

Stabilizing and Restarting the Residential Tax Credit Marketplace

As the financial markets situation has deteriorated in the second half of 2008, the marketplace for Low Income Housing Tax Credits has destabilized along with the markets generally. At present, a number of new Tax Credit apartment communities in the development pipeline and just completing construction are in significant jeopardy.

- Properties whose syndications are complete are experiencing delays in closing, or failing to close at all. These events have significant impacts on construction and bridge financing lenders, forcing further reductions in available financing.
- Properties have found pricing on credits decline from the mid 80 cent on the dollar range to the low 70 cent range, forcing sponsors to raise additional financing or equity prior to closing, often in very short time frames.
- The largest purchasers of Tax Credits in recent years have been Fannie Mae, Freddie Mac and the large banks. Those firms represented more than half of the marketplace, and all have withdrawn from the market for the foreseeable future. Traditional purchasers are not going to see profits for the next eight to ten quarters, and are thus out of the market for that period. Revising the current Federal Income Tax Code to create incentives for individual investors, sub chapter S corporations, and small corporations to invest in Tax Credits will broaden and revitalize the market.
- Many banks and lenders such as Fannie and Freddie are holding excess Tax Credits for which they have no offsetting gains. These are currently being held as assets on their books which have expiration dates and lose essentially ten percent of their value each year if they are not utilized. This creates a potential for a "fire sale" of these assets at values that are likely to be substantially below market, and current rules on "marking to market" make this problem worse. The availability of these "seasoned" credits at discount prices will likely further undercut the rapidly thinning market for newly issued credits for projects which have yet to be built.
- The overall Tax Credit marketplace is essentially frozen because equity investors are not willing to invest. Each month, more of the pipeline of Low Income Housing Tax Credit affordable housing new construction and rehabilitation projects is halted. The Tax Credit program is by far the largest remaining affordable housing program, targeted to serve lower income workforce and rural households. Rural communities have been disproportionately affected by the events in the market.
- Most state agencies rely heavily on "new production" to fortify their financial positions and pay their bills. A number of the agencies are counted on by the states to produce general fund revenue. The advent of a substantial decline in the production of new tax credit housing projects will negatively impact the financial health of many agencies. A prolonged drought in new production will force staffing reductions and program contractions, which reduces the overall capacity to underwrite affordable housing and will lengthen the current contraction in housing finance and construction. A long enough period of reduced activity could endanger their existence.

- A sustained drought in new production could essentially cause the existing infrastructure which facilitates the new production of affordable housing to collapse. It would require substantial time and energy to re-invigorate the infrastructure, thus further exacerbating the problem. This problem is especially acute in exurban and rural areas. New production contributes significant funds to localities through building permit fees, impact fees, and related infrastructure funding. This source of funding is essential to maintain and expand infrastructure in cities nationwide.

NAHMA's Board of Directors and Members propose the following policy changes to enable Tax Credit affordable housing to move forward and assist in lifting the economy out of its current downturn.

- Provide either government guarantees or backstopping to unfreeze the current market in Tax Credits. As noted above, tax credits' values depreciate over time. With the current lack of earnings in most sectors of the economy, those credits that are trading are priced at deep discounts. With the imbalance in supply and demand, there needs to be some modification to the use of credits that will preserve an orderly market.
- Use existing enacted Federal Housing Administration lending programs to provide low interest "bridge" financing to permit new development to continue in markets with significant needs for more workforce and rural housing. FHA insured financing can be used where the loans are structured to permit new and rehabilitated developments and provide an option to use Tax Credits to take out the loan within one or two five-year terms. Initial loans could be structured as five-year financing with one renewal and no lock-ins that would permit earlier conversion if market conditions permit. These loans should be underwritten and administered through the State Tax Credit Agencies. The bridge financing would be designed to allow the properties to move to full Tax Credit status easily. This could occur either during the loan period or at the end of the loan period. The implementation of these bridge loans and subsequent Tax Credit compliance should begin either at the point of conversion from the bridge loan or year six, whichever occurs first, with a ten-year compliance period. Regulatory and compliance policies and procedures should be revised to allow investors assurance on tax credit compliance as the bridge loan converts.
- Address current tax and Securities and Exchange Commission regulatory policy to stabilize the book values, pricing and price volatility of Tax Credits. With the bulk of purchasers facing uncertainty in how purchases of new Tax Credits would be valued, the market is illiquid, and purchasers are risk averse. Greater certainty in subsequent valuation is needed.
- Review current tax and regulatory policy with an eye to improve yield on Tax Credits. Policies should be developed that will allow the Federal Housing Finance Administration to place all "written down" and "written off" credits held by the GSE's and other institutions in conservatorship with the Treasury, and allow the Treasury to hold the credits to maturity. This will prevent a "fire sale" in credits from undercutting the market. Methods to allow viable but unprofitable banks to place credits with the Treasury should be explored.
- A primary goal is to create new markets for Low Income Housing Tax Credits supporting affordable workforce housing, which continues to be in short supply in all major markets. Expanding the market in Tax Credits will permit expanded production both in the new construction and rehabilitation markets. Modifying current regulations to permit expansion in the market for Tax Credits is absolutely essential.

In summary, these proposals would stimulate the construction markets just when these jobs and investment are most needed. These changes would begin to address the severe shortage of workforce and rural housing. They will provide ongoing development to keep the infrastructure of affordable housing in place, and provide a base for the expansion of this most important resource. Finally, as a direct investment that provides immediate job creation, keeping the Low Income Housing Tax Credit program viable is essential to the job growth that will bring the economy back with good long-term investments.

PROTECTING THE INTERESTS OF AFFORDABLE HOUSING PROPERTY MANAGERS AND OWNERS