TESTIMONY OF KATHERINE M. ALITZ ON BEHALF OF THE COUNCIL FOR AFFORDABLE AND RURAL HOUSING BEFORE THE SUBCOMMITTEE ON HOUSING AND COMMUNITY DEVELOPMENT, HOUSE COMMITTEE ON FINANCIAL SERVICES

LEGISLATIVE OPTIONS FOR PRESERVING FEDERALLY AND STATE ASSISTED AFFORDABLE HOUSING AND PREVENTING DISPLACEMENT OF , LOW-INCOME, ELDERLY AND DISABLED TENANTS

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Madam Chairman and members of the Subcommittee, I am the Vice President of the Council for Affordable and Rural Housing, and on behalf of myself and CARH, I want to thank you and the Committee for the opportunity today to address issues surrounding federal rural housing programs, rural housing opportunities, and rural housing legislation under discussion. We very much appreciate the Committee's ongoing interest and focus on affordable rural housing. CARH members house hundreds of thousands of low-income, elderly and disabled residents in rural America. CARH has sought to promote the development and preservation of affordable rural housing throughout its 29 year history as the association of for-profit, non-profit and public agencies, that build, own, manage and invest in rural affordable housing.

The condition of our nation's housing stock, in general, has improved over the last thirty years, but affordability of that stock is a growing problem. In rural areas throughout the country, there continues to be an overwhelming need for both affordable and decent housing. The need for rental housing is even more acute. With lower median incomes and higher poverty rates than homeowners, many renters are simply unable to find decent housing that is also affordable. While the demand for rental housing in rural areas remains high, the supply, particularly of new housing, has decreased. This is in large part due to a reduction in federal housing assistance. Neither the private nor the public sector can produce affordable rural housing independently of the other. It has been and should be a partnership.

For all of the reasons stated above CARH believes that a greater financial commitment is needed for affordable housing preservation. This certainly means more financing than provided in the Administration's Fiscal Year (FY) 2010 Budget. We note the U.S. Department of Agriculture (USDA) Rural Development (RD) Housing and Community Facilities (HCF) budget eliminates the interest subsidy component to the Section 538 guaranteed loan program. As we speak, RD had an FY 2008 pipeline of 119 properties, many preserving existing Section 515 properties, still trying to close. Last week, on an industry phone call, RD representatives stated that they could only fund 50 to 60 of these properties, the rest have already begun to get RD responses that their prior approvals were being revoked. This leaves nothing for properties approved in FY 2009, and FY 2010 also promises to be a disaster for this program. Simply put, the 538 needs the interest subsidy to provide low income housing and that must be restored. This restoration is particularly important for rural housing preservation, as the Section 538 program is being directed more and more toward the rehabilitation needs of the aging portfolio.

Similarly, many rural affordable housing rental properties are located in states decimated by the Hurricane Rita, Ike and Katrina disasters, and flooding in the mid-West. Just as affordable rural housing properties were being restored, the economic hurricane of last Fall hit, decimating the ability to raise capital. Through issues of interpretation, we understand that low income tax credits provided under Section 1400N of the Internal Revenue Code to address these disasters were not included in the exchange program under Section 1602 of the American Recovery and Reinvestment Act (ARRA) of 2009, along with other low income housing tax credits under Section 42 of the Code. CARH supports S. 1326, introduced by Senators Evan Bayh (D.IN.) and Richard Shelby (R.AL) and companion legislation H.R. 2895, introduced by Representative Artur Davis (D.AL) and Charles Boustany, Jr. (R.LA), allowing more consistent treatment for all low income housing tax credits and permitting wider use of the exchange program to restore affordable housing in these areas of the country.

As CARH members know, Section 521 Rental Assistance (RA) contracts, which were originally five years in length, were cut to one year in FY 2005 –FY 2008 in order to temporarily lower the budget outlay for RA. RA contracts, even if subject to annual appropriations, should be 5 to 20 year renewable terms, like Section 8 renewals. The administrative strain of more frequent renewal processing is already being felt by our members and observed in RD staff. Shorter term renewals and static staffing levels cause more work without corresponding increases in resources. We appreciate that the Administration and Congress recognized the movement to one-year RA contracts created a budget paradox, causing the budget to go to about $1.1 billion just to keep the contracts we have today.

The present income tax structure impedes the very preservation that we all seek. H.R. 2887, the Affordable Housing Tax Relief Act of 2009, sponsored by Representatives Artur Davis (D.AL.) and Geoff Davis (R. KY.), provides a preservation tax incentive needed to preserve Section 515 housing. Most Section 515 properties were created before the 1986 Tax Reform Act. Because rent restrictions limit any cash flow from property, new capital contributions would only generate additional passive losses which cannot be utilized by current investors. Yet, if the current owners sell a property it is almost impossible to generate sufficient cash to pay off the steep recapture taxes that would be owed. The best alternative for current limited partners is to hold the investment until death, enabling their heirs to acquire the property with a stepped up basis that avoids any recapture taxes. While that is a perfectly rational decision at the partner level, it is not consistent with sound housing policy and risks imposing far higher costs on the federal government as these capital-starved properties either continue to deteriorate as affordable housing or are sold off as market rate housing as a means of generating cash on the sale to pay off exit taxes for investors. Either way, the stock of federally assisted affordable housing is at risk of being lost, even as the affordable housing crisis in America grows worse.

A modest change in the tax rules must be adopted to preserve the stock of Section 515 affordable housing at minimal revenue cost to the federal government. This could be accomplished by waiving the depreciation recapture tax liability where investors sell their property to new owners who agree to invest new capital in the property and to preserve the property as affordable housing for another 30 years. Since very few investors subject themselves to recapture taxes today, opting instead to pass on the property to their heirs at a stepped-up basis, the cost of this proposal should be modest, while the benefit to the federal government of extending the affordability restrictions will be far-reaching.

The Fiscal Year 2010 proposed budget also allows for rural housing vouchers for low-income tenants in Section 515 projects where loans have been prepaid. CARH recommends that the voucher program should be expanded and allowed in existing and preserved Section 515 properties. Wider use and availability of rural vouchers will protect tenants who cannot afford to live in Section 515 housing, and with average annual household incomes at about $10,000, additional voucher availability is badly needed.

The Administration's budget provides additional Section 502 funding, badly needed for new homeownership in rural America, but it neglects the already existing and aging Section 515 multifamily direct loan program. The situation has grown so acute that CARH members have again met this past month to update CARH's 2003 Position Paper on the Aging Section 515 Rural Housing Portfolio. While CARH is reviewing further possible options, it is clear that billions are needed, starting with an estimated $1 billion this year, just to keep up with deferred needs.

The main focus of CARH's preservation efforts is the Section 515/514 rural rental and farm labor housing. We appreciate the introduction of the "Saving America's Rural Housing Act of 2006" (H.R. 5039) in the 109th Congress by Representative Geoff Davis (R. KY) and introduction of the "Rural Housing Preservation Act of 2007 (H.R. 4002) in the 110th Congress by Representatives Lincoln Davis (D.TN) and Geoff Davis (R. KY). In the 111th Congress, these same Representatives have reintroduced the "Rural Housing Preservation Act" (H.R. 2876). Each introduction has had a growing list of cosponsors, which we appreciate. The bulk of H.R 2876 is contained in Title VIII of the current discussion draft of the "Housing Preservation and Tenant Protection Act of 2009". CARH had supported HR 5039, as introduced, but in all the discussion about 5039's prepayment provisions that followed the paramount issue of preservation and revitalization of the Section 515 portfolio was lost. CARH supported H.R. 4002, asking that prepayment not be included in order not to distract from the larger preservation goal. H.R. 2876 and Title VIII contain the same language as the prior H.R. 4002, which CARH largely, but not entirely supports. There are three provisions that must be addressed in Title VIII of the draft preservation legislation before the Committee. First, Title VIII, requires a 30 year capital needs assessment, but provides no funding for this requirement. Real estate industry standards are to project capital needs over 10 to 20 years, the longer the term the more money must be budgeted and escrowed. Thirty years is beyond any reasonable real estate standard, beyond anything that a 515 property could be expected to finance, and achievable only with substantial additional grants and soft loan funds from the federal government.

Second, additional rent subsidy will be necessary, both to preserve properties and address the need for further tenant subsidy as the proposed legislation caps rents for participating properties at 30% of income. CARH believes that it would be most cost-effective and administratively efficient to use an existing appropriation under the existing Section 521 Rental Assistance program or project based Section 8 program to fund those amounts.

Third, Title VIII would require owners suing to receive damages for the government's breach of their contract prepayment rights return a portion of their court awards or settlement funds, up to 50% or $100,000. When Congress enacted the Emergency Low Income Housing Preservation and Resident Homeownership Act of 1988 (ELIHPA) it breached existing agreements allowing prepayment. More than 700 owners have sued and won damages in court or through settlement with the federal government. Properties receiving damages presumably have substantial equity and market value, and currently should not need access to the sort of financial restructuring contained in the contemplated legislation. However, as the years go on, current or future owners should be eligible to utilize any available tools the Agency determines are reasonably needed. This provision is impractical as owners would not have the damage awards to return (after payment of taxes, costs, fees and distribution to current and former partners). This provision would create a new breach and new round of litigation, because the settlement affecting many properties require that the owners not be treated differently than other owners, which this provision surely would do. As there is little benefit to this questionable provision, CARH believes this provision should not be included.

CARH supports the RD demonstration program effort known as the MPR, for Multifamily Preservation and Revitalization. MPR has funded some properties, but of equal importance, are even larger number of properties owners and RD have preserved on an ad hoc basis, with just a few regulatory tools. Unfortunately, RD authority today is not enough to translate these ad hoc efforts into broader preservation and the demonstration program has not had the impact we had hoped, notwithstanding RD's substantial efforts and we believe it is for two reasons. RD needs the permanent legislation contemplated in Article VIII. However, even if these provisions were to be enacted into law, we believe that there continues to be too much reliance on the Low Income Housing Tax Credit (LIHTC) program. Mr. Chairman and members of the Committee, we do not have to tell you that the LIHTC market has been severally impacted by the downturn in the economy. While the exchange program authorized by ARRA will hopefully help, rural transactions continue to be difficult and investors in the tax credit program, tend to bypass those transactions for larger urban complexes, which is why we need these other programs.

On behalf of CARH, we again thank the Committee for this opportunity to highlight the important issue of rural housing preservation. With a few relatively minor changes Congress can provide the tools needed to continue the successful public/private partnership for affordable rural housing.