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Affordable Housing

by Carl Wagner

**Seeing the Forest through the Trees:
Upcoming Congressional Legislation**

Rural rental housing demand remains high, but the supply, particularly of new housing, has decreased. This is in large part due to reduced federal housing assistance. The public and private sectors must collaborate to develop programs that reduce strain on the federal government and continue to produce ample affordable rural housing. A forest of congressional legislation is being proposed related to the affordable multi-family housing industry. Let's look at a few of the important trees.

Exit Tax Relief

Some 17,000 low-income apartment complexes with 400,000 units were built under the Section 515 rural housing program using low-interest-rate loans. Many, now two decades old, are at risk because of the interplay between the program's design and tax depreciation recapture rules. The U.S. Department of Agriculture's Rural Development (RD) Housing and Community Facilities estimates 4,250 Section 515 properties with 85,000 units, or 21 percent, "will physically deteriorate to the point of being unsafe or unsanitary within the next few years."

Almost all Section 515 properties, however, were built through limited partnership arrangements that make it hard to introduce new capital into the properties. Rent restrictions limit any cash flow from the property, so new capital contributions would generate only additional passive losses that could not be utilized by current investors. Yet if the existing owners sell the

property, it is almost impossible to generate sufficient cash to pay off steep recapture taxes. 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. This is inconsistent with sound housing policy and risks imposing far higher costs on the federal government as capital-starved affordable housing properties either continue to deteriorate or are sold off as market-rate housing to generate cash on the sale to pay off exit taxes for investors.

Legislation H.R. 1491 and S. 1318 would provide exit tax relief for affordable housing property owners, thus allowing more properties to be preserved.

**Low Income Housing Tax Credits
Income Limits -**

Under existing law, low-income housing tax credit (LIHTC) residents can earn no more than 60 percent of the area median gross income and pay no more than 30 percent of that income in rent. HUD data shows that this income level is too low to support the development of new multifamily complexes in as many as 1,700 of the 2,364 non-metropolitan counties in the nation.

Legislation has been introduced that would increase income limits. Additionally, re-introduction of legislation that would increase the tax credit volume cap would greatly enhance the tax incentive's ability to help low-income renters who live in rural areas.

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Development Costs in Basis –

In 2000, the Internal Revenue Service issued five Technical Advice Memoranda (TAM) that provide analysis of which costs are included in eligible basis for the purpose of calculating LIHTCs. The result largely prohibits developers from including many costs related to site preparation. The net effect is a fictional and illogical distinction among necessary development costs. Proposed changes to these TAM would substitute “development cost basis” for “eligible basis” and include all site preparation costs, certain development and professional fees and construction financing costs.

Nine Percent Credit and Rural Housing Set-Aside –

The LIHTC program should be amended to provide a statutory 10 percent set-aside for rural properties. RD subsidies are often regarded as below-market federal subsidies, disqualifying RD properties from the 9 percent LIHTC. Section 42 should be changed to permit the 9 percent credit for RD-assisted buildings, similar to the treatment of certain HUD-assisted properties. This would allow for a deeper subsidy where the state housing credit agencies believe it is warranted, and provide for the development of new rural housing and for the rehabilitation of existing rural housing.

Additionally, the housing credit ceiling for the LIHTC has been increased. But competition in many states is high and pits rural developments against urban developments. Proposed legislation for a small statutory set-aside for rural properties would help open credit to many areas that have thus far been unsuccessful in building new or rehabilitating existing housing.

Section 521 Rental Assistance Program

The Section 521 Rental Assistance Program, a component of the Section 515 program, subsidizes the difference between the rent a resident pays and the basic rent required to operate the property. Some Section 515 projects also utilize the Department of Housing and Urban Development’s (HUD) Section 8 Rental Assistance. Language contained in the Administration’s budget request for Fiscal Year 2008 would decrease rental assistance contract terms to one year. This action would send the wrong message to industry investors and lenders, who need the safety of longer-term subsidies to help reduce their real or perceived risks.

Preservation:

■ Owners seeking to maintain low-income restrictions through transfers face a daunting process. The rules’ interpretations vary state by state. Restrictions on transfers create a Catch-22: owners cannot readily prepay out of the program or transfer and refinance within it. Transfer rules should be streamlined.

■ Legislation introduced in the 109th Congress would have authorized a demo program of debt relief, loans, and grants to improve the physical and financial condition of the aging 515 portfolio. Without many of this initiative’s provisions, Section 515 properties lacking revenue to meet costs or fund improvements will deteriorate. Portfolio revitalization should be introduced on a permanent basis, not only as a demo program.

Government Sponsored Enterprises (GSEs):

Bipartisan legislation H.R. 1427, the “Federal Housing Finance Reform Act of 2007,” would overhaul the regulatory oversight of government-sponsored enterprises Fannie Mae, Freddie Mac and the Federal Home Loan Banks and create an independent regulator with broad powers analogous to current banking regulators. In addition, the bill creates an off-budget and non-taxpayer-financed affordable housing fund that would use funds from Fannie Mae and Freddie Mac, estimated at about \$500 million a year. The fund would dedicate hundreds of millions of dollars for the construction, maintenance and preservation of affordable housing with the first year’s funding to be dedicated to the hurricane-stricken areas of the Gulf Coast.

Section 538 Rural Rental Housing Guaranteed Loans

In addition to the legislation and ongoing discussions described above, changes should be made to the Section 538 program, which authorizes guarantees of privately-made loans for the development of new multi-family housing for low- and moderate-income people.

- The program should be expanded to communities with populations under 50,000 that are not adjacent to urbanized areas of over 50,000. This would lead to a stronger Section 538 program with more lenders, more volume and more industry acceptance
- The agency should be allowed to carry over unobligated funds from one fiscal year to the next year.

Conclusion

Overall, we believe that the legislation before the 110th Congress offers excellent opportunities to improve the supply and quantity of affordable rural rental housing, save for some concerns with the budget request language that would decrease Section 521 contract terms. We hope this article has helped you to understand some of the important issues to watch. If you have questions about any of these issues, please call Carl W. Wagner at 614-224-8800.