

Testimony of John Leith-Tetrault
President, National Trust Community Investment Corporation
Ways and Means Committee
Subcommittee on Select Revenue
Chairman Richard Neal
Hearing on Tax Incentives for Affordable Housing
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Thank you Chairman Neal, ranking member English, and members of the Subcommittee for the opportunity to testify before you today on ways to simplify and amend the tax code to make affordable housing more available. My name is John Leith-Tetrault and I am President of the National Trust Community Investment Corporation. As such, I can speak about housing rehabilitation in historic and older buildings from both the tax credit syndicator and developer perspective. Before I begin, I would also like to thank Representatives Stephanie Tubbs Jones and – again – Phil English in particular for introducing the National Trust for Historic Preservation's leading bill, HR 1043, the Community Restoration and Revitalization Act, which provides for a wide range of amendments to the federal historic rehabilitation tax credit. These changes would enhance the existing linkage between historic and low-income housing tax credits, unlock more of the historic tax credit's potential for neighborhood reinvestment, and make the historic credit easier to use for smaller, main street projects.

Four of these amendments would positively impact the economic feasibility of projects that rehabilitate existing buildings for reuse as affordable housing. HR 1043 now has 53 co-sponsors from both sides of the aisle. Senators Gordon Smith and Blanche Lincoln have introduced an identical bill, S 584 which currently has 3 Republican and 2 Democratic co-sponsors.

My organization, the National Trust Community Investment Corporation (NTCIC) -- a wholly owned for profit subsidiary of the 1949 Congressionally chartered National Trust -- has invested \$185 million in historic and new markets tax credit (NMTC) equity in housing and commercial properties over the past six years. NTCIC is a certified Community Development Entity and a recipient of \$180 million in NMTC allocations since 2003. Rehabilitation, neighborhood reinvestment, and economic development are integral components of historic preservation, since the majority of the nation's National Register historic districts overlap census tracts where there are high percentages of people living in poverty.

My testimony today will focus on the four affordable housing-related provisions of HR 1043, and provide two case studies of how subsidy amounts from both the federal low-income housing (LIHTC) and historic tax credits would increase under this bill to create a more favorable financing structure and to better achieve affordable rent structures for these transactions. The many endorsers of this bill in the affordable housing and rehabilitation tax credit industries hope the Subcommittee will consider the provisions of HR 1043 in its effort to put together a Low-Income Housing Tax Credit amendments bill.

1. ***The Nexus between Affordable Housing and Historic Rehabilitation*** – Affordable housing developers have always viewed historic and older buildings in low-income communities as an important resource for decent and affordable housing. Congress anticipated the rehabilitation of historic buildings for affordable housing in 1986 by allowing the combination of these two credits as part of the Tax Reform Act of 1986. Since the inception of the historic tax credit program, combining the LIHTCs and historic tax credits has created, based on National Park Service estimates, about 86,000 affordable housing units nationwide. Despite popular belief, most older and historic building stock is located in economically depressed low-income census tracts as evidenced by research conducted by the NTCIC. That research shows that in 2006, 67 percent or two-thirds of all historic tax credit transactions approved by the National Park Service were located in high-poverty census tracts. A prime acknowledgement of this demographic reality is the 2002 IRS ruling that allows new market tax credits and historic tax credits to be combined on certified historic commercial projects benefiting low-income businesses.

2. ***The Impact of HR 1043 on affordable housing development*** – Among HR 1043's broad set of provisions to improve the effectiveness of the historic tax credit, the following four are aimed at the historic tax credit's compatibility with affordable housing transactions:
 - a. Elimination of the basis adjustment - Section 2 of HR 1043 asks Congress to treat the historic tax credits the same as the LIHTC and NMTC by eliminating the reduction of a property's depreciable basis that is required when combining the historic and low-income housing tax credits. Since the LIHTC is calculated as a fraction of the depreciable basis, the reduction of LIHTC basis by 100 percent of the amount of the historic tax credit significantly diminishes the value of combining these incentives. At today's pricing for both LIHTC and historic tax credits – \$.95 on the tax credit dollar – the reduction in low-income tax credit value is a full 25 percent over the ten-year vesting period of the credit.

In a so-called Difficult to Develop Areas (DDAs) or Qualified Census Tracts (QCTs), the impact of reducing the LIHTC basis by 100 percent of the historic tax credit amount is even more severe. Due to the 130 percent basis boost provided to LIHTC developers of properties in these severely distressed areas, every \$1.00 of historic tax credit reduces the LIHTC basis by \$1.30. The net effect is to reduce the average value of the Low-Income Housing Tax Credit by nearly 33 percent. These provisions have the perverse impact of providing less combined credit subsidy to projects in communities with the greatest economic need. While this provision may be seen as a way to prevent double dipping, no such treatment is required by the tax code on LIHTC-only transactions, nor does the IRS require such an adjustment to the historic tax credit basis when combining

the historic tax credit and the new markets tax credits. Furthermore, the legislative history of the LIHTC and historic tax credit indicates two different purposes that act independently on historic buildings used for affordable housing. The historic tax credit's purpose is to offset the higher cost of rehabilitation over the less expensive option of demolition and new construction. The LIHTC is meant to lower conventional debt service loads on rent restricted buildings. Allowing the full benefits of twinning these two credits therefore addresses the twin impediments to using historic properties for affordable housing.

- b. Providing a 130 percent basis boost for the historic tax credit – HR 1043 asks Congress to treat the historic tax credit the same as the LIHTC by providing a 130 percent basis boost in DDAs and QCTs. By definition, these are areas where incomes are especially low and the cost of development is high. The basis boost for the LIHTC is meant to help defray higher costs such as security, insurance, materials and labor so that these added costs do not force up targeted affordable rents. The same logic should apply to the special costs of historic and old building rehabilitations that are also proportionately higher in these designated areas. The net effect of this provision of HR 1043 would increase the value of the historic tax credit by about 25 percent on a twinned transaction.
- c. Making housing an eligible use for the 10 percent “older building” portion of the historic tax credit – for reasons that are unclear from legislative history, the 10 percent portion of the historic tax credit program (the portion that accrues to non-certified historic structures) may not be used for housing. Whatever the reason was for this exclusion, it seems to be an anomaly in the context of the current national affordable housing need. Broadening the use of the 10 percent portion of the historic tax credit to include housing would open up the potential to twin the 10 percent portion of the historic tax credit with the LIHTC. This new combination of federal housing subsidies would have several valuable applications. Since the 10 percent credit is for non historic buildings only, this provision would potentially impact a much larger number of buildings eligible for both credits. The lack of historic design guidelines for the existing 10 percent portion of the historic tax credit would provide affordable housing developers with more flexibility in addressing compromises between preserving a building's architectural character and overall construction costs. This measure would also add additional subsidy to transactions aimed at preserving existing affordable units as previously awarded HUD subsidies expire.

A related change to the 10% credit, Section 6 of HR 1043 would index the eligibility date for older buildings to correspond with Congress' intent that these building be at least 50 years old. The current law requires that

10 percent portion of the historic tax credit properties must have been built before 1936. The indexing of the 10 percent tax credit eligibility date would make buildings built before 1957 eligible, adding approximately 225,000 post war multifamily properties to the stock of units that can receive the 10 percent portion of the historic tax credit.

3. Case Studies on the Impact of HR 1043 on Low-Income Tax Credit Transactions

- a. Parkside Commons, the renovation of the former Meadville Junior High School in Crawford County, PA into 56 affordable housing units and 3,000 sq. ft. of commercial space, is an example of a project that might have benefited from the enactment of HR 1043. The school is located on North Main Street in Meadville and shares prominent frontage on Diamond Park with the Crawford County Courthouse. It was built in 1921 and was threatened with demolition until the current developer, Tom Kennedy of Erie, stepped forward with a historic rehabilitation plan. The project is currently under construction and has experienced cost overruns. The developer has addressed the situation by reinvesting his developer fee into the property, cutting the scope of work by \$600,000 and phasing the project. According to the developer, Meade Junior High's conversion has gone from "feasible to marginally feasible."

Parkside Commons has utilized both the LIHTC and historic tax credits. The LIHTC contributes \$3 million and the historic tax credit provides \$1 million in equity to a total development cost of \$5.5 million. Unfortunately it is situated across the street from a Qualified Census Tract and therefore could not apply for the 130 percent LIHTC basis boost nor benefit from the proposed basis boost for the federal rehabilitation credit. The mandatory LIHTC basis reduction by the amount of the historic tax credit cost the Meade Junior High project \$781,000 dollars, more than enough to restore the \$600,000 in project enhancements abandoned due to the cost overruns. HR 1043's proposed elimination of the LIHTC basis reduction would have meant a great deal to Mr. Kennedy, the developer, and to the future tenants of the building.

- b. Worthington Commons Apartments is located on Summit, Federal and Worthington Streets in Springfield, Massachusetts. This property was formerly known as Summit Hill Apartments and was acquired in foreclosure by MassHousing. Subsequently, MassHousing selected First Resource Companies to be the developer. The redevelopment plan, which utilizes the LIHTC and historic tax credit calls for the rehabilitation of nine buildings into 111 apartments, rehabilitation of two abandoned buildings into 38 apartments, and the rehabilitation of a third abandoned building into a management office and resident community center. All of the units will be affordable.

This \$19 million project is in a Qualified Census Tract and therefore qualified for the 130 percent LIHTC basis boost. If HR 1043 were enacted, the additional 130 percent historic tax credit basis boost would result in an additional \$932,210 to the project. Additionally, \$413,000 in equity could be generated by eliminating the reduction of the low-income housing tax credit basis by the amount of the historic tax credit. If available, this additional \$1,345,210 could have been used by the developer to reduce the soft debt on the project provided by the Massachusetts Housing Partnership, (freeing these funds to be utilized for other projects in the state). Alternatively, the extra funding could have been used to establish reserves to fund operating deficits and maintenance for the property, the lack of which contributed to Summit Hill's original downfall.

Chairman Neal, ranking member English, and members of the Subcommittee, thank you again for this opportunity to discuss how the enactment of HR 1043, The Community Restoration and Revitalization Act, would allow historic tax credits to make an even more significant financial contribution to the production of affordable housing that also relies on the low-income housing tax credit. I would be happy to answer any questions members of the Subcommittee may have.