompliance with program requirements using Form 8823, Low-Income Housing Credit Notice of Noncompliance. Prior to filing Form 8823 with the IRS, an agency gives the taxpayer an opportunity to correct the noncompliance. The nature and severity of the noncompliance may result in disallowance and/or recapture of the tax credit claimed. In November 1996, we began using a new letter writing system to notify building owners that the IRS had been informed by an agency of their noncompliance with certain LIHC provisions. The Form

8823, which describes the noncompliant action, is reviewed by our tax examiners. The type of error is coded and entered in a database which is used to select the appropriate letter to be sent to the owner. Owners are advised that their noncompliance may result in an audit. Form 8823 is also used by the agencies to advise us when the owner is back in compliance. The form is currently being revised to include a "check block" section, which lists different types of infractions, to assist the agencies in categorizing the noncompliance action.

An individual claiming the credit must include certain forms as part of their annual filing requirement. Service Center return processing examiners correspond with the owner if the forms are missing and the amount claimed is above a dollar threshold. If the forms are not received, the credit claimed is removed from the return either reducing the refund or resulting in a tax due notice. In addition, an automated system to generate a report of all returns claiming the credit is now operational. Returns claiming the credit include partnerships, corporations, and individuals. This will assist us in the process of matching the credits allocated by state agencies to amounts claimed by owners. The extract report is scheduled for July of this year.

A separate compliance unit is located at the Pennsylvania District Office. This unit is responsible for training and ongoing technical support for field examiners. Training began in July, 1995 and was completed in April, 1996. The unit also provides technical support to the state agencies, property owners and practitioners. For example, we participate at the annual conference of the National Council of State Housing Agencies (NCSHA), with whom we have a very good working relationship. We believe this outreach action has a positive impact on the program. After the initial meeting in February, 1995, the filing of Form 8823 (LIHC Notice of Noncompliance) increased significantly (including 15 states which had not filed the form previously).

As concerns were raised by our Internal Audit and subsequently by GAO about the potential for owner noncompliance, an audit program was developed. Beginning with information on noncompliance provided by the state agencies through Form 8823, we prepared 210 lead packages which were assigned to our field operations. The volume of audit closures to date is relatively small and it is premature to comment on the compliance level of owners claiming the credit. However, early results do not suggest widespread abuse. This is consistent with GAO findings in which GAO conducted a sample review of properties allocated credits, and traced the credits to the investor returns. GAO did not find any significant discrepancies between credits allocated and credits claimed. However, its review was limited to reconciling the amounts claimed, and not the correctness of the amount claimed.

In November 1995, a multi-agency LIHC Steering Committee was formed. The committee provides inter-agency coordination in the administration of the credit program when used with other housing programs. The committee includes the Department of Housing and Urban Development, the National Park Service, rural housing representatives, the National Council of State Housing Agencies, and the IRS.

Conclusion

Finally, in its report the GAO makes certain recommendations for improving the low-income housing program through the regulatory process. Those recommendations will be considered as part of the regulatory process. Under that process the Service would consult with the Treasury Department about proposing new, or amending existing, regulations with respect to those areas cited in the GAO Report. Interested parties initially would be requested to submit written comments on the areas under consideration for regulation. After carefully reviewing these comments, we would further consult with Treasury on the development of proposed regulations. Any proposed regulations would provide state agencies and taxpayers with an additional opportunity for comment. Those comments would be taken into account in issuing any final regulations.

This concludes my remarks and I will be happy to answer any questions.

Chairman JOHNSON. Mr. Smith, in your testimony, you mentioned that the certifications are due February 28 and through that reconciliation process, you will be able to insure that States have not exceeded their annual credit ceiling. What actions can the IRS take if a State has exceeded its annual credit ceilings?

Mr. SMITH. We would contact the States, obviously. If the States exceeded the allocations to taxpayers, we would decrease the amount of credit allocations to the States. We have not experienced that happening. One State has recently brought a small administrative error to our attention. We are in the process of making an appropriate response to that State. We are more concerned with, obviously, what credits are passing through to the ultimate users of those credits and how that system is operating.

Chairman JOHNSON. Well, it does seem that with the disparity between those allocated and actually used, it is unlikely that you will find States using more than they have a right to use. Are you satisfied that the IRS has the authority to deal with that issue by, for instance, the following year allocating them fewer credits for any overuse?

Mr. SMITH. Part of the discussion on the unused credits—there are carryovers of unused credits and credits are returned to the Service from the States and they go into the national pool. Looking at the size of the national pool over time, the national pool has been decreasing. Last year's national pool was between $4 and $5 million, relatively small in relation to the total size of the program.

That is not the only reason why you would have unused credits. The States themselves could have carryovers of their credits. It does suggest that most of the credits are either being used or carried over by the States, since they are not being returned for redistribution in the national pool.

Chairman JOHNSON. Do you see any need to change the law to clarify your authority to deal with those situations?

Mr. SMITH. There may be a justification in proposing a change in the law to strengthen our ability to deal with that.

Chairman JOHNSON. You can think about that over time, as to whether you really have the authority you need. It probably is not a problem that is large.

Mr. SMITH. Right.

Chairman JOHNSON. Nonetheless, we want to be sure that the law does give you the ability to do that.

The other thing that is of concern in the area of enforcement is, do you have enough flexibility to deal with an individual project where the developer has performed badly as opposed to penalizing the whole State program? Is there some way, if developers are not doing the kind of job they should be doing but can come back into compliance, is it wise to penalize the investors and then a year later, make them eligible?

I am not familiar actually with how those penalties work, but I think we need to have the ability to enforce penalties so that we get compliance. On the other hand, you do not want the penalty to undermine the financial structure of the whole development so severely that you lose the housing.

Mr. SMITH. In our exam, when we do take a look at a project actually under examination, we will look at generally two phases. We take a look at the types of costs when we are actually performing an examination of a taxpayer, that are allocated to the housing project for credit purposes. For instance, syndication costs of syndicating the partnership itself should not be allocated to the project for credit purposes. We also look at the noncompliance notices that are supplied to us by the State. These tend to deal with habitation-type issues, some severe, some not as severe.

The one area——

Chairman JOHNSON. You have to deal with those habitation issues and not the State?

Mr. SMITH. When we are doing an examination of a taxpayer, when we go out actually and examine the taxpayer, we do have—on the 210 packages that we sent out, we used notifications from the States of noncompliance as the basis for selecting those examinations. So, we do have information that there were noncompliance issues when we did those.

Chairman JOHNSON. Does the State have the authority to identify noncompliance and work with that developer to regain compliance before notifying you?

Mr. SMITH. Yes, they do. The State is required to notify us between 90 and 135 days of uncovering the noncompliance. Very often, even though they are required to notify us of the noncompliance, at the time they are notifying us of the noncompliance, the problem has often already been satisfied within that period of time, because they have dealt with the building owner. So, many times, we will get a notification, which they are required to send as a noncompliance event that has been satisfied.

The one area that is—and I am reading into your question a little bit—very important for the developers is during the initial year, how much of the property is, in fact, low-income housing. There is a provision where they can look at the one subsequent year. For instance, if the developer does not meet the requirement after that period, they cannot correct in subsequent years. They lose the credit totally for that project.

So, it is not like in the fourth or fifth year, they can now meet the requirements for sufficient number, let us say, of low-income housing tenants and go back to the credits. That is a significant penalty for noncompliance in that area.

Chairman JOHNSON. That is as it should be. At least, it appears to me that it is appropriate.

If they meet the criteria the first year but, say, the fifth year are out of compliance, is anybody watching?

Mr. SMITH. Yes, we can through our examination activities. And the States, obviously, are getting information from the developers.

Chairman JOHNSON. Annually?

Mr. SMITH. I do not think it is always annually.

Chairman JOHNSON. Are we getting that kind of information annually to verify that the number of affordable units are being let to people of the proper income?

Mr. SMITH. The States are not required to forward to us the results of their monitoring plans.

Chairman JOHNSON. How can you tell then?

Mr. SMITH. We can tell if we request that from the State, but there is not a requirement. I think that surrounds one of the recommendations of GAO, that they be required to forward the results of their monitoring plan to the Service. The existing regulations do not provide for that.

Obviously, if we do institute an examination on a particular taxpayer, we can review that information during the course of the examination.

Chairman JOHNSON. The cost of instituting an individual examination is high——

Mr. SMITH. That is correct.

Chairman JOHNSON [continuing]. And if we are going to have a program that works, it does appear to me that you do have to have the ability, particularly if they are providing these papers every year where there are tax credits, to verify that the low-income unit requirements are being met.

Mr. SMITH. Most of the State monitoring plans require a validation of percentages, very often, of the requirements. For instance, the percentages of the number of people who qualify for low-income housing, it is not always a total validation, but it is true that they are not required to forward that to us.

Chairman JOHNSON. Do you feel that the States are enforcing this pretty rigorously?

Mr. SMITH. I do not have any information to believe that they are not; I do not.

Chairman JOHNSON. Do you think more site visits would be a good idea?

Mr. SMITH. Many of the States do site visits. Their monitoring plans, only one of them requires—one of the types of monitoring plans that they can choose requires site visits. We do get information on the notifications of noncompliance to us that indicate that site visits were made. From a standpoint of if more information were given to us, validated by site visits, from an administrative standpoint of administering the penalty, that certainly would be useful information. I think we would probably have to weigh it with how much additional burden we are supply——

Chairman JOHNSON. Right.

Mr. SMITH [continuing]. Costs involved and so on. So, there is a balance there, but when you have more information being supplied to us regarding areas of potential noncompliance, it can be very useful to us in administering it, yes.

Chairman JOHNSON. Thank you. Mr. Coyne.

Mr. COYNE. Thank you, Madam Chairwoman.

Mr. Smith, what are the IRS' and the Treasury's plans and timetable for implementing the GAO's recommendations?

Mr. SMITH. We do not have a regulation project formulated at this point in time. So, there is not a set timetable that would be associated with a reg project. The recommendations from GAO are relatively new, as you are aware. We are certainly going to be working with our Chief Counsel's Office and Treasury in considering the regulatory changes that GAO is recommending. At this point, we do not have a regulation project.

Mr. COYNE. Which administrative change recommended by GAO in their report would most improve the IRS' oversight of the Low-Income Housing Tax Credit Program?

Mr. SMITH. In taking a look at the administrative recommendations, I believe the recommendation that GAO is making surrounding the change in the noncompliance notification form is certainly a good one and one that we are pursuing. GAO also makes a recommendation—not one of their final, but it is incorporated in their report—about us utilizing a statistical sample or a random sample throughout the whole range of taxpayers who are claiming the credit to determine the level of compliance, as GAO mentioned before in their testimony.

We have not done that. The way we have chosen to do it is to use the information we are getting from the States, based upon the noncompliance forms that the State supplies to us in selecting returns for examination. If we went with the whole random sample, it is certainly true that would be valid in projecting the results of that sample to the universe. However, it is also, as those of you who are familiar with TCMP know, a very costly endeavor when a full random sample is selected on a segment population of the taxpayer community.

I wanted to—it escapes my thoughts right now. I did have another area in mind on an administrative change that they recommended. The matching of the K–1s, I wanted to comment on that just for a moment.

In July, I believe, of 1995, GAO did a review of the Partnership Examination Program of the Internal Revenue Service. In that review, they made a recommendation regarding the matching of K–1s from a partnership return to the actual partner's return. We agreed with that recommendation. That recommendation has not been accomplished to this point. They also mentioned in their written testimony here that that would be a good idea if we could do it, and we agree with that.

One of the difficulties we are experiencing with that is, we have not been able to scan that document. It is a rather complex document, if anybody has ever seen a K–1. What we are trying to rely on and what we are working on now, is about 3,000 partnerships comprising about 75 percent of the K–1s that are filed with us. So, we are trying to target our efforts regarding mag media filing of the K–1s by those folks and then subsequently electronic filing by those folks, so that we are able to capture the bulk of the unit without doing data entry.

Right now, we only do data entry of K–1s on approximately 10 to 15 percent of the ones we receive. If we are able to take care of the 75 percent or so using mag media, we could then concentrate on the balance using manual methods to input them.

So, we agree with that administrative recommendation made, but we are a ways from being there for other reasons. We do agree with it. That would be, certainly, helpful to us.

Mr. COYNE. OK. Since July 1995, the IRS has received approximately 210 statements of noncompliance. Overall, were the violations technical, inadvertent errors or intentional acts to abuse the low-income housing tax credit, in your judgment?

Mr. SMITH. First of all, the volume of notifications we receive from the States are considerably in excess of the 210. I think what the 210 refers to, is the number of examinations that we initiated as a result of receiving the notifications. For instance, in the first 6 months of this year, we have received approximately 5,300 notifications from the States regarding noncompliance or corrections of noncompliance.

When we look at the areas cited by the States, they run a full gamut of very minor areas, dealing with some minor habitation issues to very considerable areas, for instance, not receiving verification of the income of the tenants who are in the low-income housing project, which is a very serious one. Some of the minor ones dealing with faulty wiring or exposed pipes and things of that sort, not that they are not important issues, but very often, those are the types that get corrected prior to the expiration of the 90-day corrections period and the notification to us.

Even if they are corrected, the States do send us the notification that the noncompliance existed. So, it does run the full gamut. I do not believe we will be able to really judge which types of notifications have been the most helpful to us in determining examination potential of taxpayers until we complete many more of the examinations we have selected based upon that criteria.

Mr. COYNE. What is the status of the IRS' two-part action plan for the low-income housing tax credit?

Mr. SMITH. The two-part action plans are the ones that I mentioned. The first one was the audit activity that we instituted starting in mid-1995. So far, we have sent out the 210 lead packages. At this point, 29 of those have been completed. As I mentioned in the written testimony, it is very early to make judgments based upon that.

However, the amount of tax associated with the completed examinations amounts to about $340,000 of which about half of that is associated with the low-income housing credit. There were other issues on some of those examinations that, when we reviewed the returns, we did question.

Projecting that as an indication of compliance or noncompliance until we finish many more of those examinations, it is just simply too premature.

The second thing is our matching program that I mentioned. Hopefully when we have our runs in July 1997, as a result of our efforts at the Philadelphia Service Center, we will be able to make a judgment as to how effectively the system that we constructed for the matching of the credits is working.

Mr. COYNE. Relative to the Federal Manager's Financial Integrity Act, will the IRS' actions over the past 2 years result in the low-income housing tax credit being excluded from the Integrity Act report as a material weakness——

Mr. SMITH. I certainly hope it will. Obviously, one of the things we put on as a condition for that, in reporting internally, to our management was having a successful way of doing the matching. So, hopefully, in July 1997, we will know how that turns out.

The 1998 report on material weaknesses is required to be submitted by the Service at the end of 1998. I am certainly hopeful that we would be able to remove the——

Mr. COYNE. At the end of 1998?

Mr. SMITH. Yes.

Mr. COYNE. At the end of 1998?

Mr. SMITH. That is when that report—I am hopeful that we will be able to remove it as a material weakness internally, in our monitoring process and say we have this problem solved. The reporting for 1998, I believe, takes place at the end of the fiscal year. So, I thought your question was on that reporting for 1998. I am certainly hopeful that it will be off as a material weakness.

Mr. COYNE. Thank you.

Chairman JOHNSON. Thank you, Mr. Coyne.

Mr. Portman.

Mr. PORTMAN. Thank you, Madam Chair. Thank you, Mr. Smith. You have a lot of expertise in this.

Exams is the area where the low-income housing tax credit is really audited and where you keep track of it, I guess. Otherwise, you would not have all this knowledge. The Chief Counsel's Office handles the pooling of the credits. Who else is involved at the IRS? How do you organize it?

Mr. SMITH. The way we have it organized, the Chief Counsel's Office is responsible for reporting the pooling of the credit and a notice goes out twice during the year, one for the original allocation based upon the $1.25 of the population within the State, and one for any subsequent distribution of the national pool.

Within my office on the Commissioner's side of the house, the administration of the credit falls into two principal areas. One is at the Service Center, involving the processing of the forms received from the States: the 8609s, the 8610s and the 8823s. Then there is also the examination area. I have approximately 50 examiners who were trained during 1995 and 1996, spread throughout the country, who are handling the examinations. So that falls under my direct responsibility as the Assistant Commissioner for Examination.

Mr. PORTMAN. How much time are you putting in, say, as a percentage of your time?

Mr. SMITH. During the past week or in weeks past? [Laughter.]

Mr. PORTMAN. Certainly, during the last 24 hours, you have put a lot of time against it.

Mr. SMITH. Right, I have.

Mr. PORTMAN. Over a year's period of time, forget the filing season, just generally?

Mr. SMITH. Right. It is a fairly significant issue for us in exam, much more so——

Mr. PORTMAN. Twenty percent of your time?

Mr. SMITH. Oh, no, not 20 percent. I handle the entire examination function for the Internal Revenue Service.

Mr. PORTMAN. Ten percent?

Mr. SMITH. I would say maybe a little less than 5. I do not think there is any program I spend more than 5 percent with, because there are so many, including the Coordinated Examination Program and all the others that I know you are familiar with.

I get regular briefings on what is happening regarding the low-income housing credit. I also am the person who has to go before our senior management controls because of the material weakness

and report to the Deputy Commissioner as to the progress we are making in taking care of the material weakness that was identified. So, for those two reasons, it shows up on my radar screen with a fair degree of regularity.

Mr. PORTMAN. One specific question now, because your testimony was interesting in this regard. Of those 53 examiners, you said that they were trained in Philadelphia, I guess at the Service Center. You indicated the training took place over—it sounded like a year's period of time.

Mr. SMITH. There were three training classes.

Mr. PORTMAN. Are we to believe that there is not ongoing training?

Mr. SMITH. There is ongoing support for those—I have the unit in the Pennsylvania District that supplies ongoing technical support for the examiners who were trained during that 1-year period. There were three training classes that were conducted, similar classes, different geographic locations, different parts of the country, but the training was the same. The Pennsylvania District unit that I have established there, not only are they responsible for assisting the States, practitioners and taxpayers, but also serving as a technical recourse for our field examiners.

We have also issued, under our Market Segment Specialization Program, audit technique guidelines specifically geared toward the low-income housing credit issue. So, we do have guidelines for the examiners to follow and that is incorporated into the MSSP Program or the Market Segment Specialization Program. So, it is an ongoing type of educational guidance. They do not——

Mr. PORTMAN. This is not really on point here and I apologize for getting a little off track.

Mr. SMITH. That is OK.

Mr. PORTMAN. I would assume that you have ongoing training and not just guidance provided when someone has a question. If you have 53 people, you are bringing new people in. You are working people out of other areas, I assume, into exam on this area. It was just interesting.

One of the criticisms that many have leveled recently on the training side is that it is not consistent district to district or even region to region and sometimes there is not an adequate commitment to it. I would hope that, in this area, we are getting lots of training. Since you are, under GAO's recommendations, taking on all sorts of new responsibilities, you are going to be delving deeper into it. You are not going to be just relying on the State data, it sounds like and it sounds like you want to do that. You are going to be matching the K–1s. Mr. Coyne and I are going to give you the electronic transfer to be able to do that more easily, right? [Laughter.]

Mr. PORTMAN. I think it is, one, interesting for this hearing to bring out the fact that this is a major project at the IRS and, two, question whether these kinds of resources, the 53 examiners, the service centers, your time, even though it is 5 percent or less, whether that is an appropriate program to be within the Service.

I assume those examiners, particularly as you begin to delve more deeply, which is what I think you are suggesting is appropriate—certainly, GAO did—will have to become more expert on

housing issues generally. In terms of auditing what the developers are doing, are they keeping to the guidelines, the goldplated issue that Mrs. Johnson raised earlier? Is that true that those examiners are going to have to develop an expertise and be trained on housing issues that they may or may not have been trained on as an examiner?

Mr. SMITH. Absolutely and that is one of the reasons we chose to formulate the MSSP guideline for them. Many of our examiners are generalists. They handle a wide range of businesses that they are responsible for examining. Not all businesses or industries have the same type of intricacies or methodologies of doing business and so on. The MSSP guidelines also incorporate the very things that you are mentioning. So, before they actually start the examination, they can get an idea of how that industry operates, how the low-income housing—so when they start asking questions of the taxpayer, they are asking questions that make sense based on other people's experience who developed the MSSP guideline and also——

Mr. PORTMAN. Which is going to require a lot of training and, to the extent that we are asking the States to do more and provide more information, you are going to have to have the analysts there to be able to analyze that information. Otherwise, we are just putting another unfunded mandate on the States that is not really useful. So, it is going to involve, I would guess, even more resources.

Mr. SMITH. It very well could, especially depending upon the results of the examinations—if we do see noncompliance in those areas, obviously we would be applying more resources to them.

We are continuing to send out additional cases for examination. We just did not want to leave the impression that they were all sent out at the time of the training and we have not sent out additional cases since then. Based upon information that we continue to receive from the States regarding noncompliance, we do look at the potential for examination for some of those. I think most recently, we sent out an additional 18 cases to our field examiners to examine. One of the primary source documents that we used on selecting those cases were the notifications that we received from the States.

Mr. PORTMAN. One general question and then I will let others have a turn. Given all your various responsibilities as the Assistant Commissioner for Examinations and all the other areas that you get involved in, do you think that this program properly fits into the Internal Revenue Service or do you think that, particularly given the level of expertise that probably needs to be developed to properly audit it, it might be better placed in another department, at least, to do the more indepth analysis and examination?

Mr. SMITH. That becomes difficult because you do have the direct credit issue that we must handle on the tax returns. That is one of the primary focuses that we do handle. Is it appropriate for the taxpayers to be taking those credits? So, that portion, obviously, would have to stay with the Service.

Mr. PORTMAN. Right.

Mr. SMITH. If we looked at some of the other oversight—I am not sure if oversight is correct—but other responsibilities regarding the

program, could they be shifted to somebody else, another agency, I would imagine that potential exists. We would have to be able to insure in considering that potential that we are able to segregate the tax return information——

Mr. PORTMAN. 6103?

Mr. SMITH. 6103, things like that, to insure that we are in compliance with the requirements of 6103 when we introduce another responsible agency into the——

Mr. PORTMAN. Is this something that should be outsourced to the private sector?

Mr. SMITH. I do not believe the examinations should be outsourced to the private sector, no.

Mr. PORTMAN. OK.

Mr. SMITH. I have not seen any data regarding outsourcing of examination activities. I am only personally aware of one that has been engaged in and, I believe, that was in Florida. It dealt with use in sales taxes.

Mr. PORTMAN. Yes.

Mr. SMITH. The information I have read there——

Mr. PORTMAN. It was on the audit function.

Mr. SMITH [continuing]. Did not convince me that it was more effective to outsource that because of the costs associated with it.

Mr. PORTMAN. I will just make the general comment that, as we talk about are we getting our bang for our buck with this program, we talked about the 9,000 or 10,000 discrepancy with our GAO friends. There is another cost, of course, to the taxpayer and to the system and to the IRS which is administering this. It sounds like we are heading down the road toward more complexity, more focus and more resources.

Mr. SMITH. There is absolutely a cost for the Service to administer it, no question, sir.

Mr. PORTMAN. Thank you, Madam Chair.

Chairman JOHNSON. Thank you very much. Mr. Weller.

Mr. WELLER. Thank you, Madam Chairman. And good afternoon. I had just a couple of quick questions. A lot of what I was anxious to ask has already been covered.

In the GAO recommendations they included some thoughts regarding improving compliance monitoring. And I just wanted to get a feel from you, do you at the Service plan to institute any changes to improve compliance monitoring?

Mr. SMITH. The changes that we have instituted regarding the processing of the State forms that we receive in our Philadelphia Service Center is an effort that we've incorporated to improve compliance monitoring. That's one that we have ongoing.

If the question is referenced to the regulatory recommendations that GAO has mentioned, and there are three principal ones. Some of those involve compliance, for instance, requiring the States to do onsite visits and so on. As I mentioned, we're certainly willing to work with Treasury regarding those. I think we do have to balance those with how much burden is associated with additional regulatory requirements, the costs associated with that, and so on.

The two things we're certainly—well, I don't want to repeat myself. With respect to the one that we've already started, hopefully

by July 1997 we'll know the results of our matching with compliance efforts.

And it will be beyond that when we know the results of the actual audit activities, so that we can judge on the effectiveness of the notification to us from the States of noncompliance, and how that actually translates down into credit disallowances or the appropriateness of the credits on tax returns.

Mr. WELLER. I found your conversation with Representative Portman very helpful, just getting a better understanding of how you go about doing your job. And you mentioned costs and burdens of improving compliance along the lines of GAO's recommendations.

Can you share with us what the impact would be on the Service, the cost of improving compliance, or the burden, as you use that word?

Mr. SMITH. Well, the burden that I was referring to was the burden to the taxpayer or the States to comply. The costs for the Service surround the necessary processing cost, and the coverage cost from an examination standpoint.

As you probably know, we do have certain coverage levels on groups of returns, whether they be corporate or individual returns. Hopefully the examinations that we're now conducting will be able to provide some information on examinations, although GAO is certainly correct that those results could not be projected to the universe. So we may know how the universe is performing from the standpoint of compliance with the tax credits.

But we should have a much, much better idea how those taxpayers, where a notice of noncompliance has been received from the State, are performing on their tax returns relating to that credit.

Mr. WELLER. Finally, on the cost to your agency, do you feel that with the staff resources and budget that you have to do your job that you'd be able to improve compliance monitoring with the resources you currently have?

Mr. SMITH. Certainly I do not intend on removing resources from the program, from the examination program until we have a much better picture as to the compliance levels and the conclusion of those examinations.

But in all fairness, as you know, the size of the examination activity at the Service is contracting. We have to make more intelligent choices as to where to apply our traditional enforcement resources, and attempt to apply those in the areas where there is the greatest noncompliance needs.

If we are contracting, unless this program shows itself to be a significant area of noncompliance, obviously I would be shifting resources to other areas as I think is the expectation of our taxpayers and, I believe, the Committee also.

So as examination contracts vis-a-vis its budgets, we do have to make choices on areas of where to apply them. This will be incorporated into those choices, and, hopefully, be well guided by the results to indicate what is the level of noncompliance or compliance.

I don't want to just refer to it in a negative sense. Sometimes I do talk noncompliance, but I also want to include compliance levels, and make those judgments based on that.

Mr. WELLER. Thank you, Madam Chair.

Chairman JOHNSON. Thank you. We'll look forward to working with you, Mr. Smith, in the weeks ahead to assure that we make certain that we get the right information at the least cost to everybody, both the least cost to the providers of the information, and the least cost to the reviewers of that information.

But we do want to make sure that we get accurate and precise information that go to the public policy issues, whether or not there is compliance with the overall goals of the program to provide affordable housing, and whether we are doing that in a cost-effective manner.

In your experience, do you believe the syndicators in this program are rewarded any better, more than in other programs?

Mr. SMITH. I don't have any information on which to base an answer.

Chairman JOHNSON. Is the administration of this tax credit any more complicated than some of our other tax credits? And is this uniquely complicated?

Mr. SMITH. Well, it's certainly not a refundable credit, which is a——

Chairman JOHNSON. A blessing. I understand.

Mr. SMITH. But from administering, obviously that's a choice in the law whether it's refundable. And I say that strictly from a standpoint of administering it. So in that sense, it's easier.

It's not a simple area of the tax law. There is complexity involved with it.

Chairman JOHNSON. But, for instance, we have education tax credits, we have R&D tax credits. We have a number of other significant credit programs in the law. Is this any more or less complicated than they are?

Mr. SMITH. Not in administering them, I don't believe. Especially as compared to a refundable.

Chairman JOHNSON. Thank you very much. It's a pleasure to have you with us.

Mr. Logue, the executive director of the Michigan State Housing Development Authority, on behalf of the National Council of State Housing Agencies. Welcome.

STATEMENT OF JAMES L. LOGUE III, EXECUTIVE DIRECTOR, MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY; AND PRESIDENT, NATIONAL COUNCIL OF STATE HOUSING AGENCIES

Mr. LOGUE. Thank you. I am Jim Logue, president of the National Council of State Housing Agencies, the national nonprofit organization which represents the 53 State agencies which administer the low-income housing tax credit.

I am also executive director under Governor John Engler of the Michigan State Housing Development Authority. My authority allocates the housing credit in Michigan.

I appreciate the opportunity to testify today on behalf of the States to which Congress has committed the high trust of administering the housing credit. We are deeply grateful for the support this Committee and the Congress have so overwhelmingly given the housing credit since Congress and President Reagan created it in 1986.

The housing credit represents a remarkable approach to dealing with the low-income housing shortages which afflict almost all parts of our country. Rather than another traditional one-size-fits-all Washington-based program, top heavy with bureaucracy, Congress specified that the housing credit would be overseen by the Internal Revenue Service, but administered by the States.

Though State-based, the housing credit is one of the most thoroughly regulated and tightly overseen tax provisions ever created. For example, housing credits are awarded only to developments selected by the State in accordance with a comprehensive housing needs plan.

Housing credits cannot be claimed until the State has thoroughly reviewed the finances of the proposed development, carefully rationed the housing credit to the minimum amount needed to make the development financially feasible, and checked to make sure that it is completed according to the plan the State has approved.

Even then, the Service can recapture housing credits from any property which the State finds out of compliance with Federal income targeting, rent restrictions, or housing quality standards through its required annual monitoring.

Before Congress finally made the housing credit permanent in 1993, the stop-start history of the credit under a series of sunset deadlines discouraged many developers and investors from making the long-term commitments necessary for housing credit development.

The bill that led to housing credit permanence had bipartisan support. Two-thirds or more of both Republicans and Democrats in Congress cosponsored the Housing Credit Permanence Bill.

Eighteen months ago, Ways and Means Committee Chairman Archer asked the General Accounting Office to review the housing credit. That study took more than a year. It was a broad and extensive investigation, and now the results are in.

The facts that the GAO reported about the housing credit clearly show that the housing credit has exceeded the goals Congress expected of it. Let's look at the success story that the GAO found.

The average housing credit renter earns only 37 percent of the local median income. More than three out of every four housing credit renters have incomes below 50 percent of their area's median income.

Average housing credit apartment rents are well below market rents. They average as much as 23 percent below the maximum rents the housing credit allows. States are giving preference to apartments dedicated to serving low-income tenants much longer than the law requires.

Housing credit apartment development costs are reasonable. They average less than $60,000 per unit.

The States have developed best practices for housing credit administration. They include limitations on developer and builder fees.

GAO found almost no evidence of ineligible tenant incomes or excessive rent charges. And GAO reported that each of the properties it visited was in good condition and well maintained.

The report showcases how this unique Federal-State partnership has worked to produce needed, decent, affordable apartments for

American working families, the elderly, and other low-income people with special needs, such as those with developmental disabilities.

We believe this success story makes clear the need to increase the volume limit on housing credit apartment production, which has not been increased since the program was created in 1986.

As Congress transfers more housing responsibility to the States, the decade-old cap on housing credit volume is strangling State capacity to help millions of Americans who still have no decent, safe, affordable place to live.

The ability of States to tailor their housing credit programs to their own needs and priorities is an essential part of the housing credit success story. In my own State of Michigan, where Governor Engler's welfare reform efforts have proven so successful, housing credits have been integrated into programs designed to help people achieve self-sufficiency. Housing credits have been awarded to developments from Detroit to Kalamazoo that deal with the problems and needs of low-income families beyond housing.

Madam Chairman, we pledge to you our full expertise and energies to help this Committee shape any changes it deems necessary to housing credit administration.

Last fall, NCSHA assembled an informal housing credit commission, including representatives of all sectors of the housing credit community. The commission includes State allocating agencies, private homebuilders, nonprofit developers, housing credit syndicators, urban experts, accountants and attorneys. A list of its members is attached to my testimony.

The Commission's purpose is to help Congress strengthen housing credit administration and oversight based on the five principles the Congress has already embedded in it. They are State, not Federal administration, private-sector discipline, targeting to low-income and area needs, assured compliance, and maximum practical safeguards to maintain program integrity.

The Commission reviewed the GAO report and its recommendations after their release. The Commission, like NCSHA itself, agrees with the thrust of the four recommendations GAO has made regarding housing credit administration.

We have formulated proposals to strengthen housing credit enforcement, oversight, and compliance monitoring which go beyond GAO's recommendations. I have attached to this testimony a copy of the letter the Commission has sent to you, Madam Chairman, summarizing the changes we unanimously suggest this Committee consider.

The Commission's report also deals with actions the States and the private sector are undertaking in important areas in which further legislation or regulation is neither needed nor useful. Those changes will reduce costs and enhance the opportunity for smaller developers to participate more broadly in housing credit production.

In addition, States pledge to continue our efforts, which the GAO has so often favorably cited in its report, to develop best practices for the States to follow in administering the housing credit. We believe best practice development and simplification of housing credit procedures are best undertaken by the States, working where appropriate with the private sector.

The housing credit process ought not be frozen in statute or regulation when the States show that they can do the job themselves.

In summary, Madam Chairman, State housing agencies and NCSHA's Housing Credit Commission are committed to work with Congress in developing any legislative and regulatory changes Congress wants to consider.

In light of the strong bill of health the GAO report gives the housing credit, however, we urge that any changes be made only with considerable cause, deliberation and caution.

Madam Chairman, I welcome your questions.

[The prepared statement follows:]

Testimony of James L. Logue, III
President, National Council of State Housing Agencies
Executive Director, Michigan State Housing Development Authority
on behalf of the National Council of State Housing Agencies
before the House Ways and Means Committee Oversight Subcommittee
April 23, 1997

Madame Chairman and Members of the Ways and Means Oversight Subcommittee:

I am Jim Logue, President of the National Council of State Housing Agencies (NCSHA). NCSHA is the national nonprofit organization which represents the 53 state agencies which administer the Low Income Housing Tax Credit (Housing Credit).

I am also Executive Director under Governor Engler of the Michigan State Housing Development Authority. That Agency allocates the Housing Credit in Michigan. I have previously served as New Jersey Housing and Mortgage Finance Agency Director under Governor Kean and as HUD Deputy Assistant Secretary for Multifamily Housing under President Bush.

I appreciate the opportunity to testify today on behalf of the states to which Congress has committed the high trust of administering the Housing Credit. I also want to tell you about the group of Housing Credit experts we have assembled to be available to this Committee to help make workable and effective whatever changes this Committee chooses to recommend in Housing Credit administration and oversight.

We are deeply grateful for the support this Committee and the Congress have so overwhelmingly given the Housing Credit since Congress and President Reagan created it as part of President Reagan's tax reform program in 1986. As you know, the Housing Credit replaced all the less targeted provisions of the Internal Revenue Code which previously had encouraged private investment in affordable rental apartments.

The Housing Credit represents a remarkable new approach to dealing with the low income housing shortages which afflict almost all parts of our country. Rather than another traditional "one-size fits all," Washington-based program, top heavy with bureaucracy, Congress specified that the Housing Credit would be overseen by the Internal Revenue Service, but administered by the states.

Low income rental housing needs decisions would be made at the state level and housing production would rely on the energies and efforts of the private for-profit and nonprofit sectors. Though state-based, the Housing Credit would be one of the most thoroughly regulated and tightly overseen tax provisions ever created.

- The apartments the Housing Credit finances must be reserved for low income people for long periods at restricted rents.

- Housing Credits are awarded only to developments selected by the state in accordance with a comprehensive housing needs plan, developed by the state after public hearings.

- Housing Credits cannot be claimed until the state has thoroughly reviewed the financial needs of the proposed development, carefully rationed the Housing Credit to the amount needed to make the development financially viable for the long periods it is restricted to low income renters, and checked to make sure it was completed according to the plan the state approved.

- Even then, the Service can recapture Housing Credits from any property which the state agency, through required annual compliance monitoring, finds out of compliance with federal income targeting, rent restrictions, or housing quality standards.

The Housing Credit has provided a unique public-private partnership between government and for-profit and nonprofit developers to help meet low income apartment shortages nationwide. It successfully anticipated by a full decade the current trend toward greater state responsibility in national problem solving.

The record of the Housing Credit since Congress and President Reagan created it more than ten years ago is one of unparalleled success. It has helped finance

nearly 900,000 needed low income apartments nationwide, each dedicated to long-term low income use.

We are proud of the role Congress gave the states in regulating and facilitating the effort and achievement which both private home builders and nonprofit developers have made to create the urgently needed housing the Credit makes possible.

We are particularly grateful to Congress for permitting the states and the private sector to help design the major reforms Congress made in the Housing Credit in 1989 and since. By seeking the views of the states and the development community charged with administering the Credit and producing the apartments it finances, Congress assured that those reforms would be both effective and workable.

The most important change of all came when Congress finally made the Housing Credit permanent in 1993. Before then, the stop-start history of the Credit under a series of sunset deadlines had discouraged many developers and investors from making the long-term commitments necessary for Housing Credit development and investment. It was not until 1989 that states even received as many applications for Housing Credits as they had Credits to allocate. And lack of investor interest in a program which might disappear at any time depressed the value of those Credits in raising equity in the investor marketplace.

The bill that led to Housing Credit permanence had bipartisan cosponsorship, both broad and deep. Two-thirds or more of both Republicans and Democrats in Congress cosponsored the Housing Credit permanence bill.

Since Congress assured Housing Credit permanence, the increased investor demand for Credits has generated 25 percent more low income apartment investment per Credit dollar than before permanence. Developer demand for Housing Credits nationwide since Congress made the Housing Credit permanent exceeds their supply by more than 200 percent. As a result of this competition, states have a wider variety of sound developments from which to choose to meet their low income needs.

Eighteen months ago, Ways and Means Committee Chairman Archer asked the General Accounting Office to review the Housing Credit and make any

recommendations necessary to improve state administration and Internal Revenue Service oversight, enforcement, and compliance efforts.

The GAO study took more than a year. It was one of the broadest and most intense efforts GAO has ever undertaken. Now its results are in.

In short, the facts the GAO reported about the Housing Credit clearly show that the Housing Credit has exceeded the goals Congress expected of it. It is helping meet growing low income rental shortages in urban, suburban, and rural areas nationwide. The GAO report underscores Congress' extraordinary foresight in relying on the states to administer this revolutionary and remarkably successful program.

We believe that success story makes clear the need to increase the decade-old volume limit on the Housing Credit's capacity to help meet the increasing shortage of decent low income apartments. The federal limit on Housing Credit apartment production has not been increased since the program was created in 1986. Meanwhile, as Congress transfers more housing responsibility to the states, the decade-old cap on Housing Credit volume is strangling state capacity to help millions of Americans who still have no decent, safe, affordable place to live.

While I recognize that the GAO has taken pains to point out that it was not asked to recommend whether the Housing Credit should be continued or to express an opinion about its success, the facts that GAO reports about the Credit dramatically and emphatically answer both those questions. Let's look at the success story GAO found:

- The average Housing Credit renter earns only 37 percent of the local median income, although the law allows such renters to earn up to 60 percent.

- More than three of every four Housing Credit renters have incomes below 50 percent of their area's median income.

- Average Housing Credit apartment rents are well below market rents. They average as much as 23 percent below the maximum rents the

Housing Credit allows and 25 percent below HUD's national Fair Market Rent.

- States are giving preference to apartments dedicated to serve low income tenants much longer than the law requires. In fact, two-thirds of the apartments GAO studied were committed to low income use for 30 years or more.

- Housing Credit apartment development costs are reasonable. They average less than $60,000 per unit.

- Though not required by federal law, the states have developed voluntary "best practices" for Housing Credit administration, including limitations on developer and builder fees. The states also use Housing Credit competition to control development costs.

- In reviewing tenant files at sample properties, GAO found "almost no evidence of ineligible tenant incomes or excessive rent charges." GAO also reports that "property managers consistently adhered to program monitoring requirements by gathering and verifying household income data," and "rents charged for rental units and proportional tenant rent payments [were] accurate."

- GAO reported that each of the properties it visited was in good condition and well maintained. [1]

The GAO study should reassure Congress and this Committee about your wisdom in creating the Housing Credit. The report showcases how this unique federal/state partnership has worked to produce needed, decent, affordable apartments for American working families, the elderly, and other low income people with special needs, such as the developmentally disabled.

---

1 As our comment on the draft GAO report, reprinted on page 171 of the final GAO report, highlights, GAO described in the draft report the Housing Credit properties it inspected throughout the country as follows: "[A]ll projects we visited appeared to be in good condition and well maintained." This tribute to Housing Credit properties was eliminated in the final report. This deletion is the only substantive change GAO seems to have made between its draft and final reports.

The ability of states to tailor their Housing Credit programs to their own state needs and priorities is an essential part of the Housing Credit success story. In my own state of Michigan, where Governor Engler's welfare reform efforts have proven so successful, Housing Credits have been integrated into programs designed to help people achieve self-sufficiency. Housing Credits have been awarded to developments from Detroit to Kalamazoo that deal with the problems and needs of low income families which go beyond merely housing.

In Kalamazoo, an older, downtown residential hotel was turned into the Rickman House, a Single Room Occupancy development, serving the shelter and personal needs of 84 individuals with federal assistance and local philanthropic funds. Two daily meals are provided to residents, as is housekeeping and job training.

In Detroit's Empowerment Zone, an exciting development called Lakewood Manor will house 30 extremely low income young parents, and will provide day care, job training and placement services, educational referral, and parenting skill classes.

The Housing Credit program is not personal or corporate welfare. It helps folks who get up and go to work every day to earn their rent find decent, safe, and affordable housing. It does so by encouraging individuals and corporations to make investments in low income apartment development which they would never otherwise have reason to make.

Housing Credit apartments rent up quickly, because the need for them is so much greater than can be met under present Housing Credit volume limits. Every year, another 100,000 low cost apartments, more than the Housing Credit can produce under current limits, are demolished, abandoned, or converted to market rate use. The numbers tell a sobering story: Ten million families with incomes low enough to qualify for federal rental housing help get none. Five million pay more than half their income for housing. More than a million live without basics like plumbing, heat, or electricity.

The Housing Credit supports other important national objectives, too. Housing Credit apartments help stabilize neighborhoods. They improve housing quality and supply and act as catalysts for broader community revitalization.

Housing Credit apartment construction is a key part of our national economy's vital residential construction sector, annually generating 70,000 jobs, $1.8 billion in wages, and $700 million in tax revenue.

Madame Chairman, we respect the Committee's concern in asking for the GAO study. We hope it reassures you regarding those concerns. We pledge to you our full expertise and energies to help this Committee shape any changes it deems necessary to Housing Credit administration.

To that end, without press release or fanfare, last fall NCSHA assembled the informal Housing Credit Commission I have mentioned. It includes representatives of all sectors of the Housing Credit community from all over the nation. All of its members are Housing Credit experts. The Commission includes state allocating agencies, private home builders, nonprofit developers, Housing Credit syndicators, urban experts, accountants, and attorneys. I chair that Commission. A list of its members is attached to my testimony for your reference.

The Commission's purpose is to recommend any legislative or regulatory changes it thinks necessary to strengthen Housing Credit administration and oversight, based on the five principles Congress has already embedded in it:

- state, not federal, administration;
- private sector discipline;
- targeting to low income and area needs;
- assured compliance; and
- maximum practical safeguards to maintain program integrity.

From the beginning, the Commission has offered itself to the Ways and Means Committee in any way it can be helpful to assure that whatever additional safeguards you desire in the Housing Credit be made workable and effective. It is available to the Committee for "one stop shopping," if you want Housing Credit community-wide reaction and advice regarding proposals the Committee may consider regarding the Credit.

The Commission has met four times. During each of those all-day sessions, it discussed both recommendations it might make to Congress to improve the Housing Credit and answers to attacks which might be made on any of the five values I have enumerated above. For example, we discussed responses to any proposal to substitute federal bureaucratic judgment for the state and local decisions Congress intended in the Housing Credit. We discussed rebuttals to any proposal to reduce the private sector discipline now an integral part of the program or to reduce any of the program compliance and integrity safeguards Congress has already enacted.

The Commission reviewed the GAO report and its recommendations after their release. We have formulated additional proposals for you to consider to strengthen Housing Credit enforcement, oversight, and compliance monitoring. Our proposals go beyond those recommended by GAO. I have attached to this testimony a copy of the letter the Commission has sent to you, Madame Chairman, summarizing the changes in Housing Credit law and regulation we suggest this Committee consider, including those the GAO recommends.

Some of these recommendations may require legislation. Others, including those in the GAO report, may be implemented by regulation.

A third area of the Commission's report to you deals with actions the states and the private sector are undertaking in important areas in which further legislation or regulation is neither needed nor useful. These actions are designed to reduce the paperwork burdens the Housing Credit currently involves. Those changes will reduce costs and enhance the opportunity for smaller developers to participate more broadly in Housing Credit production. Examples include efforts we plan with the private sector to make compliance, cost certification, and other documents and procedures more uniform and streamlined among states and to simplify and improve Internal Revenue Service compliance procedures to make them more effective.

And the states pledge to continue our efforts, which the GAO so often favorably cited in its report, to develop best practices for the states to follow in administering the Housing Credit. Through NCSHA, three separate task forces of

state credit allocators from across the nation have formulated more than 30 such "best practices" since 1992.

We believe best practice development and simplification of Housing Credit procedures are best undertaken by the states, working, where appropriate, with the private sector. We invite Congressional review of our work, such as the GAO report has accomplished. The spirit of devolution which led Congress to entrust Housing Credit administration to state governments in the first place recognized the complexity and differences in housing development among the many parts of the country, including your own states. The Housing Credit process needs to be allowed to respond appropriately to those needs, and ought not be frozen in statute or regulation where the states show they can do the job themselves.

In summary, Madame Chairman, state housing agencies and NCSHA's Housing Credit Commission are committed to work with Congress in developing any legislative and regulatory changes Congress wants to consider. We want to offer you our advice, based on our ten-year experience with the Credit, to make such changes as effective and workable as Congress intends. We will also ask Congress to reject proposals which are counterproductive to creating the desperately needed low income rental supplies the Housing Credit was created to encourage or which interfere with the extraordinarily effective reliance on state judgments about local housing needs Congress intended in creating the Housing Credit.

Particularly in light of the strong bill of health the GAO report gives the Housing Credit, however, we urge that any changes be made only with considerable cause, deliberation, and caution.

Madame Chairman, I welcome your questions.

Chairman JOHNSON. Thank you very much. Thank you for your help as we've been working through this subject for the last year, and we appreciate your testimony today, and look forward to working with you as we improve this legislation.

I was very surprised at the GAO report's data that two thirds of the households in Tax Code properties were one- or two-person households.

Do you have an explanation for that?

Mr. LOGUE. I think the information suggests that that's where the market is and where the need is. And certainly market analyses that have been performed at the State level suggest that one- and two-person households—and I think even national statistics show this—represent about 60 percent of the households that are low and moderate income and eligible for this type of a program.

So it's not surprising that the size of units and the households that would be occupying them would be of that nature. We in Michigan typically find a lot of our developments are occupied by single parents with children who may be in a situation where their

income isn't sufficient to support the type of housing that's otherwise available.

Chairman JOHNSON. I guess I wonder whether that is really where the need is. I mean, we'd have to look back to the State plans and see where their priorities are, or whether this is where the market is. This is the kind of project the market would like to build because it's easy to manage: a combination of adults and older people, and then in order to qualify, a few families.

So I really need to know, and I'd be interested in knowing whether States really don't have affordable family housing at the top of their priority list, or whether they do, but they can't get projects to come forward that are primarily family units.

I mean, it's harder to run family housing. No question about it. It's harder to manage it. You want to manage it over 10 years and get tax credits and so on. Is this just not a deal that syndicators will do?

Mr. LOGUE. I don't think that's the case in general. I think certainly in Michigan we give highest priority to projects that serve larger families in our allocation system. So projects that come in with a number of units allocated or designed for large families would get a higher point score in that category than any other competing project.

I think the other information we need to look at is what is most recently happening in the credit program with regard to those types of priorities. The data the GAO used is from a period of time, 3 to 5 years ago.

Chairman JOHNSON. Right.

Mr. LOGUE. And I think that you will see in many of the State allocation plans, which have developed over time, which have more definitively targeted and identified the need, have made efforts to give priority to projects that have larger families.

Chairman JOHNSON. Is it fair to say, Mr. Logue, that actually the State plans have become more precise and targeted in the last 3 years?

Mr. LOGUE. I don't think there's any question about it. I think they get better every year.

Chairman JOHNSON. I think we do need better information on the relationship between the States' top three priorities. What's their top priority, their second top priority, and the third top priority, and what kind of units are we building in this program? If you would help us with that, I'd appreciate it.

Mr. LOGUE. We'd be happy to do that.

[The following was subsequently received:]

National
Council of
State
Housing
Agencies

April 21, 1997

The Honorable Nancy L. Johnson
Chairman, Committee on Ways and Means
Oversight Subcommittee
U.S. House of Representatives
1136 Longworth House Office Building
Washington, D.C. 20515-6350

Dear Madame Chairman:

When Ways and Means Committee Chairman Archer asked the General Accounting Office (GAO) to study the Low Income Housing Tax Credit (Housing Credit), he asked it to report on the following issues:

- how efficiently the Internal Revenue Service (the Service) is administering and monitoring it;
- what controls exist at the state level to ensure that the Credit is applied as Congress intended and that costs are reasonable;
- what controls exist to ensure that states do not allocate more Credit than they have available to allocate;
- whether those residing in the Housing Credit apartments fit the characteristics of the individuals and families for whom Congress created the program; and
- such other issues as might arise during the course of the GAO's study.

Now the GAO has finished its work. You are holding Oversight Subcommittee hearings on whether changes should be made to the Housing Credit to improve its oversight, enforcement, and compliance.

444 North Capitol Street, NW, Suite 438 Washington, DC 20001 (202)624-7710 FAX (202)624-5899

The National Council of State Housing Agencies (NCSHA), which represents all the state agencies which administer the Housing Credit, wants to help you in any way we can. To that end, without press release or fanfare, last fall we assembled an informal commission. Its members are all Housing Credit experts. They are from all across the country. They are representative of every sector of the Housing Credit community, including state allocating agencies, private home builders, nonprofit developers, Housing Credit syndicators, urban experts, accountants, and attorneys.

The Commission's purpose is to recommend any legislative or regulatory changes it thinks necessary to strengthen the Housing Credit's effectiveness, based on five principles Congress has already embedded in it:

- state, not federal, administration;
- private sector discipline;
- targeting to low income and area needs;
- assured compliance; and
- maximum practical safeguards to maintain program integrity.

From the beginning, the Commission has offered itself to the Ways and Means Committee to help assure that any additional safeguards the Congress desires are as workable and effective as Congress intends them to be.

The Commission has met four times. During those day-long sessions, it discussed recommendations it might make to Congress to improve the Housing Credit and rebuttals to attacks which might be made on any of the five values enumerated above.

On the improvement side, we discussed a number of possible expansions of the Housing Credit. We also discussed responses to proposals which might be made to the Congress: (i) to substitute federal bureaucratic judgment for the state and local decisions Congress intended in the Housing Credit; (ii) to reduce the private sector performance and cost discipline now an integral part of the program; or (iii) to change the program's low income targeting or safeguards to program compliance and integrity Congress has already enacted.

Naturally, every member of the Commission would like to see the Housing Credit expanded, so it could do more good than present decade-old constraints permit. Though each of us might have some separate proposal to make in that direction, all of us agree that the $1.25 per capita cap on the

Credit set in 1986 is being significantly annually devalued by ordinary cost increases and should be amended to reflect past and future inflation. In fact, inflation has cut the purchasing power of the Credit dollar by nearly 45 percent since 1986.

Yet, as vital as we consider this and other expansions of the Housing Credit to be, we recognize that the current Ways and Means Housing Credit review is not the place to press them. Therefore, we have resolved to limit our recommendations to those designed to advance the Ways and Means Committee's present purpose of improving Housing Credit oversight, enforcement, and compliance. To that end, the Commission unanimously suggests the following.

- We agree with the thrust of the four recommendations the GAO has made regarding Housing Credit administration. We note, however, that all four relate to matters of regulation, rather than legislation. We will be happy to work with the Service, as we traditionally have on Housing Credit regulation, and with you regarding any legislation you believe is needed to authorize those regulations.

- Specifically, with regard to independent verification by state agencies of developer information on sources and uses of funds, the Commission suggests that state agencies be permitted to establish in their Housing Credit allocation plans alternative, less expensive cost verification procedures for appropriately small properties, since those procedures involve a cost which represents a much greater proportion of total project costs in small developments than in larger ones.

- We also note that the Office of Management and Budget has suggested that legislation to authorize the Service to establish an audit procedure may be more appropriate than extension of the Single Audit Act for that purpose. The Housing Credit is unique in many regards, and the audit procedure applicable to it should take that into account. Should the Committee decide to authorize the Service to implement an audit procedure by regulation, similar to that under the Single Audit Act, we suggest that the Service, in consultation with the state allocating agencies, design those audits and coordinate them with audits undertaken under the Single Audit Act, to minimize the burden on the states.

In addition to the recommendations the GAO has made, the Commission suggests the Committee consider the following recommendations.

Strengthening Housing Credit Enforcement

Administration and enforcement of Housing Credit requirements are shared responsibilities of the federal government and state allocating agencies. Yet, even though receiving an allocation of Housing Credits is not an entitlement, Credit allocation and compliance monitoring in each state must proceed without full knowledge of concerns the federal government and even other states may have about certain Housing Credit applicants or even what action the Service has taken on cases of noncompliance a state has reported to it.

States are often inhibited from sharing compliance or other concerns about individual applicants by threat of lawsuits, which, even though the state prevails at an early stage, are enormously expensive and time consuming for the state.

We suggest the following recommendations to reduce barriers to Housing Credit enforcement and compliance:

Recommendation 1: Authorize the Service to share information with state agencies about Housing Credit noncompliance, including notification of Service action on state notices of noncompliance (Form 8823), developers in substantial noncompliance, advanced investigative proceedings, and those from whom Credits have been recaptured.

Discussion: The Service's current interpretation of disclosure laws apparently prohibits them from sharing compliance information with state agencies, because such information is considered "taxpayer information." This interpretation prevents the Service from providing feedback to state agencies on actions it takes in response to state reported noncompliance, including whether owner corrections have been accepted by the Service, whether Credits have been recaptured, whether more frequent or intense state inspections of particular properties are warranted, or whether the agency even needs to continue monitoring a building. The Service does not even advise states of advanced investigative proceedings which, if known, could alert states to cases in which special diligence may be required.

Recommendation 2: Make it a federal crime to knowingly make false material statements or representations or knowingly falsify material information on any documents relating to a Housing Credit application.

Discussion: Though some states require Housing Credit applications to be signed under penalty of perjury, the offense is rarely prosecuted and may not carry penalties appropriate to fraud of this nature. In addition, Service

sanctions which deny Housing Credits or impose other penalties on investors to whom the Credit was sold may result in punishment of the innocent investors, rather than the dishonest parties.

Recommendation 3: Provide state allocating agencies with appropriate immunity from lawsuit for sharing Housing Credit allocation, compliance, and enforcement information they reasonably believe is true with other state allocating agencies and the Service.

Discussion: Ours is a litigious society. The threat of unmerited, expensive, and time consuming lawsuits discourages state housing allocators from sharing information which they reasonably believe to be true about Housing Credit participants with other states, even though that information, if shared, would lead to appropriately increased diligence by the receiving state in allocation and compliance matters. Congress should consider providing limited immunity from suit where states share information they reasonably believe to be true about participants in the Housing Credit process.

Recommendation 4: Require that state allocating agencies make a compliance visit to the site of each Housing Credit development within one year of issuance of Form 8609 (final Credit award) and at least once every three years thereafter.

Discussion: The 1990 Tax Act requires state allocating agencies to monitor all Housing Credit properties for compliance. Service regulations permit states to select one of three monitoring options, only one of which requires site visits.

NCSHA has long suggested that all state agencies visit property sites on a regular basis. In 1993, an NCSHA task force recommended that allocating agencies visit each Housing Credit development within one year of its completion and at least once every three years thereafter. (GAO found that 39 of the allocating agencies have already selected the Service's monitoring option requiring site visits.)

Recommendation 5: Direct the Service to amend its compliance monitoring regulations to clearly define distinct classes of noncompliance, including those which could potentially trigger recapture or loss of Housing Credits and those which, if timely and reasonably corrected, would not; to clarify that certain types of noncompliance, either because they are de minimis and are corrected promptly, need not be reported to the Service; and to provide states guidance on correction of noncompliance.

Discussion: The Service requires state agencies to report all instances of noncompliance, regardless of severity or possibility of triggering Credit

recapture or loss. In practice, this requirement imposes a significant administrative burden both on the state agencies to complete and the Service to process a large number of forms reporting conditions that may not materially affect a property, and that often have been corrected by the owner before the Service is notified. The volume of these required reports makes it difficult for the Service to quickly identify and pursue serious cases of noncompliance, and produces unnecessary harassment of owners for often technical, previously corrected compliance matters.

Service compliance regulations require states to inform the Service whether the noncompliance has been corrected, but provide no definition to the state allocating agencies as to what types of corrective actions can be taken in specific noncompliance circumstances, including: (i) inadvertent or mistaken rent overcharges; (ii) inadequate income documentation for current tenants; (iii) inadequate income documentation for former tenants; and (iv) late recertification or income verifications. The regulations also do not consider whether particular types of noncompliance are so technical or minimal in nature that they can be corrected and need not reported on Form 8823, or whether particular types of noncompliance must be reported, either because of their severity, their duration, or the extent of owner misconduct.

Recommendation 6: Direct the Service to amend its compliance monitoring regulations to permit states to establish in their allocation plans a safe-harbor cure period for small or inadvertent errors of noncompliance corrected within a reasonable period as determined by the state agency.

Discussion: The legislative history of the Housing Credit implies that owners who make small or inadvertent errors of noncompliance may cure them without penalty if they do so within a 'reasonable period' after the owner becomes aware of a problem (either through its own efforts or as a result of notification from the state allocating agency). The vague phrase 'reasonable period' has never been interpreted by the Service, leaving agencies ill equipped to enforce cures and owners at risk of later Service objection to the correction.

Recommendation 7: Direct the Service to waive the annual tenant income recertification requirement for a Housing Credit property, if the owner certifies to the state agency that the building is occupied entirely by low income tenants and the state agency verifies the low income status of a percentage of the tenants by reviewing rent records, income certifications, and supporting documentation in accordance with the Service's monitoring requirements.

Discussion: In 1993, Congress authorized the Service to waive tenant income recertification in Housing Credit buildings occupied entirely by qualified low

income tenants. The Service issued a revenue procedure implementing this provision in 1994. That procedure is unworkable, however, because it requires owners to obtain a statement from the state agency documenting that "each residential rental unit in the building was a low-income unit at the end of the most recent credit period." The Service only requires state agencies to review a percentage of project files in their routine compliance monitoring reviews, however, and so should not require review of all tenants as a condition for receiving a waiver.

Recommendation 8: Direct the Treasury to amend its post-transfer compliance bond procedures to: (i) allow alternate methods of security such as letters of credit, and (ii) permit buyers instead of sellers to post security.

Discussion: Mindful of abuses of previous tax-oriented programs and fearing the possibility of ownership transfers followed by noncompliance, Congress wanted to insure that the buyers of Housing Credit properties would be at risk of meaningful financial loss for noncompliance. It expressed this protection in a post-transfer compliance procedure, mandating that the seller retains financial liability and secure it by posting a surety bond. Once a property is transferred, however, it is the buyer, not the seller, who is responsible for compliance and therefore should bear the financial responsibility for it.

In addition, as a practical matter surety bonds are available principally to large corporations; to date no Housing Credit surety bonds have been issued to any other entity. By contrast, letters of credit are available to individuals and to smaller corporations. They are every bit as financially sound as surety bonds (and in some aspects easier to liquidate than bonds). Thus, expanding the permissible post-transfer security to include letters of credit would not diminish the federal government's protection. Expanding the pool of potential post-transfer buyers would also strengthen the secondary market for Housing Credits, in turn strengthening the portfolio by giving states greater ability to bring in new ownership and management in properties requiring recapitalization.

Providing for Documentation of State Exercise of Discretion

Recommendation 9: Require state agencies to document and make available to the public their reasons for exercising the discretion permitted in their allocation plans in making Housing Credit allocations.

Discussion: The Housing Credit program requires that states allocate Housing Credits pursuant to a qualified allocation plan, adopted after public hearings. Plans may allow for discretionary actions in Credit allocation to meet state housing needs. These discretionary actions should be documented by the

state allocating agency when they are exercised. That documentation should be made available to the public.

Providing for Housing Credit Carryforward

Recommendation 10: Amend the Housing Credit statute to allow state allocating agencies to allocate their carryforward and national pool Credits before their per capita and returned Credits.

Discussion: Each state receives annual Housing Credit authority of $1.25 per resident. In the 1990 Tax Act, states were given the authority to carry forward their unused per capita and returned Housing Credits for allocation in the next calendar year. Any Housing Credits a state carries forward, but does not use by the end of the second year, revert to a national pool and are redistributed to states which use all their available Credit in the prior year.

Before the carryforward provision, states were required to use all per capita and returned Credits within the calendar year or lose them. There was no national pool. The purpose of the carryforward change was to give states 24 months to allocate their per capita and returned Housing Credits and remove the "use it or lose it" pressure some states might feel at year-end. However, due to the way the provision was drafted, states must use all of their current-year per capita and returned Housing Credits to avoid the loss of carryforward Credits to the national pool or pool Credits from the program altogether. This effectively creates an every-other-year carryforward and does not give states a full 24 months to allocate their per capita and returned Credits as Congress intended.

In 1993, the Chairman of the Ways and Means Committee wrote the Treasury that Congress did not intend this outcome in creating the national pool legislation and suggested the Service change its regulation to reflect the efficient system Congress intended. The Service responded that it agreed the Congressional intent was not served by the outcome the Service had imposed, but suggested a change in statutory language is required to permit the desired regulatory outcome.

Conclusion

We are prepared as a Housing Credit community to craft these and any other workable and effective changes you believe will meet Chairman Archer's goals, which we all share, of strengthening state administration, compliance, and oversight of the Housing Credit.

We will also continue to work as a community to strengthen areas of the Housing Credit program in which no further legislation or regulation is necessary or useful, such as reducing paperwork burdens, streamlining agency requirements, reducing costs, and enhancing the opportunity for smaller developers to participate more broadly in Housing Credit development. We are beginning work immediately, for example, to make compliance and cost certification documents and procedures more uniform among the states.

We believe strongly, however, given the strong bill of health that the GAO report actually gives the Housing Credit, that any changes should be made only with considerable cause, deliberation, and caution. And, in the words of President Reagan, who signed the Housing Credit into law: "If it ain't broke, don't fix it."

On behalf of the
Housing Credit Commission,

James L. Logue, III
Chairman

Chairman JOHNSON. Then what is the range of application fees among States that developers have to pay to a State industry. And what does the developer get?

Mr. LOGUE. Application fees, I believe, are fairly consistent across the country. I'll give you ours, which I think is fairly typical. At the start of our process, we charge, I think, a relatively modest $100 plus $5 per unit, and the maximum is $850. That's basically to do the initial review of the project.

And that, I can tell you, probably does not even cover the costs we incur in reviewing and analyzing a project through the allocation process.

Once a project has received an allocation, we generally stage fee payments through the final allocation process, and those generally are computed as a percentage of 1 year's worth of credit—and it's a total of 4 percent of 1 year's worth of credit, 2 percent at the initial, and 2 percent at the final.

Chairman JOHNSON. Does that about cover your costs then for the follow-on parts of the application process?

Mr. LOGUE. It covers the costs we have in the initial process of allocation. That does not cover compliance monitoring, long-term compliance monitoring. We charge a separate, one-time fee for that of $175 per credit unit.

I am certain that will not be sufficient to cover the costs we will incur over the low-income occupancy required period for compliance monitoring. We do not look at the program as a——

Chairman JOHNSON. A cash cow?

Mr. LOGUE [continuing]. As a cash cow for certain. Especially given the level of training we are providing now at low or no cost to the managers and owners of our properties for compliance monitoring. We have flown in at our expense national experts on compliance monitoring to give seminars to all of the managers and owners of our projects, and do that on a regular basis.

And I know that those costs are probably now getting in excess of fees we collect to administer the program.

Chairman JOHNSON. That's very interesting. It's also true that the National Council of State Housing Agencies has made recommendations about developer fees and building fees and consultant and professional fees. And these are often exceeded.

Do you think we need to be tougher? Do you think those need to be in law?

Mr. LOGUE. I would suggest they do not. I think if you look, again, at the averages, and if you look even back at the cost of the overall program, the total development costs of projects financed with the housing credit you'll see that they're about $60,000.

If you look at comparable market rental units, the National Home Builders projects those costs, the average cost at about $82,000, and interestingly, new public housing units have an average cost of about $83,000.

So we're about 40 percent below market rental housing. We're similarly about 40 percent below newly constructed public housing. So in the context of overall costs, of which developer and builder fees are part of that cost, I would say we are quite in line. In fact, much more efficient in that regard in the question of costs which include development fees.

Chairman JOHNSON. One last question. I was surprised, actually, that not all the State agencies required good market studies. We are, in my part of the country, running into a surplus of affordable rental housing, even to the extent where there is some effort to reduce public housing units.

To what do you attribute the lack of interest in good market studies?

Mr. LOGUE. Well, again, I think in the GAO analysis, they found that virtually all States perform some market analysis, that there was a range of ways in which States approached market analysis. I think virtually all States do require some form of market analysis, whether it is an independent, project specific market analysis commissioned by the agency, or the submission of market data by the developer which is then reviewed by the agency.

Market is one of the key responsibilities allocating agencies believe they have to perform. And to the extent that there is greater need to do that or need for greater refinement, I think that is a concern we can address within the industry, within the allocating agency community.

And I don't think there is any disagreement from any State agency that market analysis is a key and critical part of the responsibility of the allocating agency.

Chairman JOHNSON. Thank you. Mr. Coyne.

Mr. COYNE. Thank you, Madam Chairman. Mr. Logue, in your testimony you indicate that the Council generally supports the recommendations for improved administrative oversight of the program by the IRS and the States.

What specific types of low-income housing tax credit information do you propose that the IRS obtain from the parties involved that they're not currently receiving?

Mr. LOGUE. I do not believe it's a matter of the information that they obtain. I think it's a matter of how we can work more effec-

tively and efficiently with the IRS in sharing some of that information.

We have had excellent relationships with the IRS staff in working with this program over the 10 years it's been in existence. We have had some issues which they believe they cannot address the way we would like to because of matters of confidentiality for the taxpayer, which then puts us in the position as the parties responsible for monitoring compliance of the projects in our States, of often not knowing the outcome, for instance, of information we have sent to the IRS with regard to compliance problems we have identified, because IRS is unable to share with us the outcomes or even what actions they are taking.

I think it is a process problem. If we could find a resolution it would be helpful in sharing information back and forth.

To the extent that there is other information the IRS would find of value that they don't currently get, I think from the perspective of allocations and compliance monitoring they get quite a good bit of information, both in how much credit we allocate to a project, how much credit we allocate on an annual basis, statewide, and, again, compliance monitoring problems and issues we find.

I think it's the communication back and forth that could be improved and that would improve the overall program, taking into account the constraints they have right now on sharing that information.

Mr. COYNE. Do you have any proposals for smaller developments, any more information that you would want relative to smaller developments?

Mr. LOGUE. I think smaller developments are projects we have to look at very carefully in any kind of administrative oversight reform, because they are uniquely unable to bear high cost compliance requirements.

And I think States have done a good job in trying, for instance, in the area of cost verification, final cost verification, of looking at smaller projects in a different way than they would larger projects, recognizing they could not bear the cost of a $5,000 or $6,000 cost certification at the end of a development process. It just would be infeasible.

A look at alternative ways to deal with smaller developers and developments is important so that the administrative burdens don't become so weighty that they can't afford to do it.

Mr. COYNE. So you don't have any recommendations that the IRS should independently verify any information?

Mr. LOGUE. No. I would recommend that there are certain things that States, as contained in the GAO report, could have more formal cause verification procedures for, and that the appropriate place for that process would be at the State level.

Mr. COYNE. What do States contribute to this program relative to the Federal Government? That's the first part of the question, and could you tell us what your agency's budget is for selection and compliance of credit projects, less the fees you take in related to project applications and the title?

Mr. LOGUE. Let me try and start with the first part of the question, what the agencies contribute to the Federal process. I think, again, as I noted in my comments, this is a unique Federal-State

relationship. When you consider that the staff—and I used to work at HUD in Washington, so I'm familiar with the Federal housing bureaucracy. When you look at the level of administrative support for HUD housing programs, and look then at Federal oversight of this program, you're really talking about the IRS in the context of the Federal involvement in the process—which I think is a positive attribute of the program.

The States have the primary responsibility for carrying out the allocation and administration of the process with IRS oversight and IRS ability to enforce sanctions when compliance with the tax credit requirements is not followed.

I think States are able since the resources are used locally to meet local State needs, it is a much more effectively used resource as a result of that. It's closer to meeting the needs in the State and in the various localities within the State.

So I think overall, from any which way you looked at it, it's a much more effective and efficient way to handle Federal programs than what we might consider the common or typical process of Federal management and bureaucracy.

I think the States add a tremendous amount to it, and I think as the GAO report shows, States have taken the role they've been given very seriously, and while I'm a firm believer in continuous improvement in every program—we can certainly continue to improve this program overall—I think we've found this to be a very effective and efficient and well regulated and overseen program.

Now, the second part dealing with the costs to my agency?

Mr. COYNE. Yes.

Mr. LOGUE. As I said, we do charge what amounts to about—for any project that receives credit allocation, an amount equal to about 4 percent of 1 year's credit for that project.

With that, we have a staff in my agency of about ten people who work specifically on the housing credit program. Some of them deal with compliance monitoring. Others oversee the allocation process.

We do our site visits through that office. On the basis of the revenue we take in, and, again, this does not include compliance monitoring, but the revenue we take in through the fees versus our overhead and direct costs, we are at about break even.

The total amount? I will get you the specific figures. I want to say it's probably in the vicinity of about $350,000 a year.

Mr. LOGUE. But that includes costs you wouldn't normally consider, for instance, in a normal administrative process. We, through, for instance, our qualified allocation plan, we must hold public hearings every time we change the plan.

The cost of just publishing the notices for a public hearing can run into the $5,000 or $6,000 or $7,000 range, and that's a regular, ongoing cost we have.

But I can assure you, we are just about, on the allocation side, at about break even.

Mr. COYNE. You had put ten additional recommendations in the back of your testimony. And one of them was increasing the $1.25 per capital cap, which started at the beginning of the program. Do you have any idea what an appropriate cap would be, or would you like to say what an appropriate cap would be?

Mr. LOGUE. I would probably rather defer that. I don't think we as an organization have come up with a specific recommendation on what an appropriate cap should be. And we are cognizant that that is really not the topic for your consideration at this point.

But we do propose that the cap, just through inflation, has been eroded over time, 10 years' worth of time, and that its value today is not what it was 10 years ago, and that as other aspects of the Tax Code are indexed for inflation, indexing the tax credit for inflation or some other mechanism for recognizing its eroding value over time would be probably a place to start.

Mr. COYNE. Thank you very much.

Chairman JOHNSON. Thank you. Mr. Portman has yielded to Mr. Hulshof, who must leave.

Mr. HULSHOF. Thank you, Madam Chairman. Thank you, Mr. Portman.

Mr. Logue, I think each one of us could probably supply some anecdotal evidence of onsite visits that we've done. I've certainly been extraordinarily impressed with some of the low-income housing developments that have worked, I believe, in the Ninth Congressional District of Missouri.

It seems that we have a lot of single-parent families with children, and some of the amenities that were talked about with GAO, some of those amenities often provide additional safety features and things like that.

So I've been impressed. But I do have a couple of questions. Earlier with the GAO panel I did ask this question, and I know you were here, and I would like to ask your comment as well.

Mr. White talked about the discretion that has been provided to the States, and while they don't talk about an abuse of discretion, he did indicate in his testimony, the lack of documentation, and that this might be a way to close a loophole, if you will.

What comments would you have to that recommended by GAO?

Mr. LOGUE. We would concur with the position that discretion should be used only in a way that is consistent with the plan. Discretion is typically the ability for an allocating agency to have some discretion in decisions. It should be a formal part of the plan subject to public comment.

We believe that the exercise of any discretion, and, in fact, we recommend, our Commission recommends, that discretionary practices on the part of allocating agencies should be a matter available to the public, that there be clear reasons and rationales for the exercise of such discretion, and that it should be done in the full light of an open process.

But we do believe that discretion is a vital component to have in our process. It is a complicated program. It is an evolving program. The needs of each State evolve from year to year.

So the ability to assure that we, for administrative straightjacket reasons, are not able to make good and appropriate decisions on specific cases that are meritorious would be a harm to the program.

Mr. HULSHOF. I agree that a one-size-fits-all probably is not the direction in which we want to go. The last question with an accompanying comment, in that same earlier panel, Mr. Tanner inquired about the affordability of low-income housing in rural area across the country.

And I note that in your recommendations as far as strengthening the enforcement mechanisms, what I am about to ask you about wasn't in there. So I preface my question with that. I think perhaps you know Mr. Gross, Richard Gross from our State.

Mr. LOGUE. He's a close friend and a great director.

Mr. HULSHOF. And I think that he also provided you in advance a copy of a letter that he sent to me. There is a perceived problem, and I'd like to get your comment as president of the association, that the low-income housing tax credit is unable to assist in the development of affordable housing in many rural communities, not only in Missouri, but nationally, says Mr. Gross, because median incomes in rural counties and the corresponding rents are too low financially to support a development.

And he suggests that perhaps statutory changes should be made to the program to allow housing finance agencies to use a statewide average median family income as opposed to a rural median family income, which in the State of Missouri's instance, I think, goes from about approximately $32,000 is the rural median income to almost $42,000 for the statewide, which is a $10,000 difference.

Do you have, as president of the association, a recommendation regarding that problem and possible solution?

Mr. LOGUE. We have discussed this with our tax credit commission, and I think even though it wasn't quite in line with the specific issues we were addressing here today, it was discussed, and I think that it's safe to say that there is a general recognition of the problem, particularly in those States that have rural areas that present the same problem that Missouri has.

And I think we would be very supportive of any changes that would accommodate that particular problem in a legislative format.

Mr. HULSHOF. OK. Thank you, Madam Chairman.

Chairman JOHNSON. Thank you.

Mr. Portman.

Mr. PORTMAN. Thank you, Madam Chairman. Mr. Logue, thanks for all your comments. I had to miss some of your testimony. I apologize for that, but I've been looking through it, and certainly can't argue with the general principles of your group, that you now are president of the council and also your commission's work has been very helpful, as we work through this. I know you're going to work with us, if there's an appropriate legislative response, and certainly on the regulatory side.

You also were at HUD, as Deputy Assistant Secretary, I saw, in the Bush administration, so you've seen other Federal programs in the housing area. So I've got to give you a chance to respond to what GAO probably didn't respond to in a way that was satisfactory to you, because they were focused more on the compliance issues.

And that is how do you justify the cost differential, just that little calculation I did, which simply relates to the GAO numbers of a $453 per month average rent under the program, versus $555 per month, figuring that out over a year period of time, multiplying it by the 15-year period, and you get about an $18,000 value of the rent subsidy. And that's a zero discount rate, just $18,000.

And then the credit, the average credit subsidy, and we know it can go far higher, and sometimes lower, but the average credit sub-

sidy is $27,300. GAO gives a couple of thoughts. They said that it was difficult to compare because of the overlapping programs, which I suppose there's some legitimacy to that. But we're really focused on this program today.

And if there are other subsidies, maybe it even exacerbates the disparity. They talked about transaction costs, which is fine. But again, that shouldn't be our concern. And you've talked, in response to Mr. Coyne's questions about the transaction costs. And you've said that your fees, for example, don't even cover your costs on the application side. You said you about break even on the fees here.

Then they mentioned that public housing that was done under the credit they thought was better managed, and, finally, that it tends to be newer construction. What can you add to that? I know you feel strongly, you're a big booster of the program.

Mr. LOGUE. Certainly if the question is, is the Federal Government getting value out of the tax credit, I would say unequivocally yes. Because the value can't only be determined in comparing what is effectively a new construction capital program, which the tax credit is, to a program such as section 8 vouchers and certificates, which is a rental subsidy program, which doesn't really attack at all the problem that the tax credit was primarily targeted for, the development of new, affordable rental units in areas where affordable rental units are needed, and do not now exist.

So we've got to start off with the premise that these are, again, looking at the only other comparable rental assistance program out there today, which is the section 8 voucher and certificate program, meeting different needs.

Mr. PORTMAN. Take off your HUD parameters, and just look at it in terms of the perfect world. Because this is a rare opportunity here. We have this report. This Subcommittee is going to look at the whole program and come up with the blue sky solution. I mean, take that $9,000, $10,000.

And you talk a lot in here about giving it to the States rather than the Feds, and all the red tape and bureaucracy. I'm very interested in that approach. I think the private-sector discipline is great, the targeting and all that.

But to the extent there is a big subsidy here that exceeds perhaps some of the other Federal programs even, if you compare it to section 8 or public housing construction, then why not give that money either to the individuals or to the States? Why connect it to the tax credit, through the developers through the fees? Why not, if we can get more bang for the buck by giving you the money directly, as we do in so many other Federal programs now, let you go out and decide what your needs are in your communities. Hopefully you would then put it down to the community level in Detroit and other places.

Mr. LOGUE. Which we do.

Mr. PORTMAN. But why not go that route?

Mr. LOGUE. I think we have to start with the underlying premise, and I think the example you used, looking at the credit and the cost to the program over a 10- or 15-year period.

Mr. PORTMAN. Fifteen-year period we used.

Mr. LOGUE. That may be I think the appropriate thing to look at as far as the tax credit is concerned, is the real extended—the

low-income use for that project, which nearly always is at least 30 years now, and in States like California is 55 years. And that has not put any damper on the demand for the credit.

So from the perspective of the initial premise, I would suggest——

Mr. PORTMAN. The 15-year period is not——

Mr. LOGUE. The 15-year period is not the appropriate period.

Mr. PORTMAN. Not a fair period.

Mr. LOGUE. I would say not, because all of our projects now are at least 30 years, and many are much longer than that, as far as how much affordability commitment they've given for their project.

Mr. PORTMAN. Do you feel comfortable with regard to Michigan's programs, that 30 years will not require additional subsidies?

Mr. LOGUE. I would be, I think, irresponsible to say that I know what's going to happen in 30 years with all these developments, but I am comfortable with what we know now about the properties we have financed with the tax credit.

They are quality projects. You talked about some of the other virtues that we might look at or compare, like just giving the State the funding as opposed to maybe involving the private sector. We would engage the private development community with whatever resources we had much like we do with the tax credit to develop that housing.

We believe private ownership of housing provides a better product, particularly rental housing. We've seen that time and time again in comparing other Federal programs, particularly public housing to programs like the tax credit.

The private-sector discipline, combined with the enforcement ability that we have by virtue of this being a program administered by the IRS or overseen by the IRS, presents a very powerful way of making sure that the proper incentives are there to keep the developers who get the benefit of a tax credit interested and involved in the long-term operator and ownership of these developments.

I wish when I was at HUD—when I got to HUD we were dealing with things like the coinsurance problem, which was a disastrous program that cost the Federal Government millions of dollars which essentially allowed private-sector individuals to use the Federal insurance authority to do deals, and then essentially walk away scot-free—we had the enforcement authority the IRS has over the housing credit.

You don't have that in the tax credit. Nobody who is investing in a tax credit project is going to walk away if they are not in compliance with the program parameters. I wish I had the enforcement of the IRS when I was at HUD that the tax credit program has.

Mr. PORTMAN. So you like running it through the Tax Code because basically businesses are going to comply with the IRS?

Mr. LOGUE. I think so.

Mr. PORTMAN. We use the Tax Code for this and so many other things because this is primarily a business issue.

Mr. LOGUE. It certainly is.

Mr. PORTMAN. Because the passive loss rules for individuals really aren't that involved in that.

Mr. LOGUE. Right.

Mr. PORTMAN. And businesses comply for the most part, because they're larger businesses.

Mr. LOGUE. We have found the industry's interest in assuring compliance, that is, the syndicators and the other investors in these projects, in the tax credits, to be very helpful. So it's a reciprocal relationship. They're concerned. They have their own due diligence and review process to make sure that their investors are protected.

We have an independent yet comparable responsibility for making sure as allocators that the properties are well maintained and in compliance with the Tax Code. So you've got without any Federal bureaucracy structured around it a very powerful enforcement mechanism for properties that are financed by this.

That's why I have a lot of confidence in the long-term for this program, and I think that's why the GAO study has come out with really a consistently well performing program.

Mr. PORTMAN. A recommendation for more bureaucracy.

Mr. LOGUE. Well, I think——

Mr. PORTMAN. Well, we just heard from the IRS, they're going to need to get more examiners up to speed, and have more information coming in, more analysis, more matching of K–1s.

Mr. LOGUE. Yes. Can't argue with that.

Mr. PORTMAN. That's cost to the taxpayer, and it's more bureaucracy, and it's in an area where we've already got a lot of growth.

Anyway, we've probably spent too much time on the blue sky stuff, and I know you're a big booster of the program, and I think you make a lot of good points. But it is an interesting opportunity for us, although the credit is permanent, to look at does this really make sense, or would it be better to come up with a program that meets all the criteria that you lay out in terms of using the private sector, the nonprofit sector, States rights and having State flexibility and so on.

Why do it through the Tax Code? Does that make any sense? And, of course, this Subcommittee would lose jurisdiction. I guess that's one bad part about it. [Laughter.]

But coming down to Earth for a second, because you mentioned something that interested me in terms of the administrative costs. You said on some of the smaller projects there might be an argument to have fewer administrative burdens.

Do you have a recommendation in that regard? I think you said there's a $5,000 to $6,000 cost, typically, associated, and maybe for a smaller project there should be some carve-out, or special provisions. How would you go about that?

Mr. LOGUE. Well, that really gets to one of the GAO recommendations. It gets to sources and uses verification, which really is making sure that the costs that the developer represents to the allocating agency are, in fact, real costs, both in the application process and in the completion process.

So that, in fact, what the developer submits to the allocating agency really reflects the true costs and they're not padding costs or adding costs that really are not there to get more credit.

We concur with that specific recommendation in principle, that the GAO has made, in that independent cost verification should be required for sources and uses of funds.

And in the case of smaller projects, we only note that when you get to projects—we have projects literally of one unit in our State and I know other States do—and we're probably talking of projects of one to 25 units in size—there are alternative ways of, for instance, certifying costs at the completion of construction to what would be considered in the industry a formal cost certification, which would still provide a review, but wouldn't require the developer to pay again the $5,000 or $6,000 cost of a formal cost certification.

There are other mechanisms. We think we have some. We'd like to explore the opportunity for others that would provide us the comfort level we need to make sure we're making good allocation decisions, and yet not overburdening the small developer.

Mr. PORTMAN. Thank you.

Chairman JOHNSON. Thank you, Mr. Logue. We've talked to people who are going to testify at the next hearing. We aren't limiting ourselves just to the review of the current program, which was the task of GAO. We are interested in how one would go about making this a more powerful program, and adjusting it so that smaller developers could take part, allow rural companies to do some of the building in their own hometowns, which I think often isn't the case now.

So any ideas you have to help us with that, any changes you think we should make in the law, or that we should suggest in the regulations to be able to have the program deal more effectively with small developers would be appreciated.

I just want to ask you two things in closing. Why doesn't this program rehab urban housing?

Mr. LOGUE. Well, that's an interesting question, and I think the GAO responded to that in one way. I would respond to it another way. They basically said that rehab costs less than new construction.

I can tell you, being in housing development for almost 20 years, that is the exception rather than the rule. Rehabilitation, particularly in urban centers, other than those with unusually high intrinsic property values, like New York or maybe Los Angeles or San Francisco, the cost of rehabilitation—particularly in a State like mine, Michigan, where the housing costs are relatively low when compared to national averages—the costs of rehabilitation often in our experience is often much greater than new construction.

You also often end up with, in rehabilitation, if it was originally not a residential structure, but you're converting, say, a warehouse or some other industrial facility or a school, just staggering costs, particularly when you don't know what you're getting into, and you never know completely until you actually start construction or rehabilitation of a facility.

Chairman JOHNSON. I'd like you and your membership to give a little more consideration to this. I was just at the unveiling yesterday of a rehab project in Hartford, Connecticut, and what was different about it as you walked through was the flexibility. They could make a little nicety here, a little nicety there that developed character in a way that is normally not possible under appropriated housing rehab programs or housing construction programs, and really tailor the housing to the needs of the community, at the

same time reclaiming in a very dramatic way most of a couple block area.

So it does distress me that so little of this money is used for rehab. I was born and raised in Chicago. When you drive around the neighborhoods of Chicago, what we have to do is rehab.

So I would appreciate any thoughts you have on that in the time ahead. Also why is it that it costs $83,000 on average to build public housing units and $60,000 to build units under the tax credit program?

Those are quite startling averages that you gave us.

Mr. LOGUE. Actually they were interesting to me. I do not know the——

Chairman JOHNSON. Where do they come from?

Mr. LOGUE. Well, the public housing figures came from HUD. They came from HUD. Those are HUD's own figures.

Chairman JOHNSON. The LIHTC is from the GAO report?

Mr. LOGUE. From the GAO study.

On the question of rehab, just getting back to that for a minute, 40 percent of the units financed with the tax credit in 1996 were rehabs.

Chairman JOHNSON. OK. I missed that. We've had a lot of testimony today saying new construction, new construction.

Mr. LOGUE. And that was for last year.

Chairman JOHNSON. That was for last year?

Mr. LOGUE. Yes.

Chairman JOHNSON. OK. Well, we'll try to get more information about what type of rehabs those were.

Mr. LOGUE. Sure. We'd be happy to work with you cn that.

Chairman JOHNSON. But, you know, the GAO said most were new construction. Did they only mean 60 percent? OK. Thanks. I appreciate that.

And then on the $82,000 versus $60,000?

Mr. LOGUE. I would say that I would only be speculating as to why the public housing costs were what they are. Certainly I would know most public housing units are located, and the type of reconfiguration required in these mostly urban areas with probably higher labor costs than you would find in nonurban areas. That probably accounts for some of it.

I don't know if there are other issues that they have to contend with in those sites, such as environmental issues that you might find in urban areas that might have to be dealt with.

Chairman JOHNSON. Yes. You really are fishing. I think maybe Davis-Bacon might be a significant factor, as well.

Mr. LOGUE. I would imagine it would.

Chairman JOHNSON. It's hard to believe 20 percent. And I think we need to know that.

Let me just say in conclusion that I appreciate your testimony. As you think about the discussions you've heard today, I think we're all in agreement that we like a lot of what we see in the Low-Income Housing Tax Credit Program, and that we want to respond to some of the information that GAO has developed.

But we also want to look at in what ways could this program be strengthened and broadened. So any ideas that you have, we do actually believe in the blue sky approach.

Mr. LOGUE. Well, we appreciate that comment, and you have my full assurance and ours that we will work with you on all those. And we have ideas, some of which we've included in our letter to you from the Commission.

And we're very happy to work with you on any form of improvement.

There was one point that the GAO made that if I had just a minute, maybe I could help clarify, as far as the so-called lost credit that I think was discussed when GAO was here, or unaccounted for credit.

The years that they looked at in their study, particularly 1992–1993, were quite unique and anomalous years for the tax credit program. That was a period of time when the credit was only available for 6 months of the year. It was a very strange year, because it was sunsetted—the authority for the credit to be allocated. It was an odd year.

And the demand in that year—that's the year I think that probably accounted for some of this return credit.

Chairman JOHNSON. That's a very good comment, and very relevant. If you run a program only periodically, you get periodic data.

Mr. LOGUE. And the other point is that last year, 1996, only $46 million of credit was returned. That's less than half of what was unaccounted for in 1992.

And I think it's important to note that there will always be some credit returned each year because credit agencies have the responsibility for making sure no more than is necessary goes into each credit project.

And if the State agencies are doing their job, they are going to reduce the credit from what it was originally allocated for, because they would review the actual costs and reduce the credit.

So if you saw a situation where there was not credit returned, I would be concerned.

Chairman JOHNSON. But what I hear you saying is that the implication that the program is underutilized really reflects a lack of authorization during some months of one of the years considered?

Mr. LOGUE. I believe, and I think if we could work in getting to the bottom of that, and find out that was probably a major reason for the relatively high amount that was unaccounted for.

Chairman JOHNSON. Thank you very much for your participation. I appreciate it.

Mr. LOGUE. Thank you.

Chairman JOHNSON. The Subcommittee is adjourned.

[Whereupon, at 4:25 p.m., the hearing was adjourned.]

LOW-INCOME HOUSING TAX CREDIT

THURSDAY, MAY 1, 1997

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:25 a.m., in room 1100, Longworth House Office Building, Hon. Nancy L. Johnson (Chairman of the Subcommittee) presiding.

Chairman JOHNSON. The hearing will come to order.

I regret that we are getting a little bit later start because of the vote, but we will call the hearing to order.

It has been said that a taxpayer is someone who works for the government without having to take a civil service examination. As the Ways and Means Subcommittee on Oversight, it is our job to help make sure that tax dollars, or in the case of the low-income housing tax credit, which is revenue foregone, accomplish the goals established by the Congress.

This morning, we begin our second hearing on the administration of the low-income housing tax credit, the largest Federal program to stimulate the production of housing for low-income households.

Last week, we received testimony from the U.S. General Accounting Office about its study of the administration and operation of the credit. We also heard from the Internal Revenue Service and the National Council of State Housing Agencies, and learned that the credit has helped finance the construction and rehabilitation of a significant amount of housing for low-income Americans.

But we also learned that there are several opportunities to improve the administration of the credit.

Today, we will be hearing from two of our colleagues, Mr. Metcalf and Mr. Rangel. Mr. Rangel of course is our Committee's Ranking Democrat, and is one of the leading proponents of the low-income housing tax credit.

Mr. Metcalf will appear on behalf of the Republican Housing Opportunity Caucus.

We will also hear from a number of stakeholders, men and women who work with the credit, day in and day out.

As I mentioned last week, the GAO has given us a good starting point. But I am looking forward to suggestions that our witnesses may offer today about how to strengthen enforcement and compliance, and to how better utilize this valuable program.

Because we have a number of witnesses today, it will be necessary to adhere to the 5-minute rule, and I would like to begin by

recognizing our Ranking Member, Representative Coyne of Pennsylvania.

Mr. COYNE. Thank you, Madam Chairwoman.

Over the next several hours, the Oversight Subcommittee will have the opportunity to hear from those committed to ensuring that the low-income housing credit works effectively and efficiently as intended by the Congress.

The housing credit is the country's premier program for developing and providing affordable housing to millions of individuals and families. As confirmed by the U.S. General Accounting Office in its report to the Subcommittee last month, the housing credit has been utilized in most impressive ways, and has an outstanding track record of compliance.

Today's hearing will provide the Subcommittee with the perspectives of those critical to the continued success of the housing credit.

I look forward to the testimony here today and suggestions for improving oversight of the program, and particularly to hear from our Ranking Member, Mr. Rangel, and our colleague, Mr. Metcalf.

Thank you, Madam Chairman.

Chairman JOHNSON. Are there any other statements Members would like to make?

Mr. Weller.

Mr. WELLER. Thank you, Madam Chairman.

First, I want to applaud you for holding these hearings to examine the GAO study of the Low-Income Housing Tax Credit Program. I appreciate the leadership you have given in the past as well as with these hearings in regard to improving this tax credit program.

I look forward to working with you to develop solutions that will strengthen the successful public/private partnership that is a model program for all Federal programs.

As a fellow Member of the Republican Housing Opportunity Caucus, Madam Chairwoman, you know what a vital role the tax credit program plays in meeting our needs for affordable housing.

Ninety-five percent of the affordable housing being built today is dependent upon this tax credit. The construction of 70,000 to 100,000 new affordable units result directly from use of the credit.

Additionally, the credit program provides a critical incentive for private investment and rehabilitation of over 50,000 rental units, annually.

As a result of its successes, the integrity of the tax credit program must be protected. True, we must continue to exercise diligent oversight to ensure that the taxpayers' investment is protected. But I cannot say this in strong enough words. I believe that we must maintain the tax credit's permanent nature. We can review and improve the program without calling into question the Federal Government's commitment to foster the development of affordable housing across the Nation.

Without the backing of the Federal Government, the investment pool which provides the capital to develop affordable housing will dry up. Our witnesses today can attest to that. They were on the frontlines the last time there was a threat on the credit's permanence, and I look forward to their testimony on the importance of the credit to the development of affordable housing and the effect

of losing permanence in the efforts to raise capital from private investors.

Thank you, Madam Chairwoman.

Chairman JOHNSON. Thank you.

Mr. Metcalf, would you please come forward. Mr. Rangel will join us in a moment. As Ranking Democrat on the Committee, he is visiting with the President.

Mr. Metcalf.

STATEMENT OF HON. JACK METCALF, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WASHINGTON

Mr. METCALF. Thank you very much, Madam Chairwoman.

I would like to thank you for the opportunity to testify before the Oversight Subcommittee.

Since this is a synopsis of my written testimony, I ask permission that my written testimony be entered in the record.

Chairman JOHNSON. So ordered, Mr. Metcalf.

Mr. METCALF. As Chairman of the Republican Housing Opportunity Caucus, the RHOC, I want to express support for the low-income housing tax credit. The mission of our Caucus is to give Members of Congress interested in housing policies an opportunity to discuss their concerns, get all the new ideas possible, and coordinate a response.

The RHOC is committed to identifying alternative and innovative solutions to housing needs by promoting policies that encourage the construction, rehabilitation and preservation of affordable housing.

Additionally, we are committed to increasing home ownership, especially for first-time buyers, expanding local flexibility and fostering greater personal responsibility.

Over the past 3 years, I have visited housing projects financed by the tax credit. Two years ago, I attended the grand reopening of Whispering Pines, a 240 unit apartment complex in Lynnwood, Washington, just outside my district, which had fallen into complete disrepair.

Prior to rehabilitation with the tax credit, Whispering Pines was the community center for drug trafficking, and it was nearly abandoned.

Today, it provides affordable housing to low-income families. The transformation of Whispering Pines from a neighborhood of crime to a neighborhood for families could only be possible through the private financing that the low-income housing tax credit encourages.

The tax credit does not just provide a roof over your head, but a place you can call home, a place of your own. We can restore hope in inner cities and rural areas by rebuilding communities in need of an infusion of private financing. We can achieve this goal, not with yet another Federal program operated in Washington, DC, but with a private/public partnership with local communities, developers, and investors.

We can achieve this goal, not with Federal mandates, but with flexibility at the local level.

As this Subcommittee begins reviewing ways to improve the tax credit, I would like to make a few recommendations. First, we need to preserve the permanency of the program. I cannot stress the im-

portance of the role that permanency plays in attracting private investors. Returning to a stop/start status to which the tax credit was subjected before 1993 will disrupt the program just when it is reaching peak efficiency.

Investors are much more willing to invest capital and resources, if they are assured that the tax credit's long-term status will not change.

In fact this competition for tax dollars has generated 28 percent more equity now than before permanency. That is, investors are paying more for tax credit dollars, which increases the total number of affordable housing units available in our communities.

Even with a tax credit cap, which has not been indexed for inflation since its inception, the demand for tax credit dollars has increased as a direct result of permanency.

Second, we need to improve administrative oversight and compliance of the tax credit while retaining as much flexibility as possible. We need better oversight. But too much oversight will hinder the effectiveness of the program.

Third, we need to assure that small developers as well as large developers have access to tax credits. With increased competition for tax credit dollars, small developers may not be able to compete with larger developers who have adequate staff and resources to understand the intricacies of the tax credit program.

Additionally, we need to encourage construction of small projects. As you know, small projects of 20 or less require substantially higher equity to compensate for the loss of economies of scale associated with these properties.

This problem is further exacerbated in rural and inner-city areas whose household incomes are low, which results in extremely low tax credit rents.

Last, I believe we need to require a market study before constructing a project. The purpose of this market study is to determine the feasibility of a proposed project at a location specific, and in a market, and the viability of the project after the tax credit expires.

In conclusion, I want to offer the Housing Opportunities Caucus assistance in helping this Subcommittee find ways to improve the tax credit. Again, I thank you for this opportunity to speak before the Subcommittee.

[The prepared statement follows:]

Statement of Congressman Jack Metcalf
Subcommittee of Oversight
House Committee on Ways and Means
May 1, 1997

Madame Chairwoman, I want to thank you for the opportunity to testify before the Oversight Subcommittee.

As Chairman of the Republican Housing Opportunity Caucus (RHOC), I want to express support for the Low Income Housing Tax Credit. The mission of this caucus is to give members of Congress interested in housing policies an opportunity to discuss their concerns and coordinate a response. The RHOC is committed to identifying alternative and innovative solutions to housing needs by promoting policies that encourage the construction, rehabilitation and preservation of affordable housing. Additionally, we are committed to increasing home ownership especially for first-time home buyers, expanding local flexibility, and fostering greater personal responsibility.

We still have many problems in the housing industry: the first-time home buyer rate remains low and many families cannot find affordable housing especially in rural areas and inner cities. Many existing housing units are aging and in great need of repair. Additionally, nearly 100,000 affordable apartments are lost from the national housing supply each year through demolition, abandonment or conversion to higher income use. Consequently, low-income families are increasingly faced with a choice between living in substandard conditions and spending more money for rent.

The Tax Credit, without a doubt, has been instrumental in actually creating affordable housing for low income persons while giving states flexibility to meet local housing needs. Since its inception, the Tax Credit has been responsible for creating over 800,000 housing units throughout the nation. In Washington State alone, we have built or rehabilitated more than 12,000 low income apartments for the most vulnerable in our society.

Over the past three years, I have visited housing projects financed by the Tax Credit. Two years ago, I attended the grand reopening of Whispering Pines, a 240-unit apartment complex in Lynnwood, Washington. Prior to rehabilitation with the Tax Credit, Whispering Pines was a home for drug trafficking and was nearly abandoned. Today, it provides affordable housing to low income families. The renovated units each contain a new kitchen and bathroom, access to adequate parking, and a Head Start/Day Care Center on the premises. The transformation of Whispering Pines from a neighborhood of crime to a neighborhood for families could only be possible through the private financing that the Low Income Housing Tax Credit encourages. Places such as Whispering Pines may be unfamiliar to you, but there are scores of projects like this across the nation.

Today you will hear testimonies from supporters who will cite the merits of the Tax Credit program. I would like to focus on the Tax Credit as a rung on the ladder to home ownership. The Tax Credit gives low-income persons on the verge of homelessness an opportunity to find or retain their jobs, provide for their families and meet other necessities without worrying about finding a home. As these families move up the economic ladder, they will have a history of paying rent and can move

toward rental housing in the market. Eventually, these families can begin saving for a downpayment on a home and share in the "American Dream."

The Tax Credit does not just provide a roof over your head, but a place you can call home; a place of your own. We can restore hope in inner cities and rural areas by rebuilding communities in need of an infusion of private financing. We can achieve this goal not with another federal program operated in Washington, D.C., but in partnership with local communities, developers, and investors. We can achieve this goal not with federal mandates, but with flexibility at the local level.

As this committee begins reviewing recommendations to improve the Tax Credit, I would like to make a few recommendations. First, we need to preserve the permanency of the program. I cannot stress the importance of the role permanency plays in attracting private investors. Returning to the stop-start status to which the Tax Credit was subjected before 1993 will disrupt the program just when it is reaching peak efficiency. Investors are much more willing to invest capital and resources if they are assured that the Tax Credit's long-term status will not change.

In fact, this competition for tax credit dollars has generated 28 percent more equity now than before permanency. That is, investors are paying more for the tax credit dollars which increases the total number of affordable units available in our communities. Even with a tax credit cap which has not been indexed for inflation since its inception, the demand for tax credit dollars has increased as a direct result of permanency. During this past year, developers in Washington State requested 17 million tax credit dollars, but only $8 million was available for allocation. Additionally, this GAO report shows that we can review the status of this program without sunsetting its permanent status. If the program is sunsetted now, it will be difficult, next to impossible, to find revenue to resurrect it in the future.

Secondly, we need to improve administrative oversight and compliance of the Tax Credit while retaining as much flexibility as possible. The flexibility inherent in this program is one reason that it is so attractive. Each state has different housing needs that require different strategies. We need better oversight, but too much oversight will hinder the effectiveness of the program.

Third, we need to assure that small developers, as well as large developers, have access to tax credits. With increased competition for tax credit dollars, small developers may not be able to compete with larger developers who have adequate staff and resources to understand the intricacies of the Tax Credit program. While this is beyond the scope of the GAO Report, this is an issue that the committee should study.

Additionally, we need to encourage construction of small projects. As you know, small projects of twenty or less require substantially higher equity to compensate for the loss of economies of scale associated with these properties. This problem is further exacerbated in rural and inner city areas where household incomes are low which results in extremely low tax credit rents. Consequently, there is less incentive to build affordable housing in these areas.

Lastly, I believe we need to require a market study before constructing a project. The purpose of

this market study is to determine the feasibility of a proposed project at a location and market, and the viability of the project after the tax credit expires. This study should be up to date, part of the developer's application for housing credit dollars and reviewed by the state housing agency.

In conclusion, I want to offer the Caucus' assistance in helping this subcommittee find solutions to improve the Tax Credit. Additionally, I offer my assistance in helping both you and Chairman Archer find solutions to improve the Tax Credit. Again, thank you for this opportunity to speak before this subcommittee.

Chairman JOHNSON. Thank you very much, Mr. Metcalf, and welcome, Mr. Rangel. You have been a long and strong advocate of the low-income housing tax credit for all the years you have been on this Committee, and I welcome you as our Ranking Democrat to our Subcommittee hearing.

STATEMENT OF HON. CHARLES B. RANGEL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. RANGEL. Thank you, Madam Chairlady, and the Members of the Oversight Subcommittee.

I asked you earlier to be gentle. I am not used to being on this side of the mike.

Chairman JOHNSON. With you? Why? [Laughter.]

Mr. RANGEL. I think that the analysis that was given by the General Accounting Office sort of takes care of the serious questions we may have about the effectiveness of this program. I came to Congress to close loopholes. Seeing that it is so difficult to get funding for those things that are so important to Americans, this credit has now become an incentive which I strongly support.

I ask unanimous consent that my full statement be placed in the record.

Chairman JOHNSON. So ordered.

Mr. RANGEL. And just would like to say that I am not certain whether shelter was included as a constitutional right, but I am thoroughly convinced that poor folks that cannot find a place to live, cannot find a place to prepare to go to work, cannot find a decent place to study, or have to be kept up because of rodents and leaks, it really is a factor that disturbs a whole person's life.

The number of people that I see that are homeless, and they look like they are illiterate and unemployable—but in talking with them, these are people that just missed a paycheck. They missed paying their rent. They found themselves in the street. They lost their job. There is no place to go to pick up the pieces.

The loss of pride sometimes forces them to leave their families because they cannot produce, and when they are called ne'er-do-wells, that is what they have become.

And shelter, a home that is affordable, for so many people is the beginning, a turnaround in life. For a long time I never owned anything, but when I did buy a home, I think that was the zenith—the biggest capital investment I ever dreamed of. But just running from room to room, to be able to show my wife and my kids that I have provided a decent place for them to live, was one of the highest points in my life.

It is not different when someone finds a decent apartment, especially a new apartment. The difference in character, integrity, the sense of belonging. The fact that neighbors screen neighbors to come into these buildings. The fact that stores begin to blossom around where responsible working people are. The sense of pride that just comes through the community, and knowing that if they fix one block, that the next block surely would be more eligible to receive this type of treatment.

And the conservatives say that the overall administrative costs, because it takes the bureaucracy out of it, allows this to come in at the lowest per cost unit. It is my understanding that most of the affordable housing that is built in the United States, where the rental is $500 or less, comes under the low-income housing credit.

It works well for those who make the investment. It works well for those communities that do not find the funding on the local and State level. It reduces our Federal spending commitment as relates to the housing programs. But I really truly believe that if the General Accounting Office could follow some of the families, they would see that they made productive a lot of people that were about to give up, and lose hope that they could regain their positions in society.

Right now, we are negotiating a budget agreement which should include some pretty heavy tax cuts, a commitment to balance the budget, and therefore, a reduction in the moneys that will be available for a lot of programs.

I would have thought that the Taxwriting Committee would be involved in the tax portion of whatever came up in the Budget Committee. But I am under the impression, unless you know somebody in a negotiation, that this Committee is out of it.

Having said that, they have no problem in telling us what they want us to do in terms of raising taxes, or finding revenue raisers. And while I hope, Madam Chairlady, that it is only a rumor, I hear that we are on the list of tax provisions to be sunsetted.

I do not know whether there is a more popular piece of legislation we have in the House in terms of sponsors, but the process that we are going through, both Democrats and Republicans, does not lend itself to allowing our views to be expressed and we just may have to vote up and down on a reconciliation bill.

So I hope that the Members of this Committee that support the housing credit, that has been so successful, might be able, if you know anybody that is involved in making the decisions, then I will give a call to Senator Lott, to tell them, please do not rape what works in order to get the tax cut.

Thank you, Madam Chairlady.

[The prepared statement follows:]

STATEMENT OF CONGRESSMAN CHARLES B. RANGEL
HEARING ON THE LOW-INCOME HOUSING TAX CREDIT
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEAN
MAY 1, 1997

Thank you for including me in today's Oversight Subcommittee hearing on the Low-Income Housing Tax Credit. As you know, I continue to be an avid supporter of the Low-Income Housing Credit. Since its inception in 1986, the Low-Income Housing Credit has been the principle mechanism for attracting private sector funding for the building and rehabilitation of affordable housing. The success of the program has been extraordinary and could provide a model for designing targeted tax incentives in the future.

To date, the Low-Income Housing Credit has generated $13 billion in private-sector investment, produced 900,000 affordable housing units, initiated about one-half of all new multifamily construction nationwide, and created 90,000 jobs (worth more than $2.8 billion in wages and salaries). Without question, all of this has been accomplished as a result of State and local efforts to identify the priority housing needs of lower-income Americans, and through the tax incentives provided by the Low-Income Housing Credit.

Perhaps no area has benefited as much from the Low-Income Housing Credit as the New York City metropolitan area--with 220 LIHTC projects and 13,000 units. Only last week, I visited Gabriel House in my Congressional District. Gabriel House is a special-needs housing facility with 30 units, which was developed to serve AIDS patients and recovering substance abusers.

Gabriel House is one of two dozen low-income facilities in New York City that serves 3,500 mentally ill, substance abusers, seniors, formerly homeless and other special needs individuals. The Low-Income Housing Credit was instrumental to the development and success of Gabriel House, and an excellent example of what can be achieved through this tax-structured housing program.

Further, New York State has made more use of Low-Income Housing Credits, in providing more affordable housing to low-income residents, than any other State. Nearly 50,000 affordable housing apartments have been developed in New York since 1987, and virtually all of the units are serving families earning less than $18,000 a year.

Importantly, use of the Low-Income Housing Credit has been built around partnerships between local developers and non-profit financiers, such as the Enterprise Foundation and Local Initiatives Support Corporation (LISC), and some of New York's largest financial institutions, including Chase Manhattan, J.P. Morgan, and Bankers Trust. This provides a unique opportunity for various groups and interests to work together toward common, and mutually beneficial, goals to improve their community.

As many of the witnesses today will testify, because the Low-Income Housing Credit now is permanent law, investors are willing to compete for and pay more for LIHTC allocations. Also, particularly in New York, the limited amount of annual credits allocations (based on $1.25 per capita) creates strong competition among project developers, and thus some of the most cost-effective low-income housing properties in the country have been developed.

In addition to the economic benefits, the efficiency in administration at the State level, and the empowerment of Community Development Corporations and non-profit institutions at the local level, create a competitive environment that drives administrators, investors, and developers to uphold the Congressional mandate of the Low-Income Housing Credit--which is to create affordable housing for our Nation's poorest citizens, in the communities that need it most.

The Congress affirmed the importance of this program in 1993, when we extended the Low-Income Housing Credit permanently. And, in 1995, after the Ways and Means Committee voted to sunset the program, 218 Members of the House of Representatives and 79 Senators had to work together to ensure that the sunset was not adopted and signed into law. The decision to retain the Low-Income Housing Tax Credit was obviously a correct one, and the merits of the program again have been affirmed by the GAO in its most recent report.

We should all applaud the U.S. General Accounting Office for the outstanding report it issued to the Committee on Ways and Means last month. In my opinion, the GAO's work not only confirms that the Low-Income Housing Credit is an effective and efficient means of developing affordable housing to low-income individuals and families, but also confirms that the program is not the victim of fraud and abuse. It seems obvious to me that any thought of sunsetting the Low-Income Housing Credit can not be supported by the facts. I congratulate the General Accounting Office for their thorough review of the program.

Chairman JOHNSON. Thank you very much, Mr. Rangel.

I do know that our Chairman has fought very long and hard to have this Committee have numbers, goals that it has to reach, and leave to our Committee the responsibility as to how we reach those, with the exception of committing to the President to address some of the special problems in higher education and the great need of our students for better support in managing college costs.

Now the agreement is not final. Actually, you may know more about this from your recent conversation, but I am optimistic that this Committee will be able to make the decisions as to how we achieve our goals, and I share your enthusiasm for the quality of the study that the GAO did.

I am also impressed with the lack of significant problems in it as a major Federal program. It is the intention of this Subcommittee, I think it is fair to say, on both the part of Mr. Coyne and me, to address some of the problems that they did identify, working carefully with both the States and the private sector, so that we do not overkill on this issue of administrative change as Mr. Metcalf so responsibly pointed out.

We need to also look and see—are there ways that we can strengthen this program by better inclusion of the smaller developers and smaller projects? But also in its inner-city use. We are going to have very good panels today. I invite either of you who would like to join us for any part of our two panels, because I think the two panels will give us a lot of insight into some of the new ways this credit is being used. Most of the audience knows, and you may know, that Mr. Lazio and I have talked at some length about looking at the power of appropriated dollars in housing versus the power of these tax credit dollars, because we may find that tax expenditures are actually more effective in developing the quality housing we need, in the places we need it.

So we do have a long agenda in this area. There is, I think, broad and deep interest in this credit, and it will be the Committee's responsibility to achieve its goals in a responsible fashion.

Mr. RANGEL. Let me thank you for the support that you have given over the years.

Chairman JOHNSON. Thank you.

Are there any questions of our colleagues? Yes?

Mr. ENGLISH. Thank you, Madam Chair.

Mr. Metcalf, I very much appreciate your being here and your testimony. You have been one of the strongest defenders, in the last Congress, of the low-income housing tax credit, and I want to credit you for organizing support on the Republican side 2 years ago to make this credit permanent. I think it was your letter, and your effort that played a very significant role in building support, long term, for the permanency of the credit within the Republican Conference, and I want to salute you, and I also am a Member of the Republican Housing Opportunity Caucus, and am delighted at your leadership.

Mr. Rangel, you are a Member with enormous stature in this Congress, and for you to be here in support of the credit means that there is very strong support in this Congress, and on your side of the aisle for maintaining the permanence, which I also am supportive of.

My hope is that we can work together on a bipartisan basis within the Ways and Means Committee, and do so flexibility, on both sides, to find a solution to keep the credit permanent, if at all possible, and I think that will require flexibility on both sides.

If there is a budget deal, if there is a budget that gives us some tax relief to work with, I believe we will be under a lot of pressure to find the right mix of credits, permanent and temporary, and I think we both recognize that there are some credits right now that are temporary, that should be permanent as this credit is permanent, and let's find a way to get it done.

I appreciate your effort, sir, and your participation on this panel. Thank you, Madam Chair.

Mr. RANGEL. Thank you.

Mr. METCALF. Thank you.

Chairman JOHNSON. Thank you.

Are there other questions?

I do want to mention, since Charlie, you gave us your thoughts, but you did not read your testimony, which is not unusual. But your testimony does point out a project, Gabriel House, in which low-income housing tax credits have enabled the creation of 30 units that serve AIDS patients and recovering substance abusers, and that in fact there are 3,500 units in New York City that serve the mentally ill, substance abusers, seniors, formerly homeless, and other special needs individuals, that have been constructed through the low-income housing tax credits.

I think one of the things we do not think about very often is how this program has helped inner cities address very difficult housing problems.

Mr. RANGEL. I was at the opening, Madam Chairlady, and people that were hopeless, and they really needed more than shelter. The concept that was built around, with a church-sponsored group, is that not only was there housing involved, but there was training involved for people who have fallen into alcoholism and drugs, and young kids that had grown older but had children before their time. And educators and social workers, and the excitement of the people in finding a home that was affordable, was almost a spiritual thing. Because it is very emotional when you're coming out off the streets, and you have known a better quality of life, and you fall into the bottom. And so instead of just a beautiful apartment, you have people to help you get back on your feet, to restore the self-worth that you thought you had lost.

I just had to get out of there because it was just too moving an experience.

Chairman JOHNSON. Mr. Tanner.

Mr. TANNER. Thank you, Madam Chairlady.

I, too, would like to state my support for Mr. Rangel and his support for this program. I think that his leadership on this issue has meant a lot, not only to this country but to the people affected directly.

I have never understood the thought that anything the government may do to help people who live in this country, work in this country, pay taxes in this country and contribute to our country's well-being, that there is something evil about the government trying to help these people.

A partnership with private enterprise that results in what the GAO said—almost no evidence of ineligible tenant incomes or excess rent charges, ought to be something we should be proud of.

This is a program that is working, according to the GAO. It is making our country stronger, not only in urban areas, but also in the rural areas like my district, and I just want to say that this GAO report has given me great hope that there are programs that help people who live in this country, and who are citizens here, gain a better way of life, and I want to thank you for your leadership on this issue. I hope we can make this permanent.

Mr. RANGEL. Thank you.

Mr. METCALF. Thank you.

Chairman JOHNSON. Yes. Mr. Watkins.

Mr. WATKINS. Thank you, Madam Chair.

I would like to just add a couple of comments from personal experience.

I want to say thanks to my good friend, Hon. Charlie Rangel, and also Hon. Jack Metcalf, for your testimony.

And from a personal standpoint, I used to be a homebuilder in real depressed areas of Oklahoma. In order to maintain that homebuilding operation, I had to build in probably eight or nine different counties just in order to try to serve those areas.

I built a lot of homes for low-income individuals, and I watched these people. They are good people, many of them struggle for that basic shelter. There are a couple of things I noticed when I was able to build a home for a family, and they were able to move into, say, a little brick home. A lot of them left just lean-to shacks.

One, I found that on several occasions, the spouse, the wife, would make sure she kicked that guy out and he went on to work, because they knew they needed to make the payment on that shelter, and it was the best living conditions they had ever had, and it was the best she had ever had for her children.

And I found that there was pride that was developed. Not only did I notice that in the social situation, but I noticed also, the best of my knowledge, it also brought a different type of, if I could say, relationship.

There were young people coming to date the children, that were from a little different income level. I do not know of anyone—and I watched a lot of these families very closely and in a very personal way—that literally married down. They moved up. And many times that lean-to house in that rural depressed area did not attract some folks to come there. But when they were able to get a little bit better living condition, it brought a different income level, a different group of people, different social group, and allowed them to be more, and a better part of society.

And these were good people. But as a builder, you know, I had a feeling that I was making a contribution to a social level of improving a quality of life, that I would not have had the opportunity to do, and they had such pride, especially when they had their piece of property, their grass, their opportunity to be a family.

So I just want to say I think it has been one of the best social movements we could ever have, to allow people to have this basic thing of quality shelter.

Thank you, Madam Chair.

Chairman JOHNSON. Thank you, Congressman Watkins.

Congresswoman Thurman.

Mrs. THURMAN. Thank you, Madam Chairman.

I just want to associate my remarks with Mr. Tanner but also to lend my support to Mr. Rangel and Mr. Metcalf for their support for this program. In talking with my State housing program folks, they love this program, and on top of that, they have been able to build within the State and leverage these funds by, you know, putting some of their own programs out there that have targeted some low-income and some special needs that we have had.

To sunset this I think would be—I just do not think that is the right thing to do. We have a program the GAO has basically said

is good. We are working well. Maybe what we ought to be doing is look at this as a model of how we can look at some other programs instead of trying to tear something down that is providing the services that it was intended to. So from my State, and as a representative, I just want to say thank you for the work that you have put into this and the testimony that you have given today, and I hope that the message is sent, loud and clear, that we should not be messing with something that is working.

Chairman JOHNSON. I thank the Members for their comments, and Mr. Rangel and Mr. Metcalf for their testimony.

I think the significance of their being a housing caucus on the Republican side, with Mr. Metcalf as its Chairman, and Mr. Weller as the Chairman of the Subcommittee on this particular subject, does tell us that we are hearing this subject in a different context than we might have a few years ago.

It is interesting to me, Mr. Rangel, to hear you say that you came opposing tax credits, and now you support them. I think we may end up supporting them because they turn out to be a more flexible and powerful vehicle as opposed to an appropriated program.

So I thank everybody for their comments. I would particularly like to comment that between Mr. Rangel's comments and Wes Watkins' comments, it does remind the public that we are in the business of politics because we think it is important, spiritually. Thank you.

Will the next panel come forward, please; this is the schedule we are going to follow.

I know that the Republicans have a conference at 11 o'clock. Unfortunately, we cannot adjourn for that. If Members want to go, they are certainly welcome to do that, and return.

We do have two long panels. We need to try to finish slightly before 1, if possible, so I do not intend to break for lunch unless we break between about a quarter of 1 and 1:30.

But for that reason, we are going to observe the 5-minute rule. Both panels' testimony will be entered into the record in its completeness. But if you will please keep your statements to 5 minutes, that will maximize our time for questions.

We will start with Sister Nancy Glynn, president of Bon Secours Baltimore Health Corp.

Mr. COYNE. Madam Chairwoman.

Chairman JOHNSON. Yes.

Mr. COYNE. I just want to point out to Sister Glynn that Representative Cardin intends to be here. He is on his way over to greet you as a constituent, and certainly welcomes your testimony here today.

Chairman JOHNSON. We have had many smart and able voices from Baltimore, and from your State, because you are a leader in so many areas.

Sister Glynn.

STATEMENT OF SISTER NANCY GLYNN, PRESIDENT, BON SECOURS BALTIMORE HEALTH CORP.

Sister GLYNN. Thank you, Madam Chair, and Members of the Ways and Means Subcommittee.

It is a real privilege to be here this morning to discuss the low-income housing tax credit, and the way that it has made such a major contribution to our work, which extends beyond health care to community revitalization and stabilization in our West Baltimore neighborhood.

Bon Secours has been in West Baltimore for over 100 years, and we have made a very conscious commitment to remain, because we are so needed.

We serve a struggling urban neighborhood with many low-income residents, and want to ensure not only the health of individuals, but the health of our community.

The hospital is an anchor, and is the major employer for our neighborhood. We work collaboratively with neighborhood organizations to create a healthier community through housing, education, job training, recreational opportunities, crime prevention, and general neighborhood improvements.

We have launched an initiative called Operation ReachOut for that purpose. And one of the first goals is to improve the housing stock in the neighborhood, to provide attractive, affordable housing, to not only our own employees but to neighborhood residents, in general, who are now living in substandard housing.

The project I want to talk to you about today is Bon Secours Apartments, and it has been made possible by the low-income housing tax credit.

I am not, by any means, a housing expert, but I do know that we would not have been able to go forward with this venture without the housing credit. It is a good example of a Federal program that really works.

It encourages public/private partnerships, and provides not-for-profit-based housing developers with the resources to produce affordable homes for people who do not have a lot of income.

Private-sector corporations do not have much incentive to invest in our neighborhood, but the housing credit gives them that incentive.

We found that new housing makes a real impact in impoverished neighborhoods, not only economically and physically, but even psychologically and spiritually. It is a visible sign that things are turning around.

Lenders for Bon Secours Apartments include the city of Baltimore, the State of Maryland, and Crestar Bank. The Federal Home Loan Bank of Atlanta has made a grant to the apartments that allows us to offer lower rents.

In our first phase, we are renovating 30 units which will go to people earning between 40 and 49 percent of the area median income. Rents will range from $300 to $420 a month.

Construction started in January 1997, and our first tenants will move in within a month. Housing is just one aspect of Operation ReachOut. The other part of it involves working with community-based organizations to provide a range of social services that will help to improve the quality of life for our neighbors.

They include a literacy program, a Head Start Program, health outreach, a family support center, and a jobs skills bank that has already hired neighborhood residents to participate in the construction of the project.

Many people ask us why is a hospital getting into the housing business, and I think the answer is clear. That Bon Secours is not about just the health of individuals, but the health of our community, which so affects families and children.

Decent affordable housing, like decent affordable health care, is a requirement for success. In a neighborhood like ours, we cannot get housing developed without not-for-profits, and without a program like the low-income housing tax credit.

For all the reasons we have talked about, this kind of investment needs to be encouraged. It is one of the few tools available to attract capital to economically depressed neighborhoods.

In closing, I know that the housing credit is making a significant difference in our neighborhood, because it makes a lot of other things possible. And I want to thank you for the privilege of being here.

[The prepared statement follows:]

Testimony of Sister Nancy Glynn
President of Bon Secours Baltimore Health Corporation

Before the Subcommittee on Oversight
House Ways and Means Committee
May 1, 1997

Madame Chairman and Members of the Ways and Means Subcommittee:

Good morning. My name is Sister Nancy Glynn and I am the President of Bon Secours Baltimore Health Corporation. I am pleased to be here today to discuss the Low Income Housing Tax Credit and its contribution to our work, which extends beyond health care to community revitalization and stabilization in our southwest Baltimore neighborhood.

Bon Secours Hospital

Bon Secours Baltimore Health Corporation is a private, non-profit, community-based hospital that is part of a national health corporation called Bon Secours Health System, Inc., sponsored by the Congregation of the Sisters of Bon Secours. Bon Secours Hospital was built in 1919 with additions to the original building made in 1924, 1958, and most recently 1994, when we constructed a 90,000 square foot outpatient center. Bon Secours has made a conscious commitment to remain where we are needed most, in a struggling urban neighborhood with many low-income residents, and to ensure not only the health of individuals but the health of our community.

Bon Secours is the anchor and major employer for the surrounding west and southwest Baltimore neighborhoods. We see a critical need to work collaboratively with neighborhood organizations to create a healthier community through housing, education, job training, recreational opportunities, crime prevention, attracting businesses, and general neighborhood improvements. We have launched an initiative called "Operation ReachOut" for that purpose. One of our first goals is to act as a catalyst for the revitalization of the surrounding neighborhood through rehabilitation of vacant buildings, and to assist in providing attractive, affordable housing to employees and other neighborhood residents. Bon Secours already has helped to develop two affordable housing projects for seniors -- Benet House and Hollins Terrace.

The project I want to tell you about today, the Bon Secours Apartments, has been made possible because of the Low Income Housing Tax Credit. I am not a housing expert, but I do know that the Housing Credit seems to be a good example of a federal program that works. It encourages public/private partnerships and provides nonprofit, community-based housing developers with the resources to produce affordable homes for people who don't have a lot of income. Private sector corporations that otherwise might never invest in affordable housing have an incentive to do so through the Housing Credit.

I think new housing makes a real impact in impoverished neighborhoods, economically, physically, even psychologically. It is a visible sign that things are turning around.

The production of housing generates economic activity. Nonprofits can train and employ neighborhood residents in the construction and maintenance of housing. And upgrading the housing stock often spurs creation of small businesses that serve the neighborhood.

The Bon Secours Apartments

The Bon Secours Apartments are owned by Unity Properties, Inc., a subsidiary of Bon Secours Baltimore Health Corporation. Unity was formed to develop affordable housing in the vacant buildings located near the hospital and is part of Operation ReachOut, which I just mentioned. The Enterprise Construction Corporation (ECC), a subsidiary of Jim Rouse's Enterprise Foundation, is under contract to Unity Housing, Inc. to help develop the apartments. Another Enterprise Foundation subsidiary, the Enterprise Social Investment Corporation (ESIC), is providing the tax credit equity.

Lenders for the project include the City of Baltimore, State of Maryland, and Crestar Bank. The Federal Home Loan Bank of Atlanta has made a grant to the Apartments that allows Unity to offer lower rents. The majority of the units will go to people earning between 40 and 49 percent of the area median income. Rents will range from $300 to $420 a month.

The Bon Secours project is a full interior and exterior renovation of 15 existing rowhouses that will be converted into two rental units each. The work on these buildings, along with others being renovated for homeownership through a different project, will remove nearly all of the vacant buildings on the 1800 and 1900 blocks of West Baltimore Street adjacent to the hospital. These new homes are going to add stability to the neighborhood and strengthen the ongoing revitalization work.

Construction started in January 1997. The rowhouses will be mostly three bedroom apartments with some two bedroom units and a couple of one bedroom units. They will have living rooms, security systems and a washer and dryer. We are trying to preserve existing historic architectural features to the extent possible.

The development is located next to Bon Secours Hospital and we expect a number of the tenants will work there. In fact, Bon Secours is currently holding a waiting list of employees and other community residents who are interested in renting the units. Services are located nearby and everything is accessible to public transportation. The Baltimore City Police have agreed to help the residents establish neighborhood watch programs, and several neighboring community organizations are going to hold crime prevention workshops for the new residents of the Bon Secours Apartments.

Social Services

That's the housing side of Operation ReachOut. The other part of it involves working with community-based organizations to provide a range of social service programs to residents of the neighborhood and to develop a long-range "community plan." These services will, of course, be open to the residents of the new apartments, too. They include a literacy program, a Head Start program, health outreach and education, and a "Family Support Center" that centralizes a lot of these child and family-oriented services. A Job Skills bank is under development, and we are working with neighborhood organizations and the police on anti-crime strategies.

Community Collaboration and the Role of Nonprofits

Some people wonder why a hospital is getting into the housing business. I think the answer is clear – that Bon Secours is not about just about the health and sickness of individuals, but also about the health and sickness of our community, which so affects families and children and grown-ups. Decent, affordable housing, like decent, affordable health care, is a requirement for success.

In neighborhoods like ours, I don't think we could get housing developed without nonprofits, and without a program like the Low Income Housing Tax Credit. For all the reasons we've talked about, investment has to be encouraged. The Housing Credit does this, and it is also better targeted, provides housing for a longer term, and is more closely monitored than earlier housing programs. It is one of the few tools available to attract capital to economically depressed neighborhoods.

Nonprofits are especially important because they promote public/private partnerships by giving governments and the private sector an opportunity to work on community building efforts without taking on all of the risk themselves. They are committed to neighborhoods like ours. The best of them use inclusive, grassroots processes to determine what the greatest needs in the community are, and identify solutions to those needs. As I said earlier, Bon Secours will continue to work with many community-based organizations as we implement Operation ReachOut.

In closing, I think that the Housing Credit is making a significant difference in the Bon Secours community. Simply put, it helps to make so much else possible.

I welcome any questions you may have.

Chairman JOHNSON. Thank you very much, Sister, and Ms. Hodel.

STATEMENT OF KATHLEEN HODEL, PRESIDENT, LAKE HAVASU CITY APARTMENT OWNERS ASSOCIATION, LAKE HAVASU CITY, AZ

Ms. HODEL. I am Kathleen Hodel, a small apartment owner from Lake Havasu City, Arizona. This is a summary of my testimony.

The Low-Income Housing Program has negatively impacted local communities and threatened livelihoods. In 1986, Members of Congress were correct when they argued that giving tax credits to developers would not benefit the poor.

Tenants that are evicted from their apartments because they cannot afford the rent are not being helped by this program. I have seen it myself.

If the tenants that live in our city's so-called low-income housing can afford to own RVs, boats, and new cars, then why is the taxpayer subsidizing their apartment buildings. We are not helping the poor.

The developers are lured to these programs because it has made them millionaires. The danger is the program has become so popular, the developers have become dependent upon receiving tax credits. This has disrupted the rental market.

Congress cannot continue to allow the rental market to be flooded with low-income housing projects without analyzing the results this program has on the private sector.

Where is the report analyzing how this program affects the private rental market? Where is it? Unfortunately, I understand there is none.

The IRS has placed itself in direct competition with the private sector by targeting the same customers we target.

Tenants earning 60 percent of the medium income rent from us. The IRS is taking tenants away from us, causing our property values to decline, and discouraging future development. You cannot even give a residential income lot away in our town.

Our city's population is only 40,000, yet we have received a real education on the results of this program.

Ten years ago, a 42-unit low-income tax credit program was built. In 1995, an 84-unit project was completed with plans for another 38-unit project proposed in our city last year.

Our vacancies have been high during the past year, from 18 to 20 percent, with rents as low as $350 for a nice 2-bedroom apartment. In 1995, the 84-unit low-income project was allowed to be built with rents equal to or higher than our rents.

The real joke is the 84-unit project ended up costing the taxpayers $72,000 per unit. I could build a really nice apartment building in Lake Havasu for $30,000 per unit—really nice—and yet

this program costed $72,000 per unit. That was a joke in our community.

The so-called low-income 84-unit complex offers a swimming pool, RV and boat parking, a recreation room, patios, new full-size dishwashers with free cable TV and free rent as incentives to move into their apartments.

The results of this program on our city's rental market has been disastrous. When the 84-unit was built, our vacancies jumped to 30 percent. The lure of extra amenities made it impossible for us to compete.

So what is the answer? Conducting market studies to determine the demand for low-income housing? In the last decade, we have had numerous market studies, the results depending on who was paying for the survey.

At one time a developer hired an appraiser to determine our city's vacancy rate. His conclusion was zero vacancies. At the same time, our association conducted a study—I worked really hard on that study—I came up with 29.2 percent.

The major problem is to define comparable units fairly. We have tried it and I will tell you—it takes a miracle. Plus vacancies vary rapidly, especially in a community like ours.

Banks have already informed us that if the vacancy rate is 10 percent or higher, loans will not be made to construct or remodel apartment buildings. Therefore, because our vacancy rate is high, we cannot build or remodel. But the banks have a hard time saying no to developers with millions of dollars' worth of tax credits in their pockets. Plus it is easy to steal tenants away from older buildings with less amenities.

Trying to administer this complex program at the local level has been a nightmare. Someone has to, here, look at the local level. Someone here has to look at what is happening at the local level.

Our city officials were intimidated by Federal programs, and powerful Washington, DC, lawyers hired by the developer. Our mayor and city council were told that they would be sued under the Fair Housing Act, and we would lose our Federal grants if they did not approve the 84 units.

Our city established requirements for future tax credit housing projects. It took us 5 years to try to figure out some requirements for our city, which ended up to be illegal and violate the Fair Housing Act, if they try to implement it, it would be illegal.

If this program is allowed to continue, local governments need expert legal advice, which is going to cost everybody. Cost us even more.

One of the requirements the 84 units was to provide was security. That was one of the requirements they were supposed to provide. Yet 166 police reports were reported in just over a year. This is an example in a small town, where we have very little crime. In just over a year, we have 166 police events. That is the highest, by far, of police events.

A police event is when the police go out and physically visit the location. That is the highest in the history of Lake Havasu City. There is no procedure for the public to report noncompliances.

So I, in a little town in the middle of the desert, had to make up my own noncompliance report, and send it to the IRS and to the

State, because there was no procedure for me to say, "Hey, something is going on here, they said they were going to provide security and they did not do it." And I am still waiting to hear back from the IRS.

Apartment owners can receive tax credits for remodeling. I can, right now, receive tax credits for remodeling, but after we penciled it all out and investigated the economics, we concluded it will only benefit very large complexes and major renovations. It is not for the small folks.

The solution to this problem is to abolish this program and stop subsidizing wealthy developers. It would be less expensive to subsidize the tenants. Congress has already discussed giving vouchers to low-income tenants. This plan would enable tenants to find their own apartments, thus encouraging mixed-income apartment complexes, which HUD has already stated, it has been very successful.

I was a social worker in Watts. I know what it is like to have a concentration of people in projects. It is much better to give them money, vouchers, and let them go find their own housing. In that way, you do not have the problems with numerous police reports.

If the tax credit program is allowed to continue, it needs to be amended to read—this is so important, please hear this. It should be amended to read: The low-income housing tax credit project cannot disrupt the local market.

Finally, after years of discussion this phrase was added to our State. We worked 5 years on that phrase. And finally the State of Arizona has put that in there. I would appreciate it if you would consider amending this program and adding the phrase, it is so important that this program does not disrupt the local market.

Surely the intent of Congress when they enacted this program was not to have people with ordinary incomes live in quarters with fewer amenities than low-income people. I am sure your intentions are to help the truly needy, and not to endanger the livelihoods of people like myself.

Remember, we have to live with these projects. They don't go away. You build them, and they are there for our whole lives. And we have to look at them and deal with them every single day.

Please consider that when you vote. Also, if you would just turn to Attachment One, this is just an example of the newspaper ads that we see every day in our newspaper. We can afford little, tiny two-liners, and we have to see this every day, because the taxpayers pay for these ads.

[The prepared statement and attachments follow:]

TESTIMONY REGARDING THE LOW-INCOME HOUSING TAX CREDIT PROGRAM GIVEN BY KATHLEEN HODEL TO WAYS AND MEAN SUBCOMMITTEE ON MAY 1, 1997

I am Kathleen Hodel, a small apartment owner from Lake Havasu City, Arizona. This Low-Income Housing program has negatively impacted local communities and threatened livelihoods.

In 1986 members of Congress argued that giving tax credits to developers would not benefit the poor were unfortunately correct. Tenants that are evicted from their apartments because they cannot afford their rent are not being helped by this program.

If the tenants that live in our City's so-called "low-income housing" can afford to own RV's, boats, and new cars, then why is the taxpayer subsidizing their apartment complex?

The developers are lured to this program because it has made them mulit-millionaires. The danger is the program has become so popular that developers have become dependent upon receiving tax credits. This has disrupted the rental market.

Congress cannot continue to allow the rental market to be flooded with low-income housing project without analyzing the result the program has on the private sector. Where is the report examining how this program effects the private rental market? Unfortunately, I understand there is none.

The IRS has placed itself in direct competition with the private sector by targeting the same customers we target. Tenants earning 60% of the medium **RENT FROM US**. The IRS is taking tenants away from us causing our property values to decline and discouraging future development.

Our City's population is only 40,000, yet we have received a real education on the result of this program. Ten years ago a 42 unit low-income tax credit project was built. In 1995 an 84 unit project was completed with plans for another 38 unit project proposed to our City last year.

Our vacancy rate has been high during the past years from 18% to 20% with rents as low as $350 for a nice 2 bedroom apartment. In 1995 the 84 unit low-income project was allowed to be built with rents equal to or higher than our rents. The real joke is the cost of the 84 units project which ended up costing the taxpayers $72,000 per unit. I can build a nice apartment building in Lake Havsau for $30,000 per unit.

The "so-called" low-income 84 unit complex offers a swimming pool, RV and boat parking, a recreational room, patios, new full-size dishwashers with free cable TV and free rent as incentives to move into their apartments.

The results of this program on our City's rental market has been disastrous. When the 84 units were built, our vacancies jumped to 30%. The lure of extra amenities made it impossible for us to compete.

So what is the answer? Conducting market studies to determine the demand for low-income housing. In the last decade, we have had numerous market studies. The results depended on who was paying for the survey. At one time a developer hired an appraiser to determine our City's vacancy rate. His conclusions was ZERO vacancies. At the same time our association conducted a study showing 29.2%. The major problem is to fairly define "comparable units".

Banks have already informed us that if the vacancy rate is 10% or higher, loans will not be made to construct or remodel apartment buildings. Therefore, because our vacancy rate is high, we cannot build or remodel, but the banks have a hard time saying no to a developer with millions of dollars worth of tax credits in their pockets. Plus, it's easy to steal tenants away from older building with less amenities.

Trying to administer this complex program at the local level has been a nightmare. Our City officials were intimidated by federal programs and powerful Washington D.C. lawyers hired by the developer. Our Mayor and City Council were told they could be sued under the Fair Housing Act, and lose other federal grants if they did not approve the 84 units.

Our City established requirements for future tax credit housing projects which are illogical and violate the Fair Housing Act. If this program is allowed to continue, local governments need expert legal advise.

One of the requirements the 84 unit was to provide was "security", yet 166 police events were report in just over a year. That is by far the most police events reported for any apartment complex in the history of Lake Havasu City. There was no procedure for the public to report a non-compliance. So I made up a Non-compliance report and mailed it to the IRS, the State of Arizona and our City.

Apartment owners can receive tax credits for remodeling existing units, we investigated the economics and concluded this program only benefit very large complexes and major renovations.

The solution to these problems is to abolish the program and stop subsidizing wealthy developers. It would be less expensive to subsidize the tenant. Congress has been discussing giving vouchers to low-income tenants. This plan would enable tenants to find their own apartments thus encouraging "mixed income" apartment complexes which HUD has already stated have been very successful.

If the tax credit program is allowed to continue, it needs to be amended to read "the Low-Income Housing Tax Credit projects cannot disrupt the local rental market". Finally after years of discussion, this phrase was just added to the State of Arizona's application.

Surely, the intent of Congress when they enacted this program was not to have people with ordinary income live in quarters with fewer amenities than low-income people. Thank you for allowing me to speak today. I'm sure your intentions are to help the truly needy, and not to endanger the livelihood of people like myself.

ATTACHMENTS ARE AS FOLLOWS:

-Attachment A...Newspaper ads of the 84 unit complex showing all the amenities offered

-Attachment B...Vacancy rate of 2 privately owned apartment and the jump to 30% when the 84 units were built

-Attachment C...A letter to the editor from a senior complaining about living across a street from the 84 units

-Attachment D...Two letters of "intent to move" as of a result of the living across a street from the 84 units

ATTACHMENT A

ARE THE TAXPAYERS AWARE THEY ARE HELPING SUBSIDIZED THESE LUXURIOUS APTS WITH COUNTRY CLUB AMENITIES PLUS FREE CABLE TV AND FREE BBQ?

Casa Del Lago

APARTMENTS

NOW RENTING

AFFORDABLY BELOW MARKET

Casa Del Lago **features beautiful new and spacious two bedroom, two bath (from $415) and three bedroom, two bath (from $490) apartments**

A few of the stylish energy efficient interior appointments include:
◊ New full-size range ◊ New garbage disposals
◊ Patios/Balconies ◊ New window coverings
◊ New individualy controlled heating & cooling system
◊ New full-size dishwasher ◊ New frost free refrigerators
◊ Covered carports ◊ Thermopane windows & doors

Featuring ◊Sparkling Pool ◊Play Areas for All Ages
Laundry Facilities ◊ Bar-B-Que Area
Boat and RV Parking ◊ Beautiful Recreation Room

Due to the enormous demand for these apartments, we are currently taking applications and reservation deposits on a FIRST COME, FIRST SERVED BASIS. The leasing office is now open taking applications and reservation deposits. If you are interested in applying for one of our beautiful apartments, please come by and pick up an application. The first units available for move-in August 1st. * There is a $25.00 non-refundable application fee.

CASA DEL LAGO • (520) 855-5180

(Hwy 95 South to Oro Grande Blvd.)
3140 Kearsage Drive ◊ Lake Havasu City, Arizona

1 Year Free Cable TV or 2 Weeks Free Rent

New Apartments

• 2 bd, 2 ba. $415 • 3 bd, 2 ba. $490

Pool • Laundry • Covered parking

Casa Del Lago • (520) 855-5180

Casa Del Lago

Affordable New Apartments

Grand Opening Party!

Sat. Sept. 16th • 11-3 PM

Public Invited

FREE BBQ & Refreshments

Balloons for the Kids!

POOL ★ PLAY AREAS ★ BARBECUE AREA ★ REC ROOM
BOAT & RV PARKING ★ LAUNDRY FACILITIES

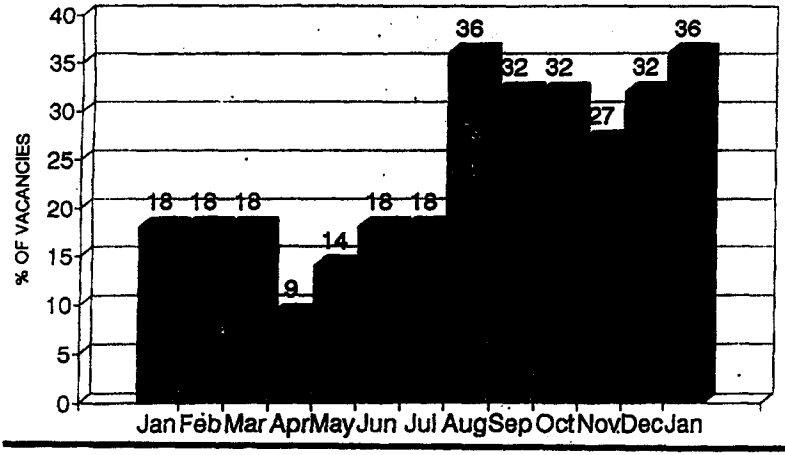
(520) 855-5180

3140 Kearsage Dr. (Hwy 95 South to Oro Grande Blvd.), Lake Havasu City, AZ

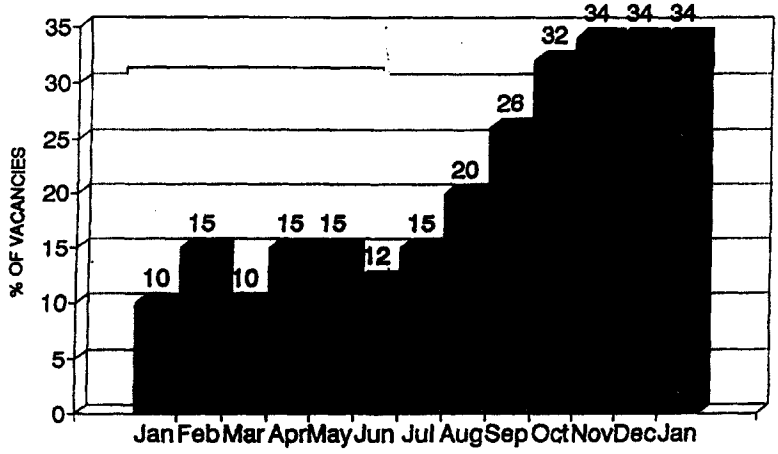
ATTACHMENT B

22 Unit Apartment Complex Vacancy Rate
January 1995 Through January 1996

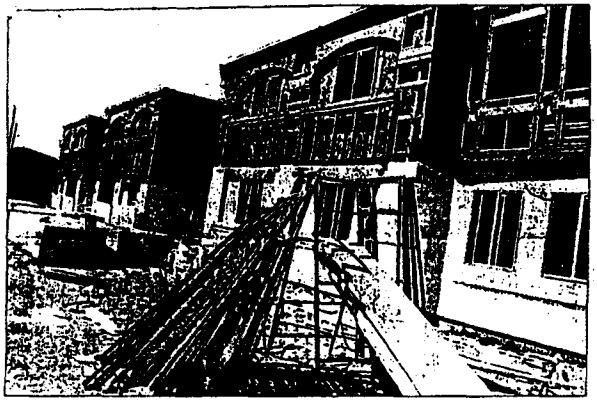
NOTE: THIS APARTMENT COMPLEX IS PRIVATELY OWNED, vacancies increased when the tax credit housing project opened in August of 1995.



41 Unit Apartment Complex Vacancy Rate
January 1995 Through January 1996



ATTACHMENT C



L.J. Friml/Today's DAILY NEWS

The new 84-unit Casa Del Lago Apartments are more than halfway finished on the city's southside. The complex boasts two and three bedroom units and a host of amenities. It is being built as an "affordable" housing complex with strict limits — both minimum and maximum — for tenants. For more on affordable housing, see the story below and the related piece on page A5.

Affordable isn't low-income when you're talking housing

By PEGGY SHAW
Today's DAILY NEWS

Low-income housing and affordable housing, according to governmental terminology used in the housing market, are the apples and oranges of government-aided housing.

Casa Del Lago, an 84-unit apartment complex under construction on the city's south side, is part of the affordable housing group, but a number of city residents still are under the impression that the complex is a low-income housing project, the developers say.

See page A5, for related story

Helping to straighten out that misconception, Pat Crosson, director of Lake Havasu City's Interagency Council, said the low-income category involves direct government subsidies to renters, where affordable housing involves tax credits and other financial perks for the developers of such housing.

Letters to the Editor

Poor project

Editor:

I am a retired resident of Lake Havasu City and I understand that the developer of the government subsidized housing project named Casa Del Lago has plans to build 38 more units right next door for seniors.

It was mentioned in a recent letter to the editor that Mr. Winnings, the above mentioned developer's new proposed project would shield the seniors from drugs, gang activity etc.

I live near the 84-unit Casa Del Lago and experience on a daily basis tenants excessive yelling and screaming out their windows, children playing in the driveways with no adult supervision instead of in the play area, speeding cars and motorcycles with loud mufflers at 1 a.m. to 3 a.m., loud rap music, large numbers of teens hanging out and loud foul language heard throughout the neighborhood.

I see the police having to frequently patrol Casa Del Lago. The tenants themselves have made numerous police reports, some being burglary and domestic violence.

The government has paid for this huge housing complex to be built and this is what results. This is just like the big projects in Washington State that I moved here to get away from. I cannot believe our City would allow this to be built. Mr. Winnings claims to have on-site security. However, all I have ever seen is a grounds keeper man with a broom.

I would have moved away from here if I didn't have such a good landlord. I cannot imagine any seniors I know moving into this proposed project and feeling secure and living quietly next door to Casa Del Lago. I am partially deaf and I have a difficulty putting up with the noise. I cannot imagine living next door.

I think everyone needs to understand that this proposed project is not like Briarwood and Beckett House where the tenants themselves get rent subsidies and some pay $50 to $100 a month.

This tax credit program used to build the 38 proposed units, the government subsidizes the already rich developer and the tenants pay full rent $295 to $350 per month.

If anyone doubts my word on this, just come down to Kearsage Drive and Oro Grande and sit and listen for 30 minutes or so. Then you can see for yourself.

John Perfill
Lake Havasu City

ATTACHMENT D

3-28-91

TO MR. & MRS OLIVA.
I JOHN PERFILI WILL BE MOVING
AT THE END OF APRIL. DUE TO THE
FACT, THAT THE NOISE FROM
ACROSS THE STREET (I.E. CASA DEL
LAGO) IS UNBERABLE, NOISY CARS,
CHILDREN - GROWNUPS. ETC.
IT IS NOT ONLY IN DAYTIME ONLY
BUT, 1:00 AM. 2:00 AM. ETC. SORRY
THAT, I AM MOVING THIS WAY.

YOUR FRIEND
AND TENAT
John Perfili

To Whom It May Concern:

I would like to express my opinion about the "Low Income Tax Credit Program". I own property and have lived crossed the street from an 84 unit Low Income Project for the past two years. As well as been a member of the Apartment Owners Association and working in opposition of the tax credit program. Our worst fears have become reality; Everything we thought would go wrong did. I won't bore you with all of the gory details and stories I could tell. You just need to know that I watch the police patrol the property several times a day and then return on a nightly basis for other calls. These calls are at the local taxpayer expense. My tenants and I have witnessed all types of crime on a daily basis. I have (as one property owner to another) attempted to discuss the problems with the manager of the 84 units with out success. His only comment is " go ahead and call the police. My wife and I have lost thousands of dollars in rents and property depreciation over the past three years. Several years ago I suffered some serious medical problems. My physician told me to eliminate the stress from my life. I have attempted to do just that. However, with the problems crossed the street along with the facts that I cannot rent my units nor sell them causes me much stress. Therefore, I am forced to move from my own home in order to keep myself alive. This should not happen to anyone. OUR GOVERNMENT SHOULD NOT BE ALLOWED TO PUT PRIVATE ENTERPRIZE OUT OF BUSINESS WITH OUR OWN TAX DOLLARS. PLEASE DO NOT ALLOW THIS TO CONTINUE.
Sincerely, Andrew J. Oliva

Chairman JOHNSON. Thank you very much, Ms. Hodel. We appreciate your testimony and your experience.

Mr. King, it's a pleasure to welcome you down to Washington here again, the head of the Connecticut Housing Finance Authority, and I welcome your testimony.

STATEMENT OF GARY E. KING, PRESIDENT, CONNECTICUT HOUSING FINANCE AUTHORITY, ROCKY HILL, CONNECTICUT

Mr. KING. Thank you, Madam Chairman, and Members of the Subcommittee. I am Gary King. I'm the president of the Connecticut Housing Finance Authority, and I've been with the authority for 11 years, and since 1992 its president.

Prior to working at the Connecticut Housing Finance Authority, I was the undersecretary for the State's OMB agency, and responsible for comprehensive planning and policy program activities.

It is from these experiences and perspectives that I come here to address you today, and I really thank you for the opportunity to testify on the tax credit program, and I guess I'm following Ms. Hodel's comments to indicate that the Nation is a diverse place. Because our experience in Connecticut could not be further from her experience in Arizona.

CHFA in Connecticut has had experience with virtually every major Federal housing program in the last 27 years. In my experience, and in the experience of the authority, this program, the tax credit program, has worked more efficiently and achieved more of its objectives than any other program with which we've had experience.

It's basically done so for four major reasons. The first, the credit enables States to meet diverse needs across the country without excessive guidance from Washington.

Second, and this is very important, the credit very effectively can bring the benefits of private investment incentives, ownership and management into public housing to meet clearly defined public needs. But, that private investment and management is tempered by public oversight and balanced with accountability to the public.

Third, the program is a very effective leverager of other resources. Unlike a direct expenditure program, it brings many resources to bear to work on agreed upon housing policies and priorities.

The fourth major reason has come up today. Since 1993, this program has been permanent. This is very, very important. Permanent authorization has created a stability which the development community, the private financial markets, and the State and local policy agencies can rely upon when planning the development of affordable housing and the rehabilitation of communities and neighborhoods everybody in Connecticut knows that this program is there and will be there to work effectively to leverage development and private investment in that development.

Permanent authorization also, as has been indicated, has improved tremendously the efficiently of the credit. The improvement has been 28 percent. Credits back prior to 1993 generated 50 to 55 cents in equity investment in the housing for tax credit dollar. Now, the investment is approaching over 70 cents on the dollar, which is a very, very effective and appropriate result.

My concern is that if the program is not permanent, we will lose these advantages.

I was gratified to see that my perspectives and opinions were confirmed by the GAO study.

Frankly, the major problem in Connecticut is that we don't have enough credits to support all the appropriate project proposals which we receive. In the last 2 years alone, we have had to reject three-quarters of the projects seeking credits because of inadequate credit availability. We've received three times the applications that we could fund.

In summary I wish to communicate to you my strong belief that the Connecticut housing community would strongly support a positive agenda by the Subcommittee that would address the administrative and technical issues raised by the GAO study. It would also support an agenda to increase the availability of these housing tax credits in Connecticut. I do not believe that it would support an agenda to significantly alter the credit program. I also believe that the Connecticut housing community would with unanimity strongly oppose any effort to "sunset" the program.

That being said, I think that if you merely do the things the GAO study suggests, you will be very effective in fine tuning the tool that you have entrusted to us to use on behalf of the Federal Government to very effectively produce affordable housing in Connecticut and the Nation.

Finally, I have heard that there are a couple of questions that are on Committee Members' minds, and I would like to briefly address a few of those.

First, in terms of needs and priorities, in Connecticut we use existing housing State policy plans and studies that are actually formally adopted by our State legislature to determine where the developments should be built, what types of housing should be built, and for whom it should be built.

Our State faces basically a housing problem with two dynamics. First, in our urban areas, we are facing significant abandonment and blight, and need to improve the quality of the housing in these areas. Conversely, suburban and rural areas have too little affordable rental housing.

I've also been told there are questions and issues concerning costs. I'm here to say that the evidence indicates that the housing credit has turned out to be very effective in producing housing at less cost than other rental housing produced by the private sector. I know that there also is concern about the number of bedrooms in units. I'm here to say that in Connecticut the experience is that we're meeting the housing needs and priorities of our State, and that over a third of the apartments we have produced have three or more bedrooms.

We've also effectively accomplished rehabilitation. Seventy-five percent of our housing goes for rehabilitation of existing housing.

The other issue I would like to address is the concern about IRS oversight and the potential interest for substituting or developing potential role for HUD, I think essentially the Connecticut agency and the State housing agencies in general play or fulfill any role that HUD might fulfill, in terms of compliance monitoring, oversight administration planning, or reporting.

I thank you for the opportunity to address the Subcommittee.

[The prepared statement follows:]

TESTIMONY OF
GARY E. KING
PRESIDENT-EXECUTIVE DIRECTOR
CONNECTICUT HOUSING FINANCE AUTHORITY
before the
HOUSE WAYS AND MEANS COMMITTEE
OVERSIGHT SUBCOMMITTEE
May 1, 1997

Madame Chairman and Members of the Subcommittee:

I am Gary E. King, President-Executive Director of the Connecticut Housing Finance Authority. I have been with the Authority since 1986 in various senior management positions and have served in my present position since 1992. Prior to coming to the Authority I was Undersecretary for the State's Office of Policy and Management, Connecticut's OMB agency. In that position, among other things, I was responsible for comprehensive planning for the State of Connecticut.

I appreciate the opportunity to testify today on the Low Income Housing Tax Credit (Housing Credit) program.

OVERVIEW

The Connecticut Housing Finance Authority has experience with virtually every major federal housing program that has been implemented during the past 27 years. In my experience none of these programs has worked more efficiently or achieved its objectives more effectively than the Housing Credit. It has done so for the following reasons:

- the program is well run by the states
- the Credit meets diverse needs across the nation without excessive "guidance" from Washington—targeting local housing needs which the state and local communities agree are essential
- the Credit efficiently brings private investment incentive, ownership, and management to meet clearly defined public needs but is tempered by effective public oversight and accountability
- the program is a very efficient leverage of private, state, and local resources for agreed upon housing and community development priorities
- administration and overhead is low

I was gratified to see this perspective confirmed by the GAO report.

The report that the Subcommittee has just received from the GAO is impressive for its thoroughness and professionalism. It identifies a few areas for improvement that can be addressed by the state allocating agencies in the same thorough and professional manner. Overall, I believe that the report clearly vindicates the wisdom of the permanent extension of the program in 1993, and the wisdom of the State of Connecticut's, the Authority's and the Connecticut development community's commitment to the program over the past ten years. Frankly, the major problem in Connecticut is that we do not have sufficient Credits to assist worthy proposals that we receive. In the past two years we have had viable applications from roughly twice as many developments as we can fund.

The Connecticut housing community would strongly support a positive agenda by the Subcommittee that addresses administrative and technical issues raised by the GAO study regarding the states' and IRS's administration of the program in order to make the best possible use of this fine tool that has been entrusted to us.

This being said I would like to address very briefly a few of the specific concerns that you and other members of the Subcommittee have raised regarding the program.

NEEDS AND PRIORITIES

In Connecticut we use existing state housing policy and need to indicate "where" development should be a priority, "what" types of housing should be built, and for "whom" it should be built.

We refer to the state's Connecticut Conservation and Development Policies Plan and Consolidated Plan for Housing and Community Development to establish priorities in our Housing Credit Qualified Allocation Plan. These Plans are adopted only after extensive needs assessments, deliberations, and comprehensive public development and hearing processes. The Conservation and Development Policies Plan is also adopted by the legislature.

Our state faces two basic dynamics with regard to affordable rental housing. In urban neighborhoods abandonment and blight are serious concerns. The supply of quality housing in urban areas is shrinking. Significant neighborhood disinvestment and a diminished quality of life are serious issues for us. Conversely, many communities surrounding urban areas, and rural areas, have little or no affordable rental housing for lower income households. This limits effective housing choice and increases economic and racial group isolation.

As a result, in Connecticut, in addition to the federal priority for low income service for the longest periods of time, we have the following preferences:

- community and housing rehabilitation in urban centers with many low and poverty income households, and areas of housing abandonment or designated urban revitalization zones

- development in towns with little to no rental housing, few low income households, and high rents,

- special needs housing for such populations as the homeless, those in transition, or individuals with mental health or substance abuse problems.

We rank applications within a class system which separates out the project applications which best meet the housing policy, priorities and needs of Connecticut and meet certain threshold criteria indicating that the project is real and ready to proceed. Within these "classes" we also rank applications based on family size served, household income, owner commitment to select residents from public housing waiting lists, and the availability of support services for any residents of special needs populations. We also look for commitment from other funding sources and provide special consideration for developments proposed as replacement of demolished public housing units.

We can now only fund applications that qualify in the "Best" category. "Better" projects do not get funded. Many worthwhile, but only "eligible" developments rarely have a chance at funding any more.

Our program is heavily focused on urban rehabilitation, new construction resulting in increased housing opportunity, and special needs housing. In recent years the vast majority of our funded developments have been in urban areas, and between 55 percent and 75 percent of these developments involve rehabilitation, improving and increasing the quality of the existing housing stock—a particularly important issue in urban areas. Nationally, the percentage of units rehabilitated using the Housing Credit in 1995 was nearly 40 percent.

I also understand the Subcommittee may be concerned that GAO found nearly two-thirds of the households in Housing Credit properties are one or two-person households. This is consistent with a national trend toward smaller household size. Sixty percent of all American households in 1994 consisted of one or two persons. Yet, in 1995, 25 percent of all Housing Credit apartments produced nationally had three or more bedrooms. In Connecticut, we have identified large family apartments as one of our most pressing housing needs. Accordingly, one-third of our 1995 Credits were allocated to three or more bedroom units. In Connecticut, it is important to understand that a significant portion of the efficiency and one-bedroom units are in developments serving special needs populations, where smaller units is an essential requirement.

In summary the demand for the program is extremely strong in Connecticut. We are currently turning away as much if not more business than we are funding. Also, the type and mix of units we finance is very appropriate to the types of priority housing needs Connecticut is facing.

HOUSING COSTS AND PROGRAM COSTS

I also understand that the Subcommittee may be concerned about costs in Housing Credit properties, including builder and developer profits and fees.

The GAO found the average Housing Credit unit is built and rents for significantly less than market rate units in the same areas.

In Connecticut, Housing Credit apartments rent for less than market rents. We closely assess the reasonableness of Housing Credit development costs, using nationally recognized cost databases and our own certified hard/soft costs and syndication cost databases. We provide developers significant point incentives for cost effectiveness. Additional points are awarded to the top three cost-effective proposals. Negative points are given for inefficiencies. We also strictly limit developer fees to 10 percent of total development cost. We limit builder profit, overhead, and general requirements to a maximum of 16 percent of the total construction contract amount. Both are consistent with national standards recommended by NCSHA.

Also, we have emphasized and re-enforced the federal priority to allocate Housing Credits to those developments which serve the lowest income households for the longest period. The lower the income of the tenant population that is served the larger the "gap" in capital expenses that cannot be covered by rent. This means that higher priority applications by necessity will require comparatively greater amounts of Credits.

The vast majority of the developments receiving Credits in Connecticut are undertaken by local, private developers or locally based nonprofits that are small and not heavily capitalized. We have allocated few Housing Credits to developments undertaken by larger developers.

I'd like to emphasize that compared to Section 8 or other assisted housing programs, state administration of the Housing Credit is much less costly. In Connecticut we have four full-time equivalent positions assigned to the entire program compared to many times that amount for traditional grant, loan, subsidy or direct funding programs.

COMPARISON TO TENANT BASED RENTAL ASSISTANCE

It is my understanding that this question has arisen: "How does the Housing Credit compare to Section 8 Existing Housing or Voucher programs?"

I think any fair analysis of the thirty year costs and benefits of the typical Housing Credit apartment will prove it is cost effective compared to the cost of Section 8 rental assistance, particularly when you take into account the federal and even some state and local bureaucratic overhead Section 8 involves and the Housing Credit avoids.

More importantly, the intent and purpose of the two programs are not comparable. The Housing Credit is a capital investment incentive for the production of new or rehabilitated apartments where they are most needed. The conversion of the resources "spent" on the Housing Credit to housing vouchers would not lead to the development or rehabilitation of housing in such areas where it is critically needed as in the urban areas of Connecticut. Vouchers do not help revitalize cities or build better communities.

Section 8 is not a production program. Section 8 is an income supplement which provides often expensive rental assistance help to those who can find an apartment that is affordable and available. Often, they cannot. Nationwide, HUD estimates that one in five, 20 percent, of all vouchers and certificates are returned by their initial recipients, because they can find no apartment affordable to them under Section 8.

In reality, the federal government is in the process of ending the traditional Section 8 project-based program and diverting existing voucher and certificates to help ease the plight of those who up until now have received the project-based assistance, as this program is progressively eliminated.

Demolition, abandonment, or conversion of rental housing is reducing the supply of lower income units by more than 100,000 per year. The Housing Credit addresses this serious concern—specifically as it relates to the issues of abandonment and housing quality in our urban areas. These are particularly serious matters in Connecticut, and particularly a serious issue and concern with HUD's housing portfolio and funded stock in Connecticut.

COMPLIANCE ISSUES

In closing, I understand there are some questions regarding the burden and appropriateness of the IRS oversight role. Some have questioned whether it should be transferred to another agency like HUD.

From the enforcement and oversight point of view, there is a large difference between the Housing Credit and the other tax provisions affecting

real estate. No one needs state approval or compliance inspection to deduct home mortgage or property taxes or to depreciate real estate. However, to claim the Housing Credit owners must win an intense, closely regulated competition. It is essential therefore that each competitor prove to the state that the development actually has been built consistent with the approved proposal and the property kept in compliance with the requirements of the Credit for thirty years or more.

The Housing Credit is the most closely regulated real estate tax provision in the Code. It may be the most closely regulated of any provision of the Code. But, the burden of regulation does not fall on the Internal Revenue Service. It falls on the states.

IRS taxpayer requirements for the Housing Credit are similar to those in any real estate transaction, including market rate apartments. The Service has no greater oversight and compliance burden in this program, except that the special and intensive state compliance procedures in the Housing Credit may call a higher percentage of recapture events to the Service's attention than the ordinary audit process does in the case of less regulated tax code provisions where mistake, fraud, and abuse may only be occasionally discovered in random audits. If the Housing Credit proves to have a greater enforcement burden on the IRS than other provisions, it is because Congress, through the states, has made the Housing Credit monitoring much more likely to reveal noncompliance than it has in any other provision of the code. However neither GAO, or anyone else, has indicated that abuse in the Housing Credit program exists.

The Service's housing related responsibilities are minimal. That's the genius of the Housing Credit. Housing policy judgment, allocation decisions, and compliance monitoring are left to the states, where Congress intended them to be. This recognizes that the states, not the federal government, are the proper and best judge of their own local housing needs, and "closer to the ground" in order to better facilitate monitoring and enforcement.

The states fulfill the role HUD might otherwise have in the Housing Credit. Imposing HUD as a regulator of the Housing Credit would be contrary to the direction pursued in recent years of devolving responsibility to the states and reducing the federal role in our national life. Also, before considering expanding any role for HUD in the Housing Credit program I would ask how effective has HUD been in administering any other housing program? Also, how fearful would developer/owners be of not maintaining compliance if they had to face the wrath of HUD as compared to the IRS, or even the state allocating agency, if they did not comply?

In 1989, Congress gave HUD and other federal agencies the responsibility to double check state decisions to make sure that no more federal subsidy goes to Housing Credit projects than is necessary for their long-term feasibility and viability as low income housing. HUD spent four years trying to design and implement a solution. This delay partially paralyzed the use of the Housing Credits with HUD subsidies. HUD eventually gave up and delegated that responsibility to any state which would take it under guidelines virtually identical to those developed by NCSHA and most states have adopted.

I would also not suggest turning other Code provisions over to other agencies such as Commerce or HHS, even if that would reduce the need for IRS staff. I can't see what would be gained. I fear it would merely complicate matters and be a loser in the end.

CONCLUSION

Thank you very much for the opportunity to testify before the Subcommittee today. I earnestly hope that any work that we do together will improve this important program and will strengthen the solid foundation for future state and local housing efforts—which is the Housing Credit. The Credit is the critically important ingredient which incorporates into the nation's housing efforts state-local priorities and control, private investment and risk, private ownership and management, effective product, efficient administration, quality housing, and long-term affordability.

Madame Chairman, I know how important these factors are to you in looking at the overall housing efforts of the federal government. Let's work to make the balance of the federal effort respond in the same way to these critically important objectives. This would be welcome and productive change, the type of change which I know interests you, and the type of change which many of us who have been in the business have been waiting for many years to see. We are at your disposal to help in any way we can.

Chairman JOHNSON. Thank you very much, Mr. King.
Mr. Haynsworth.

STATEMENT OF WILLIAM E. HAYNSWORTH, SENIOR VICE PRESIDENT, BOSTON FINANCIAL GROUP, BOSTON, MASSACHUSETTS; AND PRESIDENT, AFFORDABLE HOUSING TAX CREDIT COALITION

Mr. HAYNSWORTH. Yes, ma'am. Madam Chairman, and Members of the Subcommittee, my name is Bill Haynsworth. I'm senior vice president of Boston Financial Group, a syndication firm in Boston, Massachusetts, and president of the Affordable Housing Tax Credit Coalition on whose behalf I testify.

Many of you are familiar with the role of syndicators in the tax credit business, which primarily is to raise private capital that will ultimately pay for 50 to 60 percent of total development costs in a particular project.

Now, you may not realize that as part of our responsibilities we perform a very extensive watchdog role in making sure that the properties are properly constructed, that they're properly designed, and that they are operated on a financially sound and capable basis over the full compliance period.

We obviously have an economic incentive to do that, because we are raising money from investors who expect a certain yield brought about by the credits and other tax benefits provided by the projects. And if the projects fail in any manner, their yield is impacted, our reputation is impacted adversely, and basically we're going to be out of business if we don't do a good job.

Now, as you probably know, we form limited partnerships that raise money from corporations. These limited partnerships can be quite large. They may be $50 to $100 million in size, and they may involve the investment in from 20 to 40 separate properties.

The properties average around $2.5–$3 million of equity per property.

The syndication field has become highly competitive. There are at least 20 major national syndicators who compete vigorously to

purchase properties, and a number of major corporate investors who invest directly.

As a result of this rigorous competition, and the fact that the tax credit was made permanent in 1993, as we all know the pricing has gone up significantly since that time.

I would be concerned, very concerned that this trend would be reversed if we were to face another sunset.

Now, what do we do apart from raising money? When we look at a project, we give it extensive due diligence. We look at all the legal documentation to determine that the project is eligible for the credit under the State guidelines.

We look very carefully at the plans and specifications. We have our engineers look at the project. During the construction phase, we may advance from 60 to 80 percent of our equity, because that's needed to build the project, and for that reason, we're at risk for that.

We may have engineers go out and look at the project when appropriate to make sure that it's being properly constructed. The developer will present us with a market study, but we do our own to make sure that we agree with the rents, and that we have confidence in the pro formas that we prepare.

We look very carefully at the development and construction phase. We review all aspects of the tax credit award. And also, and most importantly, we negotiate the deal with the developer. And the developer, as you know, does get a development fee, but that development fee is withheld and only paid out as he performs.

The first portion of the developer fee is usually paid upon successful completion of the project, but then it's further advanced when he successfully operates the project, for example when he reaches break even, or achieves some sort of a debt service coverage.

We also are very interested to make sure that there are no compliance issues with the project. We have our own staff of asset managers, 18 in all, who make site visits, who review all the financial reports, send them to investors, review tenant files to make sure that eligible tenants are in the projects, and that the tax regulations are being adhered to.

From all of the above, you can see that we play a role, a very vital role in oversight on the tax credit projects, and this is at no cost to the Federal Government.

As a concluding thought, the Coalition makes three annual tax credit excellence awards, three of them annually, to the best urban, rural and special needs projects as part of a competition.

Anyone reviewing this year's applications must be impressed by the quality of the tax credit projects, their ability to provide special services to tenants to meet the needs of the handicapped, AIDS victims and the elderly, and their overall contribution to the life of the tenants.

Indeed, we're very proud to have you, Madam Chairwoman, as one of the presenters of an award last year to the San Pablo Hotel in Oakland, California, an outstanding rehabilitation project, supplying many special tenant services.

Thank you, Madam Chairman.

[The prepared statement follows:]

TESTIMONY OF WILLIAM E. HAYNSWORTH, PRESIDENT
AFFORDABLE HOUSING TAX CREDIT COALITION

BEFORE THE SUBCOMMITTEE ON OVERSIGHT,
HOUSE COMMITTEE ON WAYS AND MEANS

MAY 1, 1997

Madame Chairwoman and Members of the Committee,

My name is William E. Haynsworth. I am Senior Vice President of the Boston Financial Group, Boston, Massachusetts and President of the Affordable Housing Tax Credit Coalition on whose behalf I testify today. On behalf of the Coalition, I wish to thank the Chairwoman and the Committee for holding this hearing and allowing us to participate.

As a matter of background, in 1988 concerned syndicators, investors, developers, professional advisors (including attorneys and accountants), non-profits and others in the Tax Credit community created our organization, then known as the Coalition to Preserve the Low Income Housing Tax Credit. When we accomplished this end in 1993, with the permanent extension of the Low-Income Housing Tax Credit, we changed our name to the Affordable Housing Tax Credit Coalition. We took on broader responsibilities, including representing the interest of the Tax Credit community before Congress and the appropriate state and federal regulatory agencies, to enhancing public awareness of the many great benefits that the Credit provides to low and moderate income people in this country, and to establishing a code of ethics for participants in the Tax Credit program.

Boston Financial has had a long involvement in affordable housing, pre-dating the enactment of the Credit. Since 1969, we have financed over 1,000 affordable housing properties and since 1987 we have provided equity capital for approximately 55,000 units of Credit eligible housing in about 550 properties. In addition, through our affiliated company, we provide property management services to over 35,000 units of housing, 80% of which is affordable housing. I formerly served as the General Counsel of the Massachusetts Housing Finance Agency and as its acting Executive Director, so I have had an opportunity to see the housing world from both the public and private perspective.

As other witnesses are discussing the role of the non-profits and developers in the Tax Credit process, we will limit our remarks to the syndicator's role. You well may be aware of one of our major functions-channeling private capital into affordable housing. I am not sure that you are aware of our other major role - serving as a diligent watchdog to assure that Tax Credit projects are built as decent, safe and sanitary housing and operated on a sound financial and managerial basis in full compliance with applicable law and regulations, so that all of us involved -- including Members of Congress who authorize this housing and the residents who live in it -- can take pride in it. We provide this important administrative function at no additional cost to the federal or state governments.

Madame Chairwoman and Members of the Subcommittee, before proceeding to describe the role of the syndicator, it is critical that I reiterate that this program is truly a public and private joint venture. For the program to operate efficiently, as Congress demands, the private sector must know that it has Congressional support. It is no accident that equity prices have risen dramatically since the program was made permanent in 1993. After the Tax Credit was made permanent, investors gained confidence that this program would be around for the long term and that they could commit not only their capital but also their human resources to understanding the program. That confidence was badly shaken in 1995 when proposals were made to "sunset" (i.e. repeal) the program.

Investors will not invest in a program they see as a Congressional yo-yo. I ask, therefore, that sunset of the Tax Credit program not be considered during upcoming budget negotiations--certainly nothing contained in the GAO Report could justify that action.

Moreover, I would like to discuss an issue I understand Members of the Subcommittee raised during last week's hearings--that the cost of Section 8 certificates or vouchers is less than the cost of the Tax Credit to the federal government. That comparison is simply not fair nor apt. First, unlike the Tax Credit, a certificate or voucher

does not build or rehabilitate housing, it simply provides rental assistance if the recipient is fortunate enough to find suitable housing. Second, according to HUD in many jurisdictions a significant number of certificates are returned unused because the holder was unable to find such suitable housing--indicating a shortage of affordable housing and a need for a production program like the Tax Credit. (The return rate varied from as high as 40% and averaged 17% nationally). Third, as I understand the questioning during that hearing, the assumption was made that the Tax Credit provided a subsidy in the amount of $100 per month over 15 years (or $18,000) even though the average Tax Credit cost was found to be approximately $27,000. Even assuming that a comparison between the programs is fair, that methodology is badly flawed: the Tax Credit provides at least 30 years of housing and the subsidy it provides should be compared to the median rent for comparable newly constructed or rehabilitated housing, which the GAO stated was approximately $200 greater than median Tax Credit rents. Thus, a fair mathematical comparison shows that the subsidy provided by the Tax Credit is closer to $72,000 ($200 per month x 12 months x 30 years). Fourth, the Tax Credit is a "supply side" program that reduces rental price inflation by increasing supply while certificates simply increase demand without increasing supply.

The Role of the Syndicator

Basically, the syndicator participates with the developer in the ownership of a specific project and creates an investment vehicle, usually a limited partnership, to acquire a pool of such projects. Investors purchase limited partnership interests in these pools in exchange for Tax Credits and other benefits of ownership. Capital raised from these investors typically finances 50% to 60% of the costs to develop an apartment complex. This significant equity contribution by the private sector allows the project owner to reduce its debt service costs and pass those savings on to low-income residents in the form of lower rents.

The syndication field is very competitive. There are at least twenty major national syndicators who compete vigorously to purchase projects and a number of major corporate investors who purchase directly from developers. (The discussion which follows is generally applicable to those "direct purchasers" as well). As a result of the rigorous competition and the fact that the Tax Credit is permanent, the amount paid by the ultimate investors to the developer for project use has risen significantly in the past several years. Indeed, since the early 1990s the amount of the equity generated by the Tax Credit that goes in the project has increased about 50%.

Due Diligence - Construction and Development Phase

The syndicator plays a major role in assuring that a project is successfully built and occupied expeditiously. The syndicator often makes 60% - 80% of its total investment during the construction phase of the project, so it has a significant amount of money at risk. Indeed, in addition to the equity investment, syndicators often make bridge loans to the developer to fill the gap in time between the construction period and when investment contributions are received. Accordingly, the syndicator must see that the project is organized, financed and built properly and for that reason performs intense due diligence during the construction phase. Following is a summary of a typical syndicator's due diligence check list, often exceeding 30 pages, outlining the intense oversight responsibility filled by the syndicator:

- Organizational Phase

The syndicator must review all project documents to see that the owning entity is properly organized under state law. This includes the reviews of either the Partnership Certificate or Partnership Agreement, as well as other organizational documents and the financial statements of the individuals in the development entity. If a non-profit is a general partner, the Section 501(c)(3) status must be confirmed. In addition, the syndicator must review any relevant guarantee agreements, environmental studies, property purchase agreements, title, surveys, and a current market study to assure that there is strong demand for the property and that its design and features will attract the

target population. The syndicator must also assure that the property has no environmental hazards (or that proper actions will be taken to remediate any existing hazards) and that it is not in a flood hazard zone, wetlands area, and is in compliance with local zoning requirements and has received the applicable building permits.

- Construction and Development

The syndicator reviews the project plans, with a special eye on the quality of construction and on necessary amenities to assure an expeditious rental. The syndicator must assure that the project is built to last over time. The syndicator must also review all construction, architectural and engineering contracts, construction bonds, and a plethora of financing documents. Of real significance, many syndicators do site inspections during the construction phase, as syndicators in effect are playing the role of construction lenders.

The stakes for the syndicator are high. If the project is not constructed within the statutory two-year period for placement in service after receipt of a Tax Credit allocation, the syndicator and investor will lose its capital investment.. Moreover, the syndicator/investor must maintain ownership for at least 15 years or suffer significant Tax Credit recapture. If the underlying real estate is not properly constructed or rehabilitated, and cannot sustain its function of providing housing, it is the syndicator and investors who will pay the financial price. Accordingly, the syndicator has the highest economic incentive to assure that the project can be supported by the local market, is well-built, and with proper amenities so that it can go into service at the time projected, rent up in a timely fashion and be maintained for the long run.

- Financial and Tax Structuring

Finally, throughout the development and construction phase, the syndicator must assure that the developer is in full compliance with the applicable Tax Credit rules. In this regard, we work closely with the developer and his or her advisors and we retain experts in Tax Credit law and accounting to assist us in our review. We and our advisors review all aspects of the Tax Credit award to make sure that the Credits have been properly allocated and that the project will be eligible to generate the Credits. Frankly, our business depends on our ability to make sure that the transactions are done correctly; our investors will not invest with us in the future if we do not produce what we and they expect or if they lose tax benefits in the future due to problems that we missed. Accordingly, we conduct thorough due diligence reviews prior to making an investment.

Our review includes the following elements. We inspect the developer's application to the State Housing Credit Agency and sometimes, work with the developer in submitting that application. In any event, we want to make sure that the finished product conforms in all material respects to the application that the developer has submitted, subject to any changes which may be approved by the Agency. We also review the Agency's preliminary reservation and allocation of Tax Credits, where applicable, for any conditions which it has specifically imposed.

We pay particular attention to the "carryover allocation". As you may be aware, in almost all circumstances, Tax Credit allocations are accomplished by the issuance of a so-called "carryover allocation" which must meet certain criteria imposed by the Code and IRS regulations. Without a valid carryover allocation, the property will not qualify for Tax Credits. One of the key elements in this process is meeting the statutory requirement that more than ten percent of the development's reasonably expected basis be incurred by the close of the year in which the allocation was made (the "10% Test"). There are a number of highly technical requirements for meeting the 10% Test and I will spare the Committee these arcane details. However, we and our advisors spend many hours in each transaction scrutinizing whether the 10% Test has been appropriately met in order to assure our investors that the expected Tax Credit allocation will be valid. We routinely expect to receive independent certified public accountant's certifications as to the qualification for the 10% Test, even in those States which do not require such documentation.

When properties receive Tax Credits as a result of being financed with the proceeds of certain tax-exempt bonds (a phenomenon we see increasingly due to the tremendous competition in most States for "allocated Tax Credits"), we check to make sure that the proper Agencies have made the determinations required by the Code in such circumstances--that the property satisfies the requirements of the State's qualified allocation plan and that it uses no more than the necessary amount of Tax Credits.

We retain experienced tax counsel to prepare the partnership agreements (or, in some cases, limited liability company agreements) that govern the operations of the property's ownership entity. The structure of these transactions complies not only with the rules of Section 42, but with other tax provisions of general applicability--for example, the rules which require that partnership allocations have "substantial economic effect". Moreover, we have seen in recent years new forms of debt financing, some from public agencies, which must be carefully analyzed to assure that they are consistent with general tax principles as well as Tax Credit rules.

Finally, but perhaps most importantly, we negotiate business terms with our developers to make sure that they have a long-term financial stake in the property they have developed. Typically, a portion of developer fees (which we check to make sure are within applicable Agency guidelines) are paid out over a period of time. The developer must perform in order to be compensated, thus providing a powerful incentive for good property management and oversight by the developer. Generally, developers will be required to fund cost overruns in construction costs from their own resources, thereby making cost consciousness a must. Developers will also be required to fund operating deficits, assure adequate reserves and carry sufficient insurance coverages so that unforeseen contingencies will not have a devastating impact on the property or its residents. In the unlikely event of a disqualification for or reduction or recapture of allowable Tax Credits, developers must make up the difference to their investor partners. All these provisions are not intended to be punitive, but simply to make sure that the developer remains motivated to provide the benefits contracted for and the housing that the residents, the public and the Congress have a right to expect.

The result of the rigorous due diligence that we conduct and the tough business terms we demand can be seen in the results found in the GAO Report--properties that comply with the law and provide invaluable housing assets to communities all over the Nation.

Syndicator's Role in Compliance Monitoring

The GAO placed great emphasis on the need for compliance monitoring throughout the Tax Credit period to make sure that project tenants are Tax Credit eligible, and to assure that the projects are in a good condition so as to provide good housing to the project tenants.

Although the GAO focused on the States' role in the monitoring process, it did not address the role that the syndicator plays in assuring project compliance with the Tax Credit rules and in providing decent housing.

Just as in the construction phase, the syndicator has a strong economic incentive that the project remain in compliance with the Tax Credit rules. If a unit goes out of compliance, the syndicator and its investors face a very severe penalty- the loss of the future Tax Credits on the unit and recapture of one third of the Tax Credit taken since the inception of the project, with penalty interest thereon. I can assure you that syndicators go to great lengths to see that this does not happen as it would be devastating to our business. If a problem does occur, a syndicator may replace the management of the local property and provide operating deficit loans to the project out of its investors' funds or its own resources. We have found that if a developer is unable to provide adequate resources, it is preferable for investors to infuse funds into projects undergoing stress rather than to allow a loss of the investment and Tax Credits. The government benefits because the investors

are making the funds available rather than asking the government for additional money and the property is not lost as a housing resource.

Syndicators perform both financial-operating reviews and on-site reviews. Concerning financial reviews, most syndicators require the managing general partner of the project to submit quarterly financial data, concerning tenant rents, balance sheets, operating income and the like. Usually, one of the quarterly reports must be audited by an accountant chosen with the syndicator's approval. We track this data against an historical data base to detect trouble signs. If they occur, we offer suggestions on how to rectify any deficiencies. We provide this project information to the investors.

Significantly, we require the project owner to maintain sizable reserves so that the financial resources exist to bring a project up to a healthy financial and physical status.

Our other major involvement is site visits. Most syndicators have a staff of qualified project inspectors. Many have full time architects on staff and contract with qualified engineering and environmental consultants. Generally, site inspections are made annually. Inspectors often bring back pictures of not only of the project, but of the surrounding neighborhoods for inclusion in the file. They also check local newspaper ads to ascertain apartment vacancies and the state of the job market.

Following is a summary of the inspection process:

Exterior Inspection The inspector looks at such things as signage, parking areas, fences, sidewalks, brickwork, gutters, exterior lighting, window screens, roof, chimney, fire escapes, porches, balconies, as well as security systems and the common area.

Interior Inspection Concerning the interior of the property, the inspector will examine emergency lighting, carpeting, condition of walls and ceilings, existence of fire doors, stairways, handrails, elevators, the laundry and community rooms and other common space. The inspector will also check out the heating, ventilation and air conditioning.

Maintenance: The inspector will ascertain the acceptability of the landscaping, parking lot, exterior painted surfaces, hallways, stairways, elevators, playground equipment and community space. The inspector will also ascertain whether repairs called for in the last annual physical inspection have been satisfactorily completed, and whether the complex still has to address any major rehabilitation work.

Security The inspector may review police reports for violent crime arrest, drug activity as well as reports on non-citizen and ineligible aliens, on an as needed basis. The inspector will also check exterior lighting and look for major security problems such as graffiti in the halls, vandalism in the laundry room, abandoned cars in the parking lot, or children milling around the project during school hours.

Unit Inspection The inspectors have elaborate check lists for each building in the unit, looking at ceilings, doors, walls, floors and appliances.

Administrative Review We also look at project administration, including whether tenant files are properly maintained, the staffing arrangements, how often a complex is visited by supervisory personnel, the amount of staff turnover, the existence of operating manuals, as well as the financial record-keeping and rent collection practices of the project with emphasis on tenant income verification. We especially check on whether utility allowances are properly administered. Concerning tenant file review, we will examine annually a sample percentage varying from 5% to 15%, depending on whether the local or state agency does tenant pre-certification. There is an extensive review procedure

---

concerning the rent paid, utilities, security deposit, as well as annual tenant gross income and family assets.

From the above, you can see that the syndicator truly supplies another set of eyes and ears in addition to the Tax Credit Agency to assure that the projects are in compliance with the Tax Credit law and are well-maintained. We do more than just gather the information; we work with the owner to correct deficiencies discovered during the inspection. If the owner does not cooperate, we exercise the right under the partnership agreement to replace the project manager with either ourselves or a manager of our choosing.

We believe that the role that the syndicator plays explains in good measure the fact that the GAO found the Tax Credit properties in good physical shape and in compliance with the Tax Credit requirements.

Conclusion

Throughout this testimony, I have tried to stress how the economic interest of the project investors coincide with the public interest that the project be well built, well maintained and operated in full compliance with the Tax Credit rules. Frankly, we believe that the private sector's economic interest is one of the greatest protection that the projects have. As a result of the participation of the private sector in raising equity, providing asset management and advancing operating deficit funds, when necessary, the government receives a large dividend in the form of better built. better maintained affordable housing.

As a concluding thought, the Coalition makes three Tax Credit Excellence Awards annually to the best urban, rural and special needs projects. Anyone reviewing this year's applications must be impressed by the quality of Tax Credit projects, their ability to provide special services to tenants to meet the needs of the handicapped, AIDS victims and elderly, and their overall contribution to the life of the tenants. (Indeed, we were very proud to have you, Madame Chairman, as one of the presenters of an award last year.) Seeing what the Tax Credit accomplishes in human terms is most gratifying to us who also must deal in the world of documents, inspections, oversight and the other technical roles that we play. It is meeting the human needs that makes it all worthwhile.

WAS 31444.1

Chairman JOHNSON. Thank you, Mr. Haynsworth.

Mr. Swank.

STATEMENT OF LARRY A. SWANK, PRESIDENT AND CHIEF EXECUTIVE OFFICER, STERLING GROUP, NAPPANEE, INDIANA; AND CHAIRMAN, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. SWANK. Madam Chairman, and Members of the Subcommittee, my name is Larry Swank, and I am president and chief executive officer of the Sterling Group, Nappanee, Indiana. I'm also the chairman of the Housing Credit Group at the National Association of Home Builders.

The Sterling Group is comprised of a construction and development company and a management company.

Madam Chairman, on behalf of the 190,000 members of NAHB, I want to thank you for the opportunity to testify before the Oversight Subcommittee today regarding the low-income housing tax credit.

At the on set, let me state that NAHB is a strong supporter of the credit, are its continued permanence. We are particularly appreciative, Madam Chairwoman, of your longstanding support and dedication over the years to providing affordable housing.

Madam Chairman, I am extremely distressed, to have learned late last night that Chairman Archer has decided to recommend sunsetting the low-income housing tax credit as a means of raising revenue in the budget agreement.

Threats to sunset the credit upset the investment community confidence and development community confidence in the continuation of the credit. Madam Chairman, as you know, the NAHB adamantly opposes sunsetting the credit. We believe that the credit is essential to providing adequate affordable housing to America.

Every American should have the opportunity to live in decent, safe and affordable homes. With our Nation's growing Federal deficit concerns, the private sector should be used as the primary mechanism for meeting the demands for housing.

The credit does just that by enabling States to leverage more than $12 billion in private investment to provide decent housing. Implementing housing policy through a tax credit provides strong incentives to the private sector, and requires no elaborate government bureaucracy.

The principal tax incentive for the production of rental housing is contained in the low-income housing tax credit. The credit must be maintained and preserved as a permanent means to encourage investment in affordable housing.

Without the housing credit, thousands of low-income families would still be living in substandard housing and paying exorbitant rents.

In addition to creating affordable housing, the credit also generates jobs. An attachment to my written testimony breaks out the jobs created by the credit by State.

The integrity of the low-income housing tax credit should be protected against individual abuses that threaten the continued existence of the program. Threats to sunset the program must be eliminated, however, because they discourage participation in the program and reduce program efficiency.

It is imperative to affordable housing that the credit remain permanent. NAHB sees the issuing of the GAO report and its findings as a positive opportunity to take what we believe is a good program and make it better.

American taxpayers should have the security of knowing our government is using their dollars wisely and on well managed programs. One of the issues the GAO reported on is what controls exist to assure that projects' costs are reasonable.

Two of the components contained in the projects' costs are developers and builders fees. Let me explain briefly developers' fees to you, and if you would like we can discuss them in more detail during questions.

Developers fees compensate the developer for risks and costs that he or she incurs in the process of developing a project. The fee is set by the market, and depends not only upon risks and anticipated overhead expenses, but also on unreimbursed development costs that the developer will incur.

To calculate net development fee, the amount permitted by the allocating agency must be reduced by the developer's equity, working capital and other reserves, developer's overhead that's not reimbursed and other costs that are not reimbursed.

These fees are being properly controlled, and are not excessive. The GAO report indicates the gross development fees permitted by agencies ranging from 10 to 23 percent with most at approximately 15 percent.

Frankly, Madam Chairman, after all the costs are subtracted out, a developer walks away with 4 to 5 percent pretax.

Madam Chairman, there is a desperate shortage of affordable housing that the market demands, but can't provide on its own without credit. Over the last decade, the gap between low-income renters and low rent units have grown consistently due to the delivery of fewer low-income units and the growth in the number of low-income families.

Only yesterday I was in Holland, Michigan, less than 5 miles from where your mother lives, by the way. And I was cutting the ribbon at a ground breaking of a project that we are building in Holland, Michigan at the present time.

There was a family that applied for housing there some time ago. I'm going to talk for a moment about that family. Their names are Bill and Kathy Wells. They moved there from Chicago. Bill saw an advertisement in the Chicago Tribune, and went applied for a job at the Prince Corp., he was accepted. All of a sudden he couldn't find affordable housing.

He looked, and after several weeks found Falcon Woods, our apartment community, applied, and because of his income, was just under the amount necessary to qualify. He was able to move there, move his family, obtain the job, and now resides in Holland, Michigan.

That's an example of what the Low-Income Housing Tax Credit Program is all about. Housing projects used in the credit are benefiting those that are intended to be benefited, households with very low incomes.

It only makes good business sense to continue rental housing incentives, like the low-income housing tax credit, with an eye toward program improvements to improve efficiency.

NAHB believes that independent verification of key information should be required for sources and uses of funds. NAHB also supports the submission of a comprehensive and timely market study for the proposed project prepared by neutral or third party commissioned by the developer and reviewed by the housing agencies.

Third, NAHB recommends that HUD housing quality standards be used for determining units suitable for occupancy and that housing credit agencies be required to conduct onsite inspections for at least one third of the projects each year for compliance with these standards.

Madam Chairman, thank you for the opportunity to share NAHB's views with regard to the credit today. I would like to reiterate in my closing that NAHB opposes any efforts to subset the credit.

Thank you. I look forward to your questions.

[The prepared statement and attachments follow:]

1201 15th Street N.W.
Washington, DC 20005
(202) 822-0470
(800) 368-5242
Fax (202) 822-0572

Testimony of Larry A. Swank

on behalf of

National Association of Home Builders

before the

House Ways and Means Committee

Subcommittee on Oversight

May 1, 1997

Larry A. Swank, President
The Sterling Group
P.O. Box 450
Nappanee, IN 46550-0450

Madam Chairwoman and Members of the Subcommittee:

My name is Larry Swank and I am the President and CEO of The Sterling Group from Nappanee, Indiana. I am also the chairman of the Housing Credit Group at the National Association of Homebuilders (NAHB). The Sterling Group is comprised of a construction and development company and a management company. Since 1978, as President of the Sterling Group, I have constructed and rehabilitated more than fifteen hundred apartment units. In addition to apartment construction, Sterling has built single family homes and developed three subdivisions for single family and multifamily purposes. Sterling's portfolio consists of 72 apartment communities in Indiana and Michigan with emphasis on Section 42 Low-income housing tax credit properties.

Madam Chairwoman, on behalf of the 190,000 members of NAHB, I want to thank you for the opportunity to testify before the Oversight Subcommittee today regarding the low-income housing tax credit (LIHTC). At the outset, let me state that NAHB is a strong supporter of the credit and its continued permanence and we are particularly appreciative, Madam Chairwoman, of your longstanding support and dedication over the years to providing affordable housing.

BACKGROUND:

Created by the Tax Reform Act of 1986 as Section 42 of the Internal Revenue Code, the low-income housing tax credit became permanent in 1993 as a result of the Omnibus Budget Reconciliation Act. The LIHTC is the primary vehicles for financing the construction of low-income rental housing. Restrictions on these tax incentives unnecessarily raise the cost of rental units and subsequently reduce the number of rental units that could be provided to low-income families.

Every American should have the opportunity to live in a decent safe and affordable home. With ever growing federal budget deficit pressures, the challenges to meeting this goal are formidable. Today there are fewer government resources to go around while the nation's deepest housing problems increasingly are those being faced by low-income households in rental housing. Implementing housing policy through the tax code provides strong incentives to the private sector and requires no elaborate government bureaucracy, thus it is the most efficient way to administer policy. Federal tax incentives are a critical component of the federal government's commitment to homeownership, and tax incentives are now the principal government support for the production and rehabilitation housing for low-income families.

The principal tax incentive for the production of rental housing is contained in the low-income housing tax credit. The credit stands as the only significant federal support for expanding the stock of affordable rental housing for low-income families. The credit must be maintained to encourage investment in affordable housing. Without the housing credit, thousands of low-income families would still be living in substandard housing and paying exorbitant rents. Roughly 60,000 new and 40,000 rehabilitated rental units are created every year with the credit. The LIHTC is responsible for a quarter of all new multifamily building and virtually all the units affordable to low-income families. However, in its present form the credit too often must be supplemented with additional layers of other subsidies. Various restrictions and requirements, such as limits on the amount of credit a single taxpayer can use, unduly increase the cost of providing critically needed rental housing and reduce the number of units that could be produced with the same tax expenditure. As guiding principals with regard to the credit NAHB believes:

- The low-income housing tax credit should be maintained in order to support the production and rehabilitation of low-income rental housing.

- The integrity of the LIHTC should be protected against individual abuses that threaten the continued existence of the program. Threats to sunset the program should be eliminated because they discourage participation in the program and reduce program efficiency. The credit must remain permanent

Apartments financed with the credit are built to the same standards as market rate housing and are designed to provide affordable housing for families earning 60 percent or less of the area median income. Program guidelines stipulate that families and individuals should not pay more than 30 percent of their monthly income for rent. Tax credits allow developers to finance 40 to 50 percent of the total cost of the project with equity invested by corporations and individuals; this reduces the amount of debt financing and helps keep rents low. Without the program, such developments would require large amounts of government subsidized financing to maintain the same low rates. In the last ten years, the program has provided more than 800,000 units that otherwise would not have been available for to those persons (families) with incomes below 60 percent of area median income.

With our nation's growing federal deficit concerns, programs that encourage private-public partnerships and cooperation between state and federal governments are essential to maintaining a strong federal commitment to housing assistance programs for low income families by delivering federal funds through the most cost effective mechanisms. To this end, the private sector should be used as the primary mechanism for meeting the demands for housing. The credit does just that by enabling states to leverage more than $12 billion in private investment to provide decent housing. With the ongoing curtailment of programs administered by HUD, the housing credit assumes even greater significance in terms of the federal government's commitment to housing. As a result of the construction and rehabilitation activity, the credit has generated over 65,000 jobs and $10 billion in additional taxes in the first 9 years of existence. In 1995, the credit created 35,000 jobs, $75.7 billion in wages, and $1.1 billion in new tax revenues.

According to a study conducted by the Center on Budget and Policy Priorities in 1995, there is approximately a 4.7 million unit shortfall of affordable housing in the United States. Over the last decade, the gap between low-income renters and low-rent units has grown consistently due to the delivery of fewer low-rent units and the growth of the number of low-income families. Four out of five families with incomes below the poverty line currently spend more than 30 percent of their monthly income on housing. More than three out of five spend more than 50 percent of their income on rent and utilities. The credit is an effective means to alleviate these shortages.

GENERAL ACCOUNTING OFFICE REPORT (GAO)
GAO Report's Findings and Recommendations

Eighteen months ago, Ways and Means Committee Chairman Archer asked the GAO to review the housing credit and make any recommendations necessary to improve oversight, enforcement and compliance. The report, issued the end of March, found that for the most part the credit was working as Congress intended. For example the study found that:

- The average housing credit renter earns only 37 percent of the local median income, although the law allows renters to earn up to 60 percent.
- Average housing credit apartment rents are well below market rents. They average as much as 23 percent below the maximum rents the credit allows and 25 percent below HUD's national fair market rent.
- Housing credit apartment development costs are reasonable. They average less than $60,000 per unit.
- All state agencies had controls over development costs and states also use housing credit competition to control development costs.

The GAO report illustrates the effectiveness of private-public, federal-state partnership in producing affordable housing for American working families, the elderly and other low income people. Given the success of the program, NAHB sees the issuing of the GAO report and its findings as a positive opportunity to fine tune the credit to assure that it works even better.

We agree that there is a need to take what NAHB believes is a good program and make it better. The American taxpayers should have the security of knowing our government is not wasting their dollars on unnecessary or poorly managed programs. One of the issues the GAO was asked to report on included what controls existed at the state level and whether they are sufficient to ensure that the project costs are reasonable. Two of the components contained in a project's costs are developer's and builder's fees. A developer's fee is meant to compensate a developer for the staff time, entrepreneurial effort, work and risk involved in the development of a project. According to the GAO, all but one agency reported limits on developer's fees.[1] Fees vary from state to state because of the differences among states in building costs. Further, the fees vary with regard to the amount of risk involved. For example, a larger fee might be justified to induce the development of low-income housing in an area that is difficult to develop or would encounter delays because of community opposition. Even with the high risk involved with a tax credit project, the fees involved with one of my tax credit projects are the same as the fees and profit percentage of one of my conventional projects. The fees involved with LIHTC projects are reasonable and they are being adequately controlled because allocating agencies are reviewing sources and uses for reasonableness. The GAO report shows these controls are working.

Project development costs, including land acquisition outlays, building acquisition and/or construction costs, builders overhead and profit, and financing costs, vary widely across tax credit properties. These costs vary because of differences in the physical characteristics of properties and the need to meet broader community development needs. Differences in the physical characteristics of the properties -- including the costs of acquiring land and existing buildings, the types of buildings constructed, the geographic location, the size of the units, the amenities provided, the construction standards used and the environmental issues encountered account for many of the variations in development costs.

Other physical characteristics -- such as high local construction costs, local seismic standards, or requirements for amenities to serve residents with special needs -- may also account for the higher development costs of some properties.

The GAO shows that the credit has in many ways exceeded Congress' expectations in helping meet growing low income rental shortages in urban, suburban and rural areas nationwide. The GAO report indicates that the housing projects using the credit are benefitting those it was intended to -- households with very low incomes. The report, however, did point to some compliance and enforcement concerns. Therefore, it only makes good business sense to continue rental housing incentives, like the LIHTC, but with an eye toward program improvements to increase efficiency. To this end, NAHB has several legislative recommendations we think would strengthen the oversight and administration of the credit.

NAHB's Legislative Recommendations

Listed below are NAHB's recommendations for legislative improvements to the Low Income Housing Tax Credit Program.

- ***Independent Verification of Costs***
  Background: In evaluating the reasonableness of a project's development costs, financing deficit, and tax credit proceeds, allocating agencies are largely dependent on information submitted by developers on their sources and uses of funds. Agencies need complete information of the sources and uses of funds in order to be assured that their controls are effective at controlling federal costs. In addition, allocation agencies need to be assured the information they are receiving is reliable.

  NAHB Proposal: To ensure reliable and complete information for making final decisions in tax credit awards, an independent verification of key information should be required for sources and uses of funds submitted by the developer to the housing credit agency with the application for a final award at the date the building is placed in service.

---

[1]According to officials from the agency that has not set limits on the developer's fee, this fee is reviewed for reasonableness and, when it is considered excessive, the agency has the authority to reduce the project's tax credit award.

- ***Market Study***
  Background: Section 42 of the Internal Revenue Code (the "Code") requires housing credit allocating agencies to develop qualified allocation plans to target their tax credits to proposed housing projects that meet their "housing priorities" which are "appropriate to local conditions." The Code does not define these general broad requirements nor the seven federal "selection criteria" states must use. Therefore, states have taken various steps to obtain the data required to identify and rank their housing needs. These steps, while sufficient to establish housing priorities for a state as a whole, a region, or even a locality, may not be adequate to determine whether a particular property will be viable in a particular location. Despite this lack of federal direction, 41 of the 54 allocation agencies use market studies to determine project need.

  NAHB Proposal: In order to determine if a particular proposed property would be viable in a particular location and market, the code should be amended to require the submission of a comprehensive and timely market study for the proposed project prepared by a neutral or third party commissioned by the developer. This study should be up to date, part of the developer's application for housing credit dollar amount, and reviewed by the housing credit agency.

- ***On-Site Inspections***
  Background: The IRS currently allows states to adopt monitoring procedures that do not call for making on-site inspections of the projects or for obtaining reports of building code violations from local government agencies that perform building inspections. On-site inspections or local building inspection reports are necessary for states to determine whether the projects meet the habitability requirements in the Internal Revenue Code.

  NAHB Proposal: Current law and IRS regulations require units to be suitable for occupancy taking into account local health, safety and building codes. We recommend that HUD Housing Quality Standards be used for determining units suitable for occupancy and that housing credit agencies be required to conduct on-site inspections for at least one-third of the projects each year for compliance to these standards.

In addition to the above proposals, NAHB also supports those recommendations included in the letter sent by the Housing Credit Commission to Mrs. Johnson. We remain committed to assisting you, Madam Chairwoman and Chairman Archer in your legislative efforts to tighten oversight and compliance. Because of it success, the integrity of the credit must be protected against individual abuses that threaten the continued existence of the program. Making reforms in oversight, administration and compliance of the credit will accomplish this and ensure the continued effectiveness of the program.

CONCLUSION

NAHB is prepared to help craft workable effective changes that the Subcommittee and Committee believe are necessary to meet Chairman Archer's goals. NAHB would welcome the opportunity to discuss ideas for reform with you. Further, we stand ready to assist you in any way possible and look forward to working with you and Mr. Archer on this issue.

Madame Chairwoman, thank you again for the opportunity to share NAHB's views with regard to the credit today. I look forward to your questions.

Impact of Low Income Housing Tax Credit, by State: Calendar Year 1995						
	Number of Low Income Tax Credit Units Allocated					
	New Construction	Substantial Rehabilitation	Acquisition & Rehabilitation	Wages (thousands)	Full-time Jobs	Taxes (millions)
US Total	55,426	14,314	15,977	$756,809	34,869	$1,117.3
ALABAMA	1,438	0	150	12,644	748	20.7
ALASKA	99	0	0	1,592	49	1.3
ARIZONA	899	60	0	8,656	459	12.5
ARKANSAS	787	23	38	7,031	404	11.1
CALIFORNIA	4,644	959	156	68,545	2,570	75.1
COLORADO	938	163	232	12,113	561	17.4
CONNECTICUT	263	2	597	7,074	278	11.2
DELAWARE	294	0	0	3,201	145	3.8
DISTRICT OF COLUMB	0	190	0	895	47	2.5
FLORIDA	3,719	8	423	37,407	1,944	54.1
GEORGIA	2,228	1,260	41	27,613	1,422	46.0
HAWAII	175	0	0	3,063	86	2.3
IDAHO	398	0	26	3,672	203	5.5
ILLINOIS	2,418	498	1,195	46,175	1,613	53.6
INDIANA	1,139	234	143	13,904	656	19.8
IOWA	1,301	15	48	13,063	658	17.8
KANSAS	1,132	182	92	11,696	627	18.3
KENTUCKY	419	433	695	8,351	486	20.2
LOUISIANA	1,892	749	505	22,807	1,245	41.0
MAINE	150	0	202	2,587	124	4.6
MARYLAND	643	45	1,823	17,561	779	32.7
MASSACHUSETTS	169	859	1,287	15,845	614	30.2
MICHIGAN	2,635	174	501	33,256	1,469	43.1
MINNESOTA	918	0	503	13,121	578	18.5
MISSISSIPPI	567	21	974	9,820	526	20.4
MISSOURI	1,141	370	451	16,666	767	25.6
MONTANA	75	0	0	723	37	1.0
NEBRASKA	479	0	15	4,315	240	6.4
NEVADA	492	0	0	6,281	243	6.4
NEW HAMPSHIRE	72	0	216	2,040	89	3.8
NEW JERSEY	NA	0	0	0	0	0.0
NEW MEXICO	575	0	0	4,952	284	7.5
NEW YORK	641	3,571	4	33,067	1,200	55.0
NORTH CAROLINA	1,943	0	288	18,159	1,031	29.1
NORTH DAKOTA	184	0	0	1,622	91	2.4
OHIO	2,427	547	1,265	35,822	1,647	55.3
OKLAHOMA	1,041	123	270	11,611	611	18.7
OREGON	898	82	0	10,572	464	12.8
PENNSYLVANIA	1,806	469	475	25,684	1,126	35.8
RHODE ISLAND	91	190	682	6,180	260	12.6
SOUTH CAROLINA	1,019	146	184	9,556	585	17.6
SOUTH DAKOTA	233	0	0	1,839	115	3.0
TENNESSEE	1,555	29	270	13,833	842	24.2
TEXAS	5,205	2,553	1,306	65,053	3,525	118.1
UTAH	827	0	0	8,106	409	10.8
VERMONT	33	129	21	1,042	53	2.4

Impact of Low Income Housing Tax Credit, by State: Calendar Year 1995						
	Number of Low Income Tax Credit Units Allocated					
	New Construction	Substantial Rehabilitation	Acquisition & Rehabilitation	Wages (thousands)	Full-time Jobs	Taxes (millions)
VIRGINIA	1,528	39	300	16,576	839	24.3
WASHINGTON	1,502	64	136	21,973	792	22.2
WEST VIRGINIA	561	37	200	6,320	336	10.4
WISCONSIN	1,673	90	215	20,468	902	25.8
WYOMING	160	0	48	1,719	91	2.7

Source: NAHB estimates from National Council of State Housing Authorities data.

1201 15th Street N.W.
Washington, DC 20005
(202) 822-0520
(800) 368-5242
Fax (202) 822-0374

ECONOMICS, MORTGAGE FINANCE, AND
HOUSING POLICY DIVISION

Rough Cost Benefit Analysis
for the
Low Income Housing Tax Credit Program

The U.S. General Accounting Office (GAO) prepared a March 1997 report on the Low Income Housing Tax Credit Program. In that report, GAO estimated that the average 10-year present value stream of costs to the Federal government of a tax credit unit is $27,310.

We have prepared a rough analysis comparing benefits to federal costs for the Low Income Housing Tax Credit. Benefits are measured by taking the difference between market rate rentals and the rents paid for tax credit units. We started with the difference between the market rent (including utilities) for newly-constructed conventional apartments and the average rent for tax credit units listed in the GAO report of $453 per month. Typical rents for newly-constructed units is available from the 1995 American Housing Survey, sponsored by HUD and conducted by the U.S. Census Bureau. According to the data from this survey, the average gross rent (which includes all utilities except telephone) for a new conventional apartment was $744 per month.[2]

We did not use HUD Fair Market Rents (FMRs) as a proxy for "typical" market rents. FMRs are established by HUD to determine the eligibility of rental housing units for Section 8 Housing Assistance Payments programs. They are not necessarily intended to, and may not, accurately reflect "typical" market rents for new units due to several factors:

- FMRs are based only on existing rental units, explicitly excluding units that are newly constructed.
- FMRs were originally set at the median - or 50th percentile - of area rent distributions. The median is a standard measure of "central tendency" that statistically represents the midpoint of a set of numbers. In order to reduce the cost to the government, however, FMR's have been lowered twice - first to the 45th, then to the 40th percentile - so that they now lie significantly below the center of the rent distributions.
- The data on which FMRs are based include units receiving state and federal government subsidies, including tax credits. Some of the data (in particular, the Decennial Census data) also include public housing units.
- Much of the data on which FMRs are based include substandard units. The Decennial Census provides almost no information about unit quality, and the questionnaires used by HUD to conduct FMR surveys contain no questions about unit quality.

Starting with the above listed rents, we calculated a stream of benefits of a Low Income Housing Tax Credit unit over the fifteen year compliance period and the 30-year extended period utilizing the same present value rate used in the GAO Report (see exhibit A). For fifteen years, benefits had a present value of $41,392 per unit and for 30 years a present value of $65,770 per unit. With a federal cost of $27,310 per unit, our conclusion is that the Low Income Housing Tax Credit Program is providing benefits to low and moderate income families and elderly persons far in excess of its costs.

---

[2]Based on all adequate units rented for cash, built in 1994 or 1995, excluding moderately or severely inadequate units, public housing, and units receiving a government subsidy, with rent adjusted because the household works for or is related to the owner, or subject to rent control.

EXHIBIT A

Inflation Rate	Sum of Present Value Over 15 Years
3.00%	$41,392
Discount Rate	**Sum of Present Value Over 30 Years**
6.70%	$65,770

Year	Avg Monthly Rent	Avg LIHTC Rent	Annual Difference	Present Value
1	$744	$453	$3,492	$3,492
2	$766	$467	$3,597	$3,371
3	$789	$481	$3,705	$3,254
4	$813	$495	$3,816	$3,141
5	$837	$510	$3,930	$3,032
6	$862	$525	$4,048	$2,927
7	$888	$541	$4,170	$2,826
8	$915	$557	$4,295	$2,728
9	$942	$574	$4,424	$2,633
10	$971	$591	$4,556	$2,542
11	$1,000	$609	$4,693	$2,454
12	$1,030	$627	$4,834	$2,369
13	$1,061	$646	$4,979	$2,286
14	$1,093	$665	$5,128	$2,207
15	$1,125	$685	$5,282	$2,131
16	$1,159	$706	$5,440	$2,057
17	$1,194	$727	$5,604	$1,985
18	$1,230	$749	$5,772	$1,917
19	$1,267	$771	$5,945	$1,850
20	$1,305	$794	$6,123	$1,786
21	$1,344	$818	$6,307	$1,724
22	$1,384	$843	$6,496	$1,664
23	$1,426	$868	$6,691	$1,606
24	$1,468	$894	$6,892	$1,551
25	$1,512	$921	$7,099	$1,497
26	$1,558	$948	$7,311	$1,445
27	$1,605	$977	$7,531	$1,395
28	$1,653	$1,006	$7,757	$1,347
29	$1,702	$1,036	$7,989	$1,300
30	$1,753	$1,068	$8,229	$1,255

Chairman JOHNSON. Thank you.
Mr. Barbolla.

STATEMENT OF PATRICK BARBOLLA, FIRST VICE PRESIDENT, RURAL RENTAL HOUSING ASSOCIATION OF TEXAS, INC., TEMPLE, TX

Mr. BARBOLLA. Chairman Johnson, Ranking Minority Member Coyne, and Members of the Committee, my name is Patrick Barbolla, and I am a developer of affordable rural multifamily housing from Fort Worth, Texas.

It is my pleasure to appear on behalf of the Rural Rental Housing Association of Texas, the country's largest State association dedicated to affordable rural rental housing.

In the interests of time, I would merely highly a few of the issues raised in our written statement. Low-income housing tax credits are necessary and vital for providing affordable rural housing.

Without the availability of tax credits, few if any affordable units would be produced in rural Texas. Without a permanent tax credit program, thousands of rural Americans are doomed to their existing conditions of substandard housing or homelessness.

Again, with the increasing demands for credits, we do have several suggestions to insure that rural America remains a part of this very successful program. Each State allocates tax credits according to an allocation plan.

According to legislative history, Congress intended that any allocation procedure give a balanced consideration to the low-income housing needs of the entire State. While most States have made provision for rural areas, we recommend that Congress specifically require that the rural areas of each State receive a reasonable allocation of credits based on low-income population, or some other measure, giving due consideration to the affordable housing needs of the entire State.

Next, affordable rural housing is extremely difficult to produce without coupling the tax credits with other financing sources, especially Federal. Texas has recently formally recognized this necessary coupling and set aside a portion of its rural credits for properties either to be constructed or rehabilitated with Federal financing. In prior years, many properties that had received a comment for Rural Housing Service financing had been unable to receive a tax credit allocation. section 42 should be amended to require a tax credit allocation to properties financed by RHS or other Federal rural affordable housing programs.

Such a requirement would be consistent with the preferential treatment given to federally assisted housing under section 42(d). Once a Federal agency commits to provide financing for a rural complex, it is counterproductive and inconsistent with the concept of a Federal/State partnership for a State to withhold Federal tax credits necessary for the project to be viable.

Next: in times of limited resources for affordable housing, the rehabilitation of existing units should be seriously considered as a means of stretching tax credits. Our association does not rec-

ommend that rehabilitation properties be given any preferential treatment over new construction, merely that rehabilitation, especially in rural areas, be placed on parity with new construction for tax credit allocations.

Rehabilitation, where appropriate, allows a greater number of units to remain in or become affordable housing. Unfortunately, there is an increasing trend among many States to prefer new construction over rehabilitation. At the same time, where rehabilitation may be allowed, there is a trend to prefer vacant complexes over occupied. It is more cost efficiency to rehabilitate a complex in the early years of its deterioration rather than wait until it is uninhabitable. Statutory direction should be given to the States precluding any preferential treatment of new construction over rehabilitation, or one form of rehabilitation over another.

Our association agrees with the advisability of periodic unit inspections, including the use of inspection reports conducted by local governmental agencies. In addition, the States should be authorized and encouraged to enter into memorandums of understanding with both RHS and HUD to receive physical inspection reports performed by such agencies. This would allow the States to fulfill their duties without undue burden or expense.

Development costs should be certified by an independent CPA. States should, however, coordinate the cost certification format with any Federal agency providing financing, in order to avoid unnecessary duplication of effort or expense.

Again, we must emphasize to the Subcommittee our desire and request that the tax credit program remain permanent, because it is the only way that we are going to provide affordable housing in rural areas.

I thank you for your time, and would be pleased to answer any questions that you have.

[The prepared statement follows:]

STATEMENT OF

RURAL RENTAL HOUSING ASSOCIATION OF TEXAS, INC.

before the

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS & MEANS

U.S. HOUSE OF REPRESENTATIVES

MAY 1, 1997

Chairman Johnson, Ranking Minority Member Coyne, and Members of the Subcommittee:

On behalf of the Rural Rental Housing Association of Texas, Inc. ("Association"), I am pleased to have the opportunity to comment on the effectiveness and administration of the low-income housing tax credit provisions of Section 42 of the Internal Revenue Code. The Association is the oldest (celebrating its 20th anniversary) and largest statewide association devoted to the development, management and preservation of affordable family and elderly rental housing in rural areas. Our membership is diverse and includes for profit developers, nonprofit developers, housing authorities, management companies, service providers, financial institutions, resident managers, and others interested in affordable rural housing. The Association's address is 417-C West Central, Temple, Texas 76501. The Association's membership represents over 790 apartment communities with over 27,890 affordable rental units financed by the Rural Housing Service ("RHS") in Texas. Thank you for permitting us to share our views.

My name is Patrick Barbolla, and I am the Association's vice-president and a rural multi-family housing developer from Fort Worth, Texas.

Severe Need for LIHTC in Rural Areas

In Texas, as in most if not all states, the low income housing tax credit program is a vital component in the preservation of, and new construction of, affordable rural multi-family housing. Section 42 is now a permanent provision of the Internal Revenue Code and must remain permanent. Without the availability of tax credits under Section 42, very few affordable multi-family housing units would have been rehabilitated, or constructed, in rural Texas since 1986.

Housing conditions in rural areas are generally worse than those in metropolitan areas. Rural areas suffer from a preponderance of substandard housing and a severe shortage in the stock of affordable housing. In 1991, 4.1 million rural households in the nation paid more than 30% of their income for housing. Of those, 1.6 million paid more than 50%. That same year, 18.7 percent of rural households had incomes below the poverty rate as compared to 12.6 percent of metropolitan households. Without the availability of low income housing tax credits, even more

rural households would remain highly rent overburdened or destined to remain in substandard conditions.

Effectiveness of LIHTC compared to Legislative Purpose.

Section 42 of the Code was intended to replace the untargeted and uncoordinated tax incentives of accelerated depreciation, five year amortization of rehabilitation expenditures, expensing of construction period interest and taxes, and tax-exempt bond financing for multifamily rental property. Joint Committee of Taxation, General Explanation of the Tax Reform Act of 1986 (H.R. 3838, 99th Congress; Public Law 99-514) [May 4, 1987] (hereinafter "Blue Book") at 152. The prior tax incentives neither targeted the units to low income tenants nor limited rents. Blue Book at 153. For example, the prior tax-exempt bond provisions allowed for a complex to be financed with tax-exempt bonds if only 20% of the residents had incomes below 80% of the median income.

Low income housing tax credits have succeeded in targeting tax incentives to low income tenants. This Association thanks Chairman Archer for his foresight in requesting the first truly comprehensive and independent analysis of the low income housing tax credit program. Without the General Accounting Office's Report "Tax Credit: Opportunities to Improve Oversight of the Low-Income Housing Program" (hereinafter "GAO Report"), there would be no independent empirical data to properly evaluate the program and its administration. The program's success is established by the fact that the average annual tenant household income was $13,300 with three-fourth's of qualifying households having incomes below 50% of the area median income. GAO Report at 38.

LIHTC Use in Rural Areas

Affordable multi-family housing is extremely difficult to produce in rural Texas without the coupling of low income housing tax credits with other financing, such as HOME financing, RHS loans under the §515 program, or RHS or other rental assistance programs. Likewise, Home financing, RHS loans under the §515 program, RHS or other rental assistance programs can not produce affordable multi-family housing unless coupled with the low income tax credit program. The availability of low income tax credits is a necessary part of the continued preservation and production of affordable multi-family housing in rural Texas.

In many areas of rural Texas, the median income levels are substantially lower than the urban counterparts. For example, a two-person household at 50% of median income in Dallas is $20,900 while a two-person household at 50% of median income in Maverick County is $12,600. These income limitations equate to a maximum rent plus utilities for a one bedroom unit in Dallas of $490 per month while the maximum rent plus utilities for a one bedroom unit in Maverick county will be $295 per month. Admittedly, there may be some cost savings in rural areas over urban areas, but in no way will the lower rural costs offset the lower maximum rent levels. The Association is aware of the suggestion that the maximum qualifying income levels for rural areas be changed from the county median income to the average statewide nonmetropolitan median income. We fully support this proposed revision, but one needs to be aware of its limited application. The problem in Texas, as well as the remainder of the country, is the lower income level of its rural population. Even raising the ceiling on the qualifying incomes and, correspondingly the maximum rent levels, the fact remains that the rural population is still far poorer than its urban counterpart. Since 1989, Texas statewide median income has risen from only $24,595 to $28,900 (a 17.6% increase), while the state's median incomes for metropolitan areas has risen from $33,231 to $40,800 (a 22.8% increase), evidence of the growing disparity between the urban and rural income levels. 1997 State of Texas Consolidated Low Income Housing Plan and Annual Report (Draft) [hereinafter "Texas Report"], p.13. The continued production of, and preservation of, affordable rural housing is far more dependent upon insuring that rural areas receive their fair share of the low income tax credits that are available than raising the qualifying income level of potential tenants..

Rural Areas Need a Fair Share of LIHTC

According to the legislative history of the low income housing tax credits, "Congress intended that any allocation procedure established by the governor or State legislature give a balanced consideration to the low-income housing needs of the entire State." Blue Book at 169. In Texas, the 1997 low income housing tax credit allocation plan creates a set-aside of 15% of the total low income housing tax credits for nonmetropolitan areas. While Texas' rural population is approximately 18.9% of its total population, the 15% set-aside is a fair allocation to rural areas considering the difficulties of developing affordable housing in rural areas and the lower costs associated with rural development. While many other states have also created rural set-asides, Congress could ensure this practice continues by requiring that all state allocation plans give a "balanced consideration to the housing needs of the entire State," even to the extent of requiring the creation of a rural set-aside.

Texas' 1997 allocation plan also created a sub category of the rural set-aside that should be a model for a statutory revision to Section 42. The Texas allocation plan sets aside 25% of the credits available to the nonmetropolitan areas for properties either to be constructed or rehabilitated with financing provided by the RHS under Section 515 of the Housing Act of 1949. In prior years, many properties that had received an obligation of fund commitment for RHS financing had been unable to receive an allocation of low income housing tax credits due to either a prejudice against rehabilitation or a failure to have various amenities such as covered parking or security gates at the entrances. Now, the Texas Department of Housing & Community Affairs has made the progressive and reasonable determination that an allocation of federal tax credits should be made to those properties deemed necessary and desirable for rural Texas by the Federal agency charged with the only housing program servicing rural areas. I would recommend to the Committee that serious consideration be given to also including a similar provision within Section 42 to require the allocation of tax credits to properties financed by the RHS and other federally financed rural affordable housing programs.

Such a requirement would be consistent with the preferential treatment of Section 42(d) of allowing the waiver of the ten-year holding period for Federally-assisted buildings. Since a Federal agency charged with providing financing for rural multi-family housing has determined that a particular project deserves being rehabilitated or constructed with federal financing, it would be inconsistent for a State to withhold the federal tax credits that are necessary in order for the project to be viable. Again it must be remembered that to serve the very low and low income families of rural Texas and the nation, it is necessary that tax credits be available to work in conjunction with the RHS program.

Rehabilitation should be placed on Parity with New Construction.

The GAO Report states that the average development cost per unit of properties with rehabilitation is $48,250 while those of new construction is $67,098. (page 133). In Texas, the Texas Department of Housing and Community Affairs conducted a survey of community leaders and officials on housing conditions and 69% of respondents expressed a major or critical need for "rehabilitation and repair of existing renter-occupied housing". Texas Report at 16. The Association believes that the conditions in Texas are similar to those of other states Admittedly, there are many rural areas in Texas and the country where new construction is the only feasible means of providing affordable multi-family housing. However, States should not be allowed to arbitrarily preclude the allocation of low income housing tax credits to properties involving rehabilitation.

In times of limited federal and state resources for affordable housing, the rehabilitation of existing units should be seriously considered as a means of spreading the limited tax credit resources farther. This can best be accomplished by placing rehabilitation on parity with new construction. This Association does not recommend that properties involving rehabilitation should be given any preferential treatment over new construction, merely that it be placed on parity with new construction especially in rural areas.

The increased use of rehabilitation, where appropriate, would be a cost containment measure and allow a greater number of absolute units to remain in, or return to, the stock of

affordable housing. It has come to the Association's attention that there is an increasing trend among the States to prefer new construction over rehabilitation. At the same time, where rehabilitation may be allowed, there is a trend to prefer complexes that are vacant, or almost vacant, to those in need of rehabilitation that still have residents. While it is laudable to rehabilitate vacant complexes, it is more cost efficient to rehabilitate a complex with residents for $10,000 per unit than wait until it is a derelict at a rehabilitation cost of $30,000 per unit. The Association recommends that statutory direction be given to the States that would preclude preferential treatment of new construction over rehabilitation, and of one form of rehabilitation over another.

Residents being served.

The GAO Report estimates that tax credit units are: (1) 6% efficiency apartments, (2) 35% one bedroom units, (3) 41% are two bedroom units, (4) 16% are three bedroom units, and (5) 1% are 4 bedroom units. GAO Report at 131. The Association believes that State allocating agencies and the developers are matching the use of tax credits units with the intended clientele quite well. In Texas, as in many other states, preference is given to providing units serving the elderly, the previously homeless, the disabled, and others with special needs. This preference is given because these groups are in the greatest need for affordable housing.

That 17% of the units surveyed are three or more bedrooms would appear to this Association as adequately fulfilling the need for larger type units. In Texas, the State wide average of occupants per rental unit is 2.55. Bureau of the Census, 1990 Census of Population and Housing - Summary Population and Housing Characteristics - Texas, 1990 CPH-1-45 at 323. Only 47 of the 254 counties in Texas had an average renter-occupied unit of three or more persons with none over 3.9. Id. at 323-325. Based on this empirical data, the States are giving adequate consideration to large families in allocating the low income tax credits.

Periodic unit inspections

The Association concurs with the advisability of having periodic unit inspections. The Association also concurs with, but would expand, the GAO Recommendation that "states could contact local governmental units to obtain information on building inspections that may have been done on the properties." GAO Report at 104. In addition to relying on local governmental reports, the States should also be authorized, and encouraged to, enter into Memorandums of Understanding with both the RHS and HUD to receive copies of any physical inspections performed on the units by such governmental entities. The statute should clearly state that the state agency may rely upon the physical findings of the other governmental entities and would not be required to conduct their own inspection. This would also be a "less costly or less burdensome" means to ensure the properties' conditions.

Independent verification of cost information

This Association concurs with the advisability of having independent verification of the development cost. This Association, however, is concerned about multiplicity of formats for cost certifications submitted to various agencies. For this reason, we recommend that Congress encourage the State agencies to enter Memorandums of Understanding with both RHS and HUD on the format of the cost certification information in order that developers are not required to bear unnecessary CPA costs due to different requirements.

Project Amenities

This Association is aware of the questions raised in this Committee's hearing on April 23, 1997 regarding the possibility of excess amenities in low income housing tax credit properties. Our Association is composed of properties that do not have swimming pools, tennis courts, covered parking, security gates with pass keys, or the like. Indeed, our member properties do not have garbage disposals or dish washers. Due to the low median income levels of rural Texas and the program requirements of RHS, amenities such as these are not economically

feasible. Our members, however, do provide safe, adequate and affordable housing to low and very low income families.

This Association, however, is opposed to any legislative change that would restrict the inclusion of amenities in a low income housing tax credit property. We believe that there may be market circumstances that require the inclusion of special amenities to avoid the property having leasing difficulties. However, we would not be opposed to a legislative change that would prohibit the State agencies from giving any preference to a property having such amenities. Such a prohibition would allow the developer to include any necessary items for a successful property, but, would control costs by not allowing the agencies to mandate the their inclusion in all properties by giving special "points" or "ranking preference".

Another area for the Committee's consideration is the special "points" or "ranking preference" given to properties that provide, directly or indirectly, what is commonly known as "supportive services" to the residents. Among these amenities are (1) ambulatory/outpatient medical care, (2) dental or medical care referrals, (3) home health care, (4) transportation for residents, (5) buddy/companion services, (6) on-site child care, (7) agreements for job training of residents, and (8) similar type services. Again, while activities such as these are laudable and should not be prohibited, the State agencies should be prohibited from giving the properties that offer such supportive services any preferential treatment. Activities such as these are costly to initiate and continue and have an indirect cost on the program, such as the developer needing a larger developer fee to even offer such amenities.

Increasing the $1.25 Per State Resident Amount of LIHTC

Each state is annually allowed to issue low income housing tax credits in an amount equal to $1.25 per resident. As the GAO Report confirms, there are a substantial number of entities that receive an allocation of low income housing tax credits that are unable to complete the project and use the tax credits. Due to this slippage, an increase in the cap from $1.25 to 1.50 would have a rather small budgetary impact due to substantially smaller existing use of the low income housing tax credits than previously predicted.

RHS Housing Reserve Funds

This Association would be remiss to its members without clarifying one aspect of the GAO Report. On page 71 of the GAO Report, it is said:

> "Some have questioned the economic viability of these projects as low-income housing after the tax credits expire. For example, several experts told us that in their view, the replacement reserves required by RHS will be insufficient to meet future needs for basic maintenance or rehabilitation. According to these experts, the tax credits properties and other multifamily properties financed with RHS loans will need to obtain additional subsidies if they are to remain high quality, affordable housing units."

The low income housing tax credit was initiated to replace the four short term tax incentives and the ill-targeted tax-exempt mortgage revenue bond program. It was never intended to provide affordable housing for an indefinite period of time. In Eagle Pass, Texas, the maximum rent that the credits authorize for a two-bedroom unit (including utility allowance) at 60% of median income is $424. This is quite different from the maximum rent for a similar unit in Fort Worth, Texas of $681. In Fort Worth, it is easier to increase today's rents to develop a capital improvement fund to rehabilitate the property in 15 or 20 years. But more importantly, the policy decision facing all low income housing tax credit properties -- is it fair and proper to force today's low income residents to pay a greater amount than is reasonable necessary for rent to handle potential future rehabilitation? There are probably less than 1% of all apartment complexes in the country today that have a sufficient reserve fund to handle all projected future capital improvements. This Association believes it is unfair to single out tax credits properties in general, and RHS properties in particular, for this criticism. RHS financed properties should have a reserve fund equal to 15% of the initial cost of the property at the end of the 15th year of

operation. While we know that this is a small amount considering the potential needs, we do know that it will be far greater, percentage wise, than many other properties, tax credit or otherwise.

Conclusion

The Rural Rental Housing Association of Texas, Inc. is committed to the production and preservation of affordable housing through the low income housing tax credit program that has served our nation's rural poor so well. We greatly appreciate your consideration of our views. We again thank Chairman Archer for requesting the GAO Report for it is only with independent empirical study can this Committee and Congress make truly reasoned decisions. The GAO should also be applauded for producing such a comprehensive study in such a short period. We thank the Committee for its willingness to consider programmatic improvements to Section 42. We look forward to continuing to work with this Subcommittee in the production of decent, safe and affordable housing through Section 42.

Chairman JOHNSON. Thank you.
Mr. Weiss.

STATEMENT OF STEVEN J. WEISS, CHAIRMAN, AFFORDABLE HOUSING GROUP, SAPERSTON & DAY, BUFFALO, NEW YORK

Mr. WEISS. Thank you, Madam Chairman, and distinguished Members of the Ways and Means Oversight Subcommittee. My name is Steven Weiss, and I'm an attorney with the law firm of Saperston & Day in Buffalo, New York. I am the chairman of our firm's affordable housing group, and my practice focuses on representing small to midsized developers and institutional investors and lenders in low-income housing tax credit transactions throughout New York and in other States.

I will summarize a couple of points from my written testimony in response to the GAO study.

First, most State agencies reserve discretion for overriding or bypassing the allocation process. The GAO report concluded that even though each State allocating agency has adopted a qualified allocation plan, for the allocation of Federal tax credits based on each State's housing priorities, most States reserve discretion to override or bypass the allocation process.

While GAO appears to approve the use of discretion in instances where target needs are missed during the allocation process, or to address needs resulting from unforeseen circumstances, GAO also states that unless the use of discretion by State allocating agencies is well documented and made public, the allocation process would be undermined and would lose credibility.

The State allocating agencies should have the flexibility to respond to their particular local needs by adopting qualified allocation plans that award tax credits on the basis of the State's housing priorities.

Such housing priorities should be well defined and communicated openly to potential applicants.

The use of discretion on the part of State allocating agencies to override or bypass the allocation process should be permitted on a

very limited basis, and should only be done with complete documentation and full disclosure.

Second, State allocating agencies give preference to projects that serve the lowest income tenants. The legislative history for section 42 of the Code indicates that the original intent of the tax credit program was to provide an incentive to developers and investors for the development and ownership of affordable rental housing for households whose income is that or below specified income levels.

The Code indicates that the specified income levels are 50 and 60 percent of the area median income in which a project is located. These individuals are deemed to be low income or the working poor. Since the GAO report concluded that about 75 percent of the households examined had incomes in 1996 that were less than 50 percent of their area median income, and that according to the standards established by HUD these households met HUD's definition of very low income, the question is whether the intended population is being served.

Based on the data reported by GAO, it would appear that very low-income households as opposed to low-income or working poor households are being served. If the tax credit program which was originally intended to serve the working poor is serving the very low income, then under what program will housing for the working poor be built?

In our view, this is another reason for expanding the tax credit program to provide for the original intended beneficiaries.

The third point is that the GAO reported that the State allocating agencies may distribute $1.25 in Federal credits per capita. The GAO reported that the amount of credit available to each State allocating agency is calculated by multiplying $1.25 per capita.

This approach effectively treats the rich and poor residents in each State equally, despite the fact that only residents whose income is less than or equal to 60 percent of the median income are eligible to participate in the tax credit program.

One technical suggestion would be to base the number of credits that a State may allocate on the population of individuals at or below 60 percent of the median income.

That way, if a State has a growing population of demand for affordable housing, the program will automatically provide such States with additional credits.

The GAO reported that overall about 54 percent of applicants were not successful in competing for credits in 1995. In addition, some States, like New York, are seeing as many as $10 in applications for each dollar in available tax credits.

Furthermore, since the intended population of working poor are not being served by the tax credit program, we are in favor of an increase in the inflation adjusted figure on which a State's allotment of credits is based.

This would permit States to address the excessive demand for credits, reserve an amount of credits for the original intended beneficiaries, the working poor, and continuing to providing housing for the very low-income households.

Thank you.

[The prepared statement and attachment follow:]

Testimony of Steven J. Weiss, Esq.

Before the Subcommittee on Oversight

Committee on Ways and Means

House of Representatives

May 1, 1997

Madam Chairman and Distinguished Members of the Ways and Means Oversight Subcommittee:

My name is Steven Weiss, and I am an attorney with the law firm of Saperston & Day, in Buffalo, New York. I am the Chairperson of our firm's Affordable Housing Group, and my practice focuses on representing small to mid-sized developers and institutional investors and lenders in Low-Income Housing Tax Credit transactions throughout New York State, and in other states.

I would like to thank this Committee not only for the opportunity to testify today regarding the Federal Low-Income Housing Tax Credit Program, but also for this Committee's strong support of the Tax Credit program since its enactment in 1986.

The majority of my statement today relates to Chapters Three and Four of the recently issued report of the General Accounting Office entitled *Tax Credits: Opportunities to Improve Oversight of the Low-Income Housing Program*.

Most State Agencies Reserve Discretion for Overriding or Bypassing the Allocation Process

The GAO report concluded that, even though each State Allocating Agency has adopted a qualified allocation plan for the allocation of the Federal Tax Credits based on each state's housing priorities, most states reserve discretion to override or bypass the allocation process. While GAO appears to approve the use of discretion in instances where target needs are missed during the allocation process or to address needs resulting from unforseen circumstances, such as a natural disaster, GAO also states that unless the use of discretion by State Allocating Agencies is "well documented" and "made public", the allocation process would be undermined and would lose credibility.

In our view, the use of discretion by State Allocating Agencies to override or bypass the allocation process should be permitted in very limited circumstances, and only with full disclosure and sufficient documentation to justify the states' actions. The use of discretion to override or bypass the allocation process should not be permitted to simply help some well healed contributor to the appropriate political party. The Federal government has entrusted the States to allocate Federal Tax Credits based on the general guidelines set forth in the Internal Revenue Code, and based on each state's specific housing priorities set forth in their qualified allocation plan. The states have a fiduciary responsibility to allocate the Federal Tax Credits responsibly and should be held accountable even for the slightest appearance of impropriety. If full disclosure and documentation of such activity is required, states will improve the perception of integrity and the credibility with which the allocation process is viewed.

GAO cites New York State's "elimination of a clause in its allocation plan giving the head of the agency the discretion to award over 20% of the annual allocation," as an example of one agency's "corrective action." However, in its place, New York's Qualified Allocation Plan states:

> "Notwithstanding the scoring system set forth above, DHCR reserves the right to deny any request for an allocation of credit irrespective of its point ranking, **if such request is inconsistent with the housing goals stated herein** and shall have the power to allocate credits to a project irrespective of its point ranking, if such intended allocation is: 1) in compliance with the [Internal Revenue] Code; 2) **in furtherance of the State's housing goals stated herein;** and 3) determined by the Commissioner to be in the interests of the citizens of the State of New York."

There are a few problems with the new language. When viewed in isolation, the GAO understandably concluded that the removal of the discretionary provision was a corrective action. However, when viewed in conjunction with the replacement language, the corrective value of this change is dubious. If read literally, the Commissioner now appears to have complete discretion to allocate the credits, whereas before, only 20% of New York's Tax Credits was subject to discretion.

Second, nowhere in New York's Qualified Allocation Plan are that state's housing goals clearly stated. The implementation of New York's Qualified Allocation Plan can only be successfully accomplished with precise definition of New York's housing goals.

Third, if the State's housing goals are clearly stated, and if each project is scored based on those housing goals, then a project could not simultaneously score well and be inconsistent with the State's housing goals. Similarly, a project scored competitively based on the state's housing goals should not need to be awarded Tax Credits on a discretionary basis.

The State Allocating Agencies should be given the flexibility to respond to their particular local needs by adopting Qualified Allocation Plans that award Tax Credits on the basis of the state's housing priorities. Such housing priorities should be well defined and communicated openly to potential applicants. The use of discretion on the part of State Allocating Agencies to override or bypass the allocation process should be permitted on a very limited basis, and should be done with complete documentation and full disclosure.

Tax Credits Allocated to Proposed Projects Exceeded the Tax Credits Awarded to Projects When Placed in Service

GAO reports that Tax Credits allocated to proposed projects exceeded the Tax Credits ultimately awarded to projects when the project was placed in service. This conclusion led GAO to question whether the State Allocating Agencies produced the housing that the Federal Government was prepared to fund, and also led GAO to suggest that states may not be fully using their tax credit allocations.

One possible explanation for the difference between the number of Tax Credits allocated and the number of Tax Credits awarded relates to the fluctuation of one of the two elements of the Tax Credit Calculation. The tax credit rates fluctuate based on the Applicable Federal Rates and are published monthly. A project's Eligible Basis, as determined by the Code, multiplied by the applicable tax credit rate results in the number of tax credits generated by the project for each of ten years.

The Code permits the tax credit rates to be "locked" (and therefore the amount of credits to be fixed) at one of two discrete points in time. In general, tax credit rates may be locked

either: a) upon the allocation of Tax Credits, or b) upon a project being placed in service. The time between allocation and placement in service may be twelve to fourteen months in most cases. In a period of declining interest rates, the amount of Tax Credits calculated at the time of allocation would likely be greater than the amount of Tax Credits calculated when the project is placed in service. For example, a project that applied for and was allocated Tax Credits in November, 1990 when the 70% present value credit rate was 9.13%, might have been place in service fourteen months later in January, 1992, when the tax credit rate was 8.70%. Assuming an Eligible Basis of $5,000,000, and assuming the rate was not locked at the time of allocation, the reduction in the rate would result in the annual Tax Credits at the time of allocation exceeding the annual Tax Credits at the time the project was placed in service, by $21,500 ($456,500 less $435,000) or $215,000 over the ten year Tax Credit period.

The GAO study looked at projects placed in service from 1992 through 1994. At the time such projects would have likely received an allocation of Tax Credits, assumed to be twelve to fourteen months prior, in most instances the corresponding tax credit rate was greater at the time of allocation than the tax credit rate twelve to fourteen months later when the project would have been placed in service. The attached Exhibit A is a chart matching the Tax Credit rates for the period studied by GAO. Except for the last few years, the Tax Credit rate at the time of allocation exceeds the Tax Credit rate when placed in service.

Permanence of the Tax Credit program, tremendous competition for Tax Credits, investor confidence in the Tax Credit program and in the developers, availability of investment money, and rising tax credit rates, have all led the Tax Credit Program to deliver more and more housing units. As these trends continue, the data would likely show that the State Allocating Agencies are producing the housing that the Federal Government is prepared to fund, and that the states are fully using their tax credit allocations.

State Allocating Agencies Give Preference to Projects That Serve the Lowest Income Tenants

The GAO report concluded that about 75% of the households examined had incomes in 1996 that were at or below 50% of their area's median income, and that according to the standards established by the Department of Housing and Urban Development, these households met HUD's definition of "very low income." GAO also concluded that 71% of the residents benefited directly and indirectly from other Federal housing assistance, aside from the Tax Credits.

There appears to be a direct correlation among a tenant's income, the rent amount, the project's ability to service debt, and the need for concessionary financing. The lower the income, the lower the rent, the less cash that is available to service debt, and the greater the need for concessionary financing.

By providing a preference to projects that serve the lowest income tenants, it should not be a surprise that a majority of the residents benefited directly and indirectly from other Federal housing assistance, aside from the Tax Credits. The problem relates to the lack of availability of concessionary financing and the resulting potential lack of quality of the units being built. If the pressure by the State Allocating Agencies to serve the lowest income tenants continues, at the same time that increasingly less concessionary financing is available, then the costs will necessarily begin to be reduced. At some point, the reduction in costs will result in a lower quality product being delivered. If the trend continues, the answer to Mr. Weller's question of the GAO last week as to whether the housing can survive beyond the life of the credits, will certainly be no.

The legislative history for Section 42 of the Code indicates that the original intent of the Tax Credit Program was to provide an incentive to developers and investors for the development and ownership of affordable rental housing for households whose income is at or below specified income levels. The Code indicates that the specified income levels are 50% and 60% of the area median income in which a project is located. These individuals are deemed to be "low-income" or the "working poor." Since the GAO report concluded that about 75% of the households examined had incomes in 1996 that were at or below 50% of their area's median income, and that according to the standards established by the Department of Housing and Urban Development, these households met HUD's definition of "very low income," the question is whether the intended population is being served. Based on the data reported by GAO, it would appear that very low-income households, as opposed to low-income or working poor households, are being served. If the Tax Credit program, which was originally intended to serve the working poor, is serving the "very low income," then under what program will housing for the working poor be built?

GAO Reported that State Allocation Agencies May Distribute $1.25 in Federal Tax Credits Per Capita

The GAO reported that the amount of credit available to each State Allocating Agency is calculated by multiplying $1.25 per capita. This approach effectively treats the rich and the poor residents in each state equally, despite the fact that only residents whose income is less than or equal to 60% of the Area Median Gross Income are eligible to participate in the Tax Credit Program. One technical suggestion would be to base the number of credits that a state may allocate on the population of individuals at or below 60% of the Area Median Gross Income. That way, if a state has a growing population of demand for affordable housing, the program will automatically provide such states with additional credits. In addition, states that have greater need for affordable housing based on their population's income distribution, would be given more assistance as compared with other states that have less need for affordable housing.

The GAO reported that overall, about 54% of applicants were not successful in competing for Tax Credits in 1995. In addition, some States like New York are seeing as many as $10 in applications for each $1 in available Tax Credits. Furthermore, since the intended population of working poor are not being served by the Tax Credit Program, we are in favor of an increase in the inflation adjusted figure on which a State's allotment of Tax Credits is based. This would permit States to address the excessive demand for Tax Credits, reserve an amount of Tax Credits for the original intended beneficiaries of the program, the working poor, and continue to provide housing for the very low-income households.

Madam Chairman, this concludes my statement. I would be pleased to answer any questions.

EXHIBIT A

Allocation Date:		Placed in Service Date:	
Nov., 1990	9.13%	Jan., 1992	8.70%
Dec., 1990	9.06%	Feb., 1992	8.61%
Jan., 1991	8.96%	Mar., 1992	8.68%
Feb., 1991	8.93%	April, 1992	8.75%
Mar., 1991	8.89%	May, 1992	8.77%
April, 1991	8.91%	June, 1992	8.76%
May, 1991	8.93%	July, 1992	8.72%
June, 1991	8.92%	Aug., 1992	8.65%
July, 1991	8.95%	Sept., 1992	8.55%
Aug., 1991	8.99%	Oct., 1992	8.50%
Sept., 1991	8.94%	Nov., 1992	8.49%
Oct., 1991	8.85%	Dec., 1992	8.59%
Nov., 1991	8.78%	Jan., 1993	8.60%
Dec., 1991	8.76%	Feb., 1993	8.57%
Jan., 1992	8.70%	Mar., 1993	8.51%
Feb., 1992	8.61%	April, 1993	8.40%
Mar., 1992	8.68%	May, 1993	8.40%
April, 1992	8.75%	June, 1993	8.38%
May, 1992	8.77%	July, 1993	8.42%
June, 1992	8.76%	Aug., 1993	8.37%
July, 1992	8.72%	Sept., 1993	8.36%
Aug., 1992	8.65%	Oct., 1993	8.27%
Sept., 1992	8.55%	Nov., 1993	8.26%
Oct., 1992	8.50%	Dec., 1993	8.30%
Nov., 1992	8.49%	Jan., 1994	8.36%
Dec., 1992	8.59%	Feb., 1994	8.37%
Jan., 1993	8.60%	Mar., 1994	8.37%
Feb., 1993	8.57%	April, 1994	8.48%
Mar., 1993	8.51%	May, 1994	8.60%
April, 1993	8.40%	June, 1994	8.70%
May, 1993	8.40%	July, 1994	8.68%
June, 1993	8.38%	Aug., 1994	8.73%
July, 1993	8.42%	Sept., 1994	8.73%
Aug., 1993	8.37%	Oct., 1994	8.74%
Sept., 1993	8.36%	Nov., 1994	8.82%
Oct., 1993	8.27%	Dec., 1994	8.89%

H:\116\AFFHOUSE\TESTIMON.GAO

Chairman JOHNSON. Thank you, Mr. Weiss, and I thank the panel for their testimony. I'd like to hear you address Ms. Hodel's comments a little more directly. There are suggestions in the GAO

report that the market studies be more independent, that they independent, that they not be done by developers who have an interest in the outcome.

As this program is permanent for a longer and longer period of time, and if we do expand it to reach more people, the issues she raises are very serious. And as we do more and more—as we get tougher and tougher about code standards, and lead paint removal and things like that, we make it almost impossible to rehabilitate an existing unit, and therefore preference the tax credit program toward new construction.

So looking at the larger picture, what she says is very serious. It's a very big problem. I don't how you see it in your experience, but I'd like to hear you answer it more directly. She deserves a more direct answer. The Subcommittee needs a more direct answer.

Mr. King.

Mr. KING. In Connecticut, we think in terms of best practices. A number of years ago, we established a process where any type of market study or appraisal must be performed by a company from a list of effective, verified quality firms. We established that list. We check them out. We monitor the quality of their work to make sure it's adequate for our needs.

We select them. The developer pays for them, but we select them, and we control the process. So the types of things that Ms. Hodel was alluding to which may be occurring in Arizona don't happen in Connecticut.

Chairman JOHNSON. Specifically, Mr. King, who analyzes the market to see whether there is a need? Does the State do it, in setting your plan? Does the developer do it? Who does the market study, and who evaluates whether it's real or not.

Because my belief is from what Ms. Hodel said if somebody had done that in her area, they would see that these units, because they were nicer for the same rent, were going to drain tenants.

Mr. KING. I understand and agree. In Connecticut we employ a three stage process. We start with the State's policies and priorities and extensive needs assessments. We use these to identify where the market needs affordable housing on a general basis.

We then establish a class system to categorize projects based on need. The projects which meet the greatest need receive an absolute priority for housing credits. Those towns which don't have rental housing and those cities which have the greatest need for the rehabilitation of their housing stock get the first priority for the credit. Credits are allocated in that this fashion, and if there is not a need for the credits, we don't allocate them in the community.

So in Connecticut housing credits are allocated on a comprehensive, ongoing basis, based on documented need determined in conjunction with the State agencies and the legislature. We prioritize the need of towns and housing markets for housing credit apartments. This is why in Connecticut we have a heavy emphasis for rehabilitation in the urban areas. This is our major documented need and this is why the credits are flowing there.

We have a preference and a priority need for special needs housing for the homeless and people with AIDS or mental disabilities. This is why the funds flow there.

We work very hard to determine up front that there is not the market competition with the housing developed solely by the private market. I would say that under past programs, when the housing tax benefits were not targeted and not administered directly by State agencies such as ours and not administered in the manner that the housing program is now. We did have some experience, actually in some communities in your district, where there was some unnecessary competition because of an overproduction of the supply of affordable or market rate rental housing. We had a couple of properties that got into trouble because of this. However those lessons have been learned. Those errors have been eliminated from the administration of the housing tax credit program.

After we have established the need for a particular type of rental housing in a particular market in general, we get down to the specifics on a particular project. To do this we conduct an intensive market study, following the process I indicated. We also determine the project's appraised value, factored in the market demand for the project.

We have actually not proceeded in cases where projects would have added to the rental stock and basically exacerbated the competition with the private sector.

So it's really an ongoing, multistage process to establish need and prevent inappropriate or unnecessary competition in the market. The control and the responsibility is a partnership between our quasi-independent agency, the private sector, and our State policy and housing planning and needs assessment agencies and the legislature.

Ms. HODEL. May I respond please?

Chairman JOHNSON. Yes.

Ms. HODEL. I have found that, in talking to the city council, that even if we decide that the city council picks the person that's going to take the survey, and the developer ends up paying for it—I've discussed this over 5 years now, trying to debate this—and let's say we do have an independent type of person to take the survey, then the second problem that we faced was the definition of comparable units.

For instance, I have a little seven unit apartment building. And the developer is going to come in with a big hundred unit apartment building, and surveyor is going to say, well, yours is too small. We're not going to include yours in the study, or we've seen what appraisers use as comparable units.

Are we going to include other affordable units, government subsidized units in the survey? Does the property have a manager, does it have a pool, does it have this, on and on and on. Trying to define comparables ends up leaving us, the small little guys out of it.

If you're going to compare all those amenities, and so forth, like the normal appraiser do, then you leave the little apartment owners that are spread out throughout this country out.

Chairman JOHNSON. May I get this straight? When the survey is done, because is requires looking at comparable units, that the units have to have comparable amenities?

Ms. HODEL. That's what they're saying. When an appraiser comes, I have seen it. I have seen the definition of what appraisers used for comparable units.

Chairman JOHNSON. I'll tell you, if that's true, we need to be clear about that. Because in most of the small communities there are no places with swimming pools. They didn't build them that way 10 years ago.

And the issue is not are there units of that rent that have dishwashers. The question is are there units of that rent, period.

Ms. HODEL. Thank you very much. I have argued that for the last 5 years. Thank you.

Chairman JOHNSON. Now, we do need to get this clear, and we will pursue this, but if any of you want to comment, you're welcome to.

Mr. KING. One followup comment. I am talking about whether there is a need for affordable housing in the area at that rent. That's the issue for us.

Chairman JOHNSON. And so you look at the rent for the space, not whether the space is comparable in the sense of quality and amenities.

Mr. KING. Correct. We don't want to build an apartment building down the road that has more luxurious amenities, and then have the people move out of the apartment here and move up the road. It's unconscionable to do that. CHFA has financed 18,000 rental housing units across the State. We would be undercutting ourselves financially if we did that. We have a vested, fiduciary interest in not letting that happen.

Chairman JOHNSON. Anyone else have any comment on this?

Mr. SWANK. Yes, if I may comment, Madam Chairman.

Chairman JOHNSON. Yes.

Mr. SWANK. Representing the development community here this morning, I would say that what I have found in our Subcommittee on low-income housing tax credit within NAHB, the developers that I know across this country, and have met with and do business with, and myself being a developer from the Midwest, the market study being ordered by the developer I think is imperative, because of the fact that we want to know what's in that particular market.

And if it's ordered by the State agency or ordered by the community, not necessarily will the same information be requested that we as the developers want to know.

We want to know several things: one, we want to know if what we're risking is, is the market there, and the market, when we go into a particular area, we want to know every community, whether it's six units in size or six hundred units in size. We want to know when it was built. We want to know the occupancy levels, not only now, but what the occupancy levels have been, and the trend of occupancy within that community.

If there's not a need, the development community typically will not go into that community.

I don't know what the lady down here was referring to earlier when she said that the market study isn't including the small properties. I don't know what happens in her State. I can only speak to the States that we work in, that developers that I know, and in

my testimony we have supported the GAO report asking for market studies by third parties.

And the third parties could come from a list supported by the State agency, of which we can select from, but certainly the development community with all the onerous responsibility they have for producing the housing, and for the rent up, and for the continuation of all the eligibility of all the residents in there, don't take that lightly.

And I think we're talking about one other issue, and that's quality of life. Just because an apartment community was built 40 years ago doesn't necessarily mean that it still has the same quality of life offered to the residents in that apartment community, as does one being built today.

But conversely, it can be the other way around. Many old apartments that have been rehabbed are much, much nicer than new ones we can build for the same price today.

Chairman JOHNSON. I do think it's difficult for us to get into the quality of life issue beyond sort of basic shelter concerns, and code compliance and stuff like that.

I want to recognize Mr. Cardin who has been able to join us.

Mr. CARDIN. Thank you, Madam Chairman. I appreciate you recognizing me out of order, so I can welcome Sister Nancy to our Committee room.

Bon Secours is a wonderful facility that we have in Baltimore, and I was very impressed by not only your leadership of Bon Secours but the statement that you have made that you're interested not only in the health of the individuals as far as their medical needs, but also the community at large.

And I think that speaks well for the priorities that you have brought. I am familiar with the work that you're doing on West Baltimore Street, on the renovation of the housing there. I know first hand that that could not be done without the low-income housing tax credit assistance.

And I would hope, I want to make clear that the statement that you have made is part of our record of how you and Baltimore have used the housing tax credits for partnerships to develop more affordable housing for the people of that community.

You are making a major difference in West Baltimore, and I just want you to know that we notice that, and very much appreciate your testimony today.

Sister GLYNN. Thank you, Congressman Cardin. And thank you for your continued support.

Chairman JOHNSON. We do have a vote going on. I am going to recognize Mr. Coyne.

Mr. COYNE. Thank you, Madam Chairman. Mr. King, I wonder if you could comment for us on the effectiveness of the program, if we revert to a stop and start permanency aspect of the program that existed before 1993.

What impediments does that put up relative to getting these projects going?

Mr. KING. Well, it takes a long time and some money for a developer to come up with an idea, development proposal, and application to respond to a particular housing need. Pull together the plans, make the investments, do the preparatory work.

So there's a lot of lead time required to develop housing. It could take a year or two, or more.

What we saw when the program was not permanent is that developers didn't pursue investing in the priority areas of housing need as much as the State of Connecticut would have liked.

In our State system we rank projects according to whether or not it is a class one, class two, class three priority project. If you ranked projects prior to 1993, we saw that the applications arrayed in a descending order of importance like a pyramid.

Also, we did not have a situation where we had more applications chasing credits than there were credits to allocate. Since permanence, in response to the priorities we have clearly established, we are seeing two to three times the applications coming in than credits are available. Also these applications are for projects which respond to the top priorities in the State of Connecticut; our class one needs.

For the last 2 years we have essentially been able to only fund the class one projects. This is because the development community knows that the credits are there, if they try to build the housing for the State's priorities. They know if they invest their time, energy and resources, they have a high probability of getting funded, as long as they comply with the housing credit program's rules.

The second thing we have seen since 1993 is that the credits have been leveraged very effectively. Prior to 1993, because of the uncertainties of the investment community about the continuity of the housing credit program, we were getting 50 cents on the dollar essentially for every dollar allocated of credits. Now we're getting over 70 cents on every dollar. The investment market has became extraordinarily effective and efficient because of the program's stability.

So, permanence has provided the program much bigger impact in terms of enabling us to reach the priority needs of the State. My concern is that without permanence, without that stability, the message to the development community and the investment community will be that you have greater risk, uncertainty. My concern is that without permanence the message to the public local and State agencies will be that you cannot count on and will not see the types of projects in the volume and of the quality and with the efficiency that we need to meet those pressing urban and other needs in Connecticut and in the Nation.

Mr. COYNE. Does any of the other panelists have a differing view of that relative to permanency? Thank you.

Chairman JOHNSON. I want to ask you—Mr. Weller went to vote, and he's coming back, so he'll continue while we go to vote. But I want to ask you the following question: on the data developed by the GAO, 43 percent of units are occupied by one person; 24 percent by two people.

This suggests a lot of this is elderly housing. Only 17 percent by 3 people, 11 percent by 4 people, 6 percent by 5 or more. In other words, almost 75 percent, at least 70 percent of this housing is occupied by one or two people.

Now, it is not my understanding as a Representative that that's the big need in our Nation. I'd have to say that. The States have been pretty good at senior housing and so on.

Why? I know, off the top, I'd say because this is easier housing to provide. It's easier to manage. When you're looking 15 years, you can assume upkeep. But this wasn't my idea of what we were doing here. Where are your priorities?

Mr. King.

Mr. KING. Well, in Connecticut, and I think it's also true across the country, there's a lot of use of the tax credit to build housing for populations with special needs. About one third of the credits allocated in the last 2 years in Connecticut went to people who were in transition, homeless, suffering from substance abuse, or other health problems.

Basically, we have learned that this type of development requires efficiencies or one bedroom apartment developments. So if you're pursuing a special needs population, which is a critical issue and housing need in most States, you should expect small units with few bedrooms, because that's the appropriate type of housing for that constituency.

In Connecticut it's one third of the units produced.

Chairman JOHNSON. But this is the biggest—this is an $18 billion program. And we now have 4 minutes left. So we may have to come back to this. But one more minute.

Mr. KING. The second explanation for this GAO finding is that a high proportion of the families, or 60 percent of the families in the country are seeking or require one or two bedrooms apartment situations. We have a high divorce rate. We have single family heads of household, mothers with children.

Chairman JOHNSON. So you would say that many of those two-person households are parent/child?

Mr. KING. Yes. That type of thing also partially explains the funding. Also, please note. The GAO study focused on the period 1992 to 1994. In 1995–96, you're seeing at least one third of the units funded through the housing credit program nationwide have three bedrooms or more. This proportion was also confirmed recently in Connecticut also.

Chairman JOHNSON. OK. I must go vote. When Mr. Weller comes back, he will pick up and go forward.

The other thing I think you need to think about, another question we need to get this panel to answer, is this issue of stacking of subsidies. And if we don't, we certainly will talk about it more with the next panel.

Seventy-one percent of these units have more than a low-income housing tax credit subsidy. Now, what does that say about how we're using public moneys to leverage unit availability?

So I'm going to excuse myself, and Mr. Weller will continue as soon as he returns. And if no one is back when he finishes his questions, he'll dismiss this panel and go on to the next one.

Thank you.

[Recess.]

Mr. WELLER [presiding]. We can resume the hearing here, while people are running to vote.

I want to direct my questions I think first to the private-sector representatives on the panel. You know, my community, I represent a very diverse district. The south suburbs of Chicago as well as the South Side of the city of Chicago. And many of these are

older communities, in need of affordable housing, as the area changes, and, of course, also grows.

But the low-income housing tax credit frankly initiated a just recently, we announced a public/private partnership between the private sector as well as the local community for redevelopment of Joliet Catholic High School, which currently, the former building, which is a historical building, in a community that's 85 percent Catholic, it's a project heavily supported by the community, but redeveloping Joliet Catholic High School for senior citizen housing, affordable housing project, overwhelmingly supported by the community, and greatly anticipated by community.

And I consider it to be one of the successes of the Low-Income Housing Tax Credit Program.

I would like, I think, initially to direct my first question to Mr. Swank, representing the homebuilders today.

It's been suggested in the past, and of course there was a successful effort in 1993 to make permanent the low-income housing tax credit and since that permanency was established some have suggested perhaps making it a temporary tax credit again, restoring the temporary status, sunsetting the tax credit.

And you alluded to that issue in your testimony. From your perspective as a private builder, as someone who invests in the construction of affordable housing, should the tax credit be sunsetted, what would be the impact from your point of view as a businessperson considering investing in affordable housing?

Mr. SWANK. I think there are a couple of main points that I would like to make. First of all, the uncertainty of the continuation of the permanency of the credit program would certainly make the private community look hard at continuing to invest in finding the properties, finding the locations, seeking out the qualified allocation plan to determine where the targeting was being done within the State that they were doing business in.

Our company happens to do business in the States of Illinois, Michigan and Indiana. If that were to become a sunset provision, where we only had 2 or 3 years left in the program, we would look at those qualified plans and determine the areas in which the States were targeting that.

Second, we would not go as far out as trying to determine 2 years from now where we'll be building at, and the process we have to go through on zoning, the acquisition or optioning of property, dealing with local advocates of housing, the local council people, and various groups of that nature in all the communities that we build in.

The third is the credit value itself. If you recall, in 1993, 1992, the credit value was somewhere around 46 to 51 cents. Once it was made permanent, and everyone got comfortable with that, all of a sudden the credit value now is up over 70 cents for every credit dollar.

So there's a larger bang for the dollar, if you will, because people have confidence in the credit, and the continuation of that credit. And the corporate community, that's the investment partners in most of these properties, I would fear would again revert back to a concern about what's going to happen, and the confidence in the government and what will happen with the credits that they buy,

and they may disappear and go to some other avenue for investment.

Mr. WELLER. You know, it's projected that the tax credits are responsible for about 95 percent of the affordable housing that was constructed and made available last year throughout the Nation, about 100,000 units resulted from the tax credit.

Do you have any idea, if it was sunsetted, say, 2 or 3 years from now, because of that lack of certainty, what impact that would have on the amount of units that might be produced?

Mr. SWANK. Congressman Weller, right now, if it were not for the low-income housing tax credit I dare say there would be less than 25 percent of that housing stock being built, because we'd be relying on CDBG funds, home funds and other avenues within the local communities and State communities without having the tax credit available.

And perhaps that percentage is much lower than 25 percent of what we're currently building.

Mr. WELLER. So you would project a 75-percent reduction.

Mr. SWANK. Yes.

Mr. WELLER. In the construction, in the amount of affordable housing that would be available in the future as a result of that?

Mr. SWANK. Yes.

Mr. WELLER. Mr. Haynsworth, as a syndicator, someone who puts together the financing package, when it comes to the potential for sunsetting the tax credit, changing the status of what currently is permanent, what do you see as the impact of that on those you call upon to make decisions on where to invest their dollars?

Mr. HAYNSWORTH. Well, what is happening in the investment marketplace is that investors come in, and then they get their fill of tax credits and they leave. And to give you an example of how long it took to educate investors when the program first started in 1987, we could not interest corporations in investing in this product. It took them 4 years before we did our first fund.

And it takes a lot of time, a lot of education, a lot of resources applied to understanding the program to get these investors interested.

And we need to recycle and find new investors at all times. For example, in our last fund, we had ten investors, seven of which were new investors to the program. Older investors lose interest, because either yields are going down or their yield thresholds have been exceeded.

So we have to find these new investors. You're not going to be able to find them, because they're just not going to spend the time and effort to understand the program in the event there is a sunset provision out there.

Mr. WELLER. Mr. Swank had indicated that from his perspective he could potentially see a 75 percent drop in the amount of affordable housing that would be produced as a result of the tax credit were it sunsetted, because of lack of certainty.

Would you agree with that figure?

Mr. HAYNSWORTH. Yes. I would think so. In fact, I would think it would be even more than that, because the credit program is really the driver of all affordable housing. And there's no other viable substitute that's out there.

Mr. WELLER. Let me ask if there are other members of the panel that would like to address the permanency. Mr. Barbolla, as a homebuilder in primarily rural areas, would you like to address this question?

Mr. BARBOLLA. I think it's tremendously important to rural areas to have the permanency of the program. Without tax credits, we could see in rural Texas probably a drop, 95 percent decrease in affordable rural housing in the rural areas of Texas.

And I might still be on the high side. We might still be able to produce 5 percent. Because there's an additional problem, I think, not only the ones they've mentioned about investors.

The people outside of Washington probably don't understand the message of permanency. But I remember back in 1986, if you take away, tell investors here that we're not going to have, the program is no longer going to be permanent, then investors get worried, wait a minute, I'm making an investment for dollars today for 10 years of tax credit.

What is going to keep government from taking away the tax credit 2 and 3 years away? There are many alternative investments. I think if we remove permanency, we're going to create a scare in the market, and the price is going to go down, and we're going to be able to create less units, even in this 2 or 3 year interim period, because of the uncertainty in the market.

So not only will a lack of permanency affect us 2 or 3 years from now, I think it may immediately affect us with the uncertainty in the marketplace.

Mr. WELLER. What do you think, from the rural perspective, about attracting those willing to invest in affordable housing in rural areas as compared to more urban areas? Is there a difference? Is it more difficult to attract private investors in the rural areas?

Mr. BARBOLLA. Basically I rely upon syndication firms, such as Boston Capital, Boston Financial, to find the investors for us. I know of very few developers in rural areas who go out and try to find their own investors. They all use syndication firms.

On actually what types of investors? I'm not sure. My recent properties, we've been using more corporate investors, looking at who actually signs off on the limited partnership agreement.

Mr. Haynsworth, maybe it would be better for you to address that from the syndication standpoint.

Mr. HAYNSWORTH. Is the question is it more difficult to raise capital for rural housing? Not necessarily. I mean, if you have a project that really is a good project, we will certainly invest in it. They are much smaller, and they're much less efficient, and they're sort of harder to find, so that there's less incentive to invest, truthfully, in a smaller project.

However, we're all seeking volume. We're trying to generate as much volume as possible. So we look at every particular project, and we've done many rural projects.

Mr. BARBOLLA. Mr. Weller, if I could go back to that issue. I didn't realize you were looking at how it affects rural developers. Some of our prices are lower, because if your average project is, say, 24 units, obviously a syndicator would rather do one 300 complex, or a 200 unit complex than do, what, ten 24 unit complexes.

There is an economy of scale with the larger complexes that are lost in the rural areas. So in a way, it is more costly for the syndicator to actually perform the deal. So our, quote, net price that we have equity available is lower.

Mr. WELLER. Mr. Weiss, do you have a comment on the permanency versus sunsetting, potential sunsetting of the tax credit on how it impacts?

Mr. WEISS. Yes, thank you. I would just add that from the developers perspective, the costs involved in developing a project are significant. And the time required is also very lengthy. So that the zoning process, getting the property under control, and all the predevelopment and preconstruction processes that take place are all very expensive.

And for a developer to have the confidence to continue to do this kind of development, and at the same time have the threat that the program will be sunsetted I think would drive developers away from this kind of development and into something else.

So part of it, I think, lies in how long the sunset period would be, but also just the mere threat of it would drive developers away from this.

Mr. WELLER. What is the turn around time? When someone decides to put together a project as proposed, going through the permitting process, the zoning, do you have a perspective about what amount of time it usually takes for a project to get from idea to actual construction and development and being made available?

Mr. WEISS. I would say, that it depends on the locality—but it's probably somewhere between 9 and 12 months.

But if you add on top of that the period for the application and approval process it could be as much as a year and a half. So it's a significant investment on the part of developers and an investment where the risk increases tremendously if the sunset is even threatened.

Mr. WELLER. Mr. Swank, do you agree with that period of time?

Mr. SWANK. Yes, I do. But I would expand that a little bit. I have had one go as far as 3 years through the zoning process before the ability to proceed status in the State that I was working in before I was even eligible to submit an application.

The application first round was not approved. The second round 5 months later it was approved. So that took approximately 9 months after the first application submittal, in addition to almost 20 months of zoning process.

It was almost 3 years before we could actually close and start construction.

Mr. WELLER. Thank you, Mr. Swank. I see our Chair has returned, and my time is basically up, my 5 minutes. But, Mr. King, as someone who administers the tax credit in your State, working with the syndicators and the developers and those who need affordable housing, particularly the working poor—permanency versus sunsetting.

How would that impact the development of affordable housing in Connecticut? Would you see continued development, or would you see a drop off, as some of the other panelists have suggested?

Mr. KING. I think you would see a drop off. I don't know the precise numbers, but it clearly would alter the quality and response

of the developing community to the priorities, the difficult priorities and problems facing Connecticut.

It's difficult to build the type of housing that is a priority in Connecticut. It takes a long lead time, and overcoming and facing a lot of risks. Developers, when you have the start and stop situation, like in the past, will not respond to our needs with the same level that they have since permanency.

Mr. WELLER. There's a need for affordable housing, and what I was—in comparing the period between 1987 and 1993, when it was stop and go, in 1993 it was made permanent. Did you see a significant difference in the interest of the private sector in investing in affordable housing as a result of that permanent status versus stop and go?

Mr. KING. Four to five times more interest since permanency.

Mr. WELLER. Thank you. I know my time is up. I want to thank the panel, and I'll turn the chair back over to the Chairman. Thank you.

Chairman JOHNSON. We do have to move on to the next panel, but I know you didn't discuss stacking of subsidies, and any thoughts you have on that—we'll talk about that with the next panel—but any thoughts you have on that, we'd like to hear from you.

I mean, we have to think about how many different subsidies from the public level, Federal and State does it take to make something affordable, and is that the best way to use that money? Or should we be focusing our dollars where one set of subsidies is sufficient to accomplish our goal, rather than a series of subsidies.

I can see how in special needs housing you might need a series, but I am concerned that it's very hard for us to document the power of the low-income housing tax credit, because 71 percent of the units have some additional subsidy, either section 8 rental, or rural housing, or State grants or something.

And we do not have from the GAO report good information about the depth of subsidy stacking over these projects, and therefore it's very hard to evaluate the public benefit. I ask you to think about that and get back to us on that, any of you who care to.

The other thing I would like to know—what I see in my hometown are a lot of owners of affordable units that would love to modernize their units. They can't afford to, and they can't let the building inspector come in, because if they do, there are little code violations and so on and so forth, and the rents can't take it.

And so they'll never get their money out of it if they put $5,000 into that building. And I think you ought to begin thinking about what is that consortium of small landlords in small cities that you could back to upgrade all of their properties, so there's a competitive equality here, but would address the neighborhood issue that the Sister is talking about, and that, frankly, all of us face at home.

In my hometown, we have a surplus of affordable units, but what we really need is to be able to upgrade those units. Those landlords can't even apply for lead paint removal money. Why? Because the building inspector will come in, and they'll have to do this to code and that to code, and if it gets over a certain amount of money they'll have to put an elevator in. This is hopeless.

If we're going to keep this out there as one of our most powerful tools for developing affordable housing, and high quality affordable housing, which it clearly does, you need to help us think through how do we help a consortium of landlords.

We did this in health care, remember. We got small businesses the right to get together so they could get into lower cost plans. Now, you have to start thinking about this. I know this is harder for people to invest in, because you can't oversee the project to make sure the construction is right, and make sure that over 15 years it's going to be well managed. I understand that.

But those are all solvable problems. So I leave you with that challenge, and with that thank you very much for your testimony. We really are compelled to go ahead to the next panel.

F. Barton Harvey, the chairman and chief executive officer of the Enterprise Foundation, Washington, DC; Benson Roberts, vice president for policy, Local Initiatives Support Corp. of Washington; Herb Collins, chairman of Boston Capital Corp.; Wilfred Cooper, chairman of WNC & Associates, Costa Mesa, California; Ron Platt, legislative director, McDermott, Will and Emery, Washington, DC; Herb Stevens, Peabody & Brown; Terry Lewis, former chairman of the National Cooperative Bank.

With that, I'd like to yield to Mr. Cardin.

Mr. CARDIN. Thank you, Madam Chairman. This seems to be my day for people from Baltimore. I want to welcome Bart Harvey. Mr. Harvey recently received an article in the Baltimore Magazine that is flattering and true.

We no longer have Jim Rouse that we can call upon for his visionary leadership in housing, but we have his disciple, Bart Harvey, and we are very appreciative of it.

The article starts with Bart Harvey gave up a life of privilege to follow Jim Rouse's vision of housing the poor. That's certainly been true. And then it says that Mr. Harvey is largely responsible for selling Congress on the Low-Income Housing Tax Credit Program.

Madam Chairman, we are very fortunate to have a person of Mr. Harvey's commitment and experience here, and I look forward to his testimony.

Chairman JOHNSON. Thank you, Mr. Cardin. I must say that Baltimore has a lot that is progressive in it, but you have an incredible Member of Congress, too.

Mr. Harvey.

STATEMENT OF F. BARTON HARVEY III, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, ENTERPRISE FOUNDATION, WASHINGTON, DC

Mr. HARVEY. Thank you, Madam Chairman and thank you very much, Congressman Cardin for those remarks, and to other Members of the Committee. I'm delighted to be testifying before you.

I follow in big footsteps, Jim Rouse's footsteps, who was the founder, with Patty Rouse, of the Enterprise Foundation.

And we have been involved in the low-income housing tax credit from its very start. In fact, we worked with Senator Packwood on it in 1986, when it was first being conceived.

The Enterprise Foundation, and LISC, have also developed the corporate market in the low-income housing tax credit. Let me just take 1 minute to explain what the Enterprise Foundation does.

It works in 153 cities with 700 nonprofit groups that are all providing the opportunity for decent, affordable housing, and a path up and out of poverty. And it's both of those. It's using housing as a platform to changing lives and putting people back into the mainstream.

We've invested over the last 15 years almost $2 billion in distressed inner-city areas through loans, through grants and principally through the use of the low-income housing tax credit. And we have further commitments on the tax credit to be invested of another $500 million. And they all come from corporations.

We were very deeply involved in the GAO report. The GAO came to us, asked us to share data. We don't have a lot of people. We have to raise funds ourselves, but we did commit over the past 2 years significant manpower and resources to make sure you had all of our data, that you saw the projects, the GAO saw the projects, and that there was a fair report.

And we think that the report that came back says this program works. And I'd like to just comment on a couple of the items.

And, Madam Chairman, you have wondered about the incomes served, which are well below the required number, and it's an average that's in the GAO report, of $13,300 of income for each household.

And I'm just speaking for the Enterprise Foundation and our use. That average is really two different populations that are being served by the Enterprise Foundation. The country is changing radically from a manufacturing base to a service base.

And over 30 percent of those employed in the country today make $8 an hour or less. Thirty percent of everyone employed, that's $20,000 or less annually. This low-income housing tax credit serves that population.

The other major population that we serve are those with special needs, those that were formerly homeless, those that were mentally ill but can independently live, those that have some other special need—frail elderly are a perfect example.

I was with Congressman Rangel at the opening of Gabriel House, and I wish all of you on this Committee could have been there, because it's an extraordinary program for recovering addicts to get back into the mainstream of life.

Representative Lazio was also to be there. Unfortunately, he was pulled away at the last minute to tour the parts of this country devastated by the flood.

But the comparable numbers for this special needs population in New York are $113,000 a year to put somebody into a psychiatric hospital. And we have people who have come out of psychiatric hospitals that can, with help, live in the community in a decent way.

If people don't get some place to live, $60,000 a year for jail right now. Those are the costs in New York, $20,000 a year for a shelter.

And for an overall cost, this GAO report of $60,000—that's 3 years of being in a shelter—you get provided a decent place to live, and outside help from other nonprofit agencies, and a helping hand to get back into the mainstream. That's 3 years of costs for a unit.

Let me also say how we administer this program. We go out and check our property every year. We have asset managers. We do not have a single default in everything that we've done, and that's by design, and that's because we also work in partnership with local governments and with banks and other investors in this program.

Another benefit that comes from the way that Enterprise works with this project is that the work is done through small contractors. We have high minority participation, participation by professionals who are the architects, who are doing the drawings, who are lawyers, and so forth, as well as small subcontractors that recycle this work back into communities and into the urban areas that so desperately need those jobs.

Let me just comment—I see the red light—and I'd like to comment on a couple of issues that you had about program efficiency. If you take the tax credit the way it comes in, which is over 10 years, and you were to discount it back using the Federal rate, saying it was as safe as buying a bond, that dollar would turn into 71 cents.

And right now the credit is getting 66 cents. It's up from that 53 cents. So if an investor says this inner-city holding for 15 years with penalties is riskier than a bond, you very quickly approach that 66 cents.

There's very little leakage from this program at the current time. It's become a very efficient program because it's been allowed to work competitively in the market.

As far as subsidy stacking goes, in most parts of the country the tax credit alone will not work in and of itself. Because you have capped rents and you have certain costs that you have to meet.

And so inevitably from local governments you will get another small layer of subsidy which is through the community development block grant or the home program or some other program to make it work. If you want to get to special needs population, you need larger subsidies, because you're really getting no payment back from that population, or very little payment back from that population.

Chairman JOHNSON. Thank you, Mr. Harvey. I'm sorry. We do have to try to stick with the lights, and then during the discussion——

Mr. HARVEY. Thank you. Can I just end with one last thing, which is to say that the GAO report which we worked so hard on—this is our life blood—has come out and given it very high marks, and any approach to sunset it would seem to be—would mystify us as far as what's coming out of it.

Chairman JOHNSON. Look, don't get all riled up about rumors. You know, this is a difficult time, and we are compelled as a legislative body to balance the budget, and we're going to do that.

There is no way—I think this is probably a sentiment shared on both sides of the aisle—there is no way that one cannot change the tax structure for 7 years, looking at the burden on families at this time.

So there will be tax cuts. In the course of that, working with Members, all of whom want to increase spending, and the President, who included a lot of increased spending in his budget, sometimes people say, "Look at all this that we have to do, we have to

cut taxes, we have to cut spending, we have to increase spending, and where is it all going to come from?"

So there are long lists of things. Any one of you who have followed our struggle to reform the R&D tax credit will know that we only got that extended 9 months. So there's a lot of things on the table.

We are keenly aware of the quality of this program, and the study has shown no big problems with it. There are changes that can be made. So let's stick to our business here, and our business is to see what went wrong with this program, what can be improved about it, how can it be more powerful, and then it has to be able to hold its own with competing interests. That's the way all programs have always had to do it.

It's the job of the members who support it and the advocates to make sure we hold our own.

So, it's not bad to have a rumor like that. Maybe all of you will realize this isn't going to be rolling off a log. Nothing is rolling off a log up here any more, not an appropriated program, not a tax expenditure program.

So fine, get out there. Now, let's go on.

Mr. HARVEY. Thank you.

[The prepared statement follows:]

Testimony of F. Barton Harvey III
Chairman of the Enterprise Foundation

Before the Subcommittee on Oversight
House Ways and Means Committee
May 1, 1997

Madame Chairman and Members of the Ways and Means Subcommittee:

Good morning. My name is Bart Harvey. I am the Chairman and CEO of The Enterprise Foundation and I am pleased to be here today to discuss the Low Income Housing Tax Credit (Housing Credit).

The Enterprise Foundation works with more than 700 nonprofit organizations nationwide to help develop decent affordable housing and expand the opportunities for low-income people to move up and out of poverty into the mainstream of American life. Launched in 1982 by Jim and Patty Rouse, Enterprise has raised and committed more than $2.1 billion in loans, grants, and equity for the development of 72,000 homes nationwide. The Foundation supports a variety of community revitalization initiatives, including affordable housing, public safety, building community and individual assets, and resident-led community transformation.

Through an Enterprise Foundation subsidiary, the Enterprise Social Investment Corporation (ESIC) we use the Housing Credit to raise equity capital from corporations for investment in affordable housing. The Housing Credit is our primary means of attracting capital to economically distressed neighborhoods. As one of the largest users of the Housing Credit nationwide, we are an enthusiastic supporter of the program and we are quite pleased to have participated in the General Accounting Office's (GAO) exhaustive study lasting nearly two years. We are pleased the GAO has found that this is a highly successful federal program that is achieving its public policy purpose.

We are proud -- and believe that the Members of the House Ways and Means Committee should be equally proud -- that the Housing Credit has proven to be an excellent example of a federal program that works. By providing a tax-based subsidy that is implemented at the local level, and that harnesses the discipline of the private sector, the Housing Credit is building economically sound, quality, affordable housing that is well-targeted to areas of the nation and to households in need of housing.

In the past, questions have been raised about this program, how it operates, the degree of government oversight, and whether it is performing as expected. We believe the GAO study should lay those concerns to rest. Of course no program, administered by over 50 separate state agencies and utilized by hundreds of organizations across the nation, can be expected to operate free of any problems. There are always ways to improve government programs. But the GAO report is a ringing affirmation of our belief that this program has operated well to fulfill its public policy objectives. Among other things, the GAO found:

- Although federal rules only require that tenants in Housing Credit property earn less than 60% of area median income, in actual operation the program serves families with even lower income, an average of 37% of area median income.

- About 40% of all families living in Housing Credit properties have incomes below 30% of area median, and more than three-quarters have incomes below 50% of area media income, HUD's definition of "very low income" households.

- For 1996, average annual income of households in Housing Credit property was about $13,300.

- Approximately 64% of all households occupying Housing Credit property are headed by women.

- Rents charged for Housing Credit units averaged between 13 and 23 percent lower than the maximum rent permitted for the program under federal rules.

- The average cost of developing the units placed-in-service between 1992 and 1994 was a quite reasonable $60,000.

- The present value of the average tax credit cost per unit over the 10-year period of tax benefits was about $27,300.

- Approximately two-thirds of the properties placed-in-service between 1992 and 1994 agreed to commit the property to tenant income and rent restrictions beyond the period required in federal law. In reviewing current state allocation plans, it appears that almost all properties are committing to longer term use restrictions today.

- The state housing finance agencies have taken their responsibilities very seriously. Though not required by federal law, states have developed voluntary "best practice" procedures for administering the Housing Credit, including limitations on developer and builder fees, which have generally enabled the states to harness market competition to maximize public purpose returns.

- In describing the Housing Credit properties it visited across the nation, GAO reported that "most properties appeared to be in good condition and well maintained" and that they overwhelmingly comply with statutory and regulatory requirements of the Housing Credit program.

That this program is operating so smoothly is no accident. Congress, through its two tax writing committees, designed the Housing Credit as part of the Tax Reform Act of 1986, based on what was learned about the deficiencies of past affordable housing subsidy programs. Previous incentives were open ended, poorly targeted tax subsidies that were susceptible to abuse and long term financial problems.

The Housing Credit was created to respond to those problems. It represents a new approach to subsidizing affordable housing based on the lessons we have learned from past failures. Compared with previous housing tax incentives, it is better targeted, provides housing for a longer term, is limited in volume, and is more closely monitored. Because it depends on investor capital rather than just direct government subsidies, the Housing Credit has imposed a market discipline that makes these housing investments fundamentally sound for the long term. It is a performance-based incentive, because investors can claim the tax benefits and earn their expected return only if the housing is built on schedule, and is occupied by qualified residents at restricted rents. As a result, investors assume significant risks and assert strict business discipline in selecting projects and overseeing their development and long-term operations. This oversight by investors takes place in addition to traditional government oversight by the state housing finance agencies and by other governmental entities that may also have subsidies in these properties.

This continual oversight and monitoring was probably one of the bigger surprises to GAO in its review of the program. Speaking for our investment subsidiary, ESIC, I can tell you that one of our highest priorities is to stay on top of these properties to make sure they operate as expected, because of our strong commitment to quality affordable housing, because of the valuable resource to the neighborhood that these projects provide and, because if they don't perform our investors will not receive the returns that we have promised them. Every year we raise hundreds of millions of dollars from corporate investors, and if we don't perform for them, we will not be in this industry very long. That is particularly true of Enterprise, which operates as a nonprofit organization, and it is

equally true of the for-profit investment firms which raise equity capital for the Housing Credit.

We use the program to serve low-income people and thus also feel a moral obligation to make these projects work for the involved tenants. Enterprise has virtually no defaults in its portfolio and believes it completely complies with all regulations. And this is exactly what GAO found in its study when it randomly selected 431 tenant files for review. According to GAO, it found "almost no evidence of ineligible tenant incomes or excessive rent charges. In all but four tenant case files at four different properties, tenant data showed that property managers consistently adhered to program monitoring requirements by gathering and verifying household income data."

Another feature of this program that sets it apart from previous affordable housing tax subsidies is the large role played by community-based, nonprofit organizations working closely with their local governments. Over the past decade, the nonprofit housing industry has expanded significantly, both in production capacity and in sophistication, largely because of the set-aside for nonprofits provided in federal law. According to GAO, about 22 percent of the housing properties they reviewed were developed by nonprofit sponsors. Based on National Council of State Housing Agencies' data, we believe that figure is closer to 30 percent today.

Nonprofit housing groups can be found in all 50 states and in urban and rural areas all across the nation. These locally-based organizations serve very poor households and are particularly sensitive to the unique needs of their neighborhoods. Their sustained commitment to the community makes them especially suited to undertake community development activities. In general, nonprofits have the flexibility to work in declining real estate markets, do small-scale housing development, and link social services to housing. Nonprofits have a different set of incentives and thus can do the work no one else wants to take on.

Our use of the Housing Credit, through local nonprofit organizations, has been particularly successful as a catalyst for community-based development and neighborhood revitalization. The Housing Credit is one of the few tools available to attract capital to economically depressed neighborhoods. And it has achieved remarkable results, bringing local governments together with community-based organizations and the corporate sector to help solve urban and rural problems by providing housing, creating jobs, and renewing neighborhoods.

The secret of our success has been to form partnerships with corporations, capable affordable housing developers, and state and local governments. These financing partnerships are long-lasting and extraordinarily successful because they engage the local community in a shared effort, not only to build affordable housing but also to revive neighborhoods. By working together, the efforts of the business community, local government and the nonprofit sector are better directed to producing quality, sustainable affordable housing that improves the physical environment of the community.

In a typical arrangement, Enterprise provides technical assistance to the local nonprofit in its development activities while our subsidiary, ESIC, arranges equity financing through the Housing Credit. These deals are structured so that after the initial 15 year period, the nonprofit developer takes back full ownership of the housing, subject, of course, to long term use restrictions that limit rents and require continued targeting to low income tenants.

What this is really about is the availability of capital, which is sometimes referred to as the lifeblood of capitalism. When you compare economically distressed neighborhoods to more healthy communities, a major difference is the availability of capital. One neighborhood has it, and the other does not. Sure, an economically distressed neighborhood includes households with lower incomes and that makes a big difference. But one of the things we are understanding today is that the people who live in declining neighborhoods still have significant purchasing power. What they lack is

access to outside capital, both equity and debt. And so, the residents have trouble raising the funds to restore their homes and build their businesses. Investors and banks simply will not come into a neighborhood that shows no outward signs of rejuvenation.

This is where the Housing Credit really makes a difference because what it accomplishes is the introduction of significant capital into lower income areas. The tax incentive brings in the equity capital from major investors. The introduction of this capital is a sign to lending institutions that the private sector has reviewed the housing investment and it is a relatively safe place to invest their debt capital. This enables Housing Credit properties to be built and produces signs of life in a distressed community. We have found that this new investment triggers other investments, whether it be homeowners or landlords fixing up their existing property, or individuals establishing small businesses with the help of lending institutions who see the neighborhood development that is taking place and are newly prepared to make loans.

One of our properties, which is featured in the GAO report, offers an excellent example of how the program works. The O'Hern House in Atlanta, Georgia is a converted shoe factory that now serves as a home for people with mental illness and others who were once homeless. Working together with Atlanta Neighborhood Development Partnership (ANDP), ESIC raised the equity for the O'Hern House project. The 76 single room occupancy apartments serve tenants with incomes below 40 percent of the area median income. The nonprofit sponsor, Project Interconnections, was formed in 1986 with the mission "to develop new housing alternatives for the homeless, mentally ill". Equity capital was raised from nine local corporations and two national investors while financing assistance was also provided by the city of Atlanta and the state of Georgia. O'Hern House brings stability to its residents. Men and women who once wandered the streets are now living in a safe and secure environment and regaining their health. And the restoration of a long-vacant building is helping to revitalize a once-declining neighborhood.

Another good example of how we use this program is Blake Street Homes in New Haven, Connecticut. This involved the construction of nine homes in New Haven's Beaver Hill neighborhood, for young single mothers and their children. The project consists of three duplex structures and one triplex structure containing five three-bedroom and four two-bedroom dwellings. The nonprofit developer, HOME, Inc., was established in 1987 to address local housing problems in New Haven. The HOME board includes a retired bank president, several local attorneys and other real estate and social service professionals. HOME, Inc. also provides property management services for assisted living developments in the neighborhood.

Before concluding my remarks I want to touch on a couple of issues that were raised in last week's hearing which I believe need to be clarified.

First, is the question of program efficiency. I understand concern was raised that the properties reviewed by the GAO show an average "price" paid by investors for tax credits of "only" 53 cents for every dollar of tax credit. Understandably, there has been some confusion about what this represents and whether the federal government is getting a good return on its investment. It must be understood, however, that what is being purchased is not a real dollar of tax credits, but the right to receive ten cents of tax credits a year for ten years. And as we all know, because of the time value of money, the promise to pay ten cents in the future is worth much less than the receipt of ten cents today.

With the Housing Credit, investors put their money into the project up-front in return for receiving tax benefits back over a ten year period. Using the federal discount rate, the value of receiving ten cents a year for ten years is worth about 71 cents today. That is what is referred to as the "present value" of the dollar of tax credits provided over ten years. This is what the investor is purchasing. For the properties studied by GAO, which were placed in service during the 1992 to 1994 period, and thus probably received allocations from 1990 to 1992, the average "price" investors paid for the 71 cents of

present value tax benefits was 53 cents. However, since the program became permanent in 1993, investor yields have gone down considerably so that in today's market, investors are typically paying about 66 cents up-front for the 71 "present value" cents of tax credit benefits. We believe that is a highly efficient way of bringing equity capital into affordable housing. And remember, in return for this investment, investors are providing valuable services to the government by underwriting the feasibility of the project and managing the risk of nonperformance.

Second, is the question of comparing the cost of this project-based subsidy program to a rental subsidy program. Suggestions were made last week that the Housing Credit may not be as cost-efficient as housing vouchers. That is not necessarily true and the programs are not really comparable on that basis. The two forms of government assistance serve quite different purposes. Housing Credits are project-based subsidies designed to increase the supply of affordable housing, while rental vouchers are operating subsidies designed to make rents affordable.

Both programs – one dealing with supply, the other dealing with affordability -- have important roles as part of overall federal housing policy. But they are not substitutes for each other. Vouchers do not create housing or rebuild neighborhoods. And in many areas, a voucher is of no use where decent housing is not available. That is why a significant percentage of HUD vouchers are returned each year. Furthermore, vouchers cost far more than the $100 per month suggested in last week's hearing, and Housing Credits supply affordable housing for at least twice the 15 years cited at the hearing.

Let me conclude by saying that any attempt to curtail this program would have profound effects on the affordable, multifamily market. This program is the cornerstone of over 90 percent of all the newly produced, affordable stock. Nonprofits use the Housing Credit to reach very low-income people, families and those with special needs in their communities which helps to account for the GAO findings. Over the past ten years, Enterprise has helped nonprofit groups use this program as a central part of their housing programs. Quite simply, there are no substitutes. As you know, HUD's budget is being severely impacted and is targeted to be so for the next five years. I have heard, to my disbelief, discussion of the merit of a "substitute HUD voucher program" for the Housing Credit program. This rings hollow. Given the intense cuts in new vouchers and the re-negotiation of project-based Section 8 under mark-to-market, such a program could not achieve the goal of creating new rental stock. Furthermore, why would one want to design a new program? This one works. It ought to be increased.

That concludes my remarks. I would be happy to respond to any questions the Subcommittee may have.

Chairman JOHNSON. Mr. Roberts.

STATEMENT OF BENSON F. ROBERTS, VICE PRESIDENT FOR POLICY, LOCAL INITIATIVES SUPPORT CORP., WASHINGTON, DC

Mr. ROBERTS. Thank you, Madam Chairman. My name is Benson Roberts, and I'm vice president for policy at the Local Initiatives Support Corp. LISC is a national nonprofit that brings private capital to the revival of low-income neighborhoods and distressed rural areas as well.

We work exclusively through nonprofit community organizations, governed by the residents of those communities, with a broad rebuilding strategy that includes not only housing, but also employment, crime reduction, child care and a range of other community needs as well.

We've been in business about 17 years now. We operate in 37 parts of the country, including Connecticut, and we are about to establish a program in Western Pennsylvania.

Our affiliate, the National Equity Fund, has been the largest user of the low-income housing tax credit, over the 10 years of its existence—about $2 billion we have raised from about 130 corporations, many of them Fortune 500 corporations.

And we provide about $350–$400 million of equity through these community organizations a year.

Let me give you a sense of the kinds of projects these are. These are overwhelmingly urban projects, about 90 percent, and 85 percent of them are in low-income neighborhoods. They are very much like the Whispering Pines project that Congressman Metcalf described, and the Nelson Street project in Hartford that I believe you may have visited recently.

This is housing that's intended to rebuild the community.

We stress the importance of long-term management of these properties, so that they continue to be strong assets for the community. We work very hard to build the capacity of the community sponsors in this process. Unless this housing works for the long term, it serves no one's interest.

And we're very pleased, by the way, that that is happening. We believe the credit, in fact, is fueling a remarkable revival in urban neighborhoods around the country. Not yet widely recognized, but along with the many devastated neighborhoods, a surprising number are really coming back now.

They've got an increased tax base, lower crime, greater reinvestment all around. And the housing credit is stimulating those other effects. Last week David Broder had a column on this in Chicago.

GAO's findings were not terribly surprising to us, because of the way the credit is designed. It's designed to promote the right kind of behavior by all participants in the process.

Very briefly, pay for performance: because the credit is a pay for performance program, everyone in the process has to make sure that the program delivers. That is the most important single element, and you just can't do that with a spending program, as important as spending programs are, and we do support them.

That's not something that can be done outside the Tax Code.

Second, flexibility. Responsiveness to local needs is one of the great hallmarks of this program. It helps develop apartments, single family homes, town homes, facilities for the formerly homeless and the disabled, and the like.

It also provides a bridge to home ownership. In places like Cleveland and the Twin Cities, the credit has been used to really help move tenants into home ownership.

State administration has been a very important part of this process. The States do an outstanding job on the whole, and we certainly believe they do a much finer job than a Federal agency could.

But most important, again, it's the right incentives. The sponsors, in order to win allocations, must address State priorities. Investors must provide as much equity as possible in order to win the right to participate in the housing development.

Everybody's got to build and operate this housing on time. They have to build it well. They have to build it to last. They have to operate it responsibly, or the investors aren't going to be able to get their credits. You have to keep qualified tenants in place, at qualified rents, or, again, you don't get the flow of credits.

So the government doesn't pay for failure here. It only pays for success. That's unique.

Just very briefly, on the importance of permanent status, I agree with the comments made in the last panel. Permanence has encouraged everybody to invest more in this program, not just invest more dollars, but invest in the systems that are going to keep the program strong.

The efficiency has gone up because of permanency, and I think it goes without saying that if there were any disruption, for any reason, in this program, it would be less efficient. And I think the industry as a whole would believe that there would be no chance that the program would come back, were any sunset established.

Thank you.

[The prepared statement and attachment follow:]

Testimony of Benson F. Roberts

Good morning, Madame Chairwoman. My name is Benson Roberts. I am Vice President for Policy of Local Initiatives Support Corporation. With me today is Mary Tingerthal, President and Chief Operating Officer of our affiliate, the National Equity Fund. LISC is a national nonprofit organization that brings private sector involvement to low-income community revitalization. Our affiliate, NEF, has been the nation's largest syndicator of Low Income Housing Tax Credits, raising $350 - $400 million annually.

A New Stability for Low-Income Neighborhoods

The Housing Credit has fueled a remarkable if unheralded wave of low-income community revitalization. Indeed, stability is returning to some of this country's toughest inner-city neighborhoods. The idea that these neighborhoods might be salvageable is potentially of great national significance, because it means that America has begun to find a way to confront one of its most serious problems. While there are many, many low-income neighborhoods in deep trouble, there are others with enough revitalization activity to establish substantial, sustainable progress. Most of these reviving neighborhoods are still poor and face numerous hurdles, but the evidence of regeneration is unmistakable: population has stabilized; physical conditions are much improved; crime is down; civic engagement is greater; bank lending and property values have increased; and public services are more responsive. A renewed sense of hope, pride and responsibility is spreading in the inner-city.

Nonprofit community groups formed by churches, civic associations, and ordinary residents have led most of the serious neighborhood revitalization efforts. Government and the private sector have become critical partners and undertaken subsequent activities, but neighborhood organizations have usually taken the first initiative.

Nationwide, these community development corporations (CDCs) have produced hundreds of thousands of affordable homes, and some have invested in commercial enterprises, or are involved in anti-crime, child care, job training, health care and other activities. Equally important, community groups have brought residents together with the private sector and government to create a new sense of hope for neighborhoods that the popular press and most other outsiders usually write off as irretrievable.

CDCs succeed in so many diverse places because they embrace mainstream American values. We believe CDCs have been ahead of many of the emerging changes in federal policy.

- **Self Help.** CDCs are vehicles that community residents create to take responsibility for improving their neighborhoods and enforcing pro-social behavior.

- **Community Building.** CDCs bring people together, reinforce the social fabric, and bolster community institutions from churches to little leagues. Their mission to rebuild communities physically, economically and socially transcends housing or any other single issue.

- **Local Control.** CDCs bring decision making down to the neighborhood level, where it is closest to the people. CDCs work well with city and state officials.

- **Partnership.** CDCs are pragmatic and collaborative, not confrontational. They recognize that no single organization can revive a neighborhood alone. CDCs, government, and the private sector -- lenders, investors, property owners, developers, businesses, foundations, and others -- all contribute to and benefit from community development activities.

- **Investment.** The only long-term, sustainable way to revive low-income communities is through investment, private as well as public. A principal function of public investment is to stimulate private investment, create healthy, functioning markets, and to connect isolated, distressed communities to the economic mainstream.

- **Tangible Results.** This is perhaps the most important and distinguishing characteristic of CDCs. The visible results of community development, such as housing and retail development, are verifiable proof that community development works. Less tangible outcomes -- greater community cohesiveness, new relationships with public and private institutions, stronger community leadership, and a new sense of hope and progress -- are undeniably important, but it is CDCs' tangible results that set them apart from many other efforts and impart credibility to claims of less visible outcomes.

From a public policy perspective, CDCs are an outstanding vehicle for using the Housing Credit.

- No one has a greater stake in the housing than its residents and neighbors. Because CDCs are directly accountable to the community, the housing is designed, built and operated to maximize its benefit to the tenants and the neighborhood.

- As public purpose, charitable organizations, CDCs are naturally motivated to maximize public benefits, such as long-term affordability.

- CDCs' performance in using the Credit has been exemplary. A visit to a CDC neighborhood is usually compelling. The media have frequently praised the way CDCs use the Housing Credit. Just last week, David Broder reported that "The folks who are spearheading these efforts are inspirational." [Washington Post, April 23, 1997] Broder also noted that "LISC and its affiliated National Equity Fund are the financial lifeline for many of these efforts." Last August Ted Koppel devoted an entire Nightline to the work of CDCs in reviving the South Bronx.

- Most important, communities matter. For too long, federal housing policy seemed to treat low-income housing as a commodity rather than as part of a community. CDCs are helping to change this mistaken approach.

  ⇒ If a goal of housing policy is to maximize housing opportunity, then it is essential to preserve the neighborhoods where low-income people live, mostly unsubsidized in private housing. Otherwise, we will lose far more affordable housing to disinvestment and abandonment than federal subsidies can hope to replace.

  ⇒ Neighborhoods, good and bad, exert a strong influence on individual behavior. If a tough neighborhood makes it hard to raise a family, then it is crucial to strengthen the neighborhoods to strengthen families. The Housing Credit has helped to do just that.

  ⇒ Cities cannot be strong unless their residential neighborhoods are stable. Numerous mayors support the Housing Credit because they

have seen it stabilize neighborhoods, bolster the local tax base, spur reinvestment, and create jobs.

⇒ The suburbs too have a stake in healthy urban neighborhoods. These are the neighborhoods where many of the entire region's low wage workers live. Neighborhood decay destabilizes this work force, and undermines the region's ability to attract outside business.

The Role of LISC and NEF

LISC was created 17 years ago as a nonprofit organization to enable the private sector to assist CDCs in their efforts to transform distressed neighborhoods into healthy communities. LISC operates with the convictions that: community regeneration must come from within the community itself; that government at all levels, the private sector, and community residents all have critical roles to play and must work together as active partners; and that CDCs are the most effective agents for fighting poverty in the most distressed communities in the United States.

Our first name is "Local." We are a constellation of 37 local programs nationwide, serving over 100 cities and urban counties. Funds raised locally are matched by national LISC on a formula basis. Each LISC program is served by local staff and governed by a local advisory committee. In addition, in November 1995, we began a new Rural LISC program to invest $300 million through 68 rural CDCs nationwide.

We believe that engaging the private sector is essential to the community development process. Private involvement is not a substitute for governmental funding, and public funds are necessary to make private investment feasible. But community development requires that isolated neighborhoods join the economic mainstream. Not only is the active involvement of the private sector necessary to community development, but business leaders genuinely want to participate. It is our job -- and, we would assert, the government's job as well -- to create opportunities for them to do so.

Our primary focus has been to build the financial and technical capacity of CDCs to sponsor housing and commercial development projects. We provide project financing and technical support to CDCs: grants, loans, recoverable grants, equity investments and loan guarantees for project development, operating support, and up-front predevelopment costs. Since 1979, LISC has provided $2.2 billion in grants, loans and equity investment to over 1,400 CDCs nationwide. The funds have, in turn, leveraged an additional $3.1 billion in financing to build or rehabilitate over 68,000 homes and apartments and create $9.6 million square feet of commercial and industrial space. We provided $481 million in grants, loans, and investments to CDCs in 1996 alone.

LISC has also expanded the scope of our support for the wide range of activities undertaken by CDCs including social community development, and a wider range of economic development activities.

Since its founding in 1987, LISC's National Equity Fund has raised nearly $2 billion in investments from over 130 corporate partners, many of them Fortune 500 companies. NEF's equity is financing 37,700 rental homes in nearly 700 developments sponsored by more than 300 CDCs in 120 cities and towns nationwide.

- About 90 percent of NEF's projects are urban, and 85% are in low-income census tracts.

- About 70 percent involve rehabilitation and 30 percent new construction, although the mix varies considerably by region.

- In terms of project size: 19% have fewer than 20 units; 45% have 20 - 49 units, 27% have 50 - 99 units; and 9% have 100 units or more.

- Excluding special needs housing for the homeless and disabled: 30 percent of the units have zero or one bedroom(s); 44% have two bedrooms; and 26% have three or four bedrooms.

Effective asset management is key to NEF's success. From the first discussion of a new project, long-term financial and physical health of the project are primary concerns. The asset management approach starts with investment decisions which include careful evaluation of each project's operating costs and replacement needs. This approach continues as the project matures through NEF's sharing of operating benchmarks and technical assistance with project sponsors. Additionally, NEF works with the project sponsor to develop an Annual Plan which designs an activity and budgeting strategy for the coming year with an eye to long-range needs for the project.

Our Annual Plan program -- which is designed to bolster the asset-management capacity of our community partners -- has earned us a reputation for close oversight and proactive intervention. To complement our Annual Plan program, LISC, in collaboration with NEF, has developed an organizational development program aimed at improving the performance of CDCs as owners and managers.

The Housing Credit's Performance

The GAO report confirms by thorough research what we have learned from our own experience -- that the Housing Credit is working extremely well, housing people in need. When the Housing Credit was created in 1986, we were optimistic that it would not just produce affordable housing, but also spark the revival of distressed urban neighborhoods and isolated rural communities.

Frankly, Madame Chairwoman, the Housing Credit has done better than even we had dared to dream a decade ago. It has brought the private sector's business discipline to the mission of low-income housing and community revitalization. It has been flexible enough to accommodate a very wide range of housing, from apartment buildings to townhouses to single family homes to residential hotels for the formerly homeless. Administration by the states has kept the Housing Credit free of federal bureaucracy. And permanent status in 1993 attracted many new investors, thus increasing the efficiency of the subsidy to an unprecedented level.

Let me highlight some of the GAO's findings that underscore just how successful the Housing Credit has been.

- Although federal rules only require that tenants in Housing Credit property earn less than 60% of area median income, in actual operation the program serves families with even lower income, an average of 37% of area median income.

- About 40% of all families living in Housing Credit properties have incomes below 30% of area median, and more than three-quarters have incomes below 50% of area media income, HUD's definition of "very low income" households. For 1996, average annual income of households in Housing Credit property was about $13,300.

- Approximately 64% of all households occupying Housing Credit property are headed by women.

- About half of all units are located in urban areas, and about a quarter each in rural and suburban areas.

- Rents charged for Housing Credit units averaged between 13 and 23 percent lower than the maximum rent permitted for the program under federal rules. The average cost of developing the units placed in service between 1992 and 1994 was about $60,000.

- The present value of the average Housing Credit cost per unit over the 10-year period of tax benefits was about $27,300.

- Approximately two-thirds of the properties placed in service between 1992 and 1994 were committed to tenant income and rent restrictions beyond the period required in federal law. In reviewing current state allocation plans, it appears that even more properties are committing to longer term use restrictions today.

- In a review of 253 project tax returns that had been awarded a total of $83.3 million in Housing Credits, the GAO found only three projects that had overreported tax credits, in total by less than $50,000.

- In a sample match of Housing Credits awarded to projects compared to the tax returns of owners, GAO reports that it found little noncompliance.

- Of the 431 tenant files reviewed by GAO, it found "almost no evidence of ineligible tenant incomes or excessive rent charges. In all but four tenant case files at four different properties, tenant data showed that property managers consistently adhered to program monitoring requirements by gathering and verifying household income data."

- The state housing finance agencies have taken their responsibilities very seriously. Though not required by federal law, states have developed voluntary "best practice" procedures for administering the Housing Credit, including limitations on developer and builder fees, which have generally enabled the states to harness market competition to maximize public purpose returns.

- In describing the Housing Credit properties it visited across the nation, GAO reported that "all properties appeared to be in good condition and well maintained" and that they overwhelmingly comply with statutory and regulatory requirements of the Housing Credit program.

A Sound Policy Design

These results are no accident, but the product of sound policy design. The Housing Credit's initial structure, as well as important refinements enacted in 1989, were consciously intended to maximize public benefits and minimize public costs. Among the most important design elements are the following:

- **Pay for Performance**. The Housing Credit harnesses the business discipline of the private sector because investors receive tax benefits only if the housing performs as promised. Although grants and low-rate loans are also important housing policy tools, they cannot provide the same discipline. There are virtually no project-based rental or operating subsidies available to shield this housing from the local housing market, so rents must be set right and operating costs controlled. The pay-for-performance structure and exposure to market forces give housing sponsors and investors every reason to design, finance, and operate the housing soundly. Moreover, the federal government does not have to pay for failed housing.

- **State Administration.** States are closer to local communities than federal agencies. The states have done an outstanding job in assessing local needs, selecting projects, underwriting the Housing Credit, and overseeing projects during and after construction. Moreover, the states have been able to adjust their policies and administrative practices as the Housing Credit has matured and local conditions have changed.

- **Incentives for Efficiency.** The Housing Credit is structured to maximize efficiency, by aligning the public interest with the interests of sponsors and investors. The Housing Credit is a scarce resource for which demand far exceeds availability.

  ⇒ Prospective sponsors must address state priorities to win allocations. For example, the GAO found that even among projects placed in service 1992-1994 -- virtually all with allocations made before the Housing Credit became permanent in 1993 -- two-thirds had committed to at least 30 years of low-income occupancy, and that share is even higher today.

  ⇒ Investors must compete to participate in Housing Credit housing. Sponsors, the states and certainly the government want to maximize the amount of investment per Housing Credit dollar. Because competition has increased among investors, they are now investing 66 cents today for the right to receive a dollar of Housing Credits over 10 years with a discounted value today of 70 - 71 cents. As discussed in greater detail below, this represents a very high degree of efficiency.

  ⇒ Investors, developers and states work together to manage development and operating risk. Inherently riskier developments -- such as inner-city rehabilitations -- require special risk mitigation techniques to ensure the likelihood of success that investors demand. The performance of LISC's National Equity Fund shows that risk can indeed be managed prudently.

  ⇒ The Housing Credit system promotes ongoing compliance because the threat of recapture is a powerful motivator. Again, the private sector plays an aggressive self-enforcement role, so compliance is not just a governmental concern. We and other private investment organizations provide training and active monitoring to ensure that housing sponsors understand and fulfill their compliance responsibilities.

  ⇒ The long-term physical and financial stability of the housing is encouraged in several ways. First, the threat of recapture has a powerful influence for the first 15 years. Second, in order to succeed for even 15 years, the property must in the first place be properly designed, built, financed, and maintained, thus preparing it for longer-term service. A well structured development is good business worth maintaining. If the housing is poorly maintained, it will operate inefficiently and fail to retain tenants, triggering recapture and financial failure. The investors, sponsors, and lenders are exposed to this risk. Third, LISC's National Equity Fund provides extensive monitoring, training and technical assistance to ensure that properties remain both physically and financially sound over the long term. Our community group partners recognize that good asset management is essential to their community revitalization and housing missions. Moreover, these community partners have a contractual right-of-first-refusal to acquire the housing after 15 years, so their expectation of eventual ownership is another incentive for sound stewardship.

⇒ The local partners are also motivated to contain development costs. Virtually all of the housing in which LISC's National Equity Fund invests also requires another source of subsidy, usually controlled by states and localities. Because Housing Credits and other subsidies are very scarce and precious, there is strong motivation to minimize the use of these subsidies. The two main approaches are to minimize construction and operating costs, tempered by the need for long-term sustainability, and to maximize the investors' equity contribution based on the Housing Credits available. LISC's National Equity Fund carefully analyzes the construction cost and operating budget of every development to make sure they are reasonable and in line with local norms. We also require a certification of all sources and uses of funds when development is complete as part of our duties to investors. States and localities perform similar analyses.

Finally, the permanent status of the Housing Credit has been essential to its performance today. Prior to 1993, the temporary and sometimes interrupted status of the Housing Credit discouraged many prospective sponsors and investors, who were unwilling to get involved in a complex process requiring substantial advanced planning with no assurance that the Housing Credit would continue to be available. Even those sponsors and investors who were willing to participate in a temporary program found planning impossible even year to year, let alone over the long term. Sponsors could not anticipate staffing or financial needs, communities could not be sure of implementing revitalization strategies, cities and states could not make reliable resource allocation plans, and investors could not integrate the Housing Credit into their long-term strategies.

Permanent status has revealed the premium that sponsors and investors place on a stable, predictable policy. Investors today will provide 25 percent more per Housing Credit dollar today than prior to permanence. Sponsors must address the states' housing priorities in order to win allocations. And other participants, from syndicators to states to the Internal Revenue Service, are strengthening internal systems now that they have some confidence that the Housing Credit will exist long enough to justify such a commitment. Needless to say, any signal that the Housing Credit may again be exposed to a sunset would severely damage the efficiency and smooth market functioning that serves the public interest so well.

With these structural incentives in place, it is fully understandable that the GAO found the housing is performing so well. Yet, no system is perfect, and the GAO did recommend regulatory changes to ensure that administrative processes are sufficiently tight. We support the thrust of GAO's recommendations. LISC's President, Paul Grogan, was a member of the industry-wide commission on the Housing Credit convened by the National Council of State Housing Agencies. We concur with the Commission's further recommendations to improve Housing Credit administration, as described in the letter transmitted by NCSHA to you, Madame Chairwoman, dated April 21, 1997 and also attached to NCSHA's testimony on April 23, 1997. We welcome all appropriate steps to strengthen administration of the Housing Credit. Excellent program performance is the best assurance of Congressional and public support. The Housing Credit is one social program that works superbly. We want to keep it that way.

Other Housing Credit Issues

Finally, I would like to address certain questions that arose in the April 23 hearing.

Rental Subsidies vs. Development Subsidies. One area of inquiry concerned whether it would be less expensive to provide rental subsidies than a construction incentive like the Housing Credit. While we believe that rental subsidies are an important housing policy tool, they cannot take the place of construction subsidies.

A rental subsidy does not itself stimulate construction, unless the rental subsidy is both project-based (i.e., not portable by tenants) and sufficient to support a mortgage large enough to cover development costs, as was the case with the Section 8 production program of the 1970s and early 1980s. That program proved extremely expensive, required federally insured mortgages, and is now in crisis because Congress is unwilling to continue to subsidize rents up to twice the market level.

Development subsidies are necessary to achieve specific housing needs that rent subsidies cannot address: (1) to revitalize low-income neighborhoods, as discussed at length earlier; (2) to conserve the existing housing stock through rehabilitation; (3) to meet the needs of special populations, including the formerly homeless, the frail elderly, and the disabled, who need services that can be delivered much more efficiently on site; (4) to relieve tight regional housing markets, since housing supply adjusts very slowly to higher demand and even then unsubsidized production is absorbed by upper- and middle-income households; and (5) to serve rural areas with little decent affordable housing.

Finally, it is unrealistic to expect that Congress would increase spending on rental subsidies (or construction subsidies) if the Housing Credit were terminated. Federal appropriations for low-income housing were cut substantially in 1995, and it will be difficult enough for Congress to find the funds needed to maintain its current effort.

Efficiency of the Housing Credit. A second question is whether the Housing Credit is efficient, especially since the GAO reported that, for projects placed in service 1992 - 1994, 53 cents was invested in every dollar of Housing Credits. This statement has prompted inquiries about the "other 47 cents."

There are two essential parts to the answer. First, now that the Housing Credit is permanent and more investors want to participate, they are willing to invest 66 cents -- substantially more than at the time of the projects studied by the GAO, as it has acknowledged. Second, investors must invest up front but only receive the dollar of Housing Credits over a ten-year period. Because a dollar in the future is worth less today, the present value of this stream of Housing Credits is about 70 - 71 cents. In other words, investors today will invest 66 cents to receive Housing Credits worth 70 - 71 cents today, an "efficiency ratio" of about 93 percent. This compares very favorably with even the most efficient housing block grants. Moreover, the Housing Credit pays only for success, since investors are subject to recapture if the housing does perform as promised. I have attached a more detailed analysis for your review.

Combining the Housing Credit with Other Subsidies. Most of the housing involves other subsidies besides the Housing Credit. Whether this practice is appropriate depends less on the number of subsidy sources than on whether they are, in combination, excessive. As the GAO reports, both the state Housing Credit allocation agencies and other federal subsidy sources (or state or local agencies administering federal funds) conduct a thorough review of all sources and uses of development funds, including the reasonableness of costs and operating budgets. This multiple review requires all subsidy providers to agree that the housing makes sense.

The simple reality is that low-income housing requires a substantial subsidy, because tenants cannot afford to rents sufficient to carry most of the cost of development. Even with equity investment generated by the Housing Credit and the maximum supportable mortgage financing, many projects, especially in urban and rural areas, still face a financing gap. It has been our experience that the presence of Housing Credit investment encourages the participation of other subsidy sources and private lenders, because of the rigorous underwriting required by investors.

Conclusion

This concludes my testimony. I would be happy to answer your questions.

37 LISC Program Areas

Baton Rouge
Bay Area
Boston
Chicago
Cleveland
Connecticut Multi-Cities
Detroit
Duluth
Houston
Indiana Multi-Cities
Northwest Indiana
Indianapolis
Kalamazoo
Kansas City
Las Vegas
Greater Little Rock
Los Angeles
Greater Miami
Michigan Multi-Cities
Mid South Delta
Milwaukee
Monongahela Valley
National Rural
New Jersey Multi-Cities
New Orleans
New York City
Newark
Palm Beach County
Philadelphia
Phoenix
Puget Sound
Rhode Island
Richmond
San Diego
St. Paul
Toledo
Washington, D.C.

LOCAL INITIATIVES SUPPORT CORPORATION
733 Third Avenue, New York, NY 10017 • Phone: 212-455-9800 Fax: 212-682-5929

Chairman JOHNSON. Thank you, Mr. Roberts.
Mr. Collins.

STATEMENT OF HERBERT F. COLLINS, CHAIRMAN, BOSTON CAPITAL CORP.

Mr. COLLINS. Thank you, Madam Chairman, and Members of the Subcommittee. My name is Herb Collins. I'm the chairman of the

Boston Capital Corp., which has been in the business of affordable housing development, management and financing since its inception 23 years ago.

I might date myself, and say I've been involved in the business since 1971, both on a personal as well as a professional basis. Again, I do look forward to working with you and your staff on the legislative reforms designed to strengthen compliance and enforcement of the Low-Income Housing Tax Credit Program.

In the interest of time, I have shortened my testimony. I have filed a statement for the record. I would like to leave more time for questions, which I found to be very, very informative.

Although we in the real estate industry are aware of the tremendous success of the program, the GAO report clearly demonstrates that the low-income housing tax credit should remain a permanent part of the Tax Code, and is an excellent public-private partnership for providing affordable housing for working families, their children, and senior citizens.

The secret to the success of the credit is that it relies on local control and requires minimal involvement by the Federal Government. The program works because it provides incentives to the private sector to build the housing, which actually would not have been constructed but for the credit.

The GAO report recommends four initiatives. Most, if not all, of these recommendations would, in my estimation, strengthen the program, and help ensure its continued success.

I am particularly supportive of the recommendation regarding independent verification of sources and uses of funds submitted by developers. I also believe that requiring onsite inspections on the part of the State housing agencies is an important addition to the compliance structure.

As you know, Madam Chairman, and Members of the Subcommittee, we in the private sector also have been working on ways to improve compliance and enforcement. Some of these recommendations were offered last week, and merit your serious consideration.

I am particularly supportive of the recommendation to criminalize false material statements, or representations on any documents relating to housing credit applications. I also think that allowing State housing agencies to establish a safe harbor cure period for small and inadvertent errors of noncompliance would streamline the program.

With my remaining time I would like to highlight some of the points made by Mr. Haynsworth regarding the role of the syndicator, and how we in the private sector fit into the compliance and enforcement mechanism. Due to the excellent testimony presented to you last week by the GAO, Internal Revenue Service, and the National Council of State Housing Agencies, the Subcommittee is now aware of the joint Federal/State oversight system.

Although their role is not as formal as that of the IRS, and the State housing agencies, investors, lenders and syndicators play a unique role in ensuring compliance with the requirements of the tax credit program.

Syndicators have a fiduciary responsibility to insure that investors receive their full complement of tax credits over the designated

period. To do this, we must be involved in every stage of the application, construction and management process.

Even before the developer has applied to the State housing agency for a credit allocation, Boston Capital commissions its own market study to ensure that the proposed project is viable, given rent, income levels, vacancy rates and other market conditions.

In fact, we have three levels of market studies. One is done by the developer. We also retain an outside consultant to conduct a market study. And we ourselves, within our own staff, conduct a market study to be sure it meets our requirements.

As a point of interest, we have a portfolio of over 80,000 affordable units, of which 50,000 are tax credit units. Our properties have an average occupancy of 95 percent which clearly demonstrates that there is a demand that is being met and that the units are being built where needed.

Before construction begins, we analyze the construction quality to assure that individual capital goes into the building through an architectural and engineering review.

We continually monitor the property during construction, the lease up period, and throughout the life of the investment. Our monitoring includes a constant review of construction draws, rent rolls, occupancy reports, income and expenses, tax returns, audited financial statements, and the tax compliance work sheet.

We also visit the property on a regular basis to check the physical plant as well as tenant compliance.

This, then, is the role of the syndicator. Our investors rely on us to insure the validity of the costs, and very, very important, the long-term viability of the property, and the need in each specific market for affordable housing.

In short, to provide good, sound underwriting.

There has been discussion of some fees for the developer and the syndicator. Let me assure the Chairman and the Members of the Subcommittee that our syndication fees have been significantly reduced as a result of the permanence and other efficiencies.

As of today, a greater percent of the investor dollar goes to the property as equity capital.

Let me conclude, Madam Chairman, by again thanking you for allowing me to be here, and for the opportunity to work with you and your staff in developing improvements to the compliance and enforcement system for this very, very important program.

I would be glad to answer any questions at the end of this discussion.

[The prepared statement follows:]

Statement of
Herbert F. Collins
Boston Capital Corporation
on the Low Income Housing Tax Credit
Before
The Oversight Subcommittee
of
The Committee on Ways and Means
United States House of Representatives

May 1, 1997

Madame chairman and members of the Subcommittee:

My name is Herbert F. Collins. I am the chairman of Boston Capital Corporation. Boston Capital has been in the business of affordable housing development, management, and financing since its inception twenty-three years ago. I thank you for giving me the opportunity to testify today, and I hope I can help in your oversight of the low income housing tax credit program.

Boston Capital is one of the largest companies involved in providing equity for low-income housing. Our investment partnerships have a portfolio of over 1,900 affordable housing properties in 48 states, the U. S. Virgin Islands and Puerto Rico, representing over 80,000 apartment units. Of these, over 1,300 are tax credit properties comprising over 50,000 apartment units. We have seen several of Government programs designed to encourage the availability of affordable housing, and I can tell you without any exaggeration that the low income housing tax credit is the most effective and efficient affordable housing program Congress has created.

One of the major reasons for this is that the low income housing credit is the first program that has relied primarily upon the marketplace to determine what kind of rental housing should be built and where it should be located. Relying on the market, with overall guidance from the states where housing is to be built, is also providing a better and more appropriate product than past programs directed from Washington, D.C.

The GAO report provides confirmation that the program is well designed and is providing the affordable housing that was intended. The report, however, also points out that there are the inevitable "kinks" that are found in any new program. Along with GAO, the National Association of Homebuilders, and others, we would urge that the Subcommittee carefully review the suggestions presented. We would be pleased to offer any assistance that you may desire in that regard.

In particular, we would reinforce suggestions that the Subcommittee consider the following issues:

- appropriate penalties for noncompliance,
- full documentation when a state agency uses its discretion to vary from a state allocation plan,
- increased uniformity among states in the processing of applications for credit allocations, and
- reducing paperwork for applications for credit allocations.

The GAO report provides a reasonably accurate analysis of the state of the program, at least as it was during the 1992-1994 period that they studied. During that period, there was a risk that the credit would expire. Of course, that concern had an adverse impact on the efficiency and effectiveness of the program, as did the proposal to sunset the credit in 1995. While the future of the credit was in doubt, developers were reluctant to incur costs necessary before they could apply

to the state for a credit allocation, and investors were less willing to invest. The program is working significantly better now since we all have had a couple of additional years to become more experienced and more efficient. The state housing agencies, developers and investors have increased confidence that the credit program is, in fact, a program they can rely on. As a result, they have put more resources into making the program work as well as possible.

That said, I would like to spend the remainder of my time addressing a few of the concerns that were expressed by members of the Subcommittee at your hearing last week.

The first and most important issue is whether the credit is necessary. I think the demand for affordable housing and the lack of any significant construction or rehabilitation not using the credit proves the importance of the credit. While the credit program is limited to no more than 125,000 new apartment units each year, U. S. Census data showed an unmet demand for affordable housing of more than 5 million units last year. The Census Bureau estimates that the unmet demand for affordable housing will climb to nearly 8 million units by the year 2000. If construction or rehabilitation of affordable housing were possible without a Government incentive, it would be happening today. The demand exists. The problem is simply that, absent the credit, it is not economically feasible to build housing that is affordable by the working poor, the handicapped, and seniors of modest income.

The second important issue is whether the program is adequately designed to assure efficiency. I would suggest that the state housing agencies, the competitive environment in which developers must operate, syndicators, and investors all combine to maximize the most efficient use of the taxpayer's dollar.

Under the Internal Revenue Code, a state housing agency is not allowed to allocate credits in excess of the amount necessary to assure financial feasibility. The reality is that the marketplace is working to assure that the tax credit produces the highest quality and most cost effective housing possible. The demand for affordable housing and for financing by means of the credit creates market efficiencies. The state housing agencies enjoy increasing competition by developers for a limited amount of credits. This competition is resulting in more and better housing for each credit dollar and is assuring that the developers' profits are reasonable. As the GAO report has noted, this competition has also allowed the state housing agencies to require standards that exceed those imposed by the Internal Revenue Code.

Syndicators also play a significant role both in assuring that the developer is providing needed housing and assuring that the construction or rehabilitation is done in a way that produces the best quality housing for the lowest price. A syndicator such as Boston Capital is involved from the very beginning – even before a developer goes to the state housing finance agency for a credit allocation. On behalf of our investors, we have to be satisfied that a proposed project is an appropriate property in a market that needs additional housing. To that end, we will commission our own market study to determine rent and income levels in the area, vacancy rates and assess what market needs will actually be met by a given property.

We also use our expertise to analyze construction quality and to assure that invested capital goes into the building through an architectural and engineering review. We will often insist on modifications to improve the property so that it may compete more effectively in the long run. We will monitor the property during construction, the lease-up period and throughout the life of the investment. Our monitoring will include construction draws, rent rolls, occupancy reports, income and expenses, tax returns, audited financial statements and a tax credit compliance worksheet. We will also regularly visit sites to check the physical plant as well as tenant compliance.

Last week, you heard about the monitoring by the state housing finance agencies. They are not the only additional entities monitoring compliance. At Boston Capital we are doing our own compliance checking because we need to be able to assure our investors that their investments qualify for the housing credit and assure the long-term viability of the properties. This is an essential role of a syndicator. Our investors rely on us to assure the validity of the cost and the need in each specific market for affordable housing: in short, to provide good, sound underwriting.

The return earned by a tax credit investor is also competitive and reasonable. The primary determining factor on the return expected by investors is competition from other alternative investments. A developer of affordable housing is competing with the entire spectrum of other investment opportunities available in this country and has to show a return that is competitive in the marketplace in order to attract investors.

We pool as many as 50 properties in each limited partnership we are involved in order to minimize risk. As a result, the "risk premium" demanded by investors is smaller than it would otherwise be. It is an indication of a well designed program that it can be so successful in providing affordable housing while also allowing the level of return necessary to attract investors.

Since the tax credit became permanent in 1993, more equity has flowed into the market from corporate buyers to purchase tax credits. This has increased the amount investors will pay for credits and caused more dollars to be available to be spent on the real estate. At the same time, as prices increased and the relative number of tax credits available stayed the same, yield to investors has dropped. This has led to a reduction in overall expenses in order to mitigate yield declines and not drive investors away. Although some investors have left for alternative investments, many are still investing.

Today, fees are the lowest they have been since the beginning of the program and compare favorably to real estate funds which do not involve Federal incentives. The corporations that invest in tax credits are very sophisticated and are generally reviewing tax credit investments with both their real estate and tax departments. If fees were not reasonable or if yield dropped lower or below their threshold requirements, corporations would simply not invest in tax credits. Faced with the possibility of loss of credit, recapture, penalties and interest, most corporations depend heavily on their syndicator to underwrite the portfolio of properties and the syndicator as well as monitor the properties for the life of the investment.

Finally, I would like to address a concern that was expressed last week that the housing may, in some cases, be "gold plated" or overly fancy. I have made available to the Subcommittee photographs of some representative properties to give you a sense of the kind of properties built with the credit. I think you would agree that the properties are not opulent. On the other hand, we have seen a history of Government-assisted housing in the past that did not reflect the needs of the marketplace. The housing must be designed and constructed for long-term viability since it is much cheaper than to demolish and build replacement housing every ten or twelve years.

The failure of the public housing projects that HUD has been demolishing recently is a vivid reminder of that problem. Those properties that are not being demolished have to be saved at enormous additional cost to the Government. All of this points to the importance of good quality initial design and construction. In addition to economic viability, the housing must be accepted by the community. When Congress enacted the credit, it made certain that the local communities had notice and an opportunity to comment. This was an important provision to assure that success of the program.

I would urge the subcommittee to continue with your oversight responsibilities. This program is a major success story. The more you learn about this program, the more proud you will be that Congress has developed an affordable housing program that works. The need for affordable housing is undeniable. The housing cannot be built without help from the Federal Government.

We all know that the Federal Government's resources are very limited. I believe in the public/private partnership model to assure affordable housing. The Federal Government should not be in the housing business. This is a function that is more appropriate at the state and local level to assure that the housing meets local needs. However, this housing will not be built without a Federal financial incentive. The housing credit program, by providing a way to access private equity, is well designed to maximize the value of the Federal contribution and maximize the affordable housing that is built.

Chairman JOHNSON. Thank you very much, Mr. Collins.
Mr. Cooper.

STATEMENT OF WILFRED N. COOPER, FOUNDER AND CHAIRMAN, WNC & ASSOCIATES, INC., DIRECTOR, NATIONAL ASSOCIATION OF HOME BUILDERS, DIRECTOR, NATIONAL HOUSING CONFERENCE, AND MEMBER, EXECUTIVE COMMITTEE, U.S. CHAMBER OF COMMERCE, TAXATION COMMITTEE

Mr. COOPER. Thank you, Madam Chairman. I very much appreciate the opportunity to present this testimony on the Low-Income Housing Tax Credit Program today. I am Will Cooper, founder and chairman of WNC & Associates, of Cosa Mesa, California. We also have offices in Portland, Oregon, Houston, Texas, and Washington, DC.

For over 25 consecutive years, WNC has provided the equity capital through syndication for affordable housing for working families and the elderly in rural areas, the suburbs and metropolitan areas all across the country.

WNC has sponsored over 100 investment funds, and has over 11,000 investors, including Fortune 500 companies and individuals. As an investment sponsor, WNC acts in the capacity of a watchdog for low-income housing tax credit individual and corporate investors.

This oversight role includes thorough underwriting and due diligence of all the affordable properties in which we invest, similar to what Mr. Collins was just talking about.

In this capacity, we perform individual property market studies to verify that the properties are targeted to local tenant demand. We also review, among other things, the plans and specifications and the environmental impact of each property.

After we decide to invest in a tax credit qualified property, WNC conducts a thorough review of each tenant file to ensure that they are within compliance of section 42 guidelines.

In 1986, when Congress and President Reagan created the low-income housing tax credit, most of us, to say the least, were nervous about how well the program would work. It has turned out to be the Nation's foremost housing production program, and perhaps the best example of Federal/State, public/private partnerships.

Subsequent to 1986, Congress, the State allocating agencies, and the affordable housing industry realized that some refinements in the Low-Income Housing Tax Credit Program could make it work even more efficiently and those changes were made.

We have the same opportunity this year working from the recommendations the GAO made to you, and the additional suggestions from the commission formed by the National Council of State Housing Agencies, and the National Association of Home Builders.

I have several comments and observations I would like to share today with you. As the GAO noted last week, since the tax credit was made permanent in 1993, developer and investor confidence has been bolstered. This has provided greater competition for the

credits, ultimately allowing a significantly higher amount of tax credit dollar to go back into low-income properties.

I want to stress what has already been said: permanence has greatly increased the efficiency of the credit, assured that there are adequate investors, and guaranteed quality and experienced developers. We are also seeing affordable and quality developments designed to last well beyond the initial 15 year period.

Most States require extended use agreements that require those properties to be held affordable well beyond the statutory 15 minimum. Some of the early Farmer's Home properties we syndicated are now more than 20 years old, and with proper care they are still fully occupied and in very good condition.

We have no reason to believe that the low-income housing tax credit properties will be any different.

There was discussion last week about usage of the State by State tax credit allocations. The per capita cap of $1.25 has not been raised since 1986. There may be a State or two for whatever reason that has not always used its full allocation.

But our experience is that the need and the demand for affordable housing far exceeds the available credits. As I indicated, more equity is going into the properties, developers have become very creative in using other sources of funds to keep rents as affordable as possible. This is clear in the GAO's finding that the average median income of tenants living in low-income housing tax credit properties is $13,000.

While the strength of the Low-Income Housing Tax Credit Program is flexibility of States to structure their own programs, more consistency in administration would benefit all.

The GAO should be commended for the most professional job it did in responding to Chairman Archer's mandate last year. The study demonstrates the success of the program, and I think makes a strong case for continued permanence. I think it is fair to say that each year since the program was established, we have all learned how it can be made more efficient and cost effective.

If enacted, the recommendations of the GAO and the National Council of State Housing Agency Commission will continue the positive track record of improving the program, as we go forward.

The credit responds to the marketplace, and is not corporate welfare, nor does it create properties that resemble public housing. On the contrary, it is a program designed to encourage the private sector to build, manage and own quality housing for working Americans.

It gives that little extra boost to families and the elderly that is so badly needed in our country today.

The commitment to a low-income housing tax credit property is much longer in most instances than the minimum 15 year compliance period. Many States encourage properties to be maintained as affordable for at least 30 years.

In my home State of California, we have a 55 year obligation to keep a low-income housing property affordable. The extended compliance period has serious implications for our investors, but that is a topic for another time.

As a point of clarification, figure 1 in the GAO report speaks of tax credits and deductions, quote, unquote, as being the same or

equal tax benefits for corporations and individuals. Since individual taxpayers are subject to the passive loss section 469 rules, their tax deductions are not the same benefits that corporations receive.

In summary, Madam Chairman, WNC is committed to work with Congress in developing any legislative and regulatory change Congress will be considering. WNC's experience in affordable rental housing over the last 25 years, including the tax credit experience of the last 10 years, is available to share with you and your staff to make any changes or reforms that will serve to improve the program.

Thank you.

[The prepared statement follows:]

Testimony of Wilfred N. Cooper
Chairman, WNC & Associates, Inc.
Director, National Association of Home Builders (NAHB)
Director, National Housing Conference
Member of Executive Committee, U.S. Chamber of Commerce Taxation Committee
May 1, 1997

Madame Chair and Members of the Committee:

I very much appreciate the opportunity to present this testimony on the LIHTC today. I am Will Cooper, founder and chairman of WNC & Associates, Inc. of Costa Mesa, CA. We also have offices in Portland, OR, Houston, TX and Washington DC.

For over 25 consecutive years WNC has provided the equity capital through syndication for affordable housing for working families and the elderly in rural areas, the suburbs and metropolitan areas all across the county. WNC has sponsored over 100 investment funds and has more than 11,000 investors including Fortune 500 corporations and individuals.

As an investment sponsor, WNC acts in the capacity of a watch dog for LIHTC individual and corporate investors. This oversight role includes thorough underwriting and due diligence of all the affordable properties in which we invest.

In this capacity, we perform independent property market studies to verify that the properties are targeted to local tenant demand. We also review, among other things, the plans and specifications and the environmental impact of each property.

After we decide to invest in a tax credit qualified property, WNC conducts a thorough review of each tenant file to assure that they are within compliance of Section 42 guidelines.

In 1986 when Congress and President Reagan created the LIHTC most of us, to say the least, were nervous about how well the program would work. It has turned out to be the nation's foremost housing production program and perhaps the best example of federal-state, public-private partnerships.

Subsequent to 1986, Congress, the state allocating agencies and the affordable housing industry realized that some refinements in the LIHTC program could make it work even more efficiently and those changes were made. We have the same opportunity this year working from the recommendations the General Accounting Office made to you and the additional suggestions from the commission formed by the National Council of State Housing Agencies (NCSHA) and the National Association of Home Builders.

I have several comments and observations I would like to share today with you. As the GAO noted last week, since the tax credit was made permanent in 1993 developer and investor confidence has been bolstered. This has provided greater competition for the credits ultimately allowing a significantly higher amount of the tax credit dollar to go back into low income properties. We are also seeing affordable and quality developments designed to last well beyond the initial 15 year compliance period. Most states require extended use agreements that require those properties to be held affordable well beyond the statutory 15-year minimum. Some of the early FmHA properties we syndicated are now more than 30 years old and with proper care they are still fully occupied and in very good condition. We have no reason to believe that LIHTC properties will be any different.

There was discussion last week about usage of the state by state tax credit allocation. The per capital cap of $1.25 has not been raised since 1986. There may be a state or two, for whatever reason, that has not always used its full allocation. But our experience is that the need and the demand for affordable housing far exceeds the available credits. As I indicated, more equity is going into the properties, developers have become very creative in using other sources of funds to keep rents as affordable as possible. This

is clear in the GAO's finding that the average median income of tenants living in LIHTC properties is $13,300.

While the strength of the LIHTC program is the flexibility of state's to structure their own programs, more consistency in administration would benefit all of us involved.

The General Accounting Office should be commended for the most professional job it did in responding to Chairman Archer's mandate last year. The study demonstrates the success of the LIHTC program and, I think, makes a strong case for continued permanence.

I think it is fair to say that each year, since the program was established, we have all learned how it can be made more efficient and cost effective. If enacted, the recommendations of the GAO and the NCSHA commission will continue the positive track record of improving the program as we go forward.

The credit responds to the market place and is not corporate welfare nor does it create properties that resemble public housing. On the contrary, it is a program designed to encourage the private sector to build, manage and own quality housing for working Americans. It gives that little extra boost to families and the elderly that is so badly needed in our country today. These are families that work hard to pay their rents. They are families with children who, with this little help, can live in a decent environment and can feel better about themselves and perform better in school.

I find it encouraging that a substantial number of LIHTC properties promote social services like after-school study halls and boys and girls clubs. This is a growing trend and there are examples all across the country, but one of the most successful examples is in Speaker Gingrich's district in Georgia.

The tax credit program works because investors, who have many options in their investments, receive a fair return. Unlike many investments, however, tax credit investors must be willing to give up liquidity and be able to invest over a long time.

The commitment to an LIHTC property is much longer in most instances than the minimum 15 year compliance period required by law. Many states encourage properties to be maintained as affordable for at least thirty years. In my home state of California we have a 55 year obligation to keep an LIHTC property affordable. The extended compliance period has serious implications for our investors, but that is a topic for another time.

As a point of clarification, Figure I in the GAO report speaks of "tax credits and deductions" as being the same or equal tax benefits for corporations and individuals. Since individual taxpayers are subject to the "passive loss" (Section 469) their "tax deductions" are not the same benefits that corporations receive.

In summary, Madame Chairman, WNC is committed to work with Congress in developing any legislative and regulatory changes Congress will be considering. WNC's experience in affordable rental housing over the past 25 years, including the LIHTC experience over the last 10 years, is available to share with you and your staff to make any changes or reforms that will serve to improve the program.

Chairman JOHNSON. Thank you, Mr. Cooper.

Mr. Platt. We're going to hear Mr. Platt, and probably Mr. Stevens, and then we're going to have to go vote. Perhaps some of the other Members will be back, but we're going to have to go through another one of these rotations.

STATEMENT OF RONALD L. PLATT, LEGISLATIVE DIRECTOR, McDERMOTT, WILL & EMERY, WASHINGTON, DC, ON BEHALF OF BRUCE ROZET, CHAIRMAN OF THE BOARD, ASSOCIATED FINANCIAL CORP., LOS ANGELES, CA

Mr. PLATT. Thank you, Madam Chairman, and Mr. Coyne, and Members of the Subcommittee for allowing me to testify today on the low-income housing tax credit. I am Ron Platt with the law firm of McDermott, Will & Emery, testifying on behalf of Bruce Rozet, chairman of the board of Associated Financial Corp.

Since the inception of the low-income housing tax credit, Associated Financial has raised over $150 million in private capital for low-income housing tax credit transactions, primarily for the rehabilitation of older HUD properties.

As we think of national housing policy, particularly in light of current budget realities, I think we have to start with some hard and very realistic guiding principles.

First and foremost, the government can no longer afford to subsidize the building of new housing for very low-income families. At costs ranging up to $150,000 per housing unit, rental or ownership, the cost of government financial assistance to meet the need of families with incomes below 60 percent of the median income is prohibitively expensive.

The family with an income of $20,000 a year can only afford housing with a capital cost of $20,000–$25,000 per year, unless we're going to apply substantial other subsidies.

Since 1987, the Federal Government has allocated over $20 billion to the low-income housing tax credit to develop new and rehabilitated housing for families with incomes below 60 percent of median. It's perhaps timely to question its effectiveness, as part of the Federal role in supporting the development of affordable housing.

As noted, the program results in the development of new housing in many States at a cost of over $150,000 per rental housing unit. Since normal market economics can only support an investment of less than $25,000 per unit for families below 60 percent of median, the Low-Income Housing Tax Credit Program is directly and indirectly providing a Federal subsidy of $50,000 to more than $125,000 per housing unit built.

As a point of reference, it should be noted that the RTC, FDIC, HUD and banks with problem real estate have been dumping housing into the open market in recent years at $10,000 to $20,000 per unit.

By establishing realistic ceilings or limits for government assistance, the cost to the government will be reduced, and prospective housing projects will be more realistically made to conform to market conditions.

The use of the low-income housing tax credit should be limited to projects involving a total cost no greater than a market oriented standard, such as, for example, $40,000 per unit or less, with exceptions, of course, for those projects for special needs.

This is consistent with Congress's present efforts to mark section 8 rents to market, so that the subsidy does not exceed the market rate. This will result in directing the tax credits more toward rehabilitation and preservation of existing affordable housing stock, and away from expensive new construction, particularly in our inner cities, and still allow new construction in rural and non-inner-city areas.

Utilizing the low-income housing tax credit primarily for rehabilitation of existing housing would result in protecting a greater number of housing units from being lost to free market rent increases, condominium conversions, and, particularly, deterioration.

We lose far more housing to these forces every year than are produced by any program of new construction. The recent GAO study found that 71 percent of the tax credit unit households also benefited directly or indirectly from one or more other types of housing assistance.

The failure to insure long-term affordability is also one of the major flaws in the existing program. The current tax laws require owners to maintain affordability for families at or below 60 percent of median income for only 15 years.

A simple modification in the program could protect future affordability, and advance the important national housing objective of home ownership. Owners could be given the option to convert their properties to resident ownership, in return for forgiveness of any tax obligation that might be due on sale. The conversion option could be available between the 10th and 15th year, and owners who converted to resident ownership, as either condominiums or tenant cooperatives would pay tax only on the cash they receive.

Those not electing this option on a prospective basis would be required to maintain their properties affordable for families at or below the 60 percent median for a minimum of 30 years.

Government is subsidizing the construction.

Thank you very much.

[The prepared statement follows:]

STATEMENT OF

RONALD L. PLATT
LEGISLATIVE DIRECTOR
MCDERMOTT, WILL & EMERY
ON BEHALF OF

A. BRUCE ROZET
CHAIRMAN OF THE BOARD
ASSOCIATED FINANCIAL CORPORATION

Madame Chairman and Members of the Subcommittee, thank you for allowing me to testify today on the Low Income Housing Tax Credit. I am Ron Platt, Legislative Director, McDermott, Will & Emery, testifying on behalf of Bruce Rozet, Chairman of the Board of Associated Financial Corporation.

Meaningful evaluation of the Low Income Housing Tax Credit can only be undertaken in the context of overall national housing policy and the historic record that lead to its enactment.

National housing policy must start with some hard, realistic guiding principles. First and foremost, the government can no longer subsidize the building of new housing for very low income families. At costs ranging from $50,000 to $150,000 per housing unit - rental or ownership - the cost of government financial assistance to meet the needs of families with incomes below 50% of the median income is prohibitively expensive. The family with an income below $20,000 per year can only afford housing with a capital cost of $20,000 to $25,000 per year. To provide new housing for families at this economic level requires government assistance ranging from $40,000 to $125,000 per new housing unit built. The failure to recognize these basic economic tenets has led us to expend billions in various forms of subsidies to provide a meager few units of new housing. Countless numbers of families have been left underhoused or living in squalor to cut the ribbons on a pitiful few new projects for only a few fortunate families. Only 30% of qualifying families are served by current programs.

By facing this clear reality - the government cannot afford the cost of housing very low income families in new housing - we can significantly reduce the cost to the government and efficiently utilize those resources that can be made available to better house more needy families.

In 1986, changes in tax law resulted in substituting a tax credit incentive for tax benefits Congress had formerly provided to encourage private investment to develop low and moderate income housing. The new LIHTC was designed to attract private capital for investment in rental housing for families with incomes below 60% of median income. Approximately $3.0 billion in tax credits are available for allocation by the states each year for use in developing or rehabilitating affordable housing. Private investors - corporations and individuals - invest in these housing projects to receive the benefits of the tax credits over a ten year period.

Since 1987, the federal government has allocated over $20.0 billion in LIHTC to develop new and rehabilitated housing for families with incomes below 60% of median.

Though this program has had wide support and is administered by the states and not by HUD, it is perhaps timely to question its effectiveness as part of the federal role in supporting the development of affordable housing.

The program results in the development of new housing in many states at a cost of $50,000 to over $150,000 per rental housing unit. In California, developments in some instances have cost over $200,000 per unit. Since normal

market economics can only support an investment of less than $25,000 per unit for families below 60% of median income, the LIHTC program is directly and indirectly providing federal subsidy of $50,000 to more than $125,000 per housing unit built.

As a point of reference, it should be noted that the RTC/FDIC, HUD and banks with problem real estate have been "dumping" housing into the open market at $10,000 to $20,000 per unit. Consider that state and local government agencies - including housing authorities - are supporting new construction at $50,000 to $150,000 per unit while "around the corner" various agencies and institutions are disposing of sound affordable housing at 15% to 20% of the cost of the LIHTC government subsidized investment in new housing.

Is this a sound, cost effective way to meet affordable housing needs? Considering that it allocates billions of dollars of federal funds to producing a relatively small number of new housing units, it cannot be reasonably justified as an economic use of scarce government resources. Major changes in the LIHTC could better serve housing needs and reduce government cost and involvement.

By establishing realistic ceilings or limits for government assistance, the cost to the government will be reduced and prospective housing projects will more realistically conform to market conditions. In evaluating possible dollar limits for projects, it is interesting to note that information recently disseminated by HUD concerning mortgages held by HUD to be auctioned off to private and financial groups. The information document lists approximately $1.0 billion in previously insured HUD multifamily mortgages covering approximately 35,000 rental units in the Southeastern United States. These are non-performing mortgages that were assigned to HUD when the owners could not meet the required mortgage debt service from project operations. Simple analysis shows that normal, non-subsidized rental housing in this part of the country often cannot support a mortgage of $30,000 per unit.

The use of the LIHTC should be limited to projects involving a total cost no greater than a market-oriented standard, i.e. $40,000 per unit or less. This is consistent with Congress' present efforts to mark Section 8 rents to market. This would result in directing the tax credits more toward rehabilitation and preservation of existing affordable housing stock and away from expensive new construction. It would move national housing policy in the direction of preserving and maintaining housing that is truly affordable with a minimum need for rental assistance for those families with low incomes who cannot afford costly new housing or market rate housing. It would, in effect, utilize the same subsidies provided by the government to serve the needs of two to three times the number of total housing units now being benefitted by the LIHTC incentives and would better stabilize and improve existing neighborhoods.

Critics of this modification will argue that it does not add to the stock of affordable housing and that it relegates poor families to older housing. Neither criticism is valid. By utilizing LIHTC primarily for rehabilitation of existing housing, it results in protecting a greater number of housing units from being lost to free market rent increases, condominium conversions and deterioration. We lose far more housing to these forces every year than are produced by any program of low income new construction. Using LIHTC to stabilize existing housing and neighborhoods at levels affordable to families below the level of

60% at median income - poor working families, elderly retirees and those most in need - we serve a broad range of families who might be threatened by the vagaries of the market place and fight back against urban decay. Most important, redefining the use of the LIHTC will serve the needs of two to three families versus the cost of new construction for one family. At a time when our government resources are very limited, it is essential to serve the greatest number of families for each dollar expended.

Part of the dilemma in understanding the role of the LIHTC in comparison to other housing programs administered by HUD, is the lack of clear definition of the term "low income" housing. In fact, the LIHTC program is similar in intent to the low and moderate income housing program enacted by Congress in 1967 and 1968. The intent of that program was to provide affordable housing for families with incomes below 80% of median (LIHTC is targeted at 60% of median). The FHA 236 program achieved affordability by subsidizing the mortgage interest to an effective 1%. Affordable rents for working families is the congressionally intended objective of both the 236 and LIHTC program. It might be interesting to note that an interest subsidy program could serve a similar objective to the LIHTC at a lower cost to the government. Or, put in another context, for the $3.0 billion dollars a year in tax credits allocated which represents lost revenue to the government, a program involving interest subsidies in the same amount over the same time period could produce considerably more housing units. Congress should request a GAO analysis of the relative cost of tax credits versus interest subsidies in meeting housing objectives.

When the LIHTC is used to serving lower income families, i.e. below 30% of median income, it can only be economically feasible if it involves other subsidies.

The recent GAO study found that 71% of the tax credit unit households also benefitted directly or indirectly from one or more other types of housing assistance in addition to tax credits. About 39% received direct rental assistance -- these households had an average income of $7,858 compared with $16,709 for the other.

Besides rent subsidies, the study says many residents also benefitted from other government loan, grant, or subsidy programs. It noted one-third of the projects were financed by Rural Housing Service Section 515 permanent mortgages -- generally at 1% interest.

The real cost to the government of utilizing LIHTC to house very low income families climbs dramatically and obscures the real economics of the program.

If the objective of national housing policy is to provide newly constructed affordable rental housing for working families with incomes in the range of $15,000 - $25,000 per year, then the LIHTC program accomplishes that objective at a cost to the government of approximately $45,000 in subsidy for each unit built. If the units built serve families in the very low income range, the cost to the government will increase by 50% or more. This is the economic reality of the program. Congress must assess this cost in the context of overall national housing policy, including the programs administered by HUD.

The failure to ensure long term affordability is one of the major flaws in the existing LIHTC program. The current tax law requires owners to maintain

affordability for families at or below 60% of median income for only 15 years. After that period, owners can increase rents and marketize the properties without consideration to affordability by lower income families. In 1968, Congress made the same error in regard to the 236 program.

A simple modification in the LIHTC legislation could protect future affordability and advance the important national housing objective of home ownership. Owners could be given the option to convert their properties to resident ownership in return for a forgiveness of any tax obligation that might be due on sale. The conversion option could be available between the tenth and fifteenth year and owners who converted to resident ownership as either condominiums or cooperatives would pay tax only on the cash they received. Those not electing this option would be required to maintain their properties affordable for families at or before the 60% of median income for a minimum of thirty years. This modification in the law would not result in any appreciable cost to the government and could be available to existing LIHTC projects as well as those built subsequent to the enactment of this modification.

Why do we have the government providing $50,000 - $100,000 of the cost of each new unit built and then permit the owners to dispense with affordability restrictions in fifteen years and marketize the properties? Congress made this mistake in 1968 in the 236 program which resulted in expenditures of billions of dollars in the past few years to protect the affordability of projects built in the early '70's. We should not continue to ignore long term affordability when the government is subsidizing the construction.

In summary, I recommend the following changes to the LIHTC program:

A. Limit the use of the LIHTC to a market standard i.e. $40,000 per unit.

B. Analyze the relative cost effectiveness of an interest subsidy as compared to the LIHTC.

C. Extend affordability restrictions from fifteen to thirty years as a deed restriction.

D. Provide tax incentives to convert LIHTC housing to resident ownership between the tenth and fifteen year.

Chairman JOHNSON. Thank you very much, Mr. Platt. That long-term affordability issue is a big problem in some of the current programs as you well know.

Mr. Stevens, I'm going to go over to vote. Mr. Coyne is going to stay a while, and then vote, and Mr. Portman will be back. Thank you for your testimony.

STATEMENT OF HERBERT F. STEVENS, PARTNER, PEABODY & BROWN, WASHINGTON, DC

Mr. STEVENS. Thank you, Madam Chairman. Thank you, Mr. Coyne. I'd like to address a few of the questions that you've had in this hearing and the prior hearing.

The first one that the speaker before me raised was the issue of the cost of housing, and the question of whether or not we should have a national policy to control that cost.

I think we have a national policy to control that cost. It's in every State's qualified allocation plan. We have over 50 policies that make the cost responsive to more local needs. It would be a mistake for any witness here to attempt to substitute a dollar amount for the State's judgment as to what they need in their locality. I think that's an important part of this program, and an important strength is the ability of the States to pick the kind of housing.

In addition, the Federal mandate in section 42 already requires States to build housing at the lowest cost, and to serve the lowest possible tenant population.

Second, Mrs. Johnson asked about other Federal subsidies. And I think there was an interesting statistic in the GAO report. The GAO said that without any other Federal subsidies, the average income for the households that would be served is 45 percent of median income. That's not bad.

With Federal subsidies, the average income served was 25 percent. That's terrific. But we can't get to 25 percent of median income without other Federal subsidies.

The beauty of the credit program is that it is flexible. There are, I think, according to the GAO report, 398 percent of the households were being served in stand alone projects, stand alone meaning no other Federal subsidies.

Those were still at 45 percent of median income. That's a very low-income level, far below the 60 percent which is the maximum tax credit level. And it's something we should be proud of, even for those projects.

In addition, we have a lot of people with more special needs and with even lower incomes. And the credit program is good because it can allow those income level families to be served as well.

Third, Mrs. Johnson suggested that the type of properties being served, one and two per unit, was perhaps not representative of the country as a whole. I think that misses the issue. I think the issue is whether or not the types of units being served meet the needs of the population that the States have at low income.

I don't think necessarily the population of the country as a whole is the answer.

Fourth, I think that we have brought up in many different ways the need for extended use. And I think that it's important when you talk about extended use to talk about economic viability as well.

It does no good to say what a property costs initially if it's built too cheaply to last for 40 or 50 years. I think that that is an important aspect of the tax credit program, that it allows States to look at costs, and also the costs to develop.

Finally, I think that Congress should strengthen the hands of States in requiring market studies and requiring other engineering studies that they can use to make sure the properties truly are viable.

Thank you very much.

[The prepared statement and attachment follow:]

STATEMENT OF HERBERT F. STEVENS
BEFORE
THE SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES
MAY 1, 1997

Madam Chairman and members of the Subcommittee,

Background

I am pleased to be here today to discuss the Low-Income Housing Tax Credit. My experience with the low-income housing tax credit program, and that of my partners at Peabody & Brown, dates back to the legislation creating the tax credit as part of the Tax Reform Act of 1986. Since then, my partners and I have worked with all sectors of the tax credit program, including investors, syndicators, lenders, for profit and nonprofit developers, state credit agencies, and the Internal Revenue Service (the "Service"). I am the co-author of the book, A Developer's Guide to Low-Income Housing Tax Credits, now in its third edition, which is published by the National Council of State Housing Agencies. In addition, I have been a professor of law at Georgetown University Law Center since 1983, where I now teach the advanced course on partnership and real estate transactions, including consideration of the Tax Credit. I am also a member of the Commission appointed by NCSHA to study the Tax Credit in conjunction with the GAO report

Prior to the inception of the tax credit, my partners and I have worked since the early 1970s with the Congressional initiatives to encourage development, construction and management of affordable housing units by the private sector.

GAO Report

The GAO was asked to address certain questions and it has done so. These questions included the following: is the program doing what was intended in producing affordable housing? Who are the beneficiaries and what are the types of properties which have been developed? How are the controls over this program by the states and the Service working? In general, those of us who have been on the inside of this program for the last 10 years are pleased that a responsible outside study confirms that the program is producing quality affordable housing for tenants whom Congress intended to be the beneficiaries of this program, and that the level of compliance with Congressional requirements is high.

Subcommittee Oversight

Your committee has asked for more information on the workings of the tax credit program. Other speakers will address various aspects of this complex system of financing affordable housing. I believe that it may also be helpful to consider the history of Congress' involvement in creating and maintaining affordable housing in determining how to address the future of the housing tax credit.

History of the Public/Private Partnerships

In 1968, in response to a national cry for more affordable housing in our cities, Congress enacted legislation based on the Kaiser Commission's recommendations. This independent commission proposed the forming of "privately-funded partnerships that will join private capital with business skills to help close the low-income housing gap." The goal was to move from construction of 50,000 units of low income housing per year to 500,000 units per year. The result was Title IX of the Housing and Urban Development Act of 1968 which created the National Corporation for Housing Partnerships. NCHP raised money from major corporate investors and invested this in partnerships which developed and owned

affordable housing (then called low and moderate income housing). This model for financing affordable housing is still widely used today.

These partnerships were given low interest loans or interest or rent subsidies by HUD, initially under the so-called Section 221(d)(3) and Section 236 programs, and later under the Section 8 housing program. In addition, the Tax Reform Act of 1969 gave affordable housing special tax benefits. These included rapid depreciation of rehabilitated property, more favorable accelerated depreciation and recapture rules, and deferral of gains on sales if proceeds were reinvested in affordable housing. Since that time, and especially in the major tax acts of 1976, 1981, and 1986, tax legislation has consistently favored affordable housing, in order to continue to encourage investment by corporations and individuals. These special incentives for low income housing included more rapid depreciation than other real estate enjoyed and current expensing of construction period interest and taxes.

What Have We Learned - Things We Have Done Well

Consistent Congressional Action

First, Congress' encouragement of private sector involvement, both in debt and equity financing has been consistent since 1968. This has been a critical feature -- more important than is generally realized -- in the present success in the tax credit program. When the tax credits were created in 1986, the prior history of Congressional support for affordable housing through provisions in the tax code set the stage for the success of the new program. The capital markets, including the people and institutions who make them up, were ready in 1986 to try a new program based, in part, on Congress' prior history. In addition, the state housing finance agencies were, for the most part, familiar with the concepts of equity investment and syndication and of using multiple layers of debt and equity to finance affordable housing. Finally, the Internal Revenue Service was prepared to be supportive, rather than obstructive, of the new tax credit program, because prior legislation had been utilized to accomplish the same goals. The GAO has recognized that permanence and consistency have been helpful features attracting corporate investment, which by its nature tends to be conservative.

Investors' Tax Benefits

Second, the original theory of private sector involvement was that investors, if asked to choose between a market rate apartment complex and a restricted one would *always* choose the market rate complex to meet their investment priorities, and would, unless special incentives were provided, avoid the restricted housing. The tax benefits were designed as a substitute for the economic benefits that come from higher rents possible in non-restricted housing.

This theory has proven true in the tax credit program as well. This is especially important now, with many states requiring longer term affordable use (longer than the 15 year tax credit compliance period). This results in even less economic return from these projects to the tax credit investor. If Congress or the states wish to continue this trend toward longer term restricted use, the program must retain the flexibility to deliver an acceptable return to the investor in the form of tax benefits without also requiring a significant economic return to be produced. However, as discussed below, Congress and the states must also be careful to preserve the economic value of the property as affordable housing.

State versus Federal Regulation

Third, we have learned that the Department of Housing and Urban Development is not the most efficient producer of affordable housing. For example, at last week's hearing James Logue, President of the National Council of State Housing Agencies, compared the average cost to HUD to produce a unit of public housing of about $85,000 vs. the average cost of a unit under the tax credit program of about $60,000. This shows that the tax credit system delivers quality affordable housing at a significantly lower price, and without the cost of a large federal

administration. This favorable average price per unit of housing means that state agencies can allocate their credits to more projects, the federal government will have a lower cost per dwelling unit, and the tenants will be living in higher quality apartment complexes.

The requirement that the state housing finance agencies regulate the production of housing, as opposed to the federal government, is one of the best parts of the program. Because of the requirement for a qualified allocation plan to be adopted each year by each state, we have seen U.S. housing policy being created at the state level. This housing policy is more responsive to local needs and local resources. Moreover, the requirements for public hearings and the availability of state officials and staff in each of the states has increased public involvement in affordable housing. It is better government which produces, not surprisingly, better results.

What Have We Learned - Things We Could Do Better

Controls Are Needed

First, we have learned that tax benefits without limits or controls encourage over development and do not result in benefits which are as well targeted to those in need. Unfortunately, the tax incentives for affordable housing begun in the 1970s were expanded in 1981 so that development of all real estate was given a large tax incentive. This led to the boom and bust in real estate development in the 1980s, and to a general perception of a tax system at that time which was subject to abuse for the rich seeking shelter.

Under the tax credit program, there is a limit each year on the states' ability to allocate credits. This limit enables the states to provide incentives for the locations where new housing will be developed and the type of housing that will be created. In addition, with the monitoring systems that are in place, the Congress can obtain a better sense of the use of these tax benefits. The GAO report focused on the years 1992 to 1994. The Service should also report more extensively each year to the public on the use of the tax credits. This report should include a count of how many credits were allocated, how many were returned (and the reasons for the returns), and how many projects were placed in service from prior years' credit allocations. I agree with the testimony of James Logue when he said that the ability to have credits returned, or to recapture unused credits, is an important control which the states have to maximize the proper use of tax credits for housing in their states.

Tax Recapture Problems

Second, the prior tax incentive programs created tax benefits in the early years and tax problems later. The tax recapture burden that overhangs older low income housing properties (i.e., pre-tax credit) is now a serious problem. Although the burden is "fair" in that it falls on those investors who benefited from the tax deductions taken in earlier years, it is large and it can fall all in one year. For this reason, many investors are unable to handle the consequences. For them, their incentive is to hold on to the property as long as possible to avoid this sword of Damocles. The result is a disincentive to property transfers, rehabilitations, and new ownership with better management and more tenant involvement.

The tax credit program avoids this problem of the early tax benefits and later tax recapture in most instances. It does this because the bulk of the tax benefits in the form of tax credits do not create a rebounding gain at the end of the 15 year compliance period.

High Transfer Costs

Third, because of this tax recapture, and because of the regulatory constraints, the transfer of ownership for pre-tax credit affordable housing is difficult and expensive. These high transfer costs and disincentives work against the interests of tenants who will benefit from property rehabilitation and turnover.

In addition, the illiquidity of the housing assets causes their economic value to be depressed.

The tax credit program has improved on this aspect by having easier ownership transfers built in to the program, but it still has the same problem of illiquidity. As described above, there is not usually substantial recapture to the investors transferring the project at the end of 15 years to a new owner. Moreover, the program already envisions the idea of transfers to tenant organizations and nonprofit organizations at that time. This ease with which an owner can exit the program after 15 years in favor of a new nonprofit, a government authority or tenant organization should allow the properties to retain more of their economic value.

The tax credit program is not efficient, however, in its requirement to post a bond to avoid recapture during the 15 year compliance period in the event of a transfer of ownership. Especially given the fact that the tax benefits consist of a 10 year stream of credits, corporations must include in their pricing the risk that they will not be able to use these credits fully during the 10 year period. This can occur because the corporation may be paying the alternative minimum tax (e.g., because of a heavy infrastructure investment), or may be suffering losses for a few years during the 10 year period. To the extent that corporate investors know that they can resell their interests to other large corporate investors during the 15 year compliance period without going to the expense of posting a recapture bond, they may pay more for the tax credit investments they use. This could result in more equity being available to tax credit projects for the same federal subsidy. In other words, a more liquid market for corporations buying and selling tax credit investments will act to maximize the value of the tax credits, and the value of the properties which are allocated tax credits.

Economic Viability

One thing that we have not done well in the past is focus on the economic viability of the housing being created. In too many cases apartment complexes have run down before their time and been in need of major rehabilitation.

In this respect, the tax credit program has certain built in advantages in terms of the physical viability of the housing. First, there is not the same incentive to build using cheaper materials. In addition, the quality of the asset management of the investor community is high and they are now aware of the need to maintain a project's viability throughout the 15 year compliance period.

More can be done in this area, however. States can and should develop better guidelines to produce housing of a certain minimum high quality. Congress and the states should be careful to avoid the "cheaper is better" assumption.

In many cases, spending money now on higher quality materials will produce significant savings during the life of the property. In addition, there are still developers in the program who need quality controls as well as cost controls by the state agencies.

Complicating the Program

Another lesson learned from history is that we have made our housing programs more difficult to use over time. It is a form of strangulation by complication. Right now the tax credit program is in danger of this -- in part, because of its success. State agencies are imposing more and more restrictions on property developments -- smaller projects, and even lower income tenants, are required and, sometimes, inexperienced developers are preferred. The result is less economically and physically sound projects which ultimately hurt tenants and cost all of us more money.

Congress should not require more restrictions on tenants or types of properties if this hurts the economic viability of the projects. In addition, there are ways to simplify the program by technical changes or by guidance from the Internal

Revenue Service. We should actively try to simplify the administration of this program. By doing so, the states and the Service can focus on the important issues - such as compliance with tenant income tests, habitability, and project viability, and not on technical issues such as whether an allocation can legally be revised to add a new building. Similarly, if investors can move their focus from technical errors to serious errors, they can insure that better projects are built and managed.

I have suggested a number of changes to simplify the program in the attached exhibit. These have been collected from a number of tax credit experts around the country, including Ken Alperin, Jerry Breed, Tony Freedman, Rick Goldstein, Michael Kotin, Mike Novogradac and Kate Sullivan. I would be happy to work with the staff to explain these further.

Conclusion

The tax credit program has developed into a system that efficiently produces high quality affordable housing. By understanding those features which work well, and those which don't work well, in prior federal housing programs, Congress can strengthen those portions of the current tax credit system that contribute to its success. The states are in the forefront of developing our national housing policy, and they should be encouraged to continue this effort. The private sector has been encouraged by the permanence of the program and the support which Congress has given to it. As a result, investors and syndicators have invested, and put at risk, billions of dollars each year in affordable housing. To the extent that the regulatory system can be made more efficient, with less concern over smaller technical issues, more attention will be focused on the important need to develop the highest quality housing and make it affordable for those of lower incomes.

Exhibit to Testimony
of
Herbert F. Stevens

Recommended Simplification and Technical Changes to Low Income Housing Tax Credits

May 1, 1997

Simplification/Administrative Guidance Needed

A. Carryover Allocation Issues

1. States should be given more flexibility in setting the timing for meeting the 10% test under Section 42(h)(1)(E), particularly for end-of-the-year allocations. For example, states, at their discretion, could give applicants up to six months after the carryover allocation to meet the 10% test. This 10% test is of such importance, however, that an independent certification that the applicant has met such test should be required.

2. States should be allowed to complete the execution of the carryover allocation within 60 days of the end of the carryover allocation year.

3. As the development process continues during construction, certain physical changes to the project may become necessary through no fault of the applicant, from the design shown on the application and carryover allocation. In these cases where the amount of credits will not change for the project, the state should be able to change the allocation without getting a ruling from the Internal Revenue Service (the "Service"). This would include changes to the number or size of the buildings or number of units per building.

4. Regulations §1.42-8 contains a requirement that, in order to permit a project's credit percentage to be fixed at the time of a "binding agreement" to allocate credit to a building, the binding agreement must be dated and signed by both the taxpayer and the agency in a single month. This requirement may be being violated, unknowingly, by allocating agencies and project owners. This requirement should be deleted since it is not required by the statute and may be more the result of unfortunate phrasing than of a policy decision by IRS.

5. "Aggregate basis" of a building pursuant to §42(h)(4) should be defined. Is it before or after adjustments for items such as grants, the historic tax credit and commercial space? Does it include personal property?

B. Compliance Monitoring

1. Under the compliance monitoring Regulations §1.42-5, states should be given guidance as to what types of corrective actions can be taken in specific, commonly arising circumstances. These might include: (i) rent overcharges; (ii) inadequate income documentation for current tenants; (iii) inadequate income documentation for former tenants; and (iv) late recertifications or income verifications. The Service should also consider whether there are particular types of non-compliance that are sufficiently technical that they may be corrected and not reported on Form 8823. Finally, the Service should consider giving advice regarding whether particular types of non-compliance may not be correctable, either because of their severity, their duration or the overall extent of misconduct by a project's owner.

2. Guidance on appropriate usage of Form 8823s should be issued. Events which cause recapture should be distinguished from those which do not cause recapture.

3. The income certification rules under the tax credit follow the HUD Handbook which says that income certifications are valid only for 90 days. In an acquisition/rehabilitation project with existing tenants, this means that the owner must do

two initial income certifications for the same unit if the rehabilitation takes more than 90 days to complete (if the placed in service dates for the two credits are more than 90 days apart).

4. In the same situation, there may be a compliance problem if a tenant who is income eligible upon acquisition goes over income at the placed in service date for the rehabilitation or if the remaining term of the lease upon the placed in service date is less than 6 months.

5. There should be clarification and standardization as to what it means to "set aside" a certain number of units for tenants with special needs. Does this mean that they must be held open forever until a qualifying tenant is found?

6. Clarification should be issued with regard to how often utility estimates have to be updated if a building owner relies on local utility cost estimates.

C. Tax Exempt Bonds

1. The Service should clarify the meaning of the requirement in Section 42(h)(4) that a project is "financed" by tax exempt bonds by referring to the project meeting the requirements of Section 142(d). Alternatively, the Service could use the following standard: For purposes of paragraph 42(h)(4), a building is financed by an obligation described in subparagraph (a) if the obligations described in subparagraph (a) (i) are outstanding during the construction period, or (ii) constitute permanent financing the proceeds of which are used to pay construction costs, redeem construction financing, or to repay equity contributions made during the construction process, and the obligations were induced prior to the date the building was placed in service or, in the case of a rehabilitation, the close of the period described in Section 42(e)(3)(A).

2. It is not clear when the determination should be made that bonds have financed 50% of the aggregate basis of buildings and land. Given the uncertainties of the construction process, this should be determined at the time the bonds are issued and it should be clarified to mean that the bonds will finance 50% of the taxpayer's reasonably expected basis of buildings and land when completed.

D. Exceptions for Certain Transfers of Existing Properties

1. For existing buildings which are at least 10 years old and are being rehabilitated, the Code allows certain transfers to have occurred within the 10 years before the acquisition. For transfers after foreclosure of a "purchase-money security interest" under Section 42(d)(2)(D)(ii)(IV), the meaning of this term should be clarified to include funds used to acquire, construct, reconstruct or develop a property, and not just seller financing. Alternatively, the term "purchase-money" could be deleted and an anti-abuse provision inserted, such as adding at the end of such phrase, "unless the Secretary determines that such foreclosure or instrument in lieu of foreclosure is part of an arrangement to avoid the application of this paragraph 2,".

2. Similarly, the exception for nonprofit acquired properties in 42(d)(2)(D)(ii)(III) should clarify that this exception applies even if property is acquired by a tax exempt entity subject to indebtedness which would result in unrelated business taxable income under the debt financed property rules of Section 514 of the Code.

Technical Changes to Section 42

E. Multiple Buildings/Mixed Income

1. In multiple building projects, where one building is totally rented to qualified tenants at the end of 1997 and the partners wish to take tax credits on this building, but where the other buildings are not yet rented to the point where the entire project meets the 40% set-aside test, current law would indicate that this is not a "qualified project" at the end of 1997, and that, therefore, credits may not be taken on that first building until 1998.

This should be changed so that as buildings meet the required set aside test, they should be treated as part of a qualified project, subject to a "look back" rule to prevent abuse.

2. In a mixed income project, the owner may be unable to move qualifying tenants from one building to another if doing so changes the percentage set-aside for low income tenants in the first building based on the "next available unit" rule of Code Section 42(g)(2)(D)(ii) and Prop. Reg. Section 1.42-15. For moves in the same building the owner must treat the tenant as a new tenant and can only allow it if the tenant is still under income and is recertified.

3. In addition, the "next available unit" rule works on a building by building basis for the tax credits, but works on a project basis under tax exempt bond rules. These should be made consistent, so that developers can meet the test on a project basis for tax credit purposes. In addition, the Service should be instructed to use the authority in Section 42(n)(1)(A) to deal with multiple building projects, or the law should be amended permitting (i) compliance, (ii) allocations (throughout the compliance period) and (iii) extended use agreements to be applied and evaluated on a project basis.

4. Similarly, the unit vacancy rule should be clarified in the situation where there are vacant tax credit units and market rate units at the same time. Owners should be allowed to rent vacant market rate units to nonqualified households for a reasonable period while they are attempting to rent the vacant tax credit units to qualifying tenants.

5. When a state makes a project-based allocation, it should be allowed to determine the portion allocable to each building at the time it issues the Forms 8609, not "in the calendar year in which the building is placed in service" under Section 42(h)(1)(F)(i)(III).

F. Recapture Bonds

In situations of a legitimate transfer of a project to a new owner (especially one with significant net worth), or in the case of the death of a taxpayer, the recapture bond should be eliminated if the new owner agrees that any future potential recapture is the responsibility of the new owner/partners. The marketplace would adjust the pricing of project to cover the risk transferred with the property.

G. Subsidized Construction Financing

The rule under Section 42(i)(3)(C) relating to use of subsidized construction financing should be revised to require that the loan be repaid not before such building is placed in service but within a specified period after the building is placed in service. It is often impossible to obtain favorable permanent financing on a property before it is placed in service. In addition, if the subsidized financing is to be excluded from basis, the amount excluded should be changed from excluding the full "principal amount" of the loan to excluding only the amount of the loan used to fund such eligible basis.

H. Extended Use

If the end of the 15 year compliance period coincides with the end of a Section 8 contract and the project is subject to the three year "vacancy decontrol" phase, rents may still be raised to the tax credit limits. This would effectively make the rent too high for the former Section 8 tenants. (This may be viewed as a problem in the Section 8 program, rather than the tax credit statute.)

Mr. PORTMAN [presiding]. Thank you, Mr. Stevens.
Ms. Lewis.

STATEMENT OF TERRY LEWIS, NATIONAL COOPERATIVE BANK, NATIONAL ASSOCIATION OF HOUSING COOPERATIVES, AND NATIONAL COOPERATIVE BUSINESS ASSOCIATION

Ms. LEWIS. Thank you very much. Mr. Portman, other Members of the Subcommittee, I thank you very much for the opportunity to testify on behalf of cooperative housing, specifically in this case the National Cooperative Bank, the National Association of Housing Cooperatives, and the National Cooperative Business Association.

We work very closely with low-income housing, much of it cooperatively owned, and we're very gratified that the GAO study documents the success of the tax credit at reaching exceptionally low-income families.

But with a minor change we have the opportunity to open it up to ownership rather than simply rental. There's a good reason why Congressman Metcalf placed first on the priorities of the Republican Housing Opportunity Coalition home ownership. That is because home ownership provides very well understood benefits to the communities in which it occurs.

With the degree of control, responsibility and the pride of ownership that comes from home ownership, residents carefully maintain their property, they reject unwanted behaviors on the part of their coresidents, they participate in their communities to a much higher percent, and they raise their children with a real sense of citizenship.

The use of existing housing programs in the past by cooperative home ownership has resulted in a long-term retention of affordable housing stock, and superior financial performance.

Cooperative housing also provides lowered cost of operations, as compared to comparable rental properties managed by the same management company.

In addition, cooperative housing offers stability and affordability that single family home ownership can't match for very low-income families.

Finally, with the kind of limited equity cooperative ownership that we propose, the acquisition costs will be well within the reach of very low-income families, but they'll be able to have some modest appreciation of their equity investment over the term of their ownership.

We believe that our proposal will have little or no revenue impact. It has been submitted for budget scoring by Senator D'Amato. It will act on a par with rental use of the tax credit, and we expect that there will be no budget costs. So this minor change should not have any revenue impact.

We propose to make the change by adding permissive rather than mandatory language to section 42, that would allow the recognition and use of the program with what we call section 42 cooperatives.

The bulk of our proposed changes deals with sections of the Tax Code that deal with cooperatives and cooperative housing, not section 42 at all. And that's section 216, which defines a cooperative housing corporation, and subchapter T that deals with the comprehensive taxation of cooperatives of all types.

You ought to know, or I think I ought to tell you, what a limited equity cooperative is. A housing cooperative is a corporation that is composed of stockholders who are the residents of the property. There is an absolute identity between ownership of the corporation and occupancy of the property. Only residents can own stock. Only stockholders can reside.

The equity limitations mean that there is a control over the resale of the cooperative interest. In the case of the low-income housing tax credit, that control would mean that the cooperative interests could only be resold to eligible families, and that it could only be sold at a price that reflected a very small appreciation, the same that exists under the Mortgage Revenue Bond Funding Act.

Finally, we know that there is some use of the tax credit as it currently exists to create leasing cooperatives, but these cooperatives do not in fact provide a real sense of home ownership, or any of the benefits that come from home ownership to the residents of the property.

Typically they're run very much like any other rental property, with an option to purchase that may or may not be realized at the end of the tax credit period.

Our proposed legislation would provide an exit strategy at a very affordable price and at a time certain that would allow the cooperative to buy out the tax credit investors who would be a second class of stockholders in the corporation.

We have had a study commissioned by Abt Associates, and they estimate that about 1,600 families per year over a growth period of about 5 years would be served by an ownership rather than a rental model, unless someone really became a strong advocate of cooperative housing.

That's about 3 percent of the units produced over the 3-year period that was in the GAO study. We think that that 3 percent could be a wonderful model, of highest and best use of the tax credit, and a real leveraging of the tax credit to the social benefits of anchoring communities and providing stability and creating a better sense of citizenship that the LIHTC Program seeks to produce.

Thank you very much.

[The prepared statement follows:]

Testimony of Terry Lewis,
former chair, NCB Development Corporation
on behalf of the National Cooperative Bank,
the National Association of Housing Cooperatives, and
the National Cooperative Business Association
before the House Ways and Means Committee Oversight Subcommittee
May 1, 1997

Madame Chairman and Members of the Ways and Means Oversight Subcommittee:

I appreciate the opportunity to testify today on behalf of cooperative housing. We applaud your efforts to monitor the Low Income Housing Tax Credit, the only successful program to empower the states and local communities to create affordable housing that reaches exceptionally low income families.

As successful as the LIHTC has been, we believe it can be even better. We believe that low income families should be given the opportunity to **own** affordable housing as an alternative to renting it. We have proposed a minor legislative change to IRC Section 42 to give state housing agencies the **option** to create cooperative housing.

Through **limited-equity cooperative ownership**, our proposal would allow the LIHTC to create:

- the degree of control, responsibility, and pride of ownership that leads residents to **carefully maintain their property, reject unwanted behaviors, participate in their communities, and raise their children with a real sense of citizenship**;
- substantial public benefit in the form of **long-term retention of affordable housing stock and superior financial performance** ;
- **lowered costs of operation** compared to comparable rental properties with the same management company ;
- **stability and affordability** that single-family ownership cannot match for low-income families; and
- acquisition costs within the reach of low-income families, with **modest appreciation** over the term of ownership.

Because the LIHTC has been so successful, we recognize that it is desirable to limit changes to Section 42. The legislative change we're requesting is aimed at specific provisions in the IRC that deal with cooperatives (Section 216, which defines cooperative housing corporations, and Subchapter T, which deals in general with the taxation of non-exempt cooperatives). We propose:

- minimal amendments to Section 42, adding permissive rather than mandatory language to acknowledge that the Housing Credit can be used to create "Section 42 Housing Cooperatives";
- Section 216 A would be added to the IRC to permit Section 42 cooperatives to have two classes of stock, one owned by the Housing Credit investors, the other class owned by the residents; and
- Subchapter T would be amended to acknowledge its applicability to Section 42 cooperatives as defined in Section 216A.

This proposal adds **permissive rather than mandatory** language to acknowledge that the Credit can be used to create "Section 42 Housing Cooperative." We should let the local community, the state housing agency and the developers decide if they want either a rental property or a cooperatively owned property depending upon the needs and wishes of their market.

By way of background a housing cooperative is a corporation formed to own a multifamily property, and the only stockholders of the corporation are the owner-occupants of the apartments. Under the tax code the owners of a cooperative apartment have the same tax treatment that is available to owners of single family and condominium homes.

Before the LIHTC, federal programs for financing affordable rental housing produced a significant number of resident-owned multifamily housing units in the form of housing cooperatives. According to a 1994 Urban Institute study commissioned by the National Cooperative Bank, the cooperative housing created under these programs offered substantial public benefits in the form of both long-term retention of affordable housing stock and superior financial performance. The study concluded that "cooperative low-income housing has proven its financial viability, but currently is an under-utilized resource in the Nation's attempt to meet its affordable housing needs."

The GAO found that more than three-quarters of Housing Credit renters have income below 50% of the area's median and that the average renter earns only 37% of the local median income. **At this level of income, renters in Housing Credit properties would almost certainly never have the opportunity to own a home.** With the option of a housing cooperative , home ownership and (within strict limitations) the building of home equity will suddenly become achievable.

NCB has financed over 30,000 units of affordable housing in the United States over the past fifteen years with delinquency ratios below national averages and nominal charge offs in recent years.

Under Section 42 in its current form, a few developers have utilized a somewhat cumbersome leasing cooperative structure in the hope that it would provide a taste of ownership to low income

residents. While the intent is commendable, the residents have only the distant promise that, at some remote future date, they might, through an option to purchase, gain actual ownership. Experience indicates that resident's derive no sense of ownership from that uncertain possibility.

This proposal does not increase the Housing Credit but simply allows a cooperative structure. Our legislative proposal is anticipated to have **little or no revenue impact**, because the cooperative structure will be equal to a rental. Senator D'Amato submitted the proposed legislation to the Joint Committee on Taxation for a revenue impact estimate, and we are awaiting the results.

The Section 42 cooperatives we propose would allow the sponsor to allocate management responsibility far more appropriately, with Housing Credit investors controlling those elements of operation related to eligibility (e.g. ensuring that operating charges fall within LIHTC limitations, preventing any violation of family income limitations by incoming cooperative members, and compelling a satisfactory overall level of asset management.) Within those parameters, the cooperative (and, through its democratic processes, the residents) would control member selection, rules, the specifics of the budget, and the administration and maintenance of the property through their selection and oversight of a property management firm or personnel. Through a formal agreement, the investors would assume these authorities if the residents were unable or unwilling to manage the property in a manner consistent with the requirements of the LIHTC.

The Section 42 cooperatives we propose would also provide actual ownership from the onset, with the residents able (at a date certain and at a reasonable and ascertainable price) to become the sole and absolute controllers of their cooperative by repurchasing the interest of the Housing Credit investors. In addition, the resident's initial limited equity contribution could appreciate modestly over the term of their residency.

A 1997 study by Abt Associates, Inc. that was also commissioned by NCB concluded that "Utilization of a Section 42 Housing Cooperative program could reach annual production of approximately 1,600 within a five-year period after passage." This could result in as many as 15,000 renters within five years moving into units they would own.

We ask your support so that low-income families, in addition to finding safe and affordable housing, can achieve the American dream of home ownership.

Madame, Chairman, I welcome your questions.

Mr. PORTMAN. Thank you, Ms. Lewis, and I thank all the witnesses here. I'm sorry that I had to run in and out, but such is our schedule with the votes and other commitments on a busy day when we're balancing the budget and doing all these other things.

But I really do appreciate the testimony, and all of your comments, including those we will have now in our dialog, are a part of the record and will be helpful as we try to put together the best way to proceed with regard to the low-income housing tax credit.

So this is not in vain. I am honored to be able to sit here and ask this group of experts all these questions. I have a lot of them, but not all I'll be able to get to today. I'd like to start with some of the questions that I pursued at the last hearing, a week ago, where I know some of you were in attendance. Mr. Roberts and I spoke at that hearing.

It goes to the issue of the subsidy, some of the stacking issues, rents and so on. The first question I would have, and I will open it up to any of you, because you've all had experience in these projects. Most of you, I understand, have probably had some experience in a mix, where you have some credit units, and you also have some units that would be market rate.

If that is the case, if you've had that kind of experience if you could tell the Subcommittee how much greater the rents are in the unsubsidized units than on the credit eligible units. Give us some sense of what the gap is, with regard to specific projects you've been involved in. Mr. Roberts, could you start out?

Mr. ROBERTS. Well, Congressman, I think the GAO found, and our experience has been that virtually all of this housing is 100 percent housing credit eligible housing. There are some mixed income projects, but they are very much the minority.

Mr. PORTMAN. Would that be Mr. Collins' answer as well?

Mr. COLLINS. Yes. Although, Massachusetts has undertaken some major efforts focusing on mixed income properties, the Shaw program for example. I can't give you the details on the experience they've had, but I'm not sure it's been a positive one.

But I've seen that there is a differential in some of the rents between 10 to 20 percent. And in some cases, they might be very similar.

Mr. PORTMAN. I think the numbers that GAO came up with, as I recall in its report, was about a $100 difference. I think the average rent for low-income housing tax credit units was $453. Is that right?

And they came up with the $555 number. Do any of you dispute that number, the $555 number for nonsubsidized?

Mr. STEVENS. That's probably correct.

Mr. PORTMAN. That's probably correct?

Mr. STEVENS. That's probably correct. It's important to understand, however, that the tax credit subsidy did not go to subsidize those units paying the higher rent. In any mixed income property, this program, unlike the prior tax programs, only subsidizes the units at or below 60 percent of median.

So many areas are trying mixed income properties as a way of integrating people in the community. But frequently it's done in a transparent way, so that the tax credit units might be intermixed, and even the tenants wouldn't know. They wouldn't look any different than the other units.

But yet they would be owned separately by the tax credit partnership.

Mr. PORTMAN. Any other comments with regard to the comparison of rents? Is there any dissention from the GAO figures of $555, or roughly $100 more for nonsubsidized units?

Mr. STEVENS. There is definitely a difference. It's important in the underwriting that there be a market for these units, so that they not compete directly with the market rate units.

Most private-sector underwriters, including investors and lenders, like to see at least a 10 percent difference if not more between the market rate rents and the tax credit rents.

Mr. PORTMAN. OK. With regard to the stacking issue, quickly, the GAO report documents a lot of positive results of credit projects serving low-income households, and yet they find that 71 percent of the credit units benefited from additional subsidies of one kind or another, and some of those were rental assistance, of course, section 8 type. Some were construction.

From your experience, could you estimate for us the portion of the positive result that flows from the credit as opposed to these other subsidies, given the 71 percent figure?

I guess what I'm really asking is what is the incremental benefit that the credit provides?

Mr. HARVEY. That's a difficult one to answer directly because it depends on the subsidy and how many subsidies you're using, and what the purpose is. A lot of what the Enterprise Foundation has done, special needs housing, where the tax credit alone could not reach down to the people that you're serving, whether it's mentally ill or whether it's somebody that's off of the homeless roll, and so forth, and just has public assistance before they get into jobs.

And so you really arrive at it the other way in your underwriting. You underwrite, you figure out what is your base level that you're going to be serving, and then you start with the tax credits and then you say what additional—working typically with the city—what additional subsidies does it take to get down to this level that you're serving. What are the resources that are available?

Typically it's a community development block grant, home program, and or some other special subsidy for special needs population. And you work it out. It's all reviewed by the State, to make sure that there isn't too much subsidy in it, and that it makes sense on an overall basis.

So it's hard to say—and it will also vary dramatically around the country. There are some areas and cities that are high cost, but have low median income. That directly affects where you can set the rent at a maximum, and then what is your cost of getting there.

And that varies all across the country.

Mr. PORTMAN. Such as some of the larger urban areas on the coasts?

Mr. HARVEY. Yes. It's also out West. I mean, out West is very—they're very high cost. And some of them are lower median areas.

Mr. PORTMAN. Mr. Roberts.

Mr. ROBERTS. A question that would lead from your line of inquiry, sir, is whether in fact it makes sense to subsidize construction, or perhaps whether it would be wiser just to subsidize rental assistance.

And the question is, so why do we need to build this housing?

Mr. PORTMAN. I'm glad you asked that question, Mr. Roberts.

Mr. ROBERTS. And the answer is——

Mr. PORTMAN. You and I have talked about this, and I raised some of these questions at the last hearing, and it would be helpful if you all have thoughts on that.

Mr. ROBERTS. There are specific circumstances where rental assistance just can't get the job done. But more important, that construction——

Mr. PORTMAN. Because there's not adequate housing available?

Mr. ROBERTS. That's one example. There are some tight markets that just don't adjust fast, and any housing that is built will be absorbed at upper- or middle-income levels, and so won't reach down, ever filter down to the low-income levels.

In urban neighborhoods, for instance, an objective is really to rebuild the neighborhood, to stabilize surrounding properties, encourage additional investment and the like. You need to have an investment strategy to accomplish that.

If you have existing stock that you're trying to conserve, that, again, requires an investment strategy in order to preserve that property, and special needs housing where it's much more efficient to serve populations within a specific site. A rental assistance program can't accomplish that.

There are different tools for different purposes.

Mr. PORTMAN. Let me just pursue that for a moment, and, again, others should feel free to jump in. Let's assume, for a moment, since you took us down this line of questioning, and I was trying to be more specific on some of the information we need for the record, and will continue on that.

But if the subsidy was provided, let's say as an example, through section 8, or, for that matter, through a block grant to the State agencies, the State agencies determined who was eligible, and it was at the same level, let's say, as the tax credit subsidy—and there can be, as you know, some dispute over the level of that subsidy—then isn't there some level at which the individual would have the market power to be able to have the market work for him or her to find units, even in those urban areas?

In other words, is the housing market so different from other markets around this country where when you empower somebody by giving them the tools to be able to go and demand housing by providing more in section 8, or more in block grants, that the housing just would not be built, and so you wouldn't have these advantages that you are talking about in terms of communities being rebuilt, and therefore attracting more capital?

Is there no number at which that would happen?

Mr. ROBERTS. Yes, sir. But it is a very high number. I mean——

Mr. PORTMAN. You say it would be a higher number than the low-income housing tax credit subsidy?

Mr. ROBERTS. In order to stimulate the capital investment, it would need to approximate the rent subsidies that were present in the section 8 production program, which was a project-based subsidy program which the Congress is now trying to figure out how to sustain.

So you can do it that way. You don't have to provide just a direct construction subsidy. You can do it through a rent subsidy, but it has to be project-based, and it has to be high enough to support a mortgage to carry the construction costs.

Ms. LEWIS. And it has to be certain. Speaking from the point of view of a national lender, if you don't know 3 years ahead of time that that equity investment is going to be there, either provided by the low-income housing tax credit or by a project-based set aside of section 8, then you might as well not do your feasibility studies. You might as well not begin to option the property, begin to work with your zoning board, because you're really planning for 3 years down the road.

Mr. PORTMAN. That's a good point. And, as you know, nothing is certain up here, and even entitlements tend to change, as again as was mentioned earlier with the negotiations going on today.

But certainly if one looks at the effect that permanence had on applications, one would see that there is in fact a longer term planning process here, because applications obviously increase when you get into permanence.

Whatever permanence means around here. So I don't argue with that.

Is that all that different from an annual appropriation, or, for that matter, something even more certain, I suppose, which would be some kind of a mandatory spending item? Mr. Stevens.

Mr. STEVENS. At the hearing last week, the GAO actually stated that the comparison should have been about $200 between average median rent and the tax credit rent. If you took that $200 between median rents for the areas and the tax credit rents that were actually charged, and multiplied that times your approximately 30 years, you'd end up with a cost to the government of about $72,000 per unit, compared to the $27,000 that the GAO found.

So even doing what we might call an incremental subsidy, it would still be more expensive. And I'd like actually to have the GAO confirm that. It would be useful for the Committee.

But using their testimony last week, doing the math, it comes out to be about twice or more, the cost to the government, to use a rental subsidy as to use the tax credit.

Mr. PORTMAN. That's interesting. I'd love to see those figures, too, because you could take the GAO numbers also and assume $100 difference given the average that they used, and take that over 12 months, and you end up with a significant difference going the other way.

Mr. STEVENS. Right.

Mr. PORTMAN. If you'd simply take $100, that'd be $1,200 per year, take it out of 10, now 15 years of the program, let's say 15 years. I know California has a longer period. You end up at a zero

discount rate of about $18,000 as the value of the rent subsidy, as compared to $27,300.

Mr. STEVENS. Right.

Mr. PORTMAN. You're saying that those numbers are not accurate, because——

Mr. STEVENS. For two reasons.

Mr. PORTMAN. OK. I'll let you say it.

Mr. STEVENS. One is the incremental cost, as the GAO said in their testimony last week, was about $200 difference.

Mr. PORTMAN. Not $100?

Mr. STEVENS. Not $100. And, second, you can't really use 15 years when the tax credit is producing housing that's going to last at least 30 or more.

Mr. PORTMAN. But there's not commitment to provide it to low-income individuals after the 15 years, is there?

Mr. STEVENS. There is in most States.

Mr. PORTMAN. I know different States have different requirements.

Ms. LEWIS. The market is bidding that commitment up.

Mr. PORTMAN. What do you all think of, is it 55 in California?

Mr. COOPER. Fifty-five.

Mr. PORTMAN. That seems like a long time. What do you all think of that?

Ms. LEWIS. It depends on the availability of additional subsidies. Frankly speaking, without the availability of the ongoing subsidy——

Mr. PORTMAN. It would be difficult to attract investors.

Ms. LEWIS [continuing]. To deal with operating costs, you're going to be in a situation where the property will not be able to rehab, will begin to defer maintenance, where it will begin to experience vacancies because the target population will not be able to afford the rents.

You really need that additional rental subsidy to extend beyond the 15 year compliance period.

When I look at it from the point of view of the residents becoming owners, at the end of the current period, the proposal that Mr. Platt made, absent an operating subsidy in the form of some sort of rental subsidy, it becomes very iffy for the cooperative or for the residents with that low-income level to take on the obligation of maintaining affordability.

With an ongoing subsidy, contingent on that ongoing subsidy, it becomes practically a sure thing.

Mr. HARVEY. The real difference between this and a rental program is this is place-based, and the permanence in it is you're getting—you're really writing down most of the capital at the beginning.

Whatever can be financed will be financed from there on. That's very difficult from getting something that is based upon the rent that's coming in, the certainty of the rent that's coming in, and the period of time you'll be receiving the rent.

If it's like the programs of today, which are getting changed every 5 years, you can't finance it. We can't find banks to finance something without knowing that they've got a rent stream to amortize down their cost over a period of time.

This program really is good because it takes that certainty and puts it up front. It's really a capital write down approach to whatever we're doing.

Mr. PORTMAN. Mr. Roberts, though, talked about the project-based subsidies. Wouldn't that solve some of that problem for you? Because they attach to the building, not to the low income——

Mr. HARVEY. Yes. But again, what you're basing off of that is a 15 year certainty, or some period certainty against which you will get *x* amount of debt, and then that either makes it work or not work.

Those 15 years are being challenged right now, so that there's a discount that the capital markets will put on the certainty that it will be there for all 15 years and you'll get rent adjustments on it.

That's a problem in housing, there seems to be no certainty that these contracts really are going to be there over a period of time. If you take care of it up front, you know you've got your costs carried up front.

Mr. PORTMAN. I have one more follow up question of Mr. Stevens, and I'm going to allow Mr. Weller a chance to ask some questions. What number do you use? You mentioned the two differences, the $200 and the time period.

Do you use 30 years rather than 15 years, or what figure?

Mr. STEVENS. I think you should use 30 years, because the Federal law requires——

Mr. PORTMAN. So your 30 years is where you get the—what did you say, $72,000?

Mr. STEVENS. $72,000. Yes.

Mr. PORTMAN. OK.

Mr. STEVENS. So if you did 15 years at that, it would be $36,000. It would still be higher than the tax credit cost.

Mr. PORTMAN. OK. Doesn't GAO use present value to come up with its $27,000 figure?

Mr. STEVENS. Yes.

Mr. PORTMAN. OK. So how do you compare yours to that? They, as I recall, say it's $27,300 based on present value. So you should calculate yours on present value, as well, to compare the two?

Mr. STEVENS. Yes. So it would be lower.

Mr. PORTMAN. What discount rate are you going to use?

Mr. STEVENS. Using the GAO's rate, it was probably the Federal rate, about 7 percent. That would be for 15 years, that would be about half, using the 7 percent discount rate, it would be about half. So that would be, instead of $36,000, it would be $18,000.

Mr. PORTMAN. OK. What do investors in your projects typically use? Their cash flow? Seven?

Mr. STEVENS. Yes. For cash flow discounting?

Mr. PORTMAN. Yes.

Mr. STEVENS. Well, comparing apples and apples, you'd take the same discount rate the GAO used for the tax credit and apply that.

Mr. PORTMAN. So instead of $72,000, what's your number?

Mr. STEVENS. That would be probably more like 20.

Mr. ROBERTS. We don't have the calculator here to do this, but I would guess it would be somewhere in the high $40,000 range, $200 a month discounted at 7 percent over 30 years.

Mr. PORTMAN. I just think it's important that we all are using the same basis upon which to make these comparisons. I know it's difficult in this area to compare. We talked about apples and grapefruits and oranges at the last hearing.

With that, let me turn it over to Mr. Weller, and if you all are willing we'll ask some more follow up questions.

Mr. Weller.

Mr. WELLER. Thank you, Mr. Chairman. I'd like to direct my first question to Ms. Lewis. In your testimony, you discussed the National Cooperative Bank's proposal regarding the home ownership initiative proposal, the cooperative program.

And I was wondering to what extent are some States already doing this?

Ms. LEWIS. Well, the tax credit program as it currently stands prohibits home ownership. It is strictly a rental program. Given the benefit that has been created through the use of prior rental programs by a cooperative home ownership model, we think that that's very short sighted.

The closest you can get under the current program is what we call a leasing cooperative, under section 42, and generally it is cooperation in name only. This program would open it up to allow the sponsor to allocate real management responsibility, less than or within the framework of the tax credit, which the investor would clearly want to maintain, but ongoing property management decisions are in fact made very efficiently and effectively by well informed coop boards.

I mean, it's very clear that a well managed coop with the same property managers, same property configuration will end up with lower operating costs than a rental. Because cooperative owners make efficient decisions.

They look at the value of an investment over time, they are more willing to upgrade their window system, they are more willing to install more efficient furnaces as a replacement unit than any rental owner would be, because they know what the pay off is going to be.

And if they're individually metered, they really cut down their utility costs as well.

So cooperatives really work effectively to reduce operating costs if they are given the management authority that they would be allowed to have under this program, plus they would have the real investment that home ownership brings.

I work with limited equity cooperatives now who sell their cooperative interests for a very limited price to a very limited group of people, low-income families, and maybe, say, $2,500 is the maximum transfer value of that cooperative interest.

Well, you should see what people do with their units, in terms of improvements and maintenance, in order to maximize that little tiny $2,500 value.

And in a lot of places in the country, that $2,500 is all that's necessary to, with PMI, move into a single family home as your income level increases. Now, that's not the case all over. It really depends on your market.

But that little tiny bit of incentive and that little tiny bit of equity appreciation can have a huge impact.

Mr. WELLER. Are there particular pilot, or experiments that States are conducting right now?

Ms. LEWIS. They're not allowed to do that. Again, because home ownership is completely prohibited.

Mr. WELLER. How about initiatives on their own, unrelated to—or State housing programs unrelated to the Federal statute.

Ms. LEWIS. We can talk about cooperative housing that's produced under many, many programs, Federal, State and in the open market. Limited equity cooperatives here in the District have been encouraged by the option to purchase that the residents have, that has been exercised for a very long time.

A lot of the HUD programs, the 221(d)(3) program, the 236 program, produced a lot of cooperative housing. And you can take a look at it. I mean, I'd love to take you on a tour.

Mr. WELLER. I believe when you increase home ownership, you strengthen a community, because people want to protect that stake they have in the community, and the equity they have.

Ms. LEWIS. They do, indeed.

Mr. WELLER. The next couple of questions I'd like to direct to Mr. Cooper, if I could. The GAO report made some recommendations regarding independent market studies, and I was wondering, do you perform independent market studies to verify that the properties are targeted to local tenant needs as part of your program?

Mr. COOPER. We mentioned in our testimony about independent market studies. I think probably Mr. Collins can speak to the same issue in how he treats it, but we specifically don't rely on the market study that has been done by the original developer/builder, if you will, who engages a market analyst to do a study for him.

We go to a separate, independent, third party study so that we can verify for our investors that, in fact, the market does exist. We have actually abandoned properties, if you will, when we find early on that our independent market study doesn't give us the comfort level that we need.

Mr. WELLER. But that's standard operating procedure for you?

Mr. COOPER. That's standard procedure, correct.

Mr. WELLER. Is that the same for you, Mr. Collins?

Mr. COLLINS. It is. And we go one step further. We have an acquisition staff, who are actually very experienced in doing market studies themselves. So we'll do a third market study to confirm what was seen in the other two, or to correct accordingly.

Mr. WELLER. Will that study determine if there's already low cost tenant units already available in the neighborhood or in the community being served?

Mr. COLLINS. Yes. Actually what you're really looking at when you go into a study and see the marketability, you're really looking at the comparable rents in the area, and costs of construction of the projects in the area. And you're looking at the vacancy rates. What else?

But in general, it's a complete process to underwrite the project, to know that there is, in fact, a market for that particular rent and that particular project and the need.

Mr. WELLER. But, now, does the availability of low cost tenant units in the area, will that affect your decision, if you discover there is——

Mr. COLLINS. Yes, it will. Certainly we don't want to see something overbuilt in an area, because it will be drawing away tenants from the other particular project.

Mr. WELLER. One of the questions I focused on with the previous panel, of course, there's a discussion in the past, and of course a debate which succeeded in making permanent the low-income housing tax credit in 1993.

And since them some have discussed making it temporary again, going back to the old way. And there were some figures that were shared by some members of the previous panel which would indicate that they felt that if we eliminated the permanent status of the low-income housing tax credit, and sunsetted it with more temporary status that we would see a reduction of investment by the private sector, but also a reduction in the amount of affordable housing units available, as a result of that.

Do you agree with those figures?

Mr. COLLINS. Yes, we do. As a matter of fact, I might mention that normally people outside of Washington don't fully understand the definition of sunset. To them it's repeal. And I know in the last case, in 1993, when sunset was being talked about, even the threat of it discouraged people from investing. Referring to what Larry Swank said earlier about the development process, it takes at least 2 years to actually go through the process which ultimately results in a developer making a commitment in time and money and lost opportunity.

And in many cases, someone is really not likely to rely on a decision 2 years from that date to commit that kind of money. If you look at the investment community, a lot of what's happened when the credit was made permanent, you saw a large involvement on the part of the corporations in investing in this.

And the reason for that was because it was something of a permanent nature. And they have to build up their own staffs and they have to invest time and money themselves, and they need some lead time.

And what has happened, with the increased number of investors in the market, which was again the result of the permanence you find that the larger lenders were willing to come in at a much lower interest rate, made it much more competitive, and you've got to recognize that this program, in my 25 years of experience, this one is more market driven than the programs in the past.

In addition to that, the prices have gone up. And what that has resulted in is more money going into the project. Because there are a number of controls and constraints out there which prevent developers, syndicators or any other party taking exorbitant amounts of profit out of this. There are limits.

Mr. WELLER. So as I understand the point you're making, Mr. Collins, you were saying that with the permanent status, there is greater interest by potential lenders and investors.

Mr. COLLINS. Yes.

Mr. WELLER. And because of that, more affordable rates of credit were provided.

Mr. COLLINS. Yes.

Mr. WELLER. Bringing down the cost of construction of the units.

Mr. COLLINS. Exactly.

Mr. WELLER. Mr. Roberts, do you want to add to that?

Mr. ROBERTS. Let me just say that the projects that would be most severely curtailed would be the more difficult projects, the more time consuming projects, and the riskiest projects. And those tend to be the inner-city projects.

Mr. STEVENS. Mr. Weller, to respond to your question, also?

Mr. WELLER. Yes, Mr. Stevens.

Mr. STEVENS. We noticed that the IRS' oversight increased dramatically after the program was made permanent. And when I talked to the staff members at the IRS, they acknowledged that they have a limited budget and limited priorities also.

And that as long as the program was possibly going to last only another year, they were not given the priorities to put all their resources into it. I think the same thing is true at the State level.

It's a little bit like the Alan Greenspan effect. Comments that you all make, and actions that you take can have ripple effects in the market.

Mr. WELLER. I realize my time is running out. Is there any other panelists who would like to comment on that question, briefly?

Mr. HARVEY. Briefly, there is another effect, when you start to talk about sunset. Developers who are willing to go through the process and spend the money up front, not knowing if 2 years from now they're going to have a project that is going to come out the other end.

There's also, for the organizations, like ours, who have been built up to police it, to go out and look at it, to make sure that it's been properly built and will be there over a longer period of time.

If you say in 2 years you could not have a program any more, everyone begins to look at what they're doing, and you have to look internally as to your organization and how you deploy your assets, and whether you can really spend the money to check everything for a program that might not exist as you go forward.

So it just creates tremendous uncertainty, and investors don't like it, developers don't like it, and if you're trying to run a top notch program it's very hard to juggle people, lives, careers on that kind of a basis.

Mr. WELLER. Thank you. And I realize my time has expired, Mr. Chairman.

Mr. PORTMAN. Thank you, Mr. Weller. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Mr. Roberts, would any good purpose be served by requiring more onsite inspections of low-income housing tax credit properties, considering the GAO report showing that in their judgment there is basically zero noncompliance.

Mr. ROBERTS. I'm not sure you'd get a great deal more. We do very frequent onsite inspections ourselves. On any project of at least 30 units, we're there at least once a year. And just slightly less frequently for very small projects.

And the States are doing a great number of onsite visits, according to NCSHA's best practice standards, which most of the States already pursue. But I'm not sure it would be harmful to have the Service require State visits on a periodic basis.

Mr. COYNE. Some witnesses have told us that low-income housing tax credit allocations should be increased, and some others

have told us that a portion of the allocations goes unused. Are these views inconsistent, or are they unrelated?

Mr. Roberts.

Mr. ROBERTS. In the places we work, there is very little or no underutilization of the credits. In fact, we did a study of our own investments, and found that fewer than one-half of 1 percent of the housing projects to which we commit failed to proceed.

Mr. COYNE. Has anyone had a different experience?

Mr. HARVEY. No. Our experience would confirm that, that it's a very, very competitive system out there, and I'm sure that NCSHA can answer that question. But it seems, this underallocation is a mystery to us, because we're constantly looking and see the need to do more and more.

Mr. COLLINS. I might mention that I notice in the Chair's introductory comments the other day, she talked about $320 million in unused credits. I think it was around the 1993 period, or during the period that the study was conducted.

I can't say for a fact, but my assumption is that that was due to the fact that when you had the question of the sunset, a lot of people were sitting on the sidelines, a lot of the corporations and a lot of developers to see whether or not, in fact, the credit would remain permanent, which resulted in less activity.

But our experience, too, we do quite a bit annually. And we haven't seen any shortages.

Mr. COYNE. Mr. Roberts, in your judgment, are there any of these low-income housing tax credit projects that have failed, that you can cite?

Mr. ROBERTS. I would say there may be very rare failures, but the system is structured that when a project starts to get into trouble, there are early warning signs, and there are enough participants in the process with enough at stake so that people come and fix it.

It's distinctively different from some of the previous generation housing programs in that regard.

Mr. COYNE. So while there are some failures, there are only a very few?

Mr. ROBERTS. Very occasional, and by failure you might mean that perhaps a sponsor just can't fulfill its obligations, and so instead of the project itself failing, the sponsor fails and another sponsor is brought in to take over.

Mr. COYNE. Thank you.

Mr. PORTMAN. Just following quickly on Mr. Coyne's questions, it sounds as though, from what you're saying, and I think this is consistent with what we've been learning, that there, in fact, is excess demand out there, and I see some affirmative head shaking.

My question is sort of the flip side of that, Mr. Collins and others. Does that mean the credit is too rich? I mean, let's look at this as a taxpayer subsidized system. If the credit weren't so rich, then the States wouldn't be in the situation of the excess demand. Instead there would be more of a balance, wouldn't there?

Mr. COLLINS. I wouldn't say the credit was too rich. You have to look at the comparable costs out in the marketplace and returns, because when an investor invests in one of these complexes or in-

vestments, he's looking at other alternative investments, and they've got to be competitive.

And we're seeing right now, where the returns or the yields are getting lower, we have seen corporations withdrawing from the market because of that. It's not——

Mr. PORTMAN. Because of——

Mr. COLLINS. Because the yields are coming down, because they're not competitive with alternative investments that they're faced with. And that's what they're really looking at.

Mr. PORTMAN. OK. But you just told me that the demand is in excess of the credits available.

Mr. COLLINS. Agreed. There's still a lot of people.

Mr. PORTMAN. We can't have it both ways here. Let's decide which one it is.

Mr. HARVEY. Let me, if I could, Herb, let me turn——

Mr. PORTMAN. I understand it's all in comparison to other investments, and most of you who are in the investment business understand that.

But all I'm suggesting is, could the credit be less rich, and could there still be a viable program?

Mr. HARVEY. If you look at the credit, it's capped, Congressman Portman, and there is great demand. What we find in our organization is that there are a great many other projects they could go through because there are a lot of people to be served.

They go into that competitive process, and I think it's three to one in a number of States that apply, and only one comes out the other end.

There is money waiting at the other end, and there are a number of banks and other investors who would like to invest in a project that's going to make sense for 15 years.

The competition has lowered the yields, yet they are still willing to do a project that makes sense over that period of time. And they've stabilized those yields that they're willing to receive.

There are some other reasons why banks and financial institutions want to do that, because they have a Community Reinvestment Act, a proactive responsibility to put their money out and to do something that will cure that need for them, and also make money for them.

Mr. PORTMAN. You're opening up another area of questioning, which is interesting, and just quickly if I could go off on that. I know we may have to abandon this room for another meeting coming in, but how many of you have experienced where CRA is an influence in terms of.

Mr. STEVENS. Definitely.

Mr. PORTMAN. It is?

Mr. STEVENS. Definitely.

Mr. PORTMAN. So the flip side of that is these units in a sense are even more subsidized to the extent that now there's a CRA incentive. Do you see what I'm getting at?

It's sort of an additional subsidy in a sense, depending on how you view that requirement on banks.

Mr. HARVEY. That requirement on banks is not something that a bank makes money from. There's no subsidy. They're putting their money at risk, just as anyone else in the private sector.

Mr. PORTMAN. To meet a Federal requirement.

Mr. STEVENS. Right.

Mr. PORTMAN. That they would not otherwise do, you're saying, perhaps, except for that requirement. And passing that cost along.

Mr. HARVEY. They add to the market force that is out there for these projects. And they're competing with other investors that don't have that same requirement.

Mr. PORTMAN. Right. But do you see the point that I'm making is just when you look at the totality, and I'm not saying that the GAO should have done this. This wasn't really its charge. But there is an interesting combination here of incentives and subsidies.

The question I would have, too, for you, Mr. Harvey, if you can give us a sense of this, and maybe Mr. Collins and others have these numbers also, is what rate of return are your investors looking for these days?

I mean, what is the typical rate of return? What's the after tax return that they're expecting out of a tax credit project?

Mr. HARVEY. I'd say it's on the 15 percent order, and it just depends——

Mr. PORTMAN. Fifteen percent after tax?

Mr. HARVEY. After tax rate of return is about where it is. Now, this is for 15 years, being in this over a period of time. And that's—I think that's——

Mr. COOPER. Well, if you present value that down, it drops in half from what he just said. If you're present valuing that 15 year, 15 percent. So you're talking about more like a 7½ or 8 percent present valued. And that's what Mr. Collins was talking about, competing with alternative investments.

Mr. PORTMAN. Right. But that's the market. And there are incentives.

I just want to make one final comment, and that's to thank Mr. Platt for some of his recommendations and give him a chance to further comment if he would like. We talked a little bit about the credit, could it be altered. You gave us a couple of specific recommendations where you think it could be altered.

Do you want to comment on those further, in terms of the context of this discussion, that the credit might be adjusted?

Mr. PLATT. I think there's no question that we are probably going to face in the years to come a shortage of housing. And there's probably a need for new construction. So I'm not suggesting that that's an issue that somehow is not going to have to be dealt with.

But I'm not sure that within the confines of the current budget, one, for HUD, and two, in terms of the money allocated for the low-income housing tax credit, that that's an effective use in terms of new construction costing $100,000–$150,000. In some cases, we have found, in California, as high as $200,000 a unit for new construction. That's not an effective use of the low-income housing tax credit. Rather, we should emphasize rehabilitating and saving from deterioration the existing housing stock.

I know we're working with a not for profit group in Mr. Coyne's district to—they're interested in acquiring a HUD project that they want to rehabilitate, I believe, in Homewood, and that they've been in touch with you about.

We also would be very supportive, I think, of your suggestions in terms of cooperatives. We've been trying to do some of the same kinds of things, but within the current law, where the tenant association becomes the general partner, the leasing co-op. They're all not satisfactory substitutes for what you suggested.

And I think the cooperative mode is probably a better mode to go for than tenant owned condominiums, simply because you're going to have the restrictions that you talked about in terms of allowing people to buy into the project and so forth.

I think it is very critical to try to do something to preserve existing housing, make sure the dollars we've spent to create the low-income housing is well spent, that it stays affordable for a longer period of time, and that we offer opportunities for tenants to be empowered and own their own housing in one fashion or another.

Mr. PORTMAN. And the longer period of time is why you would support the 30 years.

Mr. PLATT. The 30 years. And as most people have commented, most States already do that. Some don't.

Mr. PORTMAN. And the $40,000 per unit is——

Mr. PLATT. In Federal law it ought to be taken out to that period of time.

Mr. PORTMAN. The $40,000 per unit is to be able to target the resources?

Mr. PLATT. Well, that's a target. It ought to be market—you're basically saying market prices. What you are doing now, the Housing Committee is doing with section 8 rents is a similar process.

You've got areas in which the rent necessary in a low-income housing project, this might not be a low-income housing tax credit project, but to service the mortgage and maintain the property is, let's say, $650 a month. You've got tenants at 20 percent of median income who are able to pay a very small percentage of that.

And so there's a significant subsidy both from the State and the Federal Government in terms of section 8 to pay that rent.

On the other hand, the market rent for a similar apartment in the same community is $450 a unit. So what Mr. Lazio's Subcommittee is driving to, and HUD's driving to is make sure that that section 8 subsidy is no greater than the market rates are.

And that's in effect what we're saying here. To do the same thing with the credit.

Mr. PORTMAN. Thank you again for your input. Mr. Coyne, additional questions?

Mr. COYNE. No questions.

Mr. PORTMAN. I want to thank the panelists for their expert testimony. It's been very, very helpful as we pursue this project of looking at the credit, and thank you for sticking with us this afternoon.

This hearing is adjourned.

[Whereupon, at 1:45 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

CLARK & CLARK

WILLIAM D. CLARK (1905-1991)
WILLIAM B. CLARK, JR.
G. BENJAMIN CLARK
NICHOLAS G. CLARK

builders · real estate development

PHONE 901 · 761-3030 · 5050 POPLAR AVE · MEMPHIS, TENN 38157

April 28, 1997

Congressman John S. Tanner
1127 Longworth Building
Washington, D.C. 20515

Dear Congressman Tanner:

I am in the process of rehabilitating two apartment properties (540 residence units) developed by my father in 1949-50. I am doing this with the help of the Low Income Housing Tax Credit program and I have encountered a feature of the law which is frustrating my efforts while providing no benefit to the Federal government or the low income families which the program is designed to serve. Namely, the Internal Revenue Code [39(c)(1)(A)] prevents the Low Income Housing Tax Credits from reducing the tax payer's regular income tax below the tentative minimum tax. In other words the credits can not be used to offset the alternative minimum tax.

In my case this restriction requires me to "syndicate" my rehabilitation project, bringing in one or more partners with sufficient tax liability above the alternative minimum tax to be able to utilize these credits. It would seem to be a matter of indifference to the government whether the credits are used by me or by syndicated partners, since the reduction of tax revenue would be identical in each case.

The negative effects of this restrictions are:

1. It is costly to me and therefore a disincentive to participate in the program. Therefore, this cost effective program, which harnesses private industry to provide housing for the nation's poor, will reach fewer families.

2. As ownership of housing is shifted out of the community to large and distant corporate investors, stewardship of the properties will inevitably suffer. This change in goals and perspective cannot be offset by governmental regulation and monitoring.

This problem can be resolved by amending IRC 38(c)(1)(A) to permit Low Income Housing Tax Credits to be used to offset alternative minimum tax. I would point out that there is a precedent: the Empowerment Zone Employment Tax Credit established by the Revenue Reconciliation Act of 1993 provides that this specific tax credit may be used to offset up to 25 percent of a tax payer's alternative minimum tax liability.

Mr. Homer Brannon
April 28, 1997

I appreciate your attention and I am sorry that I am unable to appear in person due to the impending birth of two grandchildren. I will, however, be happy to furnish any additional information you may require.

Sincerely,

William B. Clark, Jr.

WBC/bp

Statement by the
National Multi Housing Council and National Apartment Association
to the Ways and Means Committee of the U.S. House of Representatives
Oversight Subcommittee on the Low-Income Housing Tax Credit
May 1, 1997

We greatly appreciate the opportunity to speak in strong support of the Low-Income Housing Tax Credit to encourage much-needed investment in affordable housing for lower income Americans through continued permanence of the Credit.

The recently concluded thorough and exhaustive study of the Credit program by the Government Accounting Office (GAO) clearly demonstrates both the need for continuance of the Credit as well as the outstanding manner in which affordable housing is being built across America as a result of the Credit.

The National Multi Housing Council (NMHC) and the National Apartment Association (NAA) represent the majority of the nation's firms participating in the multifamily rental housing industry. Our combined memberships are engaged in all aspects of the development and operation of apartments, including ownership, construction, finance, and management. The National Multi Housing Council represents the apartment industry's largest and most prominent firms. NMHC members are the principal officers of these organizations. The National Apartment Association is the largest national federation of state and local associations of apartment industry professionals including developers, owners, investors and property managers. NAA is comprised of 150 affiliates and represents more than 25,000 professionals who own and/or manage more than 3.3 million apartments.

In 1993, the Low-Income Housing Tax Credit program became a "permanent" part of the Federal Tax Code. This permanency led to greater participation among both individual and

corporate investors, thus increasing the efficiency of the credit to a point where more than 93 percent of each dollar invested in the credit goes directly into the cost of developing an LIHTC property. In fact, the price investors now pay for the credit is more than 35 percent higher than it was in 1993, due to increased competition from investors. The result is that more dollars have been invested in providing decent, affordable housing for lower income American parents and their children. This investment is now widespread and includes many rural areas that have been in need of affordable housing. Since 1986, the Low-Income Housing Tax Credit has been responsible for more than 800,000 new or modernized affordable housing units.

In spite of the number of units of affordable housing that have been developed or modernized during the past 11 years, there is still a great unmet need for affordable housing. The Center on Budget and Policy Priorities has estimated an approximately 4.7 million shortfall in the number of affordable housing units. Unfortunately, the gap in number of units available continues to grow because of the annual number of units that are removed from our nation's stock of affordable housing. We believe it is safe to say that absent a program such as the Low-Income Housing Tax Credit, there is no practical way that the need for affordable housing would be met in the marketplace.

We would like to commend Committee Chairman Bill Archer for asking for the GAO study and to also commend Subcommittee Chairwoman Nancy L. Johnson for holding timely hearings on the Credit within 30 days of release of the GAO study. Both the study and these hearings have given a chance for supporters and critics alike to voice their opinions on the effectiveness of this program. This type of process will only help to make the Credit work even better than it does today.

As we mentioned earlier, the GAO study was extremely thorough. There can be no doubt that any major problem with implementation of the Credit program would have been uncovered by the GAO study. No major shortcomings were found. In fact, the program works so well that only a handful of errors were actually discovered by the GAO. We believe that this speaks well for a program that is designed to bring market forces to bear on meeting the problem of providing affordable housing to lower income Americans.

Can improvements be made to the Credit program? The answer is obviously "yes". Should local housing agencies be more diligent in making sure that a given Credit property is meeting an unmet need and that the economics are in place to ensure long range success of the property as affordable housing? Once again, the answer is "yes". The GAO study, diligent oversight by the appropriate Congressional committees, and a continued permanency of the Low-Income Housing Tax Credit all serve to bolster confidence in the continued success of this very worthwhile effort.

Chairman Johnson, Ranking Minority Member Coyne, and honorable Subcommittee members:

Thank you for the opportunity to address in writing the committee's interest in the administration of the Low Income Housing Tax Credit Program (LIHTC); specifically, as it relates to the April 1997 United States General Accounting Office (GAO) Study.

Regrettably, obligations before the Texas State Legislature have not afforded the time to address this committee in person; therefore, I appreciate the opportunity to submit written testimony.

My name is Larry Paul Manley, and I was appointed executive director of the Texas Department of Housing and Community Affairs (the Department) by Governor George W. Bush on August 9, 1995, and was confirmed by the Texas Senate on March 17, 1997.

As executive director, I oversee the state's lead agency responsible for affordable housing, community development and community assistance programs, and regulation of the state's manufactured housing industry. We administer funds in excess of $400 million annually, the overwhelming majority of which is derived from mortgage revenue bond financing and refinancing, federal grants and federal tax credits.

In Texas, the tax credit program is the primary means of directing private capital towards the creation of affordable rental housing. The Department believes that virtually no new multifamily construction dedicated to affordable housing has been commenced in Texas since 1987 without the utilization of LIHTC. As you are aware, tax credits provide developers of low income rental housing with a benefit that is used to offset a portion of their federal tax liability in exchange for the production of affordable rental housing. This benefit induces private sector investment in affordable housing.

Since 1987, more than $145 million has been allocated to some 930 projects creating approximately 67,800 units of affordable multifamily housing directly benefiting low and very low income families, senior citizens, persons with disabilities, and persons throughout Texas.

GAO Study

Last year, this Committee requested that the United States General Accounting Office (GAO) perform a national study of the LIHTC programs as administered by states which are authorized by the Internal Revenue Code and Regulations to allocate the tax credits. The GAO Study was released April 9, 1997.

In the GAO study, the LIHTC program for Texas is referenced eleven times on seven pages (pages 57, 58, 59, 60, 61, 68 and 114). With the exception of

two subsections (pages 68 and 114), the comments are positive. Further, the two exceptions which were less than positive are not new recommendations. Each was taken from the recommendations made by the Texas State Auditor's Office in its Audit Report dated August 19, 1996 (Texas and New York were the only two states which had already undergone performance reviews at the state level). These recommendations were considered to be good ones which would better the LIHTC program, and were incorporated into the LIHTC Standard Operating Procedures and in the 1997 Qualified Allocation Plan (QAP).

Approved by the Governing Board (the Board) of the Department in April 1997, the following comments have been specifically prepared in response to the GAO's references to Texas within its Low Income Housing Tax Credit Study:

1) GAO Study-Chapter 2, Page 57
"State Controls for Allocating Credits to Housing Varies-Some States Supplemented, Updated, or Further Analyzed Census Data."

> *GAO - "To obtain more detailed or more current information, some of the states whose consolidated plans we reviewed supplemented or updated their Census data. California inventoried its rental properties, **Texas** surveyed interest groups and residents, and Maryland convened regional advisory groups, New York asked Census to perform a special survey to update its data, and Florida hired a contractor to obtain current data. ... Despite their limitations, the Census data can be used to analyze the causes of problems such as high rent burdens and overcrowding, To varying degrees, the states have used their tabulations of Census data to analyze the availability, adequacy, affordability, and accessibility of rental housing. For example, although most states assessed availability by comparing the rate of growth in rental units with the rate of growth in the tenant population, **Texas**, Vermont, and Ohio performed further analyses to determine whether they had enough affordable units for tenants at different income levels. These additional analyses revealed shortages that the states had not previously detected and might not otherwise have sought to address."*

> **TDHCA COMMENT: Positive**

2) GAO Study-Chapter 3, Page 59
"State Controls for Allocating Credits to Housing Varies-Agencies Used Market Studies to Define Appropriateness to Local Conditions."

> *GAO - "Forty-one of the 54 allocation agencies reported relying to some degree on market studies. Our review of the qualified allocation plans for 20 agencies indicated, however, that these agencies' requirements for market studies varied considerably. Whereas some agencies set forth extensive, specific criteria, others established very general requirements: Florida's agency requires that a market study identify and evaluate the (1) best comparable and competitive existing*

and proposed properties; (2) project's dynamics, including rents, designs, and amenities; (3) historic, current, and forecasted absorption rates; (4) occupancy and vacancy levels in the market; and (5) population growth trends and other demographic data. ***Texas*** *requires an analysis of many of the same factors, as well as an overall opinion by the analyst on the adequacy, feasibility, and reasonableness of the project's costs, absorption rates, rent levels, and reserves. Nevada's agency requires "a description of the project substantiating community need" and a market or feasibility study that is "acceptable" to the state. Virginia does not require a market study but will consider one if it is submitted with the application..... The agencies with a requirement for timeliness generally specified that the market study be no older than 6 months(****Texas****) or 1 year (California and Ohio) when it is submitted with a project's application for tax credits. Most of the agencies required that the study be submitted with the application."*

TDHCA COMMENT: Positive

3) GAO Study-Chapter 3, Page 60
"State Controls for Allocating Credits to Housing Varies-Agencies Have Defined Lowest Income and Longest Periods"

GAO - "All of the 54 allocation agencies reported giving preference to proposed projects serving the lowest income tenants, and 49 of the agencies reported giving preference to proposed projects with agreements to serve qualified tenants for longer periods of time than the federal law requires. Such agreements are commonly referred to as extended use agreements.... In reviewing several states' consolidated plans, we found that different states assigned different roles to the tax credit program. Whereas ***Texas*** *planned to use its tax credits for households with incomes between 31 and 50 percent of their area's median income, North Carolina targeted its allocation to renters with incomes between 51 and 60 percent of their area's median income."*

TDHCA COMMENT: Positive

4) GAO Study-Chapter 4, Page 68
"Several Factors May Affect the Housing Actually Delivered Over Time-Some Plans Allow the Allocation Process to be Bypassed"

GAO - "Seventeen of the 20 qualified allocation plans that we reviewed provide flexibility for overriding or bypassing the allocation process. This flexibility includes removing certain restrictions, such as set-asides, at the end of the year; reserving a portion of the allocation for discretionary awards; and giving designated officials open-ended discretion. Flexibility can help target needs missed during the allocation process or needs resulting from unforeseen

circumstances.... Even when priorities have not changed, end-of-the-year awards to projects that meet identified needs may be appropriate. Similarly, giving the governor or head of the allocating agency control over a set-aside or other discretionary authority may allow for meeting unforeseen needs. Unless discretionary awards are reserved for unforeseen needs, are well-documented, and are made public, they may undermine the creditability of the allocation process. Recognizing this potential problem, New York's allocating agency, in August 1996, eliminated a clause in its allocation plan giving the head of the agency the discretion to award over 20 percent of the annual allocation, or $4.5 million. Texas' 1995 allocation plan gave senior managers considerable discretion in ranking properties to allocate tax credits. Senior managers could override the staffs' recommendations and awarded credits to applications with lower scores in order to provide for "geographic dispersion."

TDHCA COMMENT: Positive, but the discretionary factors must be identified as program goals and the reasons for the project's selection should be documented. The Texas State Auditor's Report dated August 19, 1996, made a recommendation that the Department provide a written summary of each application allocated tax credits documenting the reasons for the project's selection and that discretionary factors should be identified as program goals at the beginning of the cycle. The Department concurred with the recommendation. A written summary documenting the reasons for selection is to be compiled for all future selections. In addition, the recommendations in the State Auditor's Report have been incorporated in the LIHTC Standard Operating Procedures and have been incorporated into the 1997 Qualified Allocation Plan (QAP).

5) GAO Study-Chapter 5, page 114
"Opportunities Exist To Improve State and Federal Compliance Oversight Activities"-Third Party Reviews of Two State Agencies Found Control Weaknesses

The GAO Study points to the four concerns relative to the Department's administration of the LIHTC program addressed by the State Auditor's Report dated August 19, 1996. Those four issues have been addressed by the Department as set forth below:

A) GAO - "As discussed in chapter 3, agency management overrode staff recommendation on credit allocations in 29 of 46 projects that were evaluated for tax credits during one tax credit allocation cycle in 1995. The staff's recommendations were appropriately documented and based on applicable threshold and selection criteria."

COMMENT: The analysis performed by the Department's credit underwriting staff does not include all the factors considered by LIHTC staff and the Board. In addition to evaluating financial

feasibility reports from credit underwriting staff, the LIHTC staff and the Board consider the developer's track record, the geographic dispersion of credits within specific markets (as well as on a statewide basis) and other discretionary factors deemed appropriate and necessary by the Board and identified in the QAP. The Board is empowered to make final decisions as to the awards, including discretion allowed within the QAP. This approach is undertaken to avoid a "by the numbers" approach to reservation and allocation of credits for the greater benefit of the low income rental population of the entire state.

Far from overriding underwriting recommendations, the LIHTC staff imposed conditions on all projects including those which received unconditional recommendations from the underwriting staff. The 29 files referred to in the GAO Study were processed as follows: Nine files were underwritten by the LIHTC allocation staff due to time constraints, as was the practice for all files prior to the 1995B cycle. Eight files declined by underwriting were subsequently approved by the Board based upon discretionary factors decided upon by that body. Twelve files were re-evaluated by credit underwriting at the request of the LIHTC staff to achieve a broader geographic distribution of tax credits on a statewide basis and to satisfy the needs of under-served areas. These twelve were subsequently recommended for approval, subject to various conditions.

As to the current status of the 46 files in question, two have returned their credits, four have been granted extensions, and the balance of 40 projects have either been completed or are in various stages of construction. All conditions imposed are consistently being monitored.

The Department has determined that the discretionary factors will be documented in the future to eliminate the possibility of questions as to why certain decisions were made.

B) GAO - "In contrast to staff recommendations, agency management decisions were not well documented and failed to include Underwriting Department recommendations to the agency's Board of Directors, which was customary for projects funded by other state and federal housing programs."

COMMENT: In 1996, the Department implemented a policy of forwarding all underwriting reports, with the project summaries documenting the reasons projects were recommended for tax allocations, to the Board for its review. (The Department's report to the Board with respect to the 1995 allocations stated that "... the Department is recommending projects within reasonable limits of economic feasibility that did not secure the highest points in a bid to achieve a broad geographic distribution of the projects statewide.)

C) GAO - "Board members were in frequent contact with tax credit program staff. Since several of these Board members were actively involved in housing and real estate activities, this raised concerns of at least an appearance of a conflict of interest."

COMMENT: The Department's enabling legislation dictates that certain industry representatives be named to the Board. To prohibit them from participation altogether would have the ironic result of excluding from the process the very expertise deemed valuable and appropriate by the Legislature. The Department has taken steps to ensure that all Board inquiries related to the LIHTC program during the allocation process are routed through and handled by the Executive Director. In all situations where a conflict may arise, the affected member recuses himself or herself from discussions and voting in accordance with applicable Texas law.

D) GAO - "Several projects that initially were rejected by the underwriting department were given conditional approval at the request of the Program Manager. However, there was no documentation that the agency's Board of Directors was informed of these conditions nor that these projects were returned to the Underwriting Department to ensure that the conditions had been met."

COMMENT: The Department imposed conditions with respect to the closure of the construction loan and commencement of construction which superseded and, in many respects, were more stringent than the conditions contained in the underwriting reports prepared by the underwriting staff of the Department. Satisfaction of these conditions was appropriately reviewed by the LIHTC staff to ensure that the conditions were met. It is not the role of underwriting staff of the Department to ensure these conditions are met, rather, the LIHTC staff is charged with this responsibility.

Importance Of LIHTC Continuance

While initially posting modest results during its inception in 1987, the LIHTC program in Texas has become the most effective means of providing affordable multifamily rental units throughout the state.

As a new product in 1987, tax credits were first introduced to a Texas market suffering from a real estate recession, particularly in the Houston, Dallas/Ft. Worth, San Antonio, and Austin areas. The overbuilding of multifamily projects coupled with consumer caution resulted in a tax credit allocation of slightly more than $2 million dollars out of a possible allocation of $26 million; the smallest allocation in Department history. Consequently, the

1987 allocation was directed towards the rehabilitation of some 2,300 units of primarily abandoned properties.

The savings and loan crisis would eventually lead to the acquisition and sale of many abandoned properties at the direction of the Resolution Trust Corporation (RTC). As more projects became available, the Department was able to increase the supply of affordable multifamily units through the tax credit program. In 1988, the Department allocated more than $6 million for the rehabilitation of some 4,500 units across the state. In 1989, the allocation increased to its highest level of the three year period to more than $8,123,000. Despite a soft real estate market in the late 1980's, the Department was successful in developing a greater number of affordable units through the use of deed restrictions placed on the sale of RTC properties. This early utilization of the Tax Credit Program is commonly referred to as the Department's "paint and patch" era (the vast majority of tax credit properties were "rehabilitation" and not "new construction.")

Still, the uncertainty of this new Federal program was clearly marked by investor skepticism. Doubt and uncertainty caused the market value of the credit to be diminished. [Many developers applying for tax credits had purchased former RTC properties located in the state's larger metropolitan statistical areas.] This trend allowed the Department to issue larger portions of its tax credit allocation but, unfortunately, vast areas of the state were simply underserved by the program. New construction, if any, was greatly limited by a soft market and a lack of substantial construction or multifamily lending.

Investor skepticism was finally put to rest in 1993 when bipartisan Congressional efforts finally made the Tax Credit permanent. It is worth noting that 1993 marked the first time Texas was able to award its entire allocation of tax credits: more than $28,879,000! In fact, 1993 also marks a dramatic shift away from simply "painting and patching" properties to the creation of new affordable multifamily units.

The recent permanency of the Tax Credit program has led to even greater competition among investors. Investors clearly became more interested than ever before in participating in the program. The Department's most recent allocation in 1996 awarded nearly $27 million for the creation of 5,494 units, compared to the 1987 allocation of just over $2 million for the renovation of 2,300 units! Further, in 1996, only one in every four applications were awarded tax credits; putting the Department in the enviable position of selecting the highest quality affordable multifamily housing projects from the pool of applicants.

Texas LIHTC Properties Of Note

It is simply impossible to recognize the many innovative and unique affordable multifamily projects that would not have been provided to low income Texans without the LIHTC program. However, of the more than 930 developments in Texas, several have been noteworthy:

- Hillcrest House in Dallas opened on September 23, 1996. A property of AIDS Services of Dallas, Hillcrest is a 64-unit single room occupancy complex that provides a broad range of individually tailored services to persons who are HIV positive. Extensive services to low income individuals include: home health care, medical case management and food and legal services.

- Ash Lane Apartments of Euless, Texas put 250 units of 1, 2, and 3 bedroom apartments into service in 1993. The property continues to score extremely well on Department monitoring reports and is 100 percent set-aside for households under 60 percent of the AMFI. This property is characterized by a special swimming pool for small children, as well as exceptional landscaping.

- Park Village Apartment Homes of Conroe (near Houston) is perhaps unique for the amount of services offered to its residents. This new 144 unit property is 100 percent occupied by low and very low income families. Park Village Apartment Homes are available in 2, 3, 4, and even 5 bedroom apartments and townhomes. Park Village offers on-site childcare, a youth recreational center with activity director, swimming pool, and close location to shopping areas and an elementary school. This property continuously scores high marks on Department monitoring visits.

- The Waterford at Goldmark in Richardson (Dallas suburb) will give senior citizens in this region greater choices in apartment living. Waterford at Goldmark has recently been nominated by Department staff for an National Council of State Housing Agencies award. Approximately 20 percent of the complex, which is within the Richardson school district, will be rented at market rates with the remaining units reserved for those whose annual family income is between $19,000 and $33,000. The new complex will help fill one of Richardson's greatest housing needs. According to the 1990 U.S. Census, at least 17 percent of Richardson's population is 55 years old or older. The significant requirement of this project is age; at least one member of the household must be 55 years of age or older.

Permanence of LIHTC Is A Proven Winner For Texans

According to a 1996 National Low Income Housing Coalition report, the Low Income Housing Tax Credit produces about 100,000 affordable housing units annually, representing 94 percent of all low-income rental apartments in this country. Further, the report states that since its passage, the program has generated $12 billion in private investment and helped to create nearly 90,000 jobs annually, resulting in $2.8 billion in wages and $1.3 billion in tax revenue. An estimated 800,000 housing units for low income families have been financed through the program.

As stated previously, since 1987, Texas has allocated more than $145 million to some 930 projects creating approximately 67,800 units of affordable

multifamily housing. Clearly, low and very low income Texas families would not have benefited without this important and successful program.

According to the 1997 State of Texas Low Income Housing Plan and Annual Report, more than 1 **million** low income Texas families (elderly households, small-related family households, larger-related family households) will be in need of housing assistance by the year 2000. Many of these families will benefit from an increasingly successful LIHTC program.

On the other hand, if the LIHTC were to be "sunset", it is doubtful whether this successful program involving the private sector could be replaced with a program that has encouraged such across-the-board participation from the private sector and still obtain equivalent results for affordable multifamily housing. The 1997 funding levels for the Texas program are an estimated $24,000,000; targeted towards very low income households.

To reiterate, the LIHTC Program is the primary means of enticing private capital to invest in the creation of affordable rental housing in Texas.

Chairman Johnson, Ranking Minority Member Coyne; members of the Subcommittee, again, thank you for the opportunity to share with you the many tangible benefits of the LIHTC Program in Texas.

###

O