TESTIMONY BY
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ON BEHALF OF THE
NATIONAL MULTIFAMILY HOUSING COUNCIL
AND THE
NATIONAL APARTMENT ASSOCIATION

BEFORE THE
HOUSE COMMITTEE ON FINANCIAL SERVICES
HOUSING AND INSURANCE SUBCOMMITTEE

FOR A HEARING ENTITLED
THE FUTURE OF HOUSING IN AMERICA: GOVERNMENT REGULATIONS AND THE HIGH COST OF HOUSING

MARCH 22, 2016

Chairman Luetkemeyer, Ranking Member Cleaver, esteemed members of the Subcommittee, it is my distinct privilege to appear before you today to provide testimony on the important issues surrounding multifamily housing. My name is Clyde Holland, I am the Chairman and CEO of Holland Partner Group, based in Vancouver, Washington. We are a fully integrated real estate investment firm in the Western United States with current assets under management and development representing approximately $7.5 billion in 30,000 apartment homes. I appear before the committee today on behalf of the National Multifamily Housing Council and the National Apartment Association.

For more than 20 years, NMHC and NAA have partnered in a joint legislative program to provide a single voice for America's apartment industry. Our combined memberships are engaged in all aspects of the apartment industry, including ownership, development, management and finance. NMHC represents the principal officers of the apartment industry's largest and most prominent firms. As a federation of nearly 170 state and local affiliates, NAA encompasses over 69,000 members representing more than 8.1 million apartment homes throughout the United States and Canada.

Rental Housing – The Supply-Demand Imbalance

Housing affordability is a significant challenge facing many Americans today who are seeking to rent an apartment. The number of families renting their homes stands at an all-time high placing significant pressure on the apartment industry to meet the demand. This is making it challenging for millions of families nationwide to find quality rental housing that is affordable at their income level. For many families, the shortage of rental housing that is affordable creates significant hurdles that make it even more difficult to pay for basic necessities like food and transportation. Ultimately, this also impacts their future financial success.

This issue is not unique to households receiving federal subsidies and, in fact, is encroaching on the financial wellbeing of households earning up to 120 percent of area median income. Consider that the median asking rent for an apartment constructed in 2014 was $1,372. For a renter to afford one of those units at the 30 percent of income standard, they would need to earn at least $54,880 annually. As a basis of comparison, the median household income in 2014 was $53,657. Accordingly, this is an issue impacting those supporting the very fabric of communities nationwide, including teachers, firefighters, nurses and police officers.

According to a report by Harvard's Joint Center for Housing Studies, in 2013 more than one in four renter households – approximately 11.2 million – paid more than half of their income for rental housing. Setting aside that real (inflation adjusted) incomes in the U.S. have not risen in over three decades – clearly the key factor driving the affordability crisis – housing industry leaders agree that promoting construction, preservation and rehabilitation are three of the vital ways to meet the surging demand for apartment homes.

Changing Housing Dynamics

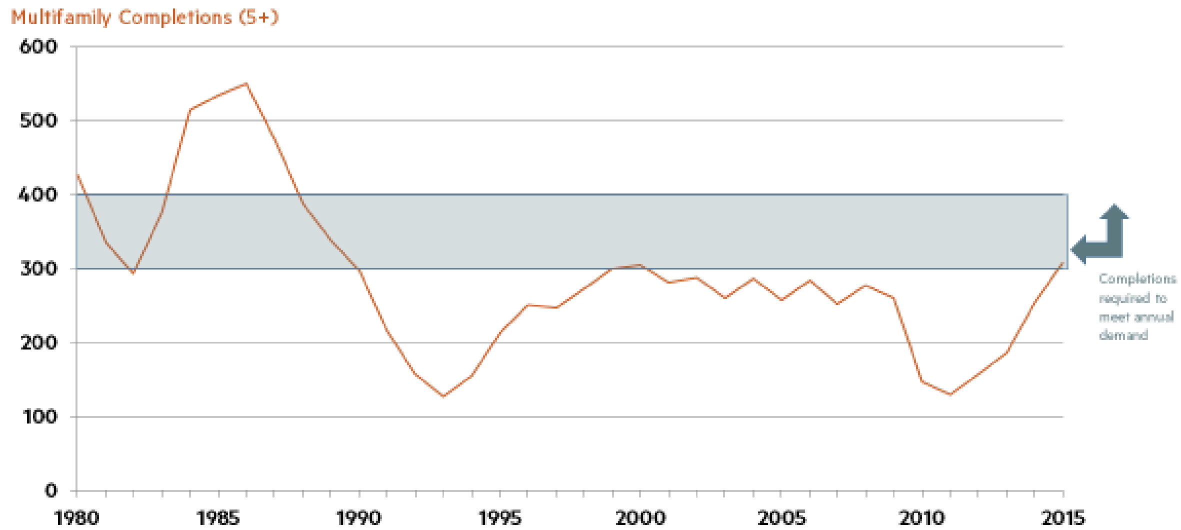
The U.S. is in the midst of a fundamental shift in our housing dynamics as changing demographics and housing preferences drive more people toward renting as their housing of choice. Rising demand is not just a consequence of the bursting of the housing bubble. In the five years ending

2015, the number of renter households was up by 7 million while the number of homeowner households was up by less than 400,000. Going back 10 years, we have added 11 million new renter households and approximately 605,000 new owner households.

Almost 75 million young adults, aged 18 – 34 are entering the housing market, primarily as renters. Almost one-third of adults in this age group still live at home with their parents, meaning there is a lot of potential pent-up demand remaining for rentals. The trends are dramatic given that the Harvard Joint Center for Housing Studies estimates that younger Americans will create 24 million new households between 2015 and 2025.

Renting is not just for the younger generations. Baby Boomers and other empty nesters are trading single-family houses for rental apartments. Over half (57 percent) of the net increase in renter households from 2005 to 2015 came from householders 45 years or older.

Today, there are over 43 million renter households. The dynamics previously cited could increase demand by as much as four million additional renter households over the next decade according to Harvard's Joint Center for Housing Studies. NMHC/NAA estimate that we currently need between 300,000 and 400,000 newly constructed apartments each year to keep up with demand; yet, an annual average of just 208,000 apartments were delivered from 2011-2015. The completion of 310,700 units in 2015 suggests that new construction is finally approaching the level needed to meet the continuing increase in demand. However, the headwinds described in this document could put a damper on sustaining this trend.

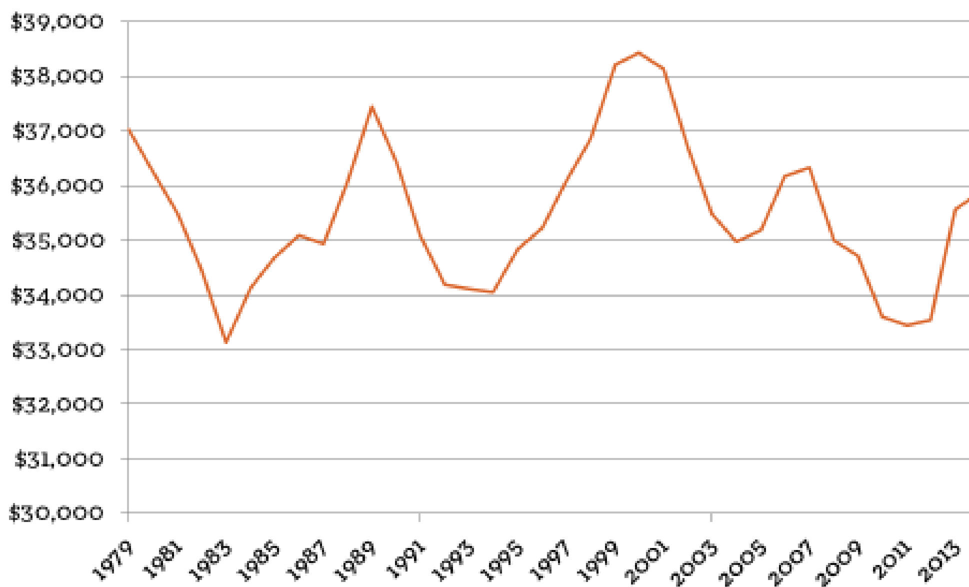


Building more apartment homes will help improve the supply-demand imbalance that drives these affordability challenges, but developers and localities must work together to remove obstacles to development. Even if local officials and planning boards agree that new, affordable apartments must be built, land costs, entitlement expenditures, labor expenses and property taxes all contribute to making their construction extremely costly.

Why are Rents So High?

As the Multifamily Completions chart above demonstrates, the nation faces a significant shortage of rental housing. Addressing this challenge will require new development and the preservation and rehabilitation of the existing housing stock. Barriers to these activities, described below, only serve to slow down the market response to our housing supply challenges. Before discussing these barriers, however, it is worthwhile to assess the reasons why Americans are facing high rents and why there is too little available rental housing that is affordable.

First and foremost, America's affordable housing shortage is more than just a housing problem. It is not only that rental housing has gotten more expensive to produce and operate, but also that other economic factors have suppressed household income growth. On an inflation-adjusted basis, median renter household income today is virtually the same as it was in 1981.



Because income stagnation is such a big part of the equation, simply building more housing cannot be the sole solution to this affordable housing shortage. In fact, in many markets where demand is strongest, even if, hypothetically, developers agreed to take no profit, the cost to build still exceeds what people can afford to pay.

Second, today's strong rent growth is a temporary situation in what is a highly cyclical market driven by factors largely outside of the industry's control. For example, the collapse of the U.S. financial markets in 2008 virtually shut down new apartment construction for a number of years, severely constricting supply right at a time when rental demand surged to levels not seen for decades. Development is only now beginning, seven years later, to meet the annual increase in apartment demand.

Finally, as mentioned above, apartment construction has increased. As new units are delivered,

rent growth will moderate. That said, even with more apartments in the pipeline, construction activity remains at best, at the low end of the level needed to make up for supply deficits in previous years. Many non-financial obstacles to new development continue to stifle new construction and raise the costs of those properties that do get built, contributing to higher rents for our residents. Many of these are imposed by localities and have to be addressed by those jurisdictions.

Barriers to Multifamily Development

Developing real estate, whether it is multifamily, single-family or commercial, is difficult. Production of any kind has its natural barriers. Those are for the most part objective barriers that can, and often do, fluctuate, but are predictable enough to still meet a pro forma. Multifamily however, brings with it a level of entitlement subjectivity layered on top of these common barriers and is much more difficult to predict.

Plainly stated, many municipalities have a development preference that works against multifamily housing production. Multifamily development often faces stiff community resistance, competes with other forms of real estate that produce sales tax revenue desired by municipalities, and is subject to increasing regulatory barriers.

Community resistance to proposed multifamily developments typically takes the form of organized community resistance efforts commonly known as “Not In My Back Yard” or NIMBY. The narrative of NIMBY typically focuses on a handful of themes outside of the normal zoning approval process, including:

- Traffic impact;
- Homeowner property values;
- School overcrowding; and
- Community character.

There is also a revenue subjectivity often found at the municipal level when it comes to multifamily versus other forms of real estate. Local governments faced with the annual task of balancing budgets feel obligated to derive as much tax revenue as possible from scarce developable land. This places multifamily in stiff competition with commercial real estate developments that produce sales tax revenue.

All these factors contribute to the uncertainty of any multifamily development. In a speech before the Urban Institute in November 2015, Jason Furman, chairman of The White House Council of Economic Advisers said that the U.S. could build a lot more apartments, but noted “multifamily housing units are the form of housing supply that is most often the target of regulation.” As an industry, we agree with this assessment.

Below is a brief summary of the most notable barriers to development within several broad categories: location, time, bureaucracy, cost and environmental assessment. Also included is a brief review of affordability mandates, which can actually depress development of new multifamily homes in addition to complicating projects that proceed.

Location

- **Land Cost:** In an attractive market—take any major metropolitan area as an example—land can account for a significant portion of total development costs. Land in those markets is not only fundamentally more expensive to purchase than land in secondary or tertiary markets, but it also typically attracts multiple bidders, each seeking to deploy the land for diverse purposes, which further drives up costs. This cost increase can stretch or stress other financial assumptions and, in some extreme cases, even make the property impossible right out of the gate.

- **Zoning Laws**: Zoning laws impact what is permitted to be built at a site. In some places, zoning requirements can make it extremely difficult to build new multifamily housing. Changing zoning can be onerous and expensive if it is even possible.

Time

- **Entitlements:** The entitlement process, which covers approvals, zoning and nearly everything in between, is an amalgam of outright costs, additional fees, land-use regulation (some of which can date back to the first half of last century) and code compliance. During the navigation of this often lengthy process, an apartment developer bears both direct and indirect costs with no assurance of a successful outcome. In some high-barrier-to-entry markets, entitlements can take four, five, six years or more before construction actually begins. Some municipalities have tried to fast track this process, but they have been met with only varying degrees of success.

  The long lead time and significant upfront investment required to obtain entitlement on land is leading some investors to rethink continued interest in multifamily development. Reduced investor demand for multifamily development may lead to fewer units delivered in the future and increased cost per unit delivered as remaining investor capital becomes scarce.

Bureaucracy

- **Regulations:** As a highly regulated sector, the apartment industry is governed by a flood of regulations stemming from diverse federal agencies such as the Department of Housing and Urban Development (HUD), the Environmental Protection Agency (EPA), Department of Labor (DOL), Occupational Safety and Health Administration (OSHA), and the Department of Energy (DOE), as well as state and local jurisdictions. Excessive regulation and compliance uncertainty results in costly mandates that divert resources from the production and operation of multifamily housing.

  Regulations must have demonstrable benefits that justify the cost of compliance and federal agencies should be aware that broad-stroke regulations often have disproportionate effects on various industries. Therefore, those rules and regulations affecting housing should reflect the industry's diverse business and operational structure and must rely on the latest scientific and/or economic evidence.

For example, NMHC/NAA have an extensive history of service in the development of national model building codes and standards. However, research shows that over-reaching codes negatively impact apartment affordability and can quell new apartment construction and building renovation.

Similarly, policymakers continue to seek ways to improve energy efficiency through legislative and regulatory efforts to establish a building rating system that would grade buildings on their energy performance and publicly disclose that information. These labels raise valuation concerns and transactional uncertainty, especially since the accuracy of these labels is not proven in the apartment sector. NMHC/NAA oppose the development of mandatory building performance labeling programs and continue to work with federal partners to expand well-known and voluntary energy management tools, such as the federal Energy Star program, in apartment properties.

Cost

- **Construction Costs**: The cost of construction in terms of labor and materials are a critical component to the cost of building apartments. Depending upon market and materials used, these have a significant impact on the viability of a given project.

- **Cost of Capital:** New regulatory regimes, such as Dodd-Frank and Basel III, are making access to capital more difficult and costlier. Increased capital requirements and conflicting new regulations are driving up the cost of borrowing from banks, as well as constricting lending in certain markets.

- **Labor Costs:** Federal building programs, as well as some state level programs, require the use of prevailing Davis-Bacon wages that have proven to be difficult to manage, complex to accurately incorporate in preliminary planning and often do not reflect the going market. Additionally, as a result of the economic downturn skilled labor migrated away from the construction industry, producing an environment today where wages have increased well in excess of inflation, which directly impacts the cost of development.

- **Impact Fees:** Impact fees are payments required of new development by local governments for the purpose of providing new or expanded public capital facilities required to serve that development. These fees typically require cash payments in advance of the completion of development, are based on a methodology and calculation derived from the cost of the facility and the nature and size of the development, and are used to finance improvements offsite from, but to the benefit of, the development.

- **Linkage Fees:** A linkage fee is assessed on a development to pay for the cost of providing a public service. These fees are attributed to select developments to pay for a benefit deemed outside of what is recovered from property taxes.

- **Business License Taxes:** These are additional municipal taxes assessed on property owners that is not assessed on other forms of housing. These are used to justify the cost of impacts not covered by property tax assessments.

- **Assessment and Inspection Fees:** These are additional municipal fees assessed on property owners to inspect rental housing for habitability. While these fees are often assessed annually, the rental housing communities often do not realize additional benefits reflecting the cost.

- **Parking Space Requirements:** The requirement to build or offer parking spaces, especially in urban settings, can significantly impact site use and cost.

Environmental Assessment

- **Environmental Site Assessment:** An environmental site assessment is a report that identifies potential or existing environmental contamination liabilities. The analysis typically addresses both the underlying land and physical improvements to the property. In many local jurisdictions, each development site requires an environmental site assessment, the results of which could require costly remediation and/or project reconfiguration. Additionally, these assessments have been used by development opponents to frustrate planning and can serve to severely hamper or defeat the entitlement process.

Affordability Mandates

- **Rent Control:** There are various forms of rent control outside of the traditional version that most are accustomed to seeing: a rent control board that sets maximum rent for a unit or the maximum amount that rent can be raised annually. Rent control, in this context, is any mechanism that obligates a property owner to set rental rates for all or a portion of the units on a property. In any form, this policy works as a disincentive to investing and developing the diversity of housing units that a community requires. There are alternatives to rent control that take slightly different approaches but have the same effect. The most common form of these is inclusionary zoning.

- **Inclusionary Zoning:** Inclusionary zoning refers to municipal and county planning ordinances that require a given share of new construction to be affordable to people with low to moderate incomes without an investment from the municipality. It is normally a condition of approval of the development. Depending on the requirements, the overall feasibility of a project could be threatened.

Bottom Line for Policymakers

The bottom line is that policymakers at all levels of government must recognize that addressing local workforce housing needs requires a partnership between government and the private sector. Municipalities have the difficult task of trying to most efficiently manage their resources to the greatest benefit of their constituents, often challenged with balancing shrinking budgets and growing needs. However, local governments also have a tool box of approaches they can take to support affordable housing production. They can do this by incentivizing for-profit entities to produce the necessary multifamily units at a price point that households can afford.

Municipalities can defer taxes and other fees for a set period of time to help the developer reduce the price point. They also own tangible assets – buildings, raw land and entitled parcels – some

of which can be leveraged to bring down the cost of construction or redevelopment. Finally, they can help streamline the development and approval processes with fast-tracking programs.

As is outlined in the following section, however, the Federal Government also has a key role to play. When both the public and private sides bring all their tools and assets into play, then there will be a greater likelihood of finding viable solutions to meet our rental housing challenges.

Key Solutions to the Nation's Housing Challenges

The nation's challenge is to reduce the barriers and obstacles that inhibit the expansion of the housing stock. While the preceding section made it clear that new construction is often impeded at the local level, there are federal solutions that may be beneficial as well. At NMHC/NAA, we believe the solution at the federal level requires a **three-pronged** answer of new development, preservation and rehabilitation:

1. **New development is absolutely critical to address the scarcity of units available for the population of Americans whose household incomes are below the average for their areas – and the one receiving the majority of attention and criticism.** There are too many instances where communities acknowledge that they have an affordability problem, but then hide behind "Not in My Back Yard" rhetoric to prevent the development of much-needed apartment homes. States and local communities can work together with the private sector to identify and quantify the costs associated with building affordable rental housing. Then, local officials and developers can help reduce the barriers and encourage new construction.

2. **Preservation means ensuring that the financing and subsidy programs that currently keep units available at below market rents continue to be there in the future, providing some degree of certainty in the affordable housing market.** This means not only stemming budget cuts for local, state and federal housing programs, but also continuing to support programs like the Low-Income Housing Tax Credit (LIHTC).

3. **Rehabilitation is vital because it can keep existing apartment stock from dwindling further.** Every year, the industry loses between 100,000 and 150,000 units to obsolescence and other factors. Most lost units are likely at the lower end of the market, disproportionately hurting the affordable supply that exists. Consider also that the nation's apartment stock is aging; in fact, more than half (51.9 percent) of all apartments were built before 1980. Without resources dedicated to support rehabilitation efforts, more stock will continue to leave the available pool.

Federal Initiatives and Programs Vital to Addressing Affordability

Congress and key agencies should play an integral role in addressing housing affordability. NMHC/NAA support the initiatives and programs outlined below designed to address the shortage of affordable housing:

GSE Reform

The first and foremost priority is getting multifamily right in housing finance reform and recognizing its unique characteristics; it is the single most important factor to ensuring that the apartment industry can meet the nation's growing rental housing demand.

The bursting of the housing bubble exposed serious flaws in our nation's housing finance system. The very successful multifamily programs of the Government-Sponsored Enterprises (GSEs), Fannie Mae and Freddie Mac, were not part of the meltdown and have actually generated over $30 billion in net profits since the two firms were placed into conservatorship. Preservation of the mortgage liquidity currently provided by the GSEs in all markets during all economic cycles is critical. NMHC/NAA urge lawmakers to recognize the unique needs of the multifamily industry.

We believe the goals of a reformed housing finance system should be to:

- **Maintain an explicit federal guarantee** for multifamily-backed mortgage securities available in all markets at all times;
- **Ensure that the multifamily sector** is treated in a way that recognizes the inherent differences of the multifamily business; and
- **Retain the successful components** of the existing multifamily programs in whatever succeeds them.

These principles can be achieved through a reformed structure that preserves the high quality and value of the current multifamily secondary mortgage market's activities.

Multifamily Federal Housing Administration (FHA) Programs

FHA Multifamily is best known for offering an alternative source of construction debt to developers that supplements bank and other private construction capital sources. It also serves borrowers with long-term investment goals as the only capital provider to offer 35-40-year loan terms. FHA lending is essential to borrowers in secondary markets, borrowers with smaller balance sheets, new development entities, affordable housing developers and non-profit firms, all of which are often overlooked or underserved by private capital providers.

In normal capital markets, FHA plays a limited, but important, role in the rental housing sector. During the most recent economic crisis, however, FHA became virtually the only source of apartment construction capital. Applications increased from $2 billion annually to $10 billion, and HUD anticipates that demand for FHA multifamily mortgage insurance will remain high for the next several years.

FHA's Multifamily Programs have continually generated a net profit, and have met all losses associated with the financial crisis with reserves generated by premiums paid through the loan insurance program structure. Because premiums have consistently reflected the risk associated with the underlying loans, and because underwriting requirements have remained strong within the program, FHA's Multifamily Programs are able to operate as self-funded, fully covered lines of business at HUD. A few programs struggled during the real estate downturn; however, any losses have been covered by the capital cushion the multifamily programs collectively generate.

It is important to the apartment industry that FHA continues to be a credible and reliable source of construction and mortgage debt. FHA not only insures mortgages, but it also builds capacity in the market, providing developers with an effective source of construction and long-term mortgage capital. The FHA Multifamily Programs provide a material and important source of capital for underserved segments of the rental market, and do so while maintaining consistently high loan performance standards. NMHC/NAA encourage Congress to continue funding FHA's Multifamily Programs, including:

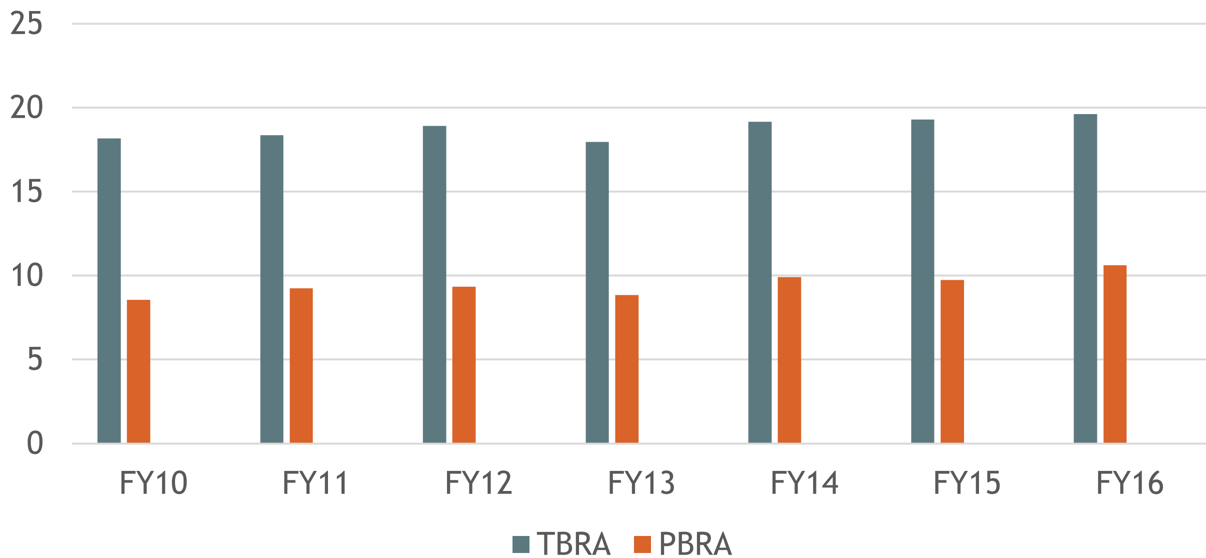
- HUD 221 (d)(4) Multifamily Loans – New Construction and Substantial Rehabilitation of Multifamily Properties
- HUD FHA 223 (f) Multifamily Loans for the Refinance or Acquisition of Multifamily Properties
- HUD FHA 241(a) Supplemental Loans
- HUD FHA 223(a)(7) Refinance of an Existing FHA Insured Multifamily Mortgages and Healthcare Mortgages

Finally, we believe a special note is warranted regarding the 221(d)(4) program. Providing flexible loan terms, including leverage from 80 percent to 90 percent and 40-year fixed rate non-recourse debt, for the construction or rehabilitation of multifamily properties is beneficial in supporting the development of workforce housing. However, we note that the program includes a bevy of restrictions, including loan size, allowable prevailing Davis-Bacon wage requirements, and other associated fees and disbursement restrictions. We ask to have a dialogue with this Committee regarding feasible ways to make modest modifications to this program to make it even more effective in encouraging the production of workforce housing.

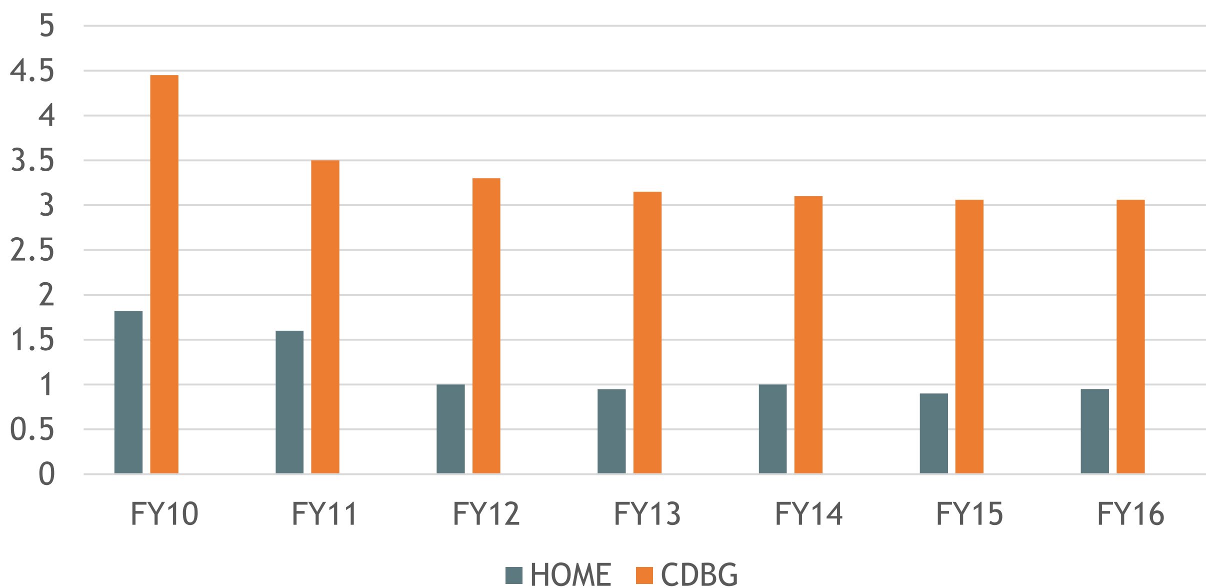
Funding for Affordable Housing Programs

Housing costs continue to grow, demand for rental housing continues to escalate, but incomes for many low income families remain stagnant. Given these realities, demand for subsidized affordable housing has increased dramatically through the economic crisis and into the recovery years since. However, federal funding for the primary programs serving low income households has been virtually flat or declining.

Programs like Tenant Based Section 8 and Project Based Rental Assistance allow low income families to rent market rate housing, taking advantage of the broad offering of privately owned and operated properties in a given market.



Programs like HOME and CDBG allow developers to address financing shortfalls often associated with affordable housing properties, and stimulate meaningful development and preservation activity as a result. In order to address housing affordability challenges for all Americans, across the income spectrum, adequate funding for these programs is essential.



Multifamily Transformation Initiative

NMHC/NAA encourage HUD to complete the Multifamily Transformation Initiative. HUD's Office of Multifamily Programs provides mortgage insurance to HUD-approved lenders to facilitate the construction, substantial rehabilitation, purchase and refinancing of multifamily housing projects. Completing the Transformation Initiative will restructure the organization and improve transactional and operational efficiency, enhance risk management tools and implement procedures that will result in significant savings across the organization.

Section 8 Housing Choice Voucher Program

This public-private partnership has the potential to be one of the most effective means of addressing our nation's affordable housing needs and supporting mixed-income communities. However, the program's potential success is limited by too many inefficient and duplicative requirements, which discourage private providers from accepting vouchers. These include a required three-way lease between the provider, resident and the public housing authority; repetitive unit inspections; resident eligibility certification; and other regulatory paperwork. Collectively, these make it more expensive for a private owner to rent to a Section 8 voucher holder.

The program has also been plagued with a flawed and volatile funding system that has undermined private-sector confidence in the program. With Congress focused on austerity measures, insufficient funding is expected to be worse in the near-term budget cycles. Common-sense reforms that could help control costs, improve the program for both renters and property owners, and increase private housing participation include:

- **Establishing** a reliable funding formula;
- **Streamlining** the property inspection process;
- **Simplifying** rent and income calculations;
- **Reducing** costly Limited English Proficiency (LEP) translation requirements; and
- **Extending** the contract term for project-based vouchers from 15 to 20 years.

NMHC/NAA support the common-sense provisions included in H.R. 3700, the "Housing Opportunity through Modernization Act of 2015." We thank Chairman Luetkemeyer and Ranking Member Cleaver for their leadership in ensuring this critical bill passed the House in February, and we strongly urge the Senate to approve it without delay so that President Obama may sign it into law.

As NMHC/NAA work with industry participants to identify new and creative ways to improve these programs Congress should consider the additional measures identified that will reduce inefficiencies and burdensome regulatory requirements.

It is also imperative for lawmakers to reinforce the voluntary nature of the program. Congress specifically made participation voluntary because of the regulatory burdens inherent in the program. However, state and local governments are enacting laws that make it illegal for a private owner to refuse to rent to a Section 8 voucher holder. Recent examples include "source of income discrimination" provisions passed by a number of cities. While often well intentioned, such

mandates are self-defeating because they greatly diminish private-market investment and reduce the supply of affordable housing.

Rental Assistance Demonstration (RAD) Program

NMHC/NAA support RAD, which was established in 2011 as an affordable housing preservation strategy for public housing authorities (PHAs). The program allows PHAs to convert public housing properties at risk of obsolescence or underfunding into project-based vouchers or rental assistance contracts under the Section 8 program. Once the units are re-designated from public housing (Section 9 of the 1937 Housing Act) to Section 8 housing, housing authorities are able to leverage private capital to address capital needs. This allows housing authorities to work with private sector developers and managers to preserve their affordable housing stock. RAD is designed to reverse the trend of lost affordable units by accessing private capital to make up for related funding shortfalls.

Government-Supported Preferred Equity

Investor equity for development transactions is the most expensive type of capital. Reducing the required return for this portion of capital, however, would reduce the cost of developing multifamily units and could help spur the construction of additional workforce housing. NMHC/NAA would like to work with this Committee on a plan that would enable a federal entity to provide developers with preferred equity to help offset the cost of workforce housing production. NMHC/NAA believe that such a program could be integrated into the very successful multifamily programs run by Fannie Mae and Freddie Mac and implemented at minimal cost.

Modifying the Community Reinvestment Act

The CRA could be modified to include greater incentives for banks to provide loans for multifamily apartments that include workforce housing. CRA guidelines currently allow banks to obtain Community Development (CD) credit for multifamily units serving occupants with incomes of up to 80 percent of area median income. While this level captures a significant portion of workforce households, the rules themselves make it difficult to obtain the CD credit due to a requirement to report incomes, information that is not captured.

The three main banking regulators – Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and Federal Reserve – control the regulations around CRA. We urge this Committee to work with the multifamily industry to encourage these regulators to make common-sense, modest changes that would remove impediments to obtaining CRA credit for workforce multifamily housing. For example, rather than relying on income to determine CRA eligibility, the determination of affordability could be based on rent levels. Notably, the Federal Housing Finance Agency (FHFA) and HUD use this type of measure for programs they administer.

Davis-Bacon Wage Determination

Under current law, developers must adhere to Davis-Bacon wage rates for construction financed by federal dollars. Unfortunately, the Department of Labor's methodology of determining these so-called prevailing wages suffers from structural defects related to the availability of data. For example, the methodology frequently produces wage rates that exceed prevailing market-based wages, which only exacerbates the cost of developing multifamily housing. NMHC/NAA request that the Committee urge the Department of Labor to reexamine and modify its methodology.

Pro-Development Tax Policy

Given that apartment firms pay tax when they build, operate, sell or transfer communities to their heirs, the nation's tax system plays a considerable role when multifamily developers and operators evaluate the viability of a given property. Tax policy that extracts too high a burden or leads to a misallocation of capital has the potential to disrupt the very construction and development that is so critical to housing America's workforce.

Leverage the Low-Income Housing Tax Credit (LIHTC) to Support Workforce Housing

While the multifamily industry supports tax reform that promotes economic growth and investment in rental housing without unfairly burdening apartment owners and renters relative to other asset classes, this debate is likely to take some time to resolve. In the shorter term, we encourage Congress to take incremental, but nonetheless significant steps, to leverage the current-law LIHTC to promote workforce housing.

Under the current LIHTC program, which has financed nearly 2.8 million apartments and served 13.3 million residents since its inception in 1986, state housing agencies issue credit allocations to developers who then sell the credits to investors. Investors receive a dollar-for-dollar reduction in their federal tax liability over a 10-year period, and developers invest the equity raised to build or acquire apartments. This equity allows apartment firms to operate the properties at below-market rents for qualifying families. LIHTC-financed properties must be kept affordable for at least 30 years.

The LIHTC has two components:

- **A 9 percent tax credit** that subsidizes 70 percent of new construction and cannot be combined with any additional federal subsidies.
- **A 4 percent tax credit** that subsidizes 30 percent of the unit costs in an acquisition of a project and can be paired with additional federal subsidies.

Program rules require owners to either rent 40 percent of their units to households earning no more than 60 percent of area median income (AMI) or 20 percent to those earning no more than 50 percent of AMI.

The following proposals could help further leverage the LIHTC and promote workforce housing:

1. **Income Averaging:** NMHC/NAA believe that the LIHTC program could be bolstered to serve a wider array of households and increase the financial viability of certain projects if Congress enacted so-called income averaging. Under this proposal, which President Obama has also included in his Fiscal Year 2017 Budget, program rules would be revised to allow owners to reserve 40 percent of the units for people whose *average* income is below 60 percent of AMI with the proviso that no LIHTC unit could be occupied by individuals earning over 80 percent AMI. Thus, if this proposal were enacted, the LIHTC program could serve a wider array of households, including those who are traditionally defined as comprising America's workforce. Additionally, the ability to use the program to house slightly higher-income families could help cross subsidize families further down the income scale.

2. **Leveraging the LIHTC Model for Preservation:** Every year, the multifamily industry loses between 100,000 and 150,000 units to obsolescence and other factors. Most lost units are likely at the lower end of the market, disproportionately hurting the affordable portion of the market. Furthermore, the nation's apartment stock is aging; in fact, as noted above, just over half of all apartments were built before 1980. Without resources dedicated to support rehabilitation efforts, more stock will evaporate from the available pool.

Although new construction will be critical to ensuring a sufficient supply of workforce housing, preservation of units is far less costly than new construction. Accordingly, NMHC/NAA believe Congress should look to using resources to maximize the preservation of existing units. We believe that the LIHTC program could be expanded to enable the acquisition of units that could be renovated and maintained as workforce housing. Furthermore, given that workforce housing supports higher rents than traditional LIHTC units, the subsidy rates could be adjusted downward and, therefore, limit the cost to taxpayers.

Tax Reform Must Not Disrupt the Industry's Ability to Construct and Operate Workforce Housing

Congress is rightly continuing to develop proposals to reform the nation's overly complex tax code to foster economic competitiveness and economic growth. That said, much is potentially at stake for the apartment industry and its ability to meet the nation's workforce housing needs given that apartment firms pay tax when they build, operate, sell or transfer communities to their heirs. We believe that any tax reform legislation should not disrupt the industry's ability to construct and operate affordable and workforce housing and, therefore, must:

- **Protect Flow-Through Entities.** The multifamily industry is dominated by "flow-through" entities (e.g., LLCs, partnerships, S Corporations, etc.) instead of publicly held corporations. This means that the company's earnings are passed through to the partners who pay taxes on their share of the earnings on their individual tax returns. Accordingly, Congress must not reduce corporate tax rates financed by forcing flow-through entities to pay higher taxes through subjecting them to a corporate-level tax or by denying credits and deductions.

- **Maintain Like-Kind Exchanges.** Largely unchanged since 1928, like-kind exchange rules enable property owners to defer capital gains tax if, instead of selling their property, they exchange it for another comparable property. These rules encourage property owners to remain invested in the real estate market while providing them with the flexibility to shift resources to more productive properties, different geographic locations or to diversify or consolidate holdings. Any proposal to revise or restrict like-kind exchanges may have a significantly harmful effect on the value and trading of property. As a result, Congress should not change present law.

- **Ensure Depreciation Rules Avoid Harming Real Estate.** Some have sought to raise revenue by significantly extending the 27.5-year depreciation period of multifamily buildings and increasing the 25 percent depreciation recapture tax rate applicable to sales. By creating a discriminatory cost recovery system that is detached from the life of multifamily buildings, these proposals would reduce development and investment, result in lower real estate values and stifle the industry's ability to create new jobs.

- **Retain the Deduction for Business Interest.** Efforts to prevent companies from overleveraging are leading to calls to scale back the current deduction for business interest expenses. Unfortunately, reducing this deductibility would greatly increase the cost of debt financing necessary for large-scale projects, curbing development activity when the nation is suffering from a shortage of apartment homes.

Conclusion

In closing, NMHC/NAA look forward to working with the Financial Services Committee and the entire Congress to address the nation's affordable workforce housing challenges. On behalf of the apartment industry and our 38 million residents, we stand ready to work with Congress to ensure that every American has a safe and decent place to call home at a price that enables individuals to afford life's necessities.