FOIA Number: 2014-0224-F

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Subgroup/Office of Origin: National Economic Council

Series/Staff Member: Carl Haacke

Subseries:

OA/ID Number: 15351

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LIHTC [Low Income Housing Tax Credit] [2]

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National Council of State Housing Agencies

Urgent

January 12, 1998

MEMORANDUM

TO: John Orszag, The White House

FR: Barbara Thompson

RE: Housing Credit Production Under Cap Increase Legislation

Here is the state-by-state list of additional Housing Credit units that could be produced under a cap increase and indexation. To produce this list, we used each state's 1997 per capita allocation as our base. In the chart we sent you earlier, we used the total value of Credits allocated in 1996 and assumed a constant allocation from 1997-2003. To make the two charts consistent, we have updated our earlier chart showing how total Housing Credit production increases under cap increase and indexation legislation. We have also re-written the paragraphs we sent you earlier to reflect the data using each state's per state allocation, which is probably the better estimation method.

Under the current $1.25 limit, 62,354 Housing Credit units will be financeable in 1999 (assuming current average credit cost per unit, indexed for inflation).

If the cap is increased by 40 percent, total production will rise to 87,296 units in 1999. If the cap is increased by 40 percent, but not indexed for future inflation, the number of units financeable each year after 1999 will shrink, as inflation takes its toll on the purchasing power of the new $1.75 cap. The total number of new units possible between 1999 and 2003 would be 117,652.

As the attached chart shows, if the cap is increased by 40 percent in 1999 and indexed against future inflation in each of the next four years, the number of additional units during the five-year period would be 142,348—24,696 more units than would be possible if the new cap is not indexed.

Attachments

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

Increase in Housing Credit Production After Adjustment for Inflation and Indexation

	Total Housing Credits Available	Total Housing Credits Allocated	Total Low Income Apartments	TC per Apt.	Adjusted Cap Available	Adjusted Cap Allocated	Total Low Income Apartments	Additional Units Produced Under Cap Increase
1987	$313,113,750	$62,885,954	34,491					
1988	$311,487,310	$209,779,916	81,408					
1989	$314,230,800	$307,182,516	126,200					
1990	$317,674,673	$213,148,840	74,029					
1991	$497,170,042	$400,420,875	111,970					
1992	$488,494,556	$337,032,273	91,300					
1993	$546,407,023	$424,704,615	106,008					
1994	$523,275,973	$495,846,892	117,099					
1995	$432,249,822	$420,838,098	84,205					
1996	$391,635,156	$379,877,799	77,003	4933.29				
Total	$4,135,739,105	$3,251,717,778	903,713					
1997	$336,134,808	$336,134,808	66,152	5081.28				
1998	$336,134,808	$336,134,808	64,225	5233.72				
1999	$336,134,808	$336,134,808	62,354	5390.73	$470,588,731	$470,588,731	87,296	24,942
2000	$336,134,808	$336,134,808	60,538	5552.46	$484,706,393	$484,706,393	87,296	26,758
2001	$336,134,808	$336,134,808	58,775	5719.03	$499,247,585	$499,247,585	87,296	28,521
2002	$336,134,808	$336,134,808	57,063	5890.60	$514,225,012	$514,225,012	87,296	30,233
2003	$336,134,808	$336,134,808	55,401	6067.32	$529,651,763	$529,651,763	87,296	31,895
Totals:			294,131				436,479	142,348

Note: Per capita allocation is increased to $1.75 in 1999 and indexed for inflation at 3% per year from 2000-2003; credit per unit is indexed at 3% per year for 1997-2003.

Source: National Council of State Housing Agencies

Increase in Housing Credit Production After Adjustment for Inflation and Indexation

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1992	$488,494,556	$337,032,273	91,300					
1993	$546,407,023	$424,704,615	106,008					
1994	$523,275,973	$495,846,892	117,099					
1995	$432,249,822	$420,838,098	84,205					
1996	$391,635,156	$379,877,799	77,003	4933.29				
Total	$4,135,739,105	$3,251,717,778	903,713					
1997	$391,635,156	$379,877,799	74,760	5081.28				
1998	$391,635,156	$379,877,799	72,583	5233.72				
1999	$391,635,156	$379,877,799	70,469	5390.73	$531,828,919	$531,828,919	98,656	28,187
2000	$391,635,156	$379,877,799	68,416	5552.46	$547,783,786	$547,783,786	98,656	30,240
2001	$391,635,156	$379,877,799	66,423	5719.03	$564,217,300	$564,217,300	98,656	32,233
2002	$391,635,156	$379,877,799	64,489	5890.60	$581,143,819	$581,143,819	98,656	34,167
2003	$391,635,156	$379,877,799	62,610	6067.32	$598,578,133	$598,578,133	98,656	36,046
Totals:			332,408				493,281	160,873

Note: Per capita allocation is increased to $1.75 in 1999 and indexed for inflation at 3% per year from 2000-2003; credit per unit is indexed at 3% per year for 1997-2003.

Source: National Council of State Housing Agencies

THE WHITE HOUSE
Office Of The Vice President

FOR IMMEDIATE RELEASE
TUESDAY, January 13, 1998

CONTACT: 202-456-7035

VP GORE ANNOUNCES LOW-INCOME HOUSING TAX CREDIT EXPANSION
FY99 Budget Includes Expansion Of Credit To Help Provide More Affordable Housing

CHICAGO -- Citing the need to empower communities and help provide more affordable housing for low-income Americans, Vice President Al Gore today (1/13) announced an unprecedented expansion of the Low-Income Housing Tax Credit (LIHTC) in the Administration's Fiscal Year 1999 budget.

"President Clinton and I are committed to helping those who live in distressed communities," Vice President Gore said after touring a Chicago South Side area, the North Kenwood neighborhood. "Americans of all income levels deserve safe, affordable housing. The expansion of the Low-Income Housing Tax Credit will help us meet that goal by providing incentives to the private sector to create quality rental housing for low-income Americans, which, in turn, will help bring new businesses to the area."

Vice President Gore was joined during the walk through the North Kenwood neighborhood by Chicago Mayor Richard Daley, U.S. Senators Carol Moseley-Braun and Richard Durbin, U.S. Rep. Bobby Rush (D-1st), Local Initiatives Support Corporation Representative Paul Grogan, and community developers and activists.

Estimating that the expansion will help build an additional 150,000-180,000 affordable housing units over the next five years, Vice President Gore said the proposal will increase the LIHTC cap by 40 percent.

"For those who question whether federal policy can make a difference or if there is hope for distressed communities, the answer is here in North Kenwood," Vice President Gore said. "After suffering 50 years of neglect and less than 10 years after the first bricks were laid on a housing credit development, we can see the results -- 2,000 new homes for people of all incomes and ages, new commercial development, and new hope and confidence for the future."

The expansion of the LIHTC builds on President Clinton's and Vice President Gore's call to permanently extend the credit; it is a key part of their agenda to empower communities. Vice President Gore chairs the Community Empowerment Board, which helps bring together the public and private sectors to create jobs and invest in our nation's most distressed urban and rural areas.

##

EXPANDING THE LOW-INCOME HOUSING TAX CREDIT:
HELPING DEVELOP MORE AFFORDABLE RENTAL HOUSING IN URBAN AND RURAL COMMUNITIES
January 13, 1998

Today, Vice-President Gore Will Announce That the Administration's FY99 Budget Includes A Major Expansion of the Low-Income Housing Tax Credit Which Will Help Spur The Private-Sector to Develop More Affordable Rental Housing for Low-Income Americans. President Clinton and Vice-President Gore's proposal to expand the Low-Income Housing Tax Credit (LIHTC) builds on their successful support to make the credit permanent in 1993, and is a key part of their agenda to empower communities, encourage the development of more affordable housing, and help provide the spark of private enterprise to distressed areas.

- **Increasing the Cap on the LIHTC from $1.25 Per Capita to $1.75 Per Capita.** Since the creation of the LIHTC in 1986, each state has been provided $1.25 per capita of housing tax credits to allocate to developers of affordable housing. Even though building costs have increased nearly 40 percent in the last decade, the amount of the credit has not been adjusted for inflation. President Clinton and Vice-President Gore will propose to increase the cap on the LIHTC from $1.25 per capita to $1.75 per capita — restoring the value of the credit to its 1986 level. *This proposal will cost $1.6 billion over five years and is fully paid for in the Clinton-Gore Administration's FY99 budget.*

- **This Expansion Will Help Develop An Additional 150,000-180,000 Affordable Housing Units Over the Next Five Years.** Estimates suggest that the LIHTC currently helps develop 75,000-90,000 affordable housing units each year. The President and Vice President's proposal to increase the cap by 40 percent will mean an additional 150,000-180,000 quality rental housing units for low-income American families during the next five years.

- **The Low-Income Housing Tax Credit Works.** Until the LIHTC was made permanent by President Clinton and Vice-President Gore in 1993, it was not working efficiently. With Congress extending the credit for only short periods of time — the credit was set to expire in 1989, then 1990, then 1991, and then 1992 — investors were not always willing to put money down for a long-term chance on low-income housing. Now, with the credit permanent, it is nearly fully utilized: in 1996, 97 percent of the available credits were allocated — the remaining were either carried over to 1997 or reallocated among the states.

    - ***Washington Post*, October 19, 1995:** "The program's goal is to produce rental housing for poor people, and by almost any measure it has been wildly successful."

    - ***Chicago Sun-Times*, December 21, 1997:** "The [Low-Income Housing] tax credit is one of the few Washington success stories. It helps construct new housing for low-income tenants as a public-private partnership... it is exactly the kind of program Americans should be demanding of the federal government."

- **Expanding the LIHTC Is Necessary To Meet the Demand for the Credit and the Demand for Affordable Housing.** While state housing agencies had $392 million worth of tax credits to allocate, developers *requested* more than $1.1 billion in credits in 1996 — that means that demand for the credits exceed supply by nearly 3 times. With such excess demand, an expanded LIHTC is needed and competition will remain fierce for the additional credits. Moreover, there are an estimated 5 million American families living in inadequate housing. Expanding the LIHTC — along the rest of the Clinton-Gore Administration's agenda to empower communities — helps to address the housing needs of American families.

- **The LIHTC Helps Low-Income Americans.** The LIHTC must help low-income American families: developers have a choice of having either at least 20 percent of their renters have incomes below 50 percent of the area median income or at least 40 percent with incomes below 60 percent of the area median income. According to GAO, about 75 percent of tax credit households met HUD's definition of "very-low income" — that is, their incomes were below 50 percent of the area's median income. Indeed, GAO estimated that the average housing credit renter earns only $13,300 per year — that's, on average, 37 percent of the area median income. The tax credit helps to lower the cost of rent: the average monthly rent was about $450 for these households.

HOW DOES THE LOW-INCOME HOUSING TAX CREDIT WORK?

➔ **The Credit Is Administered By The States.** The Low-Income Housing Tax Credit functions similarly to a block grant to State housing agencies. Currently, each state is permitted to allocate a certain amount of tax credits annually based on its population ($1.25 of credits per capita). Each state devises its own allocation plans, reflecting its own housing needs. In nearly all states, demand for the credits far exceeds their supply, thus creating the environment where project sponsors compete against one another to receive them. Each state chooses the projects that most efficiently serve low-income households.

➔ **How Are Projects Financed?** A developer usually finances a low-income housing project in part by using a private mortgage, in part using equity paid into the project from investors who receive the tax credit, and in part from other sources including local and state governments. Developers "sell" the tax credits to private investors — often organized into partnerships by syndicators such as Local Initiatives Support Coalition (LISC) and Enterprise Foundation — who use the credits to offset their income tax liability. In return for the credits, the private investors provide capital financing for the projects, filling 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, providing the investors with a rate of return over 10 years.

➔ **Using the Tax Credits.** The maximum annual credits that states may award is about 9 percent of development costs for new construction (or substantial rehabilitation) or approximately 4 percent for building acquisition and rehabilitation and federally subsidized construction. These credits are provided annually for 10 years. Since a dollar saved tomorrow is not as valuable as a dollar saved today, this amounts to 70 percent of the development costs of new rental housing and 30 percent of housing receiving other subsidies or rehabilitation of existing housing in *present value terms*. Each year about $300 million worth of new credits are available. Since the credits are provided for 10 years, the aggregate annual cost of annual credits to the Federal government is currently about $3 billion.

➔ **Ensuring Compliance.** The LIHTC is a performance-based incentive, because investors can claim the credit only if the housing is built on schedule. Moreover, once housing units have been built, state agencies are responsible for monitoring the projects for compliance with Federal requirements concerning household income, rents, and project habitability. Noncompliance with these requirements may result in tax credit recapture or the denial of previously issued or used credits. A GAO study found a good record of compliance.

CLINTON-GORE COMMUNITY EMPOWERMENT AGENDA: TAPPING THE POTENTIAL OF AMERICA'S URBAN AND RURAL COMMUNITIES

Since 1993, President Clinton and Vice-President Gore have been committed to tapping the potential of America's urban and rural communities. The Clinton-Gore Administration has worked with the private sector, states, and localities to help revitalize America's communities by bringing capital, jobs, and opportunity to distressed areas; reducing crime; cleaning up the urban environment; reinventing public housing; making housing more affordable for more American families; and making the dream of homeownership a reality.

Private Enterprise and Capital to Distressed Areas. The Clinton-Gore Administration has renewed the commitment of the Federal government to helping bring private enterprise and improving access to capital for lower-income households, minorities, and other traditionally underserved borrowers.

- ***105 Empowerment Zones and Enterprise Communities.*** The Clinton Administration has awarded announced 105 EZs and ECs – nine urban and rural EZs, two supplemental zones, and 95 ECs, four of which received enhanced awards. During the first eighteen months alone, the EZ/EC effort generated more than $2 billion of new private sector investment in community development activities.

- ***Strengthened and Simplified the Community Reinvestment Act (CRA).*** The Clinton Administration reformed CRA regulations to emphasize performance. Under President Clinton, the private sector has pledged $270 billion going forward in loans to low-income communities. Lending to minority and low-income borrowers is on the rise: since 1993, conventional home mortgage lending to African Americans increased by 67.2 percent, lending to Hispanics is up to 48.5 percent, and lending in low and moderate income neighborhoods increased 37.9 percent.

- ***Created the Community Development Financial Institutions Fund (CDFI).*** Through grants, loans, and equity investments, the Treasury Department's CDFI Fund is helping to create a network of community development financial institutions in distressed areas across the United States. This year, the CDFI Fund's budget was increased to $80 million. *The President's FY99 budget will call for $125 million for CDFI fund -- a 56-percent increase over FY98.*

Helping Bring Jobs and Opportunity to Distressed Areas. A cornerstone of the Administration's community empowerment agenda is helping to bring jobs and opportunity back to distressed areas:

- ***$3 Billion Welfare-to-Work Jobs Initiative.*** The Clinton Administration fought for a $3 billion welfare-to-work jobs initiative, as part of the Balanced Budget Agreement. The Administration is implementing this challenge fund directly to both cities and states for allocating additional resources to help long-term, hard-to-serve welfare recipients find and keep jobs.

- ***A New Welfare-to-Work Tax Credit.*** The President signed into law a new Work Opportunity Tax Credit (WOTC), which expands eligible businesses to include those who hire young adults living in Empowerment Zones and Enterprise Communities. Employers may claim a 35-percent credit on the first $10,000 of wages in the first year of employment for long-term welfare recipients, claim a 50-percent credit in the second year of employment, and treat employer-provided education, training, health care, and dependent care as wages.

- ***Job Creation through Economic Development Initiative and Section 108 Loan Guarantee.*** EDI grants are being used as an infusion of capital into community development activities, enhancing the debt financing provided by the 108 Loan Guarantee program. Together, the programs serve as a catalyst for economic development and build on the economic development successes of the community Development Block Grant program. The estimated jobs created by EDI and the 108 loan guarantee program increased from 16, 900 in 1993 to over 200,000 in 1995.

Cleaning Up The Urban Environment. The Clinton Administration has launched a landmark effort to clean up and redevelop Brownfields sites. In total, the Brownfields action agenda has marshaled funds to clean up and redevelop 5,000 properties, leveraging between $5 billion and $28 billion in private investment and creating and supporting 196,000 jobs.

- ***Brownfields Tax Incentive.*** The President signed into law a new tax incentive help motivate the private sector to clean up and put back into productive use environmentally contaminated properties in distressed communities, or Brownfields. This incentive is expected to leverage $6 billion in private sector clean up investment, and help clean up 14,000 Brownfields sites.

Reducing Crime Across the Nation. The Clinton Administration has worked hard to make urban neighborhoods safe and crime-free. As a result of the President's efforts, crime rates have plummeted in many large cities. The downturn has been particularly noticeable with respect to violent crime; the national murder rate decreased by 8 percent between 1994 and 1995.

- ***Police on the Streets.*** The Cornerstone of the Administration's efforts to fight crime is the continuing effort to put 100,000 more community policing officers on the streets. Thus far, Federal grants are funding the hiring or redeployment of more than 64,000 additional officers.

- ***Reducing Crime in Public and Assisted Housing.*** The President believes that public and assisted housing are a privilege, not a right, and residents who commit crime and peddle drugs should be immediately evicted.

- ***One Strike-and-You're-Out.*** The Administration is aggressively implementing the "One Strike and You're Out" policy that helps cities prevent drug dealers and violent offenders from terrorizing public housing residents by ensuring that people who engage in drugs and other criminal activity will face certain and swift eviction.

Making The Dream of Homeownership A Reality. The Clinton Administration has helped increase the homeownership rate to an *all-time high* of 66 percent. As a result, 67.6 million Americans own their homes. Equally encouraging, these gains have been broadly distributed among minorities, female-headed households and families with less than median income.

- ***National Homeownership Strategy.*** The National Partners in Homeownership is an unprecedented public-private partnership formed in 1995 in response to a challenge by President Clinton. These Partners have made significant strides in increasing housing production, reducing regulatory barriers, and expanding homeownership opportunities for *all* Americans.

- ***Lowering Homeownership Costs.*** During the last five years, President Clinton reduced the Federal Housing Administration (FHA) mortgage insurance premiums three times for first-time homebuyers who obtain homebuyer counseling. HUD expects 45,000 homebuyers a year to benefit from the reduction that makes homeownership more affordable. As a result, homebuyers will save $1,200 in closing costs on the average FHA mortgage of $85,000.

- ***Making FHA Work Better.*** The Clinton Administration is also revamping the Federal Housing Administration to better meet the needs of today's consumers – through streamlining and consolidating services, automating functions using the latest technology, introducing innovative new products, and forging strategic alliances with public and private partners.

Producing More Affordable Housing for All Americans. Besides the Low-Income Housing Tax Credit, the Clinton-Gore Administration has provided the necessary flexibility and incentives to communities and businesses to encourage the development of more affordable housing and has improved assistance for those with acute housing needs.

- ***HOME Investments Partnership Program.*** To date, the Administration has provided almost 310,000 families with housing assistance through the HOME program. Since 1993, the funding for the HOME program has increased by 50% -- to $1.5 billion in FY98.

- ***Homeless Assistance.*** Funding for homeless assistance has increased from $571 million in 1993 to $823 million today. The President and Vice-President's next budget will include a 40-percent increase in homeless assistance, bringing the funding level to $1.15 billion. HUD has improved the use of these program dollars, supporting a new "continuum of care" strategy. As a result, HUD's transitional and permanent housing programs are serving up to fourteen times the number of persons served in 1993.

Promoting Equal Opportunity to Achieve One America. HUD has pledged to double its targeted number of housing discrimination enforcement actions, partnering with 67 non-profit housing groups to reduce housing discrimination. HUD has also entered into 113 best practice agreements with key lenders, which are resulting in more fair lending practices and expanded opportunities for low-income minority families.

Making The City Home. The Clinton Administration has implemented several programs that targets homeownership expansion in inner cities.

- ***Officer Next Door.*** This program provides incentives for police officers to live in the communities where they work by offering a 50 percent discount on the purchase of HUD-owned foreclosed properties in designated revitalization areas. To date, HUD has accepted 261 sales contracts and closed 59 deals on HUD-held properties under this initiative.

- ***Homeownership Zones.*** This program enables cities to undertake large-scale, single family developments in inner city neighborhoods. Such developments can retain and attract stable, middle-income families into the inner cities. In addition to increasing the supply of safe and decent housing in urban areas, the program will create new jobs in the home-building industry and stimulate new investment in revitalized communities.

- ***Ginnie Mae's Targeted Urban Lending Initiative.*** Ginnie Mae is spearheading a new Federal initiative to stimulate at least $5 billion in annual mortgage loans to help about 75,000 families buy homes in one of 72 cities designated as Empowerment Zones or Enterprise Communities across the nation.

Reinventing Public Housing. The Clinton Administration has initiated a comprehensive effort to fundamentally transform public housing.

- ***Replacing the Worst Developments..*** More than $2 billion in funding has provided for the demolition and revitalization of 68 of the worst public housing developments.
- ***Improving Management.*** The Clinton Administration is cracking down on bad management in public housing by taking over the most troubled public housing authorities and forging innovative partnerships with local, state officials and residents.
- ***Rewarding Working Families.*** The Administration's Public Housing Management Reform Act of 1997 proposes new admissions policies that balance the need to achieve a greater mix of incomes in public housing with policies that offer incentives for existing poor tenants to raise their own incomes. It also allows housing authorities flexibility to design their rent systems to be consistent with local welfare programs and encourage work.

An owner loses entitlement to the credit and is required to pay back a portion of credits already taken if the project is sold or ceases to qualify for low-income use within 15 years.

The credit can only be taken if it is allocated by the State housing authority; there is an annual per-resident limit of $1.25 for total credit authority. The housing agency must require an enforceable 30-year low-income use (through restrictive covenants), although if a buyer cannot be found after the initial 15-year period, the property can be converted to market use and sold at a controlled price.

The amount of the credit that can be offset against unrelated income is limited to the equivalent of $25,000 in deductions under the passive loss restriction rules.

Impact

This provision substantially reduces the cost of investing in qualified units. Given the spending caps which limit the allocation of property to this use, excess profits to investors might normally be expected. The oversight requirements should prevent this outcome, and direct much of the benefit to qualified tenants of the housing units. Thus, although the direct benefits are received by high-income investors, the actual benefit is likely to accrue to lower- and moderate-income tenants.

Rationale

The tax credit for low-income housing was adopted in the Tax Reform Act of 1986. It replaced a number of other provisions in the law, including accelerated depreciation, five-year amortization of rehabilitation expenditures, expensing of construction-period interest and taxes, and general availability of tax-exempt bond financing.

The initial credit was nine percent a year for ten years for new housing, and four percent per year for ten years for housing receiving other subsidies, and for the acquisition of rehabilitated existing housing. These amounts totaled 90 percent and 40 percent of the cost respectively, but the credit rate is to be set to be the equivalent of 70 percent and 30 percent in present value.

There was a State ceiling per capita of $1.25. Some minor changes were made by the Revenue Bill of 1987, including carryover of credit authority by States. The credit was scheduled to expire at the end of 1989, but was extended by the Omnibus Budget Reconciliation Acts of 1989 (through 1990 with a $0.9375 ceiling).

This 1989 revision also required States to regulate projects more carefully to insure that investors were not earning excessive rates of return. The law also introduced the requirement that new projects have a long-term plan for providing low-income housing, and Act Legislation in 1990 extended the provision through 1991. The Tax Extension Act of 1991 extended the credit through the first half of 1992. The Omnibus Budget Reconciliation Act of 1993 made the credit permanent.

Assessment

The low-income housing credit is much more targeted to benefiting lower-income individuals than the more general tax provisions it replaced. Moreover, by allowing State authorities to direct use, the credit can be used as part of a general neighborhood revitalization program.

There are, however, a number of criticisms that can be made of the credit (see the Congressional Budget Office study for a more detailed discussion). The credit is unlikely to have a substantial effect on the total supply of low-income housing, based on both micro-economic analysis and some empirical evidence.

There are significant overhead and administrative costs, especially if there are attempts to insure that investors do not earn excess profits. And, in general, some economists would argue that housing vouchers, or direct-income supplements for the low-income, are more direct and fairer methods of providing assistance to lower-income individuals.

Finally, although recapture rules and low-income-use covenants limit the ability of investors to take the credit and then shift use to higher-income purposes, there is an incentive to investors to allow units to deteriorate over time.

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--, Joint Committee on Taxation. *General Explanation of the Tax Reform Act of 1986*. May 4, 1987, pp. 152-177.

--. *Staff Description and Analysis of Tax Provisions Expiring in 1992*. January 27, 1992, pp. 69-78.

U.S. Department of Housing and Urban Development, Office of Policy Development and Research. "Evaluation of the Low-Income Housing Tax Credit: Final Report," prepared by ICF, Inc. February, 1991.

Commerce and Housing:
Other Business and Commerce

MAXIMUM 28% TAX RATE ON LONG-TERM CAPITAL GAINS

Estimated Revenue Loss

[In billions of dollars]

Fiscal year	Individuals	Corporations	Total
1997	10.5	-	10.5
1998	11.5	-	11.5
1999	12.8	-	12.8
2000	14.5	-	14.5
2001	16.2	-	16.2

Authorization

Sections 11(h), 631, 1201-1256.

Description

Gains on the sale of capital assets held for more than a year are limited to a maximum tax rate of 28 percent under the individual income tax, even though rates on ordinary income go up to 39.6 percent. Also, gain on the sale of property used in a trade or business is treated as a long-term capital gain if all gains for the year on such property exceed all losses for the year on such property. Qualifying property used in a trade or business generally is depreciable property or real estate that is held more than a year, but not inventory.

The tax expenditure is the difference between taxing gains at a 31-, 36-, 39.6- and a 28-percent tax rate. It is associated only with those in these higher brackets.

Several special categories of income that are treated as capital gains have been listed separately in previous tax expenditure compendiums:

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Commerce and Housing:
Housing

LOW-INCOME HOUSING TAX CREDIT

Estimated Revenue Loss

[In billions of dollars]

Fiscal year	Individuals	Corporations	Total
1997	1.8	1.0	2.8
1998	2.1	1.1	3.2
1999	2.3	1.2	3.5
2000	2.5	1.4	3.9
2001	2.9	1.6	4.5

Authorization

Section 42.

Description

A tax credit for a portion of acquisition costs (allowed in equal amounts over ten years) is allowed for low-income housing.

The credit rate is set so that the present value of the tax credit is equal to 70 percent for new construction and 30 percent for housing receiving other Federal benefits (such as tax exempt bond financing), or for substantially rehabilitated existing housing.

The credit is allowed only for the fraction of units serving low-income tenants, which are subject to maximum rent. To qualify, 20 percent of the units in a rental project must be occupied by families with less than 50 percent of area median income, or 40 percent of the units must be occupied by families with less than 60 percent of area median income.

Transformation in the Bronx

The new South Bronx was on display this week when President Clinton visited spanking-clean neighborhoods that were burnt-out relics as recently as 15 years ago. Dismembered by highway construction in the 1950's, abandoned by the middle class in the 60's and torched by arsonists in the 70's, the Bronx was salvaged by community groups that rousted drug dealers and reclaimed the borough street by street. Nonprofit organizations then developed thousands of affordable homes and apartments, using state, city and Federal funds in concert with programs that allow corporations to reduce tax liabilities by contributing to projects for the poor.

Mr. Clinton was right when he called the Bronx a national model for urban revitalization. But with all levels of government doing less in housing, the tax credit program has had to carry more and more of the burden. The obvious success in the Bronx has encouraged participation from banks that would have avoided the borough in the past. Financial institutions have now contributed $250 million to an equity fund jointly developed by the Local Initiatives Support Corporation and the Enterprise Foundation, the country's two largest operators in the low-income housing business. In partnership with New York City, these two organizations will build 5,000 new units over the next three years. In addition, they are now exporting Bronx know-how to other communities in New York City and across the country.

In the Bronx itself, the next step is to employ Federal loans in an attempt to replace businesses that fled during the fire and chaos of the 1970's. Creating businesses is more difficult than building houses. But if the participants work as diligently during the next decade as they have in the past, the enterprise has an excellent chance.

Watching the Construction

Rain and snow fall during the early-morning walk to Times Square, where cement trucks are lined up, idling, at the high-rise construction site on the corner of 43d and Broadway. One at a time they pull into position and empty their slurry into the cement pump, which probes the gaps in a skeletal upper story. The drivers carefully hose down their vehicles, from whose flanks hang five-gallon plastic buckets. The water hisses against the tires and undercarriage and echoes hollowly off the cement trough — all of it nearly inaudible because this corner, where the Condé Nast building is rising, is the nucleus of noise in Manhattan.

Some people love the big-hole stage of high-rise construction, when they can peer into the earth and be reminded that the substrate of the city is, in fact, natural rock. Some people love the cleared-ground stage, when a new prospect suddenly opens and light penetrates the neighborhood from forgotten angles. But this is perhaps the most appealing stage of all, when the still disarticulated pieces of the whole — conduit and pipes and rebar and steel beams — are being craned upward, in full view of residents of the Woodstock Hotel, who gather on warm days to watch. The building going up at 4 Times Square will eventually be 48 stories tall. It will have a character, a complexion that is a function of its design, the use of its ground-floor retail spaces, and its tenants — Condé Nast and the law firm of Skadden Arps Slate Meagher & Flom.

But right now this building, approaching the halfway point, is at that interesting stage when it no longer belongs to the developer, the Durst Corporation, or to the architects, Fox & Fowle, or to its future tenants. It belongs to the construction workers, men and a few women dressed, for the most part, in brown duck and wearing hard hats with all the aplomb of a young Sinatra in his snap-brim Cavanaugh.

The building is so deep and now so high that it can be hard to catch glimpses of the crew at work. One man scurries across the highest, most easterly beam. Another appears for an instant against the blaze-orange construction fencing that edges each floor. A shower of welder's sparks falls from the corner of an upper floor, pleasantly reminiscent of that moment when, on summer evenings in Yosemite, they used to push a bonfire off Glacier Point.

The New York Times

FRIDAY, DECEMBER 12, 1997

Weather
Today: Mostly cloudy, flurries. High 42. Low 32. Wind 5-10 mph
Saturday: Partly sunny, cold. High 42. Low 30. Wind 7-11 mph
Yesterday: Temp range: 41-46
Wind chill N/A. Details Page D2

The Washington Post

FINAL
Inside: Weekend
Today's Contents on Page A2

121st Year No. 7 FRIDAY, DECEMBER 12, 1997 25¢

Ex-Secretary Cisneros Is Indicted

Former Mistress, Aides At HUD Also Charged

By Toni Locy
Washington Post Staff Writer

Former housing secretary Henry Cisneros was indicted yesterday by a federal grand jury on 18 felony counts of conspiracy, obstruction of justice and making false statements to the FBI involving more than $250,000 in payments he made to an ex-mistress.

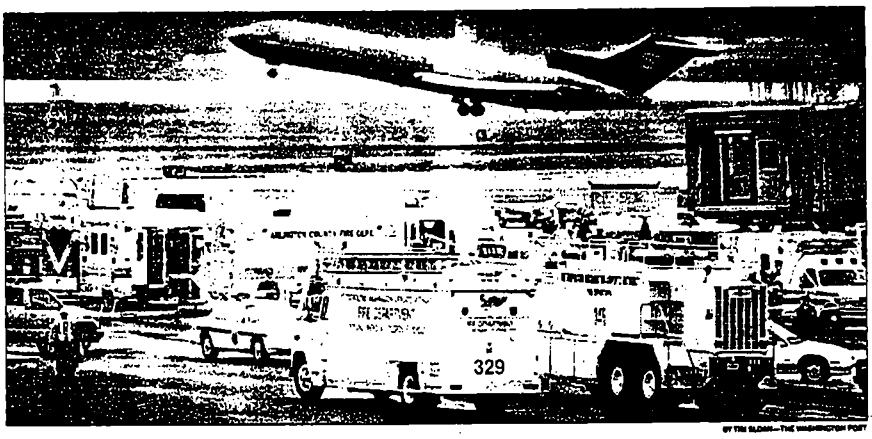
The indictment also charges the former mistress, Linda Medlar, 45, of Lubbock, Tex., with conspiracy and with making a false statement. Also indicted were two former Cisneros aides, Sylvia Arce-Garcia, 43, of Los Angeles, who was charged with conspiracy, and John D. Rosales, 41, of the Washington area, who was charged with conspiracy and two counts of making false statements.

The 66-page indictment outlines a multifaceted conspiracy in which Cisneros, who headed the Department of Housing and Urban Development from 1993 through 1996, worked frantically before, during and after his confirmation to keep Medlar from disclosing the true nature of their long relationship and the full extent of payments he had made for several years to keep her quiet.

Contrary to what Medlar and Cisneros had said at the time, the grand jury determined, Medlar had threatened to disclose publicly the relationship and the payments he had made to her. The grand jury also said Cisneros had made payments to a second woman with whom he had an affair, though it did not name her. Medlar knew about the other woman and was being paid to also keep that quiet.

And despite what Cisneros told the

See CISNEROS, A42, Col. 1



FUMES AT NATIONAL AIRPORT

A busy section of National Airport was closed after fumes sent four people to the hospital and left others with irritated throats and nausea. US Airways, the only airline affected, canceled or delayed some flights. Above, a tarmac is filled with emergency vehicles. Story on Page D1.

Long Road Ahead for Global Warming Pact

Administration Turns to Process of Making Its Case in Congress

By Peter Baker and Helen Dewar
Washington Post Staff Writers

With a far-reaching global warming treaty now in hand, President Clinton and his administration turned their attention yesterday to the daunting task of selling the agreement on Capitol Hill.

The White House said it will not even submit the treaty for ratification in the Senate—where at this point it would meet with almost certain defeat—until it can persuade key developing nations such as China and India to limit their production of greenhouse gases, much as the United States and other wealthy nations would under the pact.

Instead, the administration opened what will be at least a year-long domestic campaign to promote the unprecedented agreement before sending it to Congress, probably in 1999. White House officials argued that the deal reached in Kyoto, Japan, would not require cuts in U.S. emissions as drastic as may have first appeared necessary. And Clinton took aim at critics with a mocking attack on their fears that the treaty will spell economic doom.

"I see already the papers are full

See KYOTO, A40, Col. 1

The Cost of Kyoto

■ If new technology and business incentives can't reduce greenhouse gas emissions enough, Americans may have to learn to live with much more drastic measures.

WORLD, *Page A41*

At the White House, Vice President Gore discusses treaty.

Microsoft Told To Suspend Software Link

Judge Issues Temporary Ruling, Names 'Special Master' to Probe Distribution of Internet Browser

By Rajiv Chandrasekaran
Washington Post Staff Writer

A federal judge moved to blunt Microsoft Corp.'s market dominance yesterday, telling the company that it cannot force makers of personal computers to distribute its Internet-browsing software until a court-appointed official has fully examined the controversial practice.

The decision hands at least a temporary victory to the Justice Department, which has long sought to mute Microsoft's power in the technology industry. The ruling, also a boon to many of the software giant's competitors, could hinder Microsoft's ability to create new versions of its popular Windows computer operating system, some legal specialists said.

The Justice Department had asked U.S. District Judge Thomas Penfield Jackson to hold Microsoft in contempt of court for making PC manufacturers install its Internet Explorer software as a condition of licensing Windows 95. The department argued that Windows and Internet Explorer are two separate products and that by distributing them together, Microsoft was violating the terms of a 1995 agreement with the government that attempted to constrain some of the company's business practices.

Justice insisted that quick action was needed to halt Microsoft's practices before the company gained dominance of the browser market. If it did, the government warned, Microsoft effectively would be able to dominate commerce and content on the Internet.

Though declining Justice's request to hold

See MICROSOFT, A26, Col. 1

■ *In Silicon Valley, competitors applaud ruling as "good first step."* *Page G1*

Chastened Swiss Banks Search for Key to New Prosperity—and Respect

By Anne Swardson
Washington Post Foreign Service

ZURICH—Few sites are cozier than this city's Bahnhofstrasse at Christmastime.

Tidy streetcars glide along the middle of the street. Designer boutiques—Cartier among the jewelers, Yves St. Laurent a typical clothier—line the sidewalks. The store windows blaze with colorful holiday decorations. And looming over both sides of the thoroughfare and surrounding squares are the solid stone buildings of the great banks of Switzerland: Credit Suisse, Union Bank of Switzerland and Swiss Bank Corp. are the Big Three, each dating back 85 years or more. Equally august are such smaller banks as Julius Baer, J. Vontobel and Zurich Cantonal Bank.

But the reassuring facades are misleading. Analysts within and outside Switzerland agree that Swiss banks are in their deepest trouble in decades. The banks, known the world over for probity and prosperity, are heading into the next century chastened—and less profitable.

Even the long tradition of the Big Three was broken this week when Union Bank and Swiss Bank announced they plan to merge. The move was praised as a timely and well-matched marriage, but it can also be seen as a defensive maneuver against the multitude of threats now facing the banks of Switzerland.

As a legion of critics now charge, Swiss banks badly mishandled claims from descendants of Holocaust victims to deposits entrusted to them in wartime conditions. But they also suffer from an entirely different, and arguably more severe, set of woes. The issue of Jewish accounts, it turns out, has masked a profound crisis in the fundamental economic health of the banks and in the rules that underpin them.

Since 1990, about $28 billion of the Swiss banks' loans have gone bad, mostly because of unwise lending. Last year, apparently for the first time, all of the Big Three reported financial losses. The number of smaller banks has fallen by one third, mostly through buyouts; one small bank was force to close, and Swiss taxpayers had to bail out a larger one.

"There has never been a period in the postwar era when Swiss banks have had such a difficult time," said Urs W. Birchler, a director of the Swiss National Bank, the country's central bank.

Most indications are that the worst is over

See SWISS, A40, Col. 3

Montgomery May Pump Up Teaching Staff

Superintendent's Plan Stresses Key Subjects

By Fern Shen
Washington Post Staff Writer

Montgomery County School Superintendent Paul L. Vance proposed yesterday adding 238 teachers next year for elementary reading, middle school math and high school algebra classes—an initiative intended to address parents' and political leaders' growing concern over class size.

County Executive Douglas M. Duncan (D) called the issue a priority last week, vowing to take advantage of a revenue windfall in his budget to reduce class size in the county's public schools. Yesterday, Duncan applauded Vance's $9.2 million plan, included in the proposed $939.5 million budget released by the school superintendent.

"I think the class size proposal is very innovative and targets the right places," Duncan said. "It's exactly what I had requested. It's affordable, and I think it's very encouraging."

Vance unveiled his proposal as Maryland released results of public school assessment tests that show that Howard County again had the state's top scores. Montgomery's scores improved, but its state standing slipped; scores in Prince George's and Charles counties declined. [Details, Page A37.]

Vance's proposal, instead of reducing the student-teacher ratio by a small increment across the whole school system, would reduce it dramatically in areas considered to be critical "gateways" to students' academic achievement.

"We know from the research of the National Institutes of Health, for example, that early intervention is critical for reading success," Vance said last night at Rockville High School, where he presented his 1998-99 budget to the school board and an assembly of parents, principals, administrators and teachers.

"Reading problems solved by 30 minutes a day of intervention in kindergarten and first grade require

See VANCE, A37, Col. 1

The Secret of a Senator's Success?

Behind-the-Scenes Consulting Firm Steered Money to Candidate

Triad Management helped propel Sam Brownback to victory.

By Ruth Marcus
Washington Post Staff Writer

When Sam Brownback celebrated his election as a Republican senator from Kansas last year, he thanked the usual list of family, staff and supporters—except for one.

Unmentioned among his Kansas backers was a Washington consulting firm called Triad Management Services. But Brownback had ample reason to be grateful to Triad, which played a significant though invisible role in propelling him to office.

Perhaps most important was a last-minute issue advertising blitz sponsored by a mysterious organization that the Brownback campaign said it had no knowledge of, yet was actually a group run by Triad. The advertising, which came in the last two weeks of what had been a neck-and-neck race, totaled $410,000—a significant sum in a campaign in which Brownback himself spent $2.2 million.

The ads, paid for by a nonprofit group called Citizens for the Republic Education Fund, lauded Brownback as a "conservative Republican taxfighter" and labeled his opponent, stockbroker Jill Docking, an out-of-state liberal.

The advertising is only part of extensive behind-the-scenes help that Triad provided directly and indirectly to Brownback's campaign, according to evidence amassed in recent weeks by Democratic investigators for the Senate Governmental Affairs Committee. Triad, which bills itself as a contribution advisory service for conservative donors, steered contributors Brownback's way, helped him make fund-raising calls and recommended

See BROWNBACK, A38, Col. 1

Police Say Man Slipped Through Their Hands

Suspect in Va. Student's Death Was Twice in Custody, Had Broken Parole

By Eric Lipton and Wendy Melillo
Washington Post Staff Writers

Pennsylvania police had Arthur J. Bomar Jr. in custody on assault charges at least twice before he allegedly abducted, raped and murdered George Mason University star [illegible] day they said they also are investigating his possible involvement in three other Pennsylvania homicides that occurred after he was paroled in 1990 from a Nevada prison.

Bomar, 38, became a suspect in Willard's death nearly a year after her body was found and shortly [illegible] arrested and convicted [illegible] os, Philadelphia law enforcement sources said yesterday. Bomar also is being investigated in connection with the 1993 slayings of two video store clerks in Warminster Township, Pa., authorities said.

Bomar had served 11 years in prison in Nevada for a 1978 murder [illegible] from an argument

INSIDE

Lawrence Remembered

■ M. Larry Lawrence has been disinterred from Arlington National Cemetery for burial in San Diego, where he has been remembered as a rich Democratic bigwig who gave and got what he wanted.

NATION, *Page A21*

Yeltsin Restricted

■ Physicians further restricted the activities of Russian President Boris Yeltsin, who is recuperating at a government sanitarium outside Moscow from what his aides and physicians said is a serious viral infection.

WORLD, *Page A51*

Players Fined

■ The Wizards' Tracy Murray and Rod Strickland were fined $25,000 apiece for fighting with one another Wednesday in Charlotte. The fines were believed to be the largest ever levied by the NBA franchise.

SPORTS, *Page H1*

New Speed Limit

■ The speed limit along

ASSOCIATED PRESS

Blair Hosts Adams In a Historic Visit

■ Sinn Fein leader Gerry Adams met yesterday with British Prime Minister Tony Blair and called the talks "a good moment in history." Adams, above, arrived for the meeting at 10 Downing Street—first visit by an Irish Republican leader to the prime minister's official residence in 76 years.

WORLD, *Page A45*

Stocks Keep Falling

■ The stock market tumbled again—the Dow Jones industrial average fell 129.80 points— as investors grew more alarmed about economic conditions in

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- Enterprise
- Boston Capital
- Senator Graham
- Rangel
- Ranking Dem on ~~W~~ Finance -
- Roth
- Archer

WHAT IS THE LOW INCOME HOUSING TAX CREDIT?

Enacted as part of the Tax Reform Act of 1986, the Tax Credit offers corporate and individual investors a credit against their federal income taxes based on the cost of acquiring, rehabilitating or constructing low income housing. The Tax Credit is the main federal resource for affordable housing, producing about 110,000 low income rental units per year. In 10 years, the Credit has helped create more than 900,000 units of rental housing nationwide.

WHAT IS THE TAX CREDIT'S HISTORY?

Created by the Tax Reform Act of 1986, the original legislation expired in 1989, and Congress enacted temporary extensions each year until 1992. In August 1993, however, Congress passed a permanent Tax Credit and President Clinton signed it into law later that month.

HOW DO TAX CREDITS BENEFIT LOW INCOME TENANTS?

The equity provided by Tax Credits helps leverage additional private and public funds. It enables CDCs to secure favorable mortgage rates and maintain low rents. The Tax Credit program allows community-based developers to produce significant amounts of affordable housing and make a true economic impact on impoverished neighborhoods.

HOW DOES THE TAX CREDIT PROGRAM WORK?

The Tax Credits allow corporations and individuals to deduct from their federal taxes up to 90 percent of the cost of a development's construction or renovation for 10 years. Corporations invest in NEF's annual limited partnerships. NEF then purchases a 99 percent limited partnership in each project partnership. And those project partnerships, which are formed by CDCs, develop and often manage the affordable housing. Tax Credits are available only for the low income units in a housing development, and only if 20 percent of those units are rented to tenants who earn less than half the area's median income or if 40 percent go to those who make less than 60 percent of the median income. The units will generally remain affordable for at least 30 year.

HOW ARE TAX CREDITS ALLOCATED?

The total dollar volume available to a state is limited to an annual cap of $1.25 per capita. State housing agencies administer the Tax Credit and approve housing development applications.

5/97

18TH STORY of Level 1 printed in FULL format.

MAY 1, 1997, THURSDAY

SECTION: IN THE NEWS

LENGTH: 2677 words

HEADLINE: PREPARED TESTIMONY OF
LARRY A. SWANK
ON BEHALF OF NATIONAL ASSOCIATION OF HOME BUILDERS
BEFORE THE HOUSE WAYS AND MEANS COMMITTEE
SUBCOMMITTEE ON OVERSIGHT

Nancy Johnson

BODY:

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 lowincome 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 decem 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 lowincome 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 isresponsible 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 dependenton information submitted by developers on their sources and uses of funds.Agencies need complete information of the sources and uses of funds in order tobe 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.

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 $4 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 onsite 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 (CHART NOT TRANSMITTABLE) Impact of Low Income Housing Tax Credit, by State: Calendar Year 1995 (CHART NOT TRANSMITTABLE)
NOTE:
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.
END

LANGUAGE: ENGLISH

LOAD-DATE: May 3, 1997

19TH STORY of Level 1 printed in FULL format.

MAY 1, 1997, THURSDAY

SECTION: IN THE NEWS

LENGTH: 3830 words

HEADLINE: PREPARED TESTIMONY OF
WILLIAM E. HAYNSWORTH
PRESIDENT
AFFORDABLE HOUSING TAX CREDIT COALITION
BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON OVERSIGHT

BODY:

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-channelling 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 apublic 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 socalled "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 toreceive 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 toassure 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 fries 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.
END

LANGUAGE: ENGLISH

LOAD-DATE: May 3, 1997

20TH STORY of Level 1 printed in FULL format.

Federal News Service

MAY 1, 1997, THURSDAY

SECTION: IN THE NEWS

LENGTH: 30289 words

HEADLINE: HEARING OF THE OVERSIGHT SUBCOMMITTEE
OF THE HOUSE WAYS AND MEANS COMMITTEE
SUBJECT: LOW INCOME HOUSING TAX CREDITS
CHAIRED BY: REPRESENTATIVE NANCY JOHNSON (R-CT)
1100 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, DC
10:00 AM EDT

BODY:

REP. JOHNSON: If the hearing would come to order. I regret that we're 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 low-income housing tax credits, which is revenues foregone -- accomplish the goals established by the Congress.

This morning, we begin our second hearing on the administration of 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 there were several opportunities to improve the administration of the credit.

Today we'll 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, the men and women who work with the credit day-in and day-out.

Johnson
Rangel
Coyne

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 to better utilize this valuable program.

Because we have a number of witnesses today, it will be necessary to adher to the five-minute rule, and I'd like to begin by recognizing my 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 insuring that 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 United States 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 prospective 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 Chair.
REP. JOHNSON: Are there any other statements that members would like to make? Mr. Weller.

REP. WELLER: Thank you, Madman Chair. First, I want to applaud you for holding these hearings to examine the GAO study of low-income housing tax credit program. I appreciate the leadership you've given in the past as well as with these hearings in regard to improving this credit -- tax credit program, and look forward to working with you to develop solutions that will strengthen this success public/private partnership that is a model program for all federal programs.
As a fellow member of the Republican Housing Opportunity Caucus, Madam Chair, 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.

Weller

The construction of 70,000 to 100,000 affordable units result directly from the 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 program must be protected. Truly we must continue to exercise diligent oversight to insure that the taxpayer's investment is protected. But I cannot say this in strong enough words. I believe 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 will attest to that.
They were on the front lines the last time there was a threat on the credit's permanence, and I look forward to their testimony on the important of the credit to the development of affordable housing, and the affect of losing permanence in the efforts to raise capital from private investors.
Thank you, Madam Chair.
REP. JOHNSON: Thank you.
Mr. Metcalf, would you please come forward. Mr. Rangel will join us in a moment. As the ranking Democrat on the committee, he is visiting with the President.

Metcalf

Mr. Metcalf.
MR. METCALF: Thank you very much, Madam Chairwoman. I'd like to thank you for the opportunity to testify before the Oversight Committee. Since this is a synopsis of my written testimony, I ask permission that my written testimony be entered into the record. REP. JOHNSON: So order, 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 homeownership, especially for first-time buyers, expanding local flexibility, and fostering greater personal responsibility.

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, 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 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 innercities and rural areas by rebuilding communities in need of an infusion of private financing.

We can achieve this goal with not yet another federal program operated in Washington, D.C., 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 committee begins reviewing ways to improve the tax credit, I'd like to make a few recommendations. First, we need to preserve the permanency of the program. I cannot stress the importance the role of 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.

Secondly, we need to improve administrative oversight and compliance of the tax credit, while maintaining 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 or innercity areas, whose household incomes are low, which results in extremely low tax credit rents.

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 specific in the market, and the viability of the project after the tax credit expires.

In conclusion, I want to offer the Housing Opportunity 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.

REP. 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've been on this committee.

As ranking Democrat, I welcome you to our subcommittee hearing.

REP. RANGEL: Thank you, Madam Chairlady, and the members of the Oversight Committee. I asked you earlier to be gentle. I'm not used to being on this side of the light.

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 the loopholes and to eliminate credits, but now seeing that it's 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 -

REP. JOHNSON: So order.

REP. RANGEL: -- and just would like to say, I'm not certain whether shelter was included as a constitutional right, but I'm entirely convinced that poor folks that can't find a place to live, can't find a place to prepare to go to work, can't 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.

A number of people that I see that are homeless and they look like they're illiterate and unemployable, but in talking with them, these are people who just missed a paycheck. They missed paying their rent. They found themselves in the street. They've lost their job. There's no place to go to pick up the pieces. The loss of pride sometimes forces them to leave their families because they can't produce. When they're called "ne'er do wells," that's what they have become. A shelter, a home that's affordable, for so many people is a beginning, a turnaround in life.

I've never owned anything, but when I did buy a home, I think that was the zenith of 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 no 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 there. The sense of pride that just comes through the community in knowing that, if they fix one block, that the next block surely would be more eligible to receive this type of treatment.

The conservatives say that the overall, administrative cost because it takes the bureaucracy out of it, allows this to come in at the lowest per cost unit so that -- it's my understanding -- that 90 percent of the affordable housing that's built in the United States where the rental is $500 or less, comes under the low-income housing.

It works well for those who make the investment. It works well for those communities that don't find the funding for local -- on the local and state level. It reduces our commitment as it relates to the housing programs, but I really truly believe that if the General Office of Accounting 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 the could regain their positions in society.

Right now we're negotiating a budget agreement, which should include some pretty heavy tax cuts, a commitment to balance the budget, and therefore, a reduction in the monies that will be available for a lot of program. I would have thought that the tax writing committee would be involved in the tax portion of whatever came up in the Budget Committee. But I'm under the impression that unless you know somebody in the negotiation, that this committee's 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. While I'm hoping, Madam Chairlady that it's only a rumor, I hear that we're on the list in terms of being sunsetted.

I don't know whether there's a more popular piece of legislation we have in the House in terms of sponsors, but the process that we're going through -- both Democrats and Republicans -- doesn't lend itself to allowing our views to be expressed. We may just have to vote up or down on the reconciliation bill.

So I hope that the members of this committee that support this concept that has been so successful might be able -- if you know anybody that's involved in making the decisions -- and I'll give a call to Senator Lott -- to tell then, please don't delete what works in order to get the tax cut.

Thank you, Madam Chairlady.

REP. JOHNSON: I 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 the final -- actually, you may know more about this from your recent conversation, but I'm optimistic that this committee will be able to make the decisions as to how we achieve our goals.

I share your enthusiasm for the quality of the study that the GAO did. I'm also impressed with the lack of significant problems in it, as a major federal program; and it is the intention of the subcommittee I think it's fair to say on both the part of Mr. Coyne and I to address some of the problems that they did identify, working carefully with both the states and the private sector so that we don't overkill on this issue of administrative change, as Mr. Metcalf so responsibly pointed out; and to also look and see if there are other ways that we can strengthen this program by better inclusion of the smaller developers in smaller projects, but also with innercity youths.

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; and then most of the audience knows and you may know that Mr. Lazio and I have talked at some length about looking at appropriate -- the power of appropriated dollars in housing versus the power of these tax credit dollars, because we 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, 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.

REP. RANGEL: Thank you for the support that you've given over the years.

REP. JOHNSON: Are there any questions of our colleagues?

Yes.

REP. 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 the support on the

Republican side two 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. I also am a member of the Republican Housing Opportunity Caucus and am delighted with 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, I think, means 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 flexibly, and 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. I think we both recognize 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 efforts, sir, and your participation on this panel.

Thank you, Madam Chair. REP. JOHNSON: Thank you. Are there other questions?

I do want to mention, since Charlie, you gave us your thoughts, but you didn't read your testimony -- which is not unusual and not a loss, 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 credit.

I think one of the things that we don't think about very often is how this program has helped innercities address very difficult housing problems.

REP. RANGEL: I was at the opening, Madam Chairlady, and people that were homeless, and they really needed more than shelter.

The concept that was it 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, into guns -- young kids that had grown older, but had had children before their time, educators and social workers.

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 off the streets and you've known a better quality of life, and you've fallen to the bottom -- and so, instead of just a beautiful apartment, you have people to help you to 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.

REP. JOHNSON: Mr. Tanner.

MR. TANNER: Thank you, Madam Chair, and 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.

Tanner

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's 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 current income or excessive rent charges, ought to be something we should be proud of.

This is a program that's working, according to the GAO. It is making our country stronger, not only in urban areas; but also in the rural areas like in

13TH STORY of Level 1 printed in FULL format.

Federal News Service

MAY 1, 1997, THURSDAY

SECTION: IN THE NEWS

LENGTH: 3940 words

HEADLINE: PREPARED TESTIMONY OF
BENSON F. ROBERTS
VICE PRESIDENT FOR POLICY
LOCAL INITIATIVES SUPPORT CORPORATION
BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON OVERSIGHT
SUBJECT - THE LOW INCOME HOUSING TAX CREDIT

BODY:
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 lowincome 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 theyhave 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.

70% rehab
30% new construction.

-- 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 dis~~abled: 30 percent of the units have zero or one bedroom(s); 44% have two bedrooms~~; and 26% have~~

64% have less than 50 units

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 innercity 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 longerterm 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-firstrefusal 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.

END

LANGUAGE: ENGLISH

LOAD-DATE: May 3, 1997

14TH STORY of Level 1 printed in FULL format.

MAY 1, 1997, THURSDAY

SECTION: IN THE NEWS

LENGTH: 1985 words

HEADLINE: PREPARED STATEMENT OF
HERBERT F. COLLINS
BOSTON CAPITAL CORPORATION
ON THE LOW INCOME HOUSING TAX CREDIT
BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS
THE OVERSIGHT SUBCOMMITTEE

BODY:

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:

7 appropriate penalties for noncompliance,

7 full documentation when a state agency uses its discretion to vary from a state allocation plan,

7 increased uniformity among states in the processing of applications for credit allocations, and

7 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 marketefficiencies. 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 compee tive in thFsmarketplace in order to attract investors. oo We plel as many as 50 properties in each limited par aership we g re 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 credis increas haation. Breakingamount investors will pay for credits and caused more dollars to be available to be spent on the real estate. At the same time, asprices increased and the relative number of tax credits available stayed the same, yield to investors has dropped. This has led to a reducaion in overell expenses in order to mitigate yield declineive innot dr Betors 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 werablerablesonge extentf 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 pr theties forstf life of the investment.

Finally, to add likeprograms of 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 replanement housill beery 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.

END

LANGUAGE: ENGLISH

LOAD-DATE: May 3, 1997

15TH STORY of Level 1 printed in FULL format.

MAY 1, 1997, THURSDAY

SECTION: IN THE NEWS

LENGTH: 2046 words

HEADLINE: PREPARED STATEMENT OF
RONALD L. PLATT
LEGISLATIVE DIRECTOR
MCDERMOTT, WILL & EMERY
ON BEHALF OF A. BRUCE ROZET, CHAIRMAN OF THE BOARD
ASSOCIATED FINANCIAL CORPORATION
BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON OVERSIGHT
SUBJECT - HEARING ON THE LOW-INCOME HOUSING TAX CREDIT

BODY:

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 costover $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 familieswho 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 5 15 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.

END

LANGUAGE: ENGLISH

LOAD-DATE: May 3, 1997

16TH STORY of Level 1 printed in FULL format.

MAY 1, 1997, THURSDAY

SECTION: IN THE NEWS

LENGTH: 4579 words

HEADLINE: PREPARED STATEMENT OF
HERBERT F. STEVENS
BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS
THE SUBCOMMITTEE ON OVERSIGHT

BODY:
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 LowIncome 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, includingconsideration 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 thehistory 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 werereinvested 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 recognizedthat 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 theft 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 theft 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 importantcontrol 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 "fatf" 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 gara 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 isdifficult 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 yearcompliance 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 anew 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.

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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 theft 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 Section 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 Section 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 MonitoringPEABODY & BROWN

1. Under the compliance monitoring Regulations Section 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 "setaside" 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,".

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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 taxPEABODY & BROWN
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.)

END

LANGUAGE: ENGLISH

LOAD-DATE: May 3, 1997

17TH STORY of Level 1 printed in FULL format.

Federal News Service

MAY 1, 1997, THURSDAY

SECTION: IN THE NEWS

LENGTH: 2331 words

HEADLINE: PREPARED TESTIMONY OF
GARY E. KING
PRESIDENT-EXECUTIVE DIRECTOR
CONNECTICUT HOUSING FINANCE AUTHORITY
BEFORE THE HOUSE WAYS AND MEANS COMMITTEE
OVERSIGHT SUBCOMMITTEE

BODY:
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, ! 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 urbanareas, 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 towardsmaller 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 .995 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 1.0 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 basednonprofits 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 tothe 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.
END

LANGUAGE: ENGLISH

LOAD-DATE: May 3, 1997

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.

REP. RANGEL: Thank you.
MR. METCALF: Thank you.
REP. JOHNSON: Yes, Mr. Watkins.
REP. WATKINS: Thank you, Madam Chair. I'd like to just add a couple comments from personal experience. I won't say, thanks to my good friend, the Honorable Charlie Rangel, and also the Honorable Jack Metcalf for your testimony.
From a personal standpoint, I used to be a home builder in rural, depressed areas of Oklahoma. In order to maintain that home building 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. I watched these people. They're good people. Many of them struggle to have basic shelter. There were a couple 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 a lean-to -- shacks.
I found that in several occasions, the spouse -- the wife -- would make sure she kicked that guy out and he went on to work, because they needed to make a payment on that shelter and it was the best living conditions they had ever had, and the best she had ever had for their children. I found that pride was developed.
Not only did I notice that in the social situation, but I noticed also that to the best of my knowledge, it also brought a different type of -- I might could say -- relationship. They were young people coming to date the children that were from a little different income level. I don't know if anyone -- and I watched a lot of these families very closely, very personal -- that literally married down -- they moved up -- and many times that lean-to house in the real depressed area didn't 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 and a different group of people -- different social groups, and allowed them to be more -- and a better part of society. These were good people. But as a builder, you know, I had a feeling that I was making a contribution, a social level of improving the quality of life that I wouldn't have had the opportunity to do. They had such pride, especially when they had their piece of property, their grass, their able -- their opportunity there to be a family.
So, I just want to say, I think it's been one of the best social movements we could ever have, to allow this basic thing -- quality shelter.
REP. JOHNSON: Thank you, Congressman Watkins.
Congresswoman Thurman.
REP. THURMAN: Thank you, Madam Chair.
I just wanted 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. On top of that, they've 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've had.
To sunset this, I think, would be -- I just don't think that is the right thing to do. We have a program the GAO has basically said is good. We're working well. Maybe what we ought to be doing is looking 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've put into this and the testimony that you've given today. I hope that the message is being sent loud and clear that we should not be messing with something that's working.

REP. 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's interesting to me, Mr. Rangel, to hear you say you came opposing tax credits, and now you support them. I think we may end up supporting them because they turn out to be more flexible and powerful vehicles, as opposed to appropriated programs.

So, I thank everybody for their time. I would particularly like to comment that between Mr. Rangel's comments and Wes Watkins' comments that it does remind the public that we're in the business of politics because we think it's important, spiritually.

Would the next panel come forward please. This is the schedule we are going to follow. I know the Republicans have a conference at 11 o'clock. Unfortunately, we cannot adjourn for that, if members want to go, they're certainly welcome to do that and return.

We do have two long panels. We need to try to finish slightly before one, if possible. So I don't intend to break for lunch, unless we break between about a quarter of one and 1:30. For that reason, we are going to observe the five-minute rule. Your testimony will be -- both panels' testimony will be entered into the record in its completeness, but if you'll please keep your statements to five minutes, that will maximize our time for questions. We'll start with Sister Nancy Glynn, president of Bon Secours Baltimore Health Corporation.

REP. COYNE: Madam Chairwoman?

REP. JOHNSON: Yes.

REP. COYNE: I just wanted to point out to Sister Glynn that Representative Cardin intends to be here. He's on his way over to greet you as a constituent, and certainly welcomes your testimony here today.

REP. 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.

SISTER GLYNN: Thank you, Madam Chair, and members of the Ways and Means Subcommittee. It's a real privilege to be here this morning to discuss the low-income housing tax credit and the way that it's made such a major contribution to our work, which extends beyond health care to community revitalization and stabilization in our west Baltimore neighbors.

Bon Secours has been in west Baltimore for over a hundred years, and we've made a very conscious to remain because we're so needed. We serve a struggling, urban neighborhood, with many low-income residents, and want to insure -- 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've launched an initiative called, "Operation Reachout" for that purpose. 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 that I want to talk to you about today is Bon Secours Apartments. It's been made possible by the low-income housing tax credit. I'm not by any means a housing expert, but I do know that we wouldn't have been able to go forward with this venture without the housing credit.

It's 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 don't have a lot of income.

Private sector corporations don't have much incentives to invest in our neighborhoods, but the housing credit gives them that incentive. We've found that new housing makes a real impact in impoverished neighborhoods, not only economically and physically, but even psychologically and spiritually. It's 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 $30 to $420 a month.

Construction started in January of '97, 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 Headstart 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? I think the answer is clear. Bon Secours is not about just the health of individuals, but the health of our community, which so affects family and children. Decent, affordable housing, like decent affordable health care is a requirement for success.

In a neighborhood like ours, we can't get housing developed without not-for-profits, and without a program like the low-income housing tax credit. For all the reasons we've talked about, this kind of investment needs to be encouraged. It's 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.

REP. JOHNSON: Thank you very much, Sister.

Ms. Hodel.

MS. HODEL: I'm 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've 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 units? We're 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, 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 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 median income rents from us. The IRS is taking tenants away from us, causing our property values to decline and discourage future development. You can't even give a residential 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 low-income -- 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, two-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 $82,000. I could build a really nice apartment building in Lake Havasu for $30,000 -- really nice -- and yet this project is costing $72,000 -- that was a joke in our community. The so-called, low-income 84-unit complex offers a swimming pool, RV and boat parking, a recreational room, patio, new, full- sized dishwashers with free cable TV and free rent as incentive to move in.

The results of this program on our city's rental market has been disastrous. When the 84-unit was built, our units 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 depended on, who was paying for the survey. At one time, a developer hired an appraiser to determine our vacancy rate. His conclusion was, general 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've tried it and I 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 an apartment building. Therefore, because our vacancy rate is high, we cannot build or remodel. The banks have a hard time saying, no, to developers with millions of dollars, with the tax credit in their pockets, plus it's easy to steal tenants away from older buildings with lesser 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's happening here. 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 that they would be sued under the Fair Housing Act, and we would lose our federal grant, if they did not approve the 84 units.

Our city established requirements for future tax credit housing projects. It took us like five years to try to figure out some requirements for this. They ended up to be illegal and violate the Fair Housing Act right now if they tried to implement it right now.

If this program is allowed to continue, local governments need expert legal advice, which is going to cost everybody. It's going to 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 appeared in just over a year. This is an example, in a small town where we have very little crime. Just over here, we have 166 police events. That is the highest, by far, of police events. That's when the police go out and physically visit the location. That is the highest in the history of Lake Havasu City.
There's no procedure for the public to report noncompliances, so I -- I, in a little town in the middle of the dessert, 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's going on here. They said they were going to give security and they did not do it." I'm 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 cancelled it all out and investigated the economic, we concluded it would only benefit very large complexes and major, major renovations. It's 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 been very successful.
I was a social worker in Watts. I know what it's 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 that just fell on the floor with the 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 five years on that phrase. Finally, the state of Arizona has put that in there. I would appreciate it if you would consider amending your -- this program and adding -- it is so important that this project -- that this program cannot disrupt the local market.
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. I am sure your intentions are to help the truly needed 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're there for our whole life. 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 your Attachment 1, these are just an example of the ads we see every day in our newspaper. We can afford little tiny two-liners and we see -- have to see this every day, because the taxpayers pay for these ads.
REP. JOHNSON: Thank you very much, Ms. Hodel. We appreciate your testimony and your experience.
Mr. King, it's a pleasure to welcome you down here to Washington again, the head of the Connecticut Housing Finance Authority, and I welcome your testimony.
MR. KING: Thank you, Madam Chair, members of the Subcommittee.
I'm Gary King, president of the Connecticut Housing Finance Authority. I've been with the Authority for 11 years and since 1992 its president. Prior to working with the Connecticut Housing Finance Authority, I was the under secretary for the state's OMB agency and responsible for comprehensive planning and policy for program activities.

It is from these experiences and perspectives that I come to address you today, and I really thank you for the opportunity to testify on the tax credit program. I guess, I'm following Ms. Hodel's comments to indicate that the state is -- 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, these programs -- this program -- the tax credit program -- has worked more efficiently and achieved more effective objectives than any other program we've had experience with. It's basically done so for four major reasons.
The first is that the credit does enable states to meet diverse needs across the country, without excessive guidance from Washington. Secondly, the credit -- and this is very important -- can bring very effectively private investment incentive, ownership management to meet clearly defined public needs. But that investment and management is tempered by public oversight and balanced with public accountability -- accountability to the public.
Third, the program is a very efficient leverager of other resources. Not a direct expenditure program, but really brings many resources to bear to work on agreed upon housing policy and priority. It's also come up today -- I think the fourth major reason, particularly since 1993 -- is this program has been permanent. This is very, very important, because it has created a stability in terms of whether the development community, the private markets, the state policy agencies, everybody in Connecticut knows that this program is there to work effectively to leverage development.

It also, as indicated, has improved tremendously the efficiency of the credit. That statistic is 28 percent improvement. Credits back prior to 1993 may have generated 50 to 55 cents on the dollar, now they're approaching over 70 cents on the dollar, which is a very, very effective and appropriate result. My concern would be, that if it was not permanent, we would lose these advantages.
I was gratified to see that these perspectives were confirmed by the GAO study. Frankly, the major problem in Connecticut is that we don't have enough credits to support viable, appropriate proposals. In the last two years alone, we have had to reject because of inadequate credits, three times the amount of projects -- we received three times the applications than we could fund.
Basically, I'd like to communicate to you 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. That being said, I think that if you do those things that the GAO study suggests, it would be very effective in terms of finetuning the tool that you've entrusted to us to use on behalf of producing affordable housing.
I know that I've heard there are a couple of questions that are in committee members' minds and I'd just 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 two dynamics of the housing problem.
First, in the urban areas, we are facing significant abandonment and blight and need to improve the quality of the housing. I think that in terms of other issues, there are cost issues. I'm here to say that the credit in Connecticut has turned out to be very effective in producing housing at less cost than the private sector.
I know that there's concern about the bedroom size -- number of units. I'm

here to say that in Connecticut the experience is that we're meeting the housing needs and priorities and in over a third of the apartments, the bedrooms are three or more bedrooms.

We've also effectively accomplished rehabilitation in the city. Seventy-five percent of our housing goes for rehabilitation of existing housing. The other issue I'd just like to raise is that if the concern is about IRS oversight, and if there's interest in substituting HUD, I think essentially the Connecticut agencies -- the state housing agencies -- play the role that HUD might have fulfilled in terms of compliance.

I thank you for the opportunity to address the committee. REP. JOHNSON: Thank you very much, Mr. King.

Mr. Haynsworth.

MR. HAYNSWORTH: Yes ma'am. Madam Chairwoman, members of the committee, 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 ax Credit Coalition, on whose behalf I testify.

Many of you are familiar with the role of syndicators in the tax credit business, which essentially primarily is to raise private capital that will ultimately pay for 50 to 60 percent of total development cost of a particular project.

Now as part of that, which you may not realize, is that we do -- 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 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 in doing that.

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 to $3 million worth 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 '93, as we all know, the pricing has gone up significantly since that particular time. I would be concerned if -- very concerned that this trend would be reversed if in fact 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, obviously, 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.

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. We do market studies -- independent market studies -- to make sure. 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 the proformas that we prepare, we have confidence in.

We look very carefully at the development and construction phase, financial tax structuring, we review all aspects of the tax credit award and also -- and most importantly -- we negotiate the deal with the developer. The developer, as you know, does get a development fee; but that development fee is withheld and only paid out as he performs. The developer fee, the first portion of it, may be paid upon successful completion of the project, but then, it's further advanced when he successfully operates the project, perhaps reaches breakeven, or gets some sort of debt service coverage.

We also are very interested to make sure that the property -- that the compliance issues -- there are no compliance issues with the project. We have our own staff of asset managers, 18 in all, who will make site visits, who review all the financial reports, send them to investors, make site visits, inspect the projects, review tenant files to make sure that eligible tenants are in the projects, and the taxpayer regulations are being adhered to.

From all 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 tax credit excellence awards, three of them annually for the best urban, rural and special needs projects as part of their 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 lives 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.

REP. JOHNSON: Thank you very much, Mr. Haynsworth.

Mr. Swank.

MR. SWANK: Madam Chairwoman, members of the subcommittee, my name is Larry Swank, and I am president and CEO of the Sterling Group in Nappanee, Indiana. I'm also 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 Chairwoman, on behalf of the 190,000 members of NAHB, I want to thank you for the opportunity to testify before the Oversight Committee today, regarding the low-income housing tax credit.

At the onset, let me state that NAHB is a strong supporter of the credit, at its continued permanence, and we are particularly appreciative, Madam Chairwoman, of your long-standing support and dedication over the years to providing affordable housing.

Madam Chairwoman, I am extremely distressed, especially today to have learned late last night that Mr. Archer has decided to recommend sunsetting the low-income housing tax credit as a means of raising revenue in a budget agreement. Threats to sunset the credit upsets the investment community's confidence, and development community's confidence in the continuation of the credit.

Madam Chairwoman, as you know, 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 demand 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 the tax code 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 the 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. Attached to my written testimony is a chart which 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, 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. The American taxpayers would have the security of knowing our government is using their dollars wisely on well-managed programs.
One of the issues the GAO has asked to report on include what controls exist to insure projects' costs are reasonable.

Two of the components contained in the projects' costs are developments -- 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 unreimbursed development costs that the developer will incur.
To calculate net development fees, 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 in 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 Chairwoman, after all the costs are subtracted out a developer walks away with four to five percent, pre- tax.
Madam Chairwoman, there's 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 and number of low-income families.
Only yesterday I was in Holland, Michigan, less than five miles from where your mother lives, by the way. I was cutting the ribbon at a groundbreaking 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, went an applied for a job at the Prince Corporation, found that 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, he was able to move in there -- move in 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 benefitting those that it is intended to, households with very low incomes. However, it only makes good business sense to continue rental housing incentives like the low-income housing tax credit with an eye toward community programs.

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 a neutral or third-party commissioned by the developer and reviewed by the housing credit agencies; and 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 on-site inspections for at least one- third of the projects each year for compliance of these standards.

Madam Chairwoman, 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 sunset the credit.

Thank you. I look forward to your questions.

REP. JOHNSON: Thank you.

Mr. Barbolla.

MR. BARBOLLA: Chairman Johnson, ranking minority member Coyne, and members of the committee. My name is Patrick Barbolla and I'm a developer of affordable, rural, multi-family housing in Forth 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 interest of time, I will merely highlight 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 balance consideration to the low-income housing needs of the entire state.

While most states have made provisions 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 commitment 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 rehabiliation of existing units should be seriously considered as a means of stretching tax credits. Our association does not recommend that rehabilitation properties be given any preferential treatment over new construction, merely that rehabiliation -- especially in rural areas -- be placed on a parody 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 rehabiliation may be allowed, there is a trend to preserve vacant complexes over occupied.

It is more cost-efficient 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 committee our desire and request that the tax credit program remain permanent, because it is the only way we are going to provide affordable housing in rural areas.

I thank you for your time and would be pleased to answer any questions you may have.

REP. JOHNSON: Thank you very much.

Mr. Weiss.

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 Saberstein & Day in Buffalo, New York. I'm the chairperson -- chairman of our firm's affordable housing group. My practice focuses on representing small to mid-sized developers, 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 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 at or below specified income levels.
The code indicates that the specified income levels are 50 percent 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 originally intended beneficiaries.
The third point is that the GAO reported that the state allocating agencies may distribute the $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 the 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 the 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 $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 credit 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 continue to provide housing for the very low income households. Thank you.
REP. 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 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.
As we do more and more -- as we get tougher and tougher about code standards, lead paint removal and things like that, we make it almost impossible to rehabilitate an existing unit, and therefore preference the tax credit program to new construction.

I mean, looking at the larger picture, what she says is very serious. It's a very big problem. I don't know how big it is -- you see it as big in your experience, but I'd like to hear you address it more directly. She deserves a more direct answer, the committee needs a more direct answer.
Mr. King.
MR. KING: Well, the issue in Connecticut, I think in terms of best practices, we a number of years ago, established a process where the main type of market study or appraisal -- we have a list of effective, you know, verified quality firms. We established that list, we checked 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. We control the process so the types of things that Ms. Hodel was alluding to in Arizona don't happen in Connecticut. The second thing is --
REP. JOHNSON: Specifically, Mr. King, how do you -- who analyzes the market to see whether there is a need? Do you 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, that if somebody had done that in her area they would see that these units, because they were nicer for the same rents, were going to drain tenants.
MR. KING: Right.
It's really a three-stage process. We start with the state's policies and priorities and extensive needs assessments, identify where the market needs affordable housing in a general basis. We then establish a basically absolute priority. Those towns which don't have rental housing get the first dibs on the credit, and those whose credits are allocated in that fashion -- if there is not a need for the credits, we don't allocate them in the community.
So that is done on a comprehensive ongoing basis in conjunction with the state agencies and the legislature. So we prioritize the towns and the market.
That's why in Connecticut we have a heavy emphasis for rehabiliation of urban areas. That's why the credits are flowing there.

If we have a preference and a priority need for special needs housing for the homeless or people with AIDS or mental disabilities, that's why the funds flow there.
So there is not the market competition with the private market. I would say this that under past programs, when we had the -- tax credits were not targeted and not administered, we did have some experience and actually come communities in your district, where there was some competition between overproduction of supply of housing -- in rental housing, we had a couple of properties that got into trouble because of that. Those lessons were learned in that they have been eliminated from the administration of the tax credit program.
We get down to the specifics of a particular project, we then do an intensive market study like I indicated in the appraised value. Those are factored in. We have actually not proceeded in a few 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, multi-staged process. The control is a partnership between our quasi-independent agency, the private sector, but also the state policy and the legislature.
MS. HODEL: May I respond, please?
I have found that in talking with the city council, 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 five years now trying to debate this. Let's say we do have an independent type of person take this,

then the second problem that we faced was the definition of comparable units. For instance, I have a little seven-unit apartment building. They're going to come in with a big hundred-unit apartment building and they're going to say: "Well, yours is too small. We're not going to include yours in the study," or, we've seen what appraisers compare things as. Are we going to include other affordable units, government subsidized units in the survey? Does the survey 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 guys, out of it. You know, if you're going to compare all those amenities, et cetera, like the normal appraisers do, then you leave the little apartment owners who are spread out throughout this country out.

REP. JOHNSON: May I get this straight? When the survey is done, because it 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 use.

REP. JOHNSON: I 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 ten years ago.

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've argued that for the last five years, thank you.

REP. 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: Just one followup comment, I'm talking about whether there's a need for affordable housing in the area at that rent. That's the issue for us.

REP. 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: We don't want to build an apartment building down the road that has more amenities and then have the people move out of the apartment here and move up the road. That's unconscionable to do that.

Many of the projects -- CHFA has financed 20,000 rental housing units in other programs across the state. We would be undercutting ourselves if we did that. So that's why we have a vested interest in not letting that happen.

REP. JOHNSON: Anyone else have any comment on this?

MR. SWANK: Yes, if I may comment, Madam Chairwoman.

Representing the development community here this morning, I would say that what I have found in our subcommittee on low-income housing tax credits 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.

If it's ordered by the state agency or ordered by the community, not necessarily will the same information be requested that we as developers want to know. We want to know several things. One, we want to know what we're risking, if the market is there. When we go into a particular area, we want to know every community, whether it's six units in size or 600 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 studies 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, the developers that I know.

In my testimony, we have supported the GAO report asking for market studies by third parties, and the third party 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 continuation of the eligibility of all the residents in there, don't take that lightly.

I think we're talking about one other issue, and that's quality of life. Just because an apartment community was built four years ago doesn't necessarily mean it 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's been rehabed are much, much nicer than new ones we can build for the same price today.

REP. JOHNSON: Yes, 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, stuff like that.

I want to recognize Mr. Cardin, who's been able to join us.

MR. CARDIN: Thank you, Madam Chair, 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 at Bon Secours, but your statement that you made that you're interested in not only the health of the individuals as far as their medical needs, but also the community at large. 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 could not be done without the low-income housing tax credit assistance; and I just hope that and want to make it clear that the statement you made as part of our record of how you and Baltimore have used the housing tax credits for partnerships to develop more affordable housing to the people of that community. You are making a major difference in west Baltimore.

I just want you to know that we've noticed that and very much appreciate your testimony today.

SISTER GLYNN: Thank you, Congressman Cardin, and thank you for your continued support.

REP. JOHNSON: We do have a vote going on. I'm going to recognize Mr. Coyne.

REP. COYNE: Thank you, Madam Chairwoman.

Mr. King, I wonder if you could comment for us relative to 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 to come up with an idea to respond to a particular housing need, put together the plans, make the investments, do the preparatory work. So there's a lot of lead time in that. It could take a year or two.

What we saw when the program was not permanent is that developers didn't make the investment in the priority types of housing as much as the state of Connecticut would have liked.

In our system, we rank projects according to a class 1, class 2, class 3 priority and we saw a pyramid type of approach prior to 1993. We did not have a situation where we had more applications chasing fewer credits. Since permanence -- because we have the priorities clearly established, we are seeing two to three times the applications coming in and credits are available for the top priorities in the state of Connecticut.

So, for the last two years, we have essentially been able to only fund the class 1 projects. That's because the development community knows that the credits are there, so if they build the housing to the state's priority, they have a high probability of getting funded, as long as they comply with our rules. The second thing is that we have seen the credits leveraged very effectively because prior to '93, because of the uncertainties in the investment community, we were getting 50 cents on the dollar, essentially for the credits. Now we're getting over 70 cents. That's made much more of an impact in terms of being able to reach the priority needs of the state. My concern is, without permanence, without that stability, the message to the development community, the investment community is, you have greater risk uncertainty and we will not see the types of projects in the volume and the quality, and with the efficiency that we need to meet those pressing urban and other needs in Connecticut.

REP. COYNE: Does any of the other panelists have a different view from that relative to permanency?

(No verbal response.)

REP. COYNE: Thank you.

REP. JOHNSON: I want to ask you, Mr. Weller -- oh, he's coming back, so we can continue while we go to vote; but I wanted to ask you the following question: On the data developed by the GAO, 43 percent of the units are occupied by one person; 24 percent by two people. This suggests that a lot of this is elderly housing. Only 17 percent by three people; 11 percent by four people; six percent by five 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 a big need in our nation. I'd have to say that, but states have been pretty good at senior housing and so on, why? 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?

Yes, Mr. King.

MR. KING: Well, in Connecticut -- and I think it's also true across the country -- there's a lot of investment with use of the tax credit with special needs populations. About one-third of the credits in the last two years in Connecticut went to people who were in transition, homeless, substance abuse, that type of activity -- or that type of problem.

Basically, we've learned that those types of developments require efficiencies or one bedroom types of development. So, if you're pursuing a special needs population, which is a critical issue, you should expect smaller units, because that's the appropriate type of housing for that. So in Connecticut, it's one-third.

REP. JOHNSON: But this is the biggest -- this is an $18 billion program, and we now have -- we may have to come back to this, but one more minute.

MR. KING: Right. The second thing is that the -- a high portion of the families, or 60 percent of the families in the country are one and two-bedroom type of situations. We have mothers with children. We have a high divorce rate. Single family heads of households --

REP. JOHNSON: So you would say that many of those two- person households are parent/child?

MR. KING: Yes. And in Connecticut -- and it's also confirmed recently -- the GAO study was 1992-94, 1995-96, you're seeing one-third to 25 percent of it being three bedrooms or more.

REP. JOHNSON: Okay, I must go vote. When Mr. Weller comes back, he will pick up and go forward. But, the other thing I think you need to think about, one other question we need to get this panel to answer, is this issue of stacking of subsidies. If we don't, we certainly will talk about it more with the next panel.

Seventy-one percent of these units have more than the low-income housing tax credit subsidy. You know, what does that say about how we're using public monies to leverage unit availability?

So, I'm going to excuse myself and Mr. Weller will continue as soon as he returns. If no one is back before hand, he will dismiss this panel and go on to the next one.

Thank you.

(Break.)

REP. WELLER: (Chairing on behalf of Chair Johnson.)

We can resume the hearing here while people are running to vote.

I want to direct my question, I think, first to the private sector representatives of the panel. You know, in my community, I represent a very diverse district, the south suburbs of Chicago, as well as the southside of the city of Chicago. 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, just initiated just recently. We announced the public/private partnership between the private sector as well as local community for redevelopment of Joliet Catholic High School, which currently -- the former building, which is an historical building, in a community that's 85 percent catholic, a project heavily supported by the community for redeveloping Joliet High School for senior citizen housing, an affordable housing project overwhelmingly supported by the community and greatly anticipated by the community, and I consider to be one of the successes of the low-income housing tax credit program.

I'd like to direct -- I think initially direct -- my first question to Mr. Swank, representing the home builders 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. Since that permanency was established, some have suggested perhaps making it a temporary tax credit again, restoring the temporary status, sunsetting the tax credit.

You alluded to that issue in your testimony.

From your perspective as a private builder, 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 business person 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 qualified allocation plans, to determine where the targeting was being done within the states that they were doing business in.

Our company happens to do business in both the states of Illinois, Michigan and Indiana. If that were to become a sunset provision where we only had two or three years left in the program, we would look at those qualified plans and determine the areas in which the states were targeting that.

Number two, we would not go as far out as trying to determine two years from now where we will be at and the process we have to go through on zoning, the acquisition and option of property, dealing with local advocates of housing, the available council people and various groups of that nature in all the communities that we do build in.

The third thing is the credit cost or the credit value. As 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.
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, the confidence in the government and what will happen with the credits that they buy. They may disappear and go to some other avenue to invest in.

REP. WELLER: You know, it's projected that the tax credits 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 credits.
Do you have any idea if it was sunsetted, say, two or three 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. Perhaps that percentage is much lower than 25 percent of what we're currently building.
REP. WELLER: So you would project a 75 percent reduction?
MR. SWANK: Yes.
REP. WELLER: In the construction and amount of affordable housing that will be available in the future?
MR. SWANK: Yes.
REP. 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 which 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, the -- what is happening in the investment marketplace is, investors come in and then they get their fill of tax credits and they leave. 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 four years before we did our first fund. It takes a lot of time, a lot of education, a lot of resources applied to understanding the program to get these investors interested.
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. As older investors -- either yields are going down and existing investors are no longer interested, because 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 that there's a sunset provision out there.
REP. WELLER: Mr. Swank had indicated that from his perspective that you could potentially see a 75 percent drop in the amount of affordable housing that would be produced as a result of the tax credit being sunsetted, because of a 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 less than that. Just because the credit program is really the driver of all affordable housing. There's no other viable substitute that's out there.

REP. WELLER: Let me ask if there are other members of the panel that would like to address the permanency. Mr. Barbolla, as a home builder in primarily rural areas?

MR. BARBOLLA: 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 -- a 95 percent decrease in affordable rural housing in the rural areas of Texas, and I may still be on the high side. We might still be able to produce five percent.

Because there's an additional problem, I think, not only the ones they've mentioned about with investors; but people outside of Washington believe -- they probably don't understand permanency. Remember back in '86, if you take away the investors here, we're not going to have -- the program's no longer going to be permanent, then investors get worried, "Well, wait a minute. I'm making an investment for dollars today for ten years of tax credit. What's going to keep the government from taking away the tax credit two and three years away?" There are many alternative investments.

I think if we remove permanency, we're going to create a scare in the market and supplies are going to go way down, and we're going to be able to create less units, even in this two or three-year interim period, because of the uncertainty in the market. So, not only will a lack of permanency affect this two or three years from now, I think it may immediately affect us with the uncertainty in the marketplace.

REP. WELLER: From the rural perspective with attracting those willing to invest in affordable housing in rural areas 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 or Boston Financial to find the investors for us. I know very few developers in rural areas go out and try to find their own investors. They all use syndication firms.

I think that -- on actually what type of investors, I'm not sure my recent properties would be using more corporate investors, you know, looking at who actually signs off on the limited partnership agreement. Mr. Haynsworth, maybe it would be better for you to address that from a syndication standpoint.

MR. HAYNSWORTH: Is the question that, is it more difficult to raise capital for rural housing? Not necessarily. If you have a project that really is a good project, we will certainly invest in it. They are much smaller and much less efficient, and they're sort of harder to find so that there's less incentive to invest, truthfully, in a small project.

However, we're all seeking volume. We're trying to generate as much buying 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.

REP. WELLER: Sure.

MR. BARBOLLA: 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-unit complex or 200-unit complex than the 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.

REP. 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 developer's perspective, the cost 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 pre-development and pre-construction processes that take place are all very expensive.

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 a development 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.

REP. WELLER: What is the turnaround time? You know, if someone decides to put together a project as proposed, going through the permitting process, the zoning -- do you have a perspective on what the amount of time is it usually takes for -- MR. WEISS: If you add --

REP. WELLER: -- someone to come up with the idea to actual construction and development being made available.

MR. WEISS: I would say, alone, that's probably about somewhere between -- it depends on the locality, but it's probably somewhere between nine 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 investment where the risk increases tremendously if the sunset is even threatened.

REP. 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've have one go as far as three years through the zoning process for the ability to proceed status in the state that I was working in before I was even eligible to submit an application. The application the first round was not approved. The second round, five months later, it was approved. So that took approximately nine months after the first application submittal, in addition to almost 20 months of zoning process. It was almost three years before we could actually close on it and start construction.

REP. WELLER: Thank you, Mr. Swank.

I see our chair has returned and my time is basically up, my five minutes, but Mr. King, as someone who administers the tax credit in your state, with respect to working with the syndicators, 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 dropoff as some of the other panelists have suggested?

MR. KING: I think you would see a dropoff. I don't know precise numbers, but it would clearly alter the quality and response of the developing community to the priorities -- the difficult priorities. It's difficult to build the type of housing that's priority in Connecticut. It takes a long lead time, a lot of risk; and developers -- when you have the stop and start situation in the past, did not respond with the same level they have to our needs when they have some permanency. REP. WELLER: There's a need for affordable housing. 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. REP. WELLER:

Thank you. I know my time is up. Thank you very much to the panelists. I'll turn the chair back over to the chairman.

Thank you.

REP. JOHNSON: We do have to move on to our next panel. I know you didn't discuss stacking of subsidies and any thoughts you have on that -- we will talk about that with the next panel, but any thoughts that 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 of 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 goals as in 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 when 71 percent of the units have additional subsidy, either section VIII rental, or real housing, or state grants, or something. We do not have from the GAO report good information about the depth of subsidy stacking over these projects. Therefore, it's very hard to evaluate, you know, the public benefit.

I ask you to think about that and get back to us on that; and -- any of you who care to. And then the other thing I'd like to know -- I don't want an answer to, because unfortunately, we don't have time for an answer, this is the beginning of a dialogue -- and this comes out of my concern about Ms. Hodel's testimony.

But I see in my hometown a lot of affordable -- owners of affordable units that would love to modernize their units. They can't afford to. They can't let the building inspector come in, because if they do, there are little code violations, so on and so forth, and the rents can't take it 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 was 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, right, because the building inspectors will come in and they'll have to do this code and that code, and if it gets over a certain amount of money, they'll have to put an elevator in. This is hopeless.

So, we do need to look at, is there a way? If we're going to keep this out there as one of our most powerful tools of 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.

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, to make sure 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're really compelled to go ahead to the next panel.

Mr. F. Barton Harvey, the chairman and chief executive officer of the Enterprise Foundation, Washington, D.C.; Benson Roberts, vice president for policy, Local Initiatives Support Corporation of Washington; Herb Collins, chairman of Boston Capital Corporation; Wilfred Cooper, chairman of the WNC & Association, Costa

Mesa, California; Ron Platt, legislative director, McDermott, Will and Emery, Washington, D.C.; Herb Stevens, Peabody & Brown, Terry Lewis, former chair of the National Cooperative Bank.

With that I'd like to yield to Mr. Cardin.

MR. CARDIN: I thank you, Madam Chair. This seems to be my day for people from Baltimore.

I want to welcome Bart Harvey. Mr. Harvey recently received an article in a Baltimore magazine which 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.

The article starts, "Bar Harvey gave up a life of privilege to follow Jim Rouse's vision of housing reform." That's certainly been true. Then it says that, "Mr. Harvey is largely responsible for selling Congress on the low-income housing tax credit program."

Madam Chair, we are very fortunate to have a person of Mr. Harvey's commitment and experience here, and I look forward to his testimony.

REP. JOHNSON: Thank you, Mr. Cardin. I must say that Baltimore is nearby and has a lot of successful people in it, but you have an incredible member of Congress. Mr. Harvey.

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 Patti Rouse of the Enterprise Foundation. 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 Liz, who is to my right, have also developed the corporate market in the low-income housing tax credit. Let me just take one minute to explain what the Enterprise Foundation does. It works in 153 cities with 700 nonprofit groups that are providing the opportunity for decent affordable housing, and a path up and out of poverty.

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, innercity areas through loans, through grants, and principally through the use of the low-income housing tax credit. 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 and 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 two 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.

We think the report that came back says this program works. I'd like to just comment on a couple of he items, and Madam Chair, you have wondered about the incomes served, which are well below the required number. It's an average that's in the GAO report of $13,300 of income for each household.

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 the manufacturing base to a service base. Over 30 percent of those employed in the country today make $8 an hour or less -- 30 percent of everyone employed, that's $20,000 or less. 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 are 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. He was pulled away at the last minute to tour the devastated parts of this country 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.
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 for jail right now -- those are the costs in New York -- $20,000 a year for a shelter. For an overall cost in this GAO report of $60,000, that's three 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 three years of cost 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. 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 of the -- participation by professionals who are the architects, who are doing the drawings, who are lawyers, et cetera, as well as small subcontractors that recycle this work back into the communities and to 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 ten 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.
Right now the credit is getting 66 cents, it's up from that 53 cents. So, if an investor says, this innercity holding for 15 years with penalties, if it doesn't work, 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. So, inevitably, from local governments you will get another small layer of subsidy, which is through block grant or the home program or some other program to make it work. If you want to get to special needs populations, you need larger subsidies because you're really getting no payment back from that population, or very little payment back from that population.
REP. JOHNSON: Thank you, Mr. Harvey. I'm sorry, we do have to try to stick to the lights.
MR. HARVEY: Thank you. Could I just end with one last thing, which is to say that this GAO report, which we worked so hard on -- this is our life blood -- has come out and given it a very high report.

Any approach to sunset it would seem to be -- would mystify us as far as what's coming out of it.
REP. JOHNSON: Don't get all riled up about rumors. Now, this is a difficult

time; and we're 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's no way that one cannot change the tax structure for seven 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 increased spending, and a President who has included a lot of increased spending in his budget -- some times people shout out and they 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. You know, where is it all going to come from?"

So, in our long list of things, and as one who has -- any one of you who has followed our struggle to reform the R&D tax credit, you will know that we only got that extended nine months. You don't think there are a lot of people sitting up here who aren't going to be benefitting from that? 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. It is the committee and Mr. Archer has said over and over and over again, the committee is going to do this; so, you know, let's stick to our business here and our business is to say -- to see what went wrong with this program, you know, what can be improved about it, to be more powerful? 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's the job of the members to support it, and the advocates, to make sure we hold our own. You know, it's not bad to have a rumor like that. Maybe all of you will realize, this isn't going to be rolling off the log. Nothing is rolling off the log up here anymore, not an appropriated program, nor a tax expenditure program.

So, fine, you know, get out there. Now, let's go on.

Mr. Roberts.

MR. ROBERTS: Thank you, Madam Chairwoman. My name is Benson Roberts. I'm vice president for policy at Local Initiatives Support Corporation. 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, through a broad rebuilding strategy, that includes 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 credit over the ten years of its existence, about $2 billion we have raised from about 130 corporations, many of them Fortune 500 corporations. We provide about $350 to $400 million of equity through these community organizations a year.

The kinds of -- let me give you a sense of the kinds of projects these are. These are overwhelmingly urban projects, about 90 percent, including -- 85 percent of them are in low-income neighborhoods. They're very much like the Whispering Pines project that Congressman Metcalf described -- the Nelson's Free Project in Hartford, I believe, you may have visited recently. This is housing intended to rebuild a community.

We stress the importance of long-term management of these properties so that they continue to be strong assets for the community. We worked very hard to build a capacity of community sponsors in this process. Unless this housing works for the long term, it serves no one's interest. We're very pleased by the way that is happening.

We believe that the credit, in fact, is fueling a remarkable revival in urban neighborhoods around the country. Not widely yet 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 various other factors. Last week David Broder has a column on this in Chicago.

The 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. You just can't do that with a spending program, as important as spending programs are. We 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, townhomes, facilities for the formerly homeless and the disabled and the like. It also provides a bridge to homeownership in places like Cleveland and the twin cities. The credit has been used to really help move tenants through into homeownership. 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 incentive. Its 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 thing 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 the 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 the permanency.

I think it goes without saying that if there were any disruptions for any reason in this program, it would be very inefficient and I think that the industry as a whole would believe that there'd be no chance that the program would come back were any sunset established.

REP. JOHNSON: Thank you.

Mr. Collins.

MR. COLLINS: Thank you, Madam Chairwoman and members of the subcommittee. My name is Herb Collins, I'm the chairman of the Boston Capital Corporation, 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 one for the record. I actually would like to leave more time out for questions, which I have 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 LIHTC should remain a permanent part of the tax code, and is the best 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 this credit.
The GAO report recommends four initiatives. Most, if not all of these recommendations, would in my estimation strengthen the program and help insure its continued success. I am particularly supportive of the recommendation regarding independent verification on 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 that were offered last week merit your serious consideration. I am particularly in support 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, inadvertent areas of noncompliance, would streamline the program in both administration and compliance.
With my remaining time, I would like to highlight some of the points may 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 and Internal Revenue Service, and the National Council of State Housing agencies, the subcommittee is now aware of the joint, federal and state oversight system.
Although their role is not as formal as that of the IRS and the state housing authorities, investors, lenders and syndicators play a unique role in insuring compliance with the requirements of the tax credit program. Syndicators have a fiduciary responsibility to insure that investors receive their full complement of tax credit 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 credit allocation.
Boston Capital does commission its own market study to insure 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 have an outside consultant conduct a market study, and we ourselves within our own staff conduct a market study to be sure it meets our requirements.
A point of interest is that we have a portfolio of over 80,000 affordable units of which 50,000 are tax credit units, and have an average occupancy of roughly 95 percent, demonstrating that there is a demand that is being met; and that the units being built are needed.
Before construction has begun, we use our expertise to analyze the construction quality to assure that individual capital that goes into the building through an architectural engineering review. We continue to exercise the responsibility

by monitoring the property during construction, the lease up period, and throughout the life of the investment. Our monitoring includes a constant review of construction drawings, rent rolls, occupancy reports, income and expenses, tax returns, audit the financial statements and the tax compliance worksheet. 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 assure the validity of the cost -- and very, very importantly -- 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 a developer and a syndicator. Let me assure the chairwoman 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 invested 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 will be glad to answer any questions at the end of this discussion.

REP. JOHNSON: Thank you very much, Mr. Collins.

Mr. Cooper.

MR. COOPER: Madam Chair, members of the committee, I very much appreciate the opportunity to present this testimony on the long-term permanence of the tax credit today.

I am Wil Cooper, founder and chairman of WNC & Associates from Costa Mesa, California. We also have offices in Portland, Oregon, Houston, Texas, and Washington, D.C. 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 more than 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 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 environment impact of each property.

After we decide to invest in a tax credit qualified property, WNC conducts a thorough review of each tenant file, and to insure 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 of 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 that 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.

I want to stress what has already been said -- permanence has greatly increased the efficiency of the credit, insured 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 farmers' home 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 the low-income housing tax credit properties will be any different. There was discussion last week about usage of a state by state tax credit allocation. The per capita capital 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 tenants -- 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 tax credit properties is $13,000. While the strength of the low-income housing tax credit programs, 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 response to Chairman Archer's mandate last year.

The study demonstrates the success of the program, and I think makes a strong case for its continued permanence. I think it's 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 GAO and the National Council of State Housing Agencies 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 a 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 one on 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 Chairwoman, 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 last 25 years, including the tax credit experience of the last ten years, is available to share with you and your staff to make any changes or reform that will serve to improve the program.

Thank you.

REP. JOHNSON: Thank you very much, Mr. Cooper.

Mr. Platt. We're going to hear Mr. Platt and then probably Mr. Stevens, and then we'll -- perhaps some of the other members will be back, but we may have to go through another one of these recesses.

MR. PLATT: Thank you, Madam Chair, Mr. Coyne and member 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 and Emery, testifying on behalf of Bruce Rozet, chairman of the board of the Associate Financial Corporation.

Since the inception of the low-income housing tax credit, Associate 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 value principles. First and foremost, the government can no longer afford to subsidize the building of new housing for very low-income families. With costs ranging up to $150,000 per housing unit, rental or ownership, the cost for government financial assistance to meet the needs of families with incomes below 60 percent of the median income is prohibitively expensive.

A family with an income of $20,000 a year can only afford housing with a capital cost of $20,000 to $25,000 a 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 and $20,000 per unit. By establishing realistic ceilings or limits for government assistance, the cost to the government will be reduced and the respective 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' present efforts to mark section VIII 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 innercity, and still allow new construction in rural and non- innercity areas.

Utilizing the low-income housing tax credit primarily for rehabilitation of existing housing will 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 in any program of new construction.

The recent GAO study found that 71 percent of the tax credit unit households also benefitted 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 requires 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 homeownership. 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 tenth and fifteenth year, and owners who converted to resident ownership as either condominiums or tenant cooperatives would pay tax only on the cash they received.

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. We should not continue to ignore long-term affordability when the government is subsidizing he construction.

Thank you very much.

REP. JOHNSON: Thank you very much, Mr. Platt. That long- term affordability issue is a big problem in some of our current programs, as you well know.

Mr. Stevens, I'm going to go on over to vote. Mr. Coyne's going to stay awhile until Mr. Portman gets back.

Thank you for your testimony.

MR. STEVENS: Thank you, Madam Chair, thank you, Mr. Coyne.

I'd like to just address a few of the questions that you've had in this hearing and in the prior hearing.

On 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. I think 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, 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, Ms. Johnson asked about other federal subsidies. I think there's an interesting statistic in the GAO report. The GAO said, "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, 39 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. The credit program is good because it can allow those income leveled families to be served as well.

Third, Ms. Johnson suggested that the type of properties being served -- one and two units -- 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 meets the needs of the population that the states have at low income. I don't think necessarily that the population in 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. I think that it's important when you talk about extended you that you 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 cost of development.

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.

MR. PORTMAN: [Chairing on behalf of Chair Johnson.]

Ms. Lewis.

MS. LEWIS: Thank you. 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 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, homeownership. That is because homeownership provides very well understood benefits to the communities that it is involved in.

With the degree of control, responsibility and the pride of ownership that comes from homeownership, residents carefully maintain their property, they reject unwanted behaviors on the part of their co-residents, 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 homeownership 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 will 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 cost. 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 deal with sections of the tax code that deal with cooperatives and cooperative housing, not section 42 at all. That's section 216, which defines cooperative housing and subchapter T that deals with the comprehensive taxation of cooperatives of all types.

You ought to know -- I think I ought to tell you -- what a limited equity cooperative is. Cooperatives -- Housing Cooperative is a corporation that is composed of stockholders who are the residents of the property. There's an absolute identity between ownership of the corporation and occupancy of the property, only resident can own stock, only stockholders can reside.

The equity limitations means that there's a control over the resale of the cooperative interest. In the case of low-income housing tax credits, that control would mean that the cooperative interest could only be resold to eligible families, and 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 homeownership or any of the benefits that come from homeownership 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, at a time certain, that would allow the cooperative to buy out the tax credit investors, who are the 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 gross period of about five 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 three percent of the units produced over the three-year period that was in the GAO study.

We think that that three percent could be a wonderful model of highest and best use of the tax credit, and a real leveraging of the tax credit to provide many of the social benefits that anchoring communities, providing stability and creating a better sense of citizenship really seeks to do.

Thank you very much.

MR. PORTMAN: Thank you, Ms. Lewis, and I thank all the witnesses here. I'm sorry I had to run in and out. Such is our schedule with the votes and other commitments on a busy day when we're balancing the budget and all these other things. But I really do appreciate the testimony and be it known that -- although it's a rather sparse attendance right now -- of course all your comments, including those we will have now in our dialogue, are 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 credit. So this is not in vain, folks.

I am honored to be able to sit here and ask this group of experts all these questions. I have a lot of them. Not all will we be able to get to today, but I'd like to start with some of the questions that I pursued at the last hearing. We had a hearing a week ago. Some of you, I know, were in attendance. Mr. Roberts and I spoke at that hearing.

It goes to the issue of the subsidy, some of the stacking issues, the rents and so on. The first question I would have -- and I would open it up to any of you, because you've all had experience in these projects. Most of you, I understand, probably have 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, you want to start?
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: Can you give me then -- would that be Mr. Collins' answer also?
MR. COLLINS: Yes. I also saw -- we have some, especially in Massachusetts, they have some major efforts programs, which focus on mixed income. I can't give you the details on the experience it had, but -- I'm not sure it's been a positive experience, but it has seen there is a differential in some of the rents between ten to 20 percent. In some cases, they might be very similar.
MR. PORTMAN: I think the numbers the GAO came up with, as I recall in their report, was about $100 a difference. I think the average rent for low-income housing credit units was $453. Is that right? And then they came up with the $555 number.
Do you all dispute that number, the $555 number for non- subsidized?
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 rents. 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 it frequently is 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 figure of $555 or roughly $100 more for non-subsidized units?
MR. STEVENS: There's 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 ten percent difference, if not more, between the market rate rents and the tax credit rents.
MR. PORTMAN: 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, I think, 71 percent of the credit units benefitted from additional subsidies of one kind or another. Some of those were rentals, of course, section VIII type similar construction.
I guess what I would ask is, again -- anyone feel free to respond here -- from your experience could you estimate for us the portion of the positive results that flows from the credit as opposed to these other subsidies, given this 71 percent figure. I guess I'm really asking, 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 in 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 the homeless roll, et cetera, and just had public assistance before they get into jobs.
So, you really arrive at it the other way and you're 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 credit and you say, what additional

working -- typically working 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 block grants, home programs, and/or some other special subsidy for a special needs population.

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 also varies dramatically around the country. There are some areas and cities that are high cost that 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. That varies all across the country.

MR. PORTMAN: Such as some of the urban areas on the coast?

MR. HARVEY: Yes, but it's also out west. I mean, out west is very -- you know, 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 to subsidize rental assistance. And the question is, "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: Again, you and I 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. We -- and that -- 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 it 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, and 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. I was trying to be more specific on some of the information we need for the record and we'll continue on that.

But, if the subsidy was provided, let's say as an example, through section VIII, or for that matter, through a block grant to the state agencies, and the state agencies determine who's 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?

Is the housing market so different than other markets around this country where, when you empower somebody by giving them the tools to be able to go in and demand housing by providing more in section VIII, or more block grants, that the housing just would not be built so you wouldn't have these advantages you're talking about in terms of communities being rebuilt, and therefore, attracting more capital? Is that just -- is there no number at which that would happen?

MR. ROBERTS: Yes, sir, but it's a very high number.

MR. PORTMAN: You said it would be a higher number than the low-income housing credit.

MR. ROBERTS: In order to stimulate the capital investment, it would need to approximate the rent subsidies that were present in the section VIII production programs, 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 for rent subsidies, 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 three 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 to satisfy the section VIII, 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 three years down the road.

MR. PORTMAN: That's a good point, and as you know, nothing is certain up here, even entitlements tend to change. Again, we mentioned earlier, 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 the applications obviously increase when you get into permanence -- whatever permanence means around here -- so, I don't argue with that.

But there probably -- there are other ways of permanence, as we see with this tax as an example. The discussion of whether in fact it will remain permanent, is that all that different than an annual corporation -- or for that matter, something even more certain, I suppose, which would be some kind of a mandatory spending item. Mr. Stevens.

MR. STEVENS: Yes, at the hearing last week, the GAO actually stated that the comparison should have been about $200 between average median income -- sorry, 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. I'd like to actually have the GAO confirm that. That 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 a $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: You'd just -- if you simply take $100, $1,200 a year, take it out to ten, now 15, years of the program -- 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: Okay, I'll let you say it.
MR. STEVENS: One is the incremental cost. The GAO said at the testimony last week, it was about $200 difference.
MR. PORTMAN: Not $100?
MR. STEVENS: Not $100. In fact, 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 is there -- well, but there's no commitment to continue to provide it to low-income individuals after 15 years, is there? MR. STEVENS: There is in most states.
MR. PORTMAN: I know different states have different requirements. What are the --
MS. LEWIS: The market is bidding that commitment up.
MR. PORTMAN: What do you all think of the -- is it 55 in California?
MR. STEVENS: 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 will be difficult to attract investors?
MS. LEWIS: -- 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 you made -- absent an operating subsidy in the form of some sort of rental subsidy, it becomes very iffey for the cooperative and 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 both -- this is place based and the permanence in it is you're getting all of the -- you're really writing down most of the capital at the get-go; and then whatever can be financed will be financed from there on, and that's very different 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 that that rent is coming in over. If it's like the programs of today which are getting changed every five years, you can't finance it. We can't find banks to go and finance something without knowing that they've got a rent stream to amortize down their debt over a period of time. So 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.

REP. 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 the low-income individual?
MR. HARVEY: Yes, again, what you're basing off that is a 15-year certainty or some period certainty against what you will get X amount of debt, and then you would -- and that either makes it work or not work.
Again, those 15 years are being challenged right now so that there's a discount that the capital markets will put onto certainty that it will be there for all 15 years and that you'll get rent adjustments on it. That's a problem in

housing, that 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 upfront, you know you've got your costs carried up front.

REP. PORTMAN: Just -- I have one more followup question to 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?

MR. STEVENS: I think you should use 30 years, brcause the federal law requires --

REP. PORTMAN: So the 30 years is where you get the -- what did you say, $72,000?

MR. STEVENS: Yes, $72,000. So if you did 15 years at that, it would be $36,000. It would still be higher than the tax credit cost.

REP. PORTMAN: Okay, doesn't GAO use present value to come up with their $27,000 figure?

MR. STEVENS: Yes.

REP. PORTMAN: So, how do you compare yours to that? I mean, they -- as I recall, $27,300 is placed 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. It would be lower.

REP. PORTMAN: What would -- what discount rate are you going to use?

MR. STEVENS: Using the GAO's rate, it was probably the federal rate, about seven percent. That would be for 15 years -- that would be about half. Using a seven percent discount rate, that would be about half. So that would be -- instead of $36,000, it would be $18,000.

REP. PORTMAN: Okay.

MR. STEVENS: And then --

REP. PORTMAN: What do investors in your projects typically use for their cashflow? Seven?

MR. STEVENS: Yes. For cashflow discounting?

REP. PORTMAN: Yeah.

MR. STEVENS: I was just using -- comparing apples and apples, you'd take the same discount rate the GAO used for the tax credit and apply that.

REP. PORTMAN: Okay. So, instead of $72,000, what's your number, roughly?

MR. STEVENS: Probably more like $20,000.

REP. PORTMAN: Any percent?

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, the $200.

MR. STEVENS: Yes, $200.

MR. ROBERTS: Two hundred dollars a month discounted at seven percent over the years.

REP. PORTMAN: I just think it's important that we all are using the same basis upon which to make these comparisons. Again, I know it's difficult in this area to compare. We talked about apples, grapefruits and oranges at the last hearing.

With that, let me turn it over to Mr. Weller, and if you all are willing, we will ask some more followup questions.

Mr. Weller.

REP. 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 homeownership initiative proposal -- cooperative program. I was wondering to what extent are some states already doing this?

MS. LEWIS: Well, the tax credit program as it currently stands prohibits homeownership. It is strictly a rental program. Given the benefits that have been created through the use of prior rental programs by a cooperative homeownership model, we think that that's very shortsighted. The closest you can get under the current program is what we call a leasing cooperative under section 42. 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're more willing to install more efficient furnaces as a replacement unit than any rental owner would be, because they know what the payoff is going to be. 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're given the management authority that they would be allowed to have under this program, plus they would have the real investment that homeownership 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. In a lot of places in the country, that $2,500 is all that's necessary to this PMI to 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.

REP. WELLER: Other -- I guess, directly are there particular pilots or experiments that states are conducting right now?

MS. LEWIS: They're not allowed to do that. Again, because homeownership is completely prohibited.

REP. WELLER: Initiatives on their own, unrelated to part of state housing programs?

MS. LEWIS: Oh, 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.

You can take a look at it. I'd love to take you on a tour.

REP. WELLER: I believe when you increase homeownership, you strengthen a community, because people want to protect that stake they have in the community --

MS. LEWIS: They do indeed.

REP. WELLER: -- and the equity that they have.

I think next -- a couple other questions I'd like to direct to Mr. Cooper, if I could. The GAO report made some recommendations regarding independent market studies. I was wondering, do you perform independent market studies to verify that properties are targeted to local tenant needs as part of your program?

MR. COOPER: We mentioned in the testimony about independent market studies. I think -- probably Mr. Collins can speak to the same issue and 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 analysis to do a study for him. We go to a separate, independent, third-party study so that we can verify, comfortably, for our investors that in fact the market exists in reality as it really is.

We have actually abandoned properties, if you will, when we find early on that the market study doesn't give us the comfort level that we get from a separate study.

REP. WELLER: But that's standard operating procedure for you?

MR. COOPER: That's standard procedure, yeah.

REP. WELLER: Is that the same for you, Mr. Collins? Do you want to comment?

MR. COLLINS: It is and we go a step further. We have an acquisition staff, who actually are very experienced in doing market studies themselves. So we do a third market study to confirm what we've seen in the other two, or correct accordingly.

REP. WELLER: Would that study determine whether there's already low-cost tenant units already available in them, in the neighborhood, or in the community being served? MR. COLLINS: Yes, actually what you're really looking at when you go into the study, you see the marketability and you're really looking at the comparable rents in the area and cost of construction in the projects in the areas, and you're looking at the vacancy rates -- what else?

In general, it's a complete sort of process to underwrite the project to know that there is in fact a market for that particular rent and that particular project and a need.

REP. WELLER: But, now, does the availability of low-cost tenant units in the area, would that affect your decision, if you discover there is --

MR. COLLINS: Yes. Certainly we don't want to over -- see something overbuilt in an area, because it will be taking tenants from the other particular projects.

REP. WELLER: One of the questions that focused on the previous panel -- of course there's the discussion in the past, and of course, the debate which succeeded in making permanent, low-income housing tax credit in 1993. Since then, some have discussed making it temporary again, going back to the old way. 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 to low-income housing tax credit and made it -- sunset it at a 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."

I know in the last case, in the 1993, when it was being talked about -- even the threat of it, discouraged people from investing. Recognizing what Larry Swank said earlier, it takes at least two years, I think, to actually go through the process that really results in a developer making a commitment in time and money and lost opportunity.

You know, in many cases, someone's really not likely to rely on a decision two years from that date to commit that kind of money. If you look at the investment community, a lot of what was happening when the credit was made permanent, you saw sort of a large involvement on the part of the corporate corporations in investing in this. The reason for that was because it was something of a permanent nature. They have to build up their own staffs and they have to invest time and money themselves, and they need some lead time. What has happened with the increased number of investors in the market, which

was again the result of the permanency, you find that the larger lenders are willing to come in at a much lower interest rate which made it much more competitive. 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. What that has resulted in is more money going to the projects, because there are a number of controls and constraints out there which prevent developers, syndicators, or any other parties from taking exorbitant amounts of profit out of this. There are limits.

REP. WELLER: So, if I understand the point you're making, Mr. Collins, you were saying that with the permanent status, there was more -- greater interest by potential lenders and investors?
MR. COLLINS: Yes.
REP. WELLER: And because of that, more affordable rates of credit was provided.
MR. COLLINS: Yes.
REP. WELLER: Bringing down the cost of construction of the units.
MR. COLLINS: Exactly.
REP. WELLER: Mr. Roberts, you want to add to that?
MR. ROBERTS: Just to say that the projects that would be most severely curtailed would be the more difficult projects, the more time consuming projects, and the riskier projects, and those tend to be the innercity projects.
MR. STEVENS: Mr. Weller, to respond to your question, also.
REP. WELLER: Please, go ahead, Mr. Stevens.
MR. STEVENS: We noticed that the IRS' oversight increased dramatically after the program was made permanent. When I talk with the staff members at the IRS, they acknowledge that the have a limited budget and limited priorities, also. As long as the program was possibly going to only last another year, they were not -- given their priorities -- going 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 you take can have ripple effects in the market.

REP. WELLER: I realize my time is running out. Is there any other panelist who would like to comment on that question, briefly?
MR. HARVEY: Briefly, there is another effect. When you start to talk about sunset, et cetera, you've got -- it starts really with the developers who are willing to go through the process and spend the money up front not knowing if in a few years from now if they're going to have a project that's going to come out on the other end.
It'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 it's been properly built and will be there over the longer period of time. If you say in two years, you know, you could not have a program any more, everyone begins to look at what you'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 may not exist as you go forward.
So it just puts in tremendous uncertainty. Investors don't like it. Developers don't like it. If you're trying to run a top-notch program, it's very hard to juggle people's lives, careers on that kind of basis.
REP. WELLER: Well, thank you and I realize my time has expired, Mr. Chairman. Thank you.
REP. PORTMAN: Thank you, Mr. Weller.
Mr. Coyne.
REP. 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's report showing, in their judgment there's basically zero noncompliance.

MR. ROBERTS: I'm not sure you'd get a great deal more. We do very frequent onsite inspections ourselves of any project of at least 30 units. We're there at least once a year and just slightly less frequently for very small projects. 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, you know, require state visits on a periodic basis.

REP. COYNE: Some witnesses have told us that low-income housing tax credit allocation should be increased; and some others have told us that a portion of the allocations go unused. Are these views inconsistent, or are they unrelated? Mr. Roberts?

MR. ROBERTS: We have -- 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 one percent of the housing projects to which we commit failed to proceed.

REP. COYNE: Has anyone had a different experience?

MR. HARVEY: No, our experience would confirm that. It's a very, very competitive system out there, and it seems -- I'm sure the NCSHA can answer that question, but it seems this under allocation is a mystery to us, because we're constantly looking and see the need to do more and more.

MR. COLLINS: I might mention -- I notice in the Chairwoman's introductory comments the other day at the hearing, she talked about $320 million in credits unused. In fact, I think it was around the '93 period or during the period the study was conducted. I can't say for a fact -- my assumption is it was due to the fact -- when he had the question with the sunset, less people actively -- a lot of people were sitting on the sidelines -- a lot of corporations and a lot of developers -- to see whether or not in fact the credit would be continued permanent, and had less activity.

Our experience, too, we do quite a bit annually and we haven't seen any shortages.

REP. COYNE: Mr. Roberts, in your judgment, are there any of these low-income housing tax credit projects that have failed, that you can say?

MR. ROBERTS: I can say there may be very rare failures. But the system is structured so that when a project starts to get into trouble there are early warning signs, and there are enough participants in the project 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.

REP. COYNE: So while there are some failures, very few?

MR. ROBERTS: Very occasional and by very, you might mean that perhaps a sponsor just can't fulfill its obligations. So, instead of the project itself failing, the sponsor fails and another sponsor is brought in to take over.

REP. COYNE: Thank you. REP. PORTMAN: Just to followup quickly on Mr. Coyne's question. It sounds as though from what you're saying -- and I think it's consistent with what we've been learning, that there is actually an excess demand out there. I see some affirmative head shaking.

My question, sort on the flip side of that to Mr. Collins and others -- does that mean the credit is too rich?

MR. COLLINS: I'm sorry, I can't hear you.

REP. PORTMAN: Doesn't that mean the credit might be too rich? I mean, let's look at this as a fact fair subsidized system.

If the credit weren't so rich, then the states wouldn't be in this situation of there being excess demand? Instead there'd be more of a balance, wouldn't it?
MR. COLLINS: I wouldn't say that the credit is too rich. If you look at the comparable costs out in the marketplace and returns. Because when an investor invests in one of these complexes for investment, he's looking at other alternative investments that's going to be competitive.
What we're seeing right now with the returns and yields getting lower, we're seeing investors -- corporations withdrawing from the market because of that.
REP. PORTMAN: Because of --
MR. COLLINS: Because the yields are coming down, they're not competitive with alternative investments that they're faced with.
REP. PORTMAN: But you just told me that the demand is in excess of the credits available.
MR. COLLINS: There's still a lot of people, I'm just saying --
REP. PORTMAN: You can't have it both ways here. Let's decide which one it is.
MR. HARVEY: Let me, if I could? Let me --
REP. PORTMAN: I understand it's all in comparison to other investments, and most of you in the investment business understand that. But all I'm suggesting is, could the credit be less rich and could this still be a viable program.
MR. HARVEY: If you look at the credited cast, Congressman Portman, and there's great demand. What we find in our organization is that there are a great many other projects that you go through because there are a lot of people to be served, they go into that competitive process. I think it's three-to-one in a number the states apply, and only one comes out the other end.

There is money waiting at the other end. 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 yield that they will receive, 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 assure that need for them and also make money for them.
REP. PORTMAN: You're opening up a whole 'nother area of questioning, which is interesting. Just quickly, if I could draw from that. I know that we may have to abandon this room for another meeting coming in, but how many of you have experienced that where CRA is an influence?
Again, the flip side of that is, are these units in a sense even more subsidized to the extent now we have -- there's the CRA incentive. 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 requirements 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 project.
REP. PORTMAN: You have a federal requirement.
MR. HARVEY: Right.
REP. 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.
REP. PORTMAN: Right, but do you see the point that I'm making, when you look at the totality -- and I'm not saying that the GAO should have done this. It wasn't really their charge, but there is an interesting combination here of

incentives and subsidies.

The question I'd have for you, Mr. Harvey, is if you can give us a sense of this -- and maybe Mr. Collins and others have these numbers also -- what rate of return are your investors looking for these days? 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 on -- REP. 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 7.5, eight percent present value. That's what Mr. Collins is talking about competing with alternative investments.

REP. PORTMAN: Right.

But that's the market. I just want to make one final comment and that is to thank Mr. Platt for some of his recommendations and give him a chance, if he would like, to talk --- we talked a little about the credit. Could it be altered.

You come up today and give 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: Sure, I think that there's no question that we have -- and probably are going to face in the years to come -- a shortage of housing. There's probably a need for new construction. So I'm not suggesting that that's an issue that's somehow 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, the money allocated for low-income housing tax credit, that that's an effective use in terms of new construction that's costing $100,000 and $150,000. In some cases, we've gone in California as high as $200,000 a unit -- that that's an effective use of the low-income housing tax credit -- rather than 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. They're interested in acquiring a HUD project that they want to rehabilitate, that they've been in touch with me 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 current law where, you know, the tenant association becomes the general partner with the leasing coop. They're all not satisfactory subject to 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 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 the housing, to make sure that the dollars we've spent to create the low-income housing that it stays affordable for a longer period time, and that we offer opportunities for tenants to be empowered and own their own housing in one fashion or another.

REP. PORTMAN: And the longer period of time is why you would support the 30 year --

MR. PLATT: Thirty years, and as most people would see that most states already do that -- some don't --

REP. PORTMAN: Then the $40,000 per unit is --

MR. PLATT: In the federal law, it ought to be taken out to that period of time.

REP. PORTMAN: The $40,000 per unit is to be able to target the resources.

MR. PLATT: That's a target. It ought to be market -- you're basically saying market prices. What you're doing now -- the housing committee is doing with section VIII 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, so there's a significant subsidy both in state and federal government in terms of section VIII 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 to make sure that the section VIII subsidy is no greater than the market rates are. That's in effect what we're saying here, to do the same thing with the credit.
REP. PORTMAN: Thank you again for you input.
Mr. Coyne, additional questions for the panel?
REP. COYNE: No, Mr. Chairman.
REP. PORTMAN: I want to thank the panel 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. END

LANGUAGE: ENGLISH

LOAD-DATE: May 6, 1997

37TH STORY of Level 1 printed in FULL format.

APRIL 23, 1997, WEDNESDAY

SECTION: IN THE NEWS

LENGTH: 4151 words

HEADLINE: PREPARED STATEMENT OF
JAMES R. WHITE
ASSOCIATE DIRECTOR, TAX POLICY & ADMINISTRATION ISSUES
GENERAL GOVERNMENT DIVISION
BEFORE THE HOUSE WAYS AND MEANS COMMITTEE
SUBCOMMITTEE ON OVERSIGHT
SUBJECT - TAX CREDITS OPPORTUNITIES TO IMPROVE
OVERSIGHT OF THE LOW-INCOME HOUSING PROGRAM

BODY:
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 lowincome 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 i 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.

50,000

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.

$10 →
$9

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 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 c 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 liming 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 nontax credit financing varied, but they generally included reviewing projects/1 rents and operating expenses, private mortgage terms, and non-tax credit public subsides-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 or-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 state 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 parmer level. But over reporting of tax credits by partners could be detected by matching tax credits reported on the Schedule K-ls, 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) However, resource constraints have prevented IRS from transcribing all the Schedule K-ls 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. 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.

1. Tax Administration: IRS' Partnership Compliance Activities Could be Improved (GAO/GGD .:5-151, June 16, 1995).

(FIGURES: NOT TRANSMITTABLE)

END

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