Statement of Robert Rozen, RRozen Associates
Federal Housing Finance Agency Listening Session
Future Activities in the Affordable Housing Preservation Market
July 19, 2023

Thank you for convening this Listening session to receive recommendations on the Enterprises' next Duty to Serve Underserved Markets Plans and what actions can be taken with regard to the Future Activities in the Affordable Housing Preservation Market

My name is Robert Rozen. I am a housing credit policy attorney and have been working on the Low-Income Housing Tax Credit program since before its enactment in 1986. I represent the nonprofit side of the industry where my clients advocate for increased resources for the Housing Credit and reforms to protect program integrity and strengthen the affordable housing mission of this critically important program.

I believe Fannie Mae and Freddie Mac are positive forces in the affordable housing market and their Duty to Serve commitments elicited through FHFA make an important contribution towards efforts to address the nation's affordable housing needs.

The issue I want to discuss is how FHFA can preserve longer term housing affordability by adopting new policies to require that Government Sponsored Enterprises not provide financing for properties that could or did take advantage of a loophole to prematurely end affordability requirements in the Low-Income Housing Tax Credit program. This loophole, known at the Qualified Contract ("QC") provision, is resulting in the loss of approximately 10,000 affordable housing apartments annually.

Background

The Low-Income Housing Tax Credit ("Housing Credit") is a production subsidy provided to developers who agree to rent their properties to qualifying low-income residents at reduced rents for a minimum of 30 years, including a 15-year tax compliance period and another 15-years of extended use subject to deed restriction. This is the essential structure of the program and it is commonly understood. However, there are two little-known exceptions to the requirement that Housing Credit properties remain affordable for 30 years: 1) in the case of foreclosure; and 2) where a "qualified contract" is presented to the state Housing Credit agency.[1]

Under the foreclosure exception, the rent and income limitations may be terminated for property in foreclosure. This was created to facilitate the placement of debt on Housing Credit properties by giving lenders better protection against default. Under the QC provision, an owner of a Housing Credit property may, after Year 14, approach the Housing Credit allocating agency to request a qualified contract. This request begins a one-year period during which the allocating agency seeks a qualified buyer to purchase the property and maintain it as affordable for the duration of the extended use period. The required purchase price for a qualified contract is stipulated by Section 42

[1] Section 42(h)(6)(E)

and was designed to allow investors a regulated cash profit upon disposition after 15 years as part of their overall inflation-adjusted return on the original equity contribution.[2]

While the original intent of this provision was to create a limited return and some liquidity for investors at a time when the Housing Credit was an unproven program, for some properties it has come to function as a nearly automatic affordability opt-out after just 15 years of affordability. This is because the QC formula price in nearly all cases significantly exceeds the market value of the property as affordable housing. As a result, it is rare for the allocating agency to find a buyer willing to pay the QC price. If the allocating agency fails to identify a qualified buyer within one year, the property is released from the affordability requirements of the Housing Credit program. At that point, the owner is free to either sell the property at market value without any deed restriction or continue to own and manage the property while charging market rents, subject only to a three-year rent protection period for existing tenants.

The QC provision was added to section 42 in 1989, three years after the program was originally enacted, when the program went from a 15 year affordability requirement to 30 years. It was a compromise aimed at the individual investor market to permit owners to exit the program while limiting their returns. The statutory buyout price limiting the growth in the value of the property to the rise in inflation on the equity contribution was thought to be a significant limit on returns. As the Housing Credit investment market has matured, the formula limitation has not worked out as intended, in part because the equity share in Housing Credit property grew considerably after 1989 when tax credit prices were only about 43 cents for a dollar of tax credits. As credit prices rose, the share of the property financed with equity rose to such an extent that the statutory formula became unworkable in the sense that it creates such a high buyout price that it prevents housing finance agencies from finding buyers under the QC process. Concurrently, prospective sales profits became unnecessary to attract investors. The QC provision in section 42 has accordingly emerged as a means of enabling some owners to remove properties from the extended low-income use commitment, thus permitting higher rents, displacement of low-income residents, and windfall profits. As owners raise rents after completing the QC process, there is a loss of affordable housing.

For most of the life of the Housing Credit program, the QC provision was a little noticed, unused option for owners of Housing Credit properties. While the law permits states to require a waiver[3], few did so and tax credit applicants did not finance their properties with the intention of utilizing the QC option to remove the affordability restrictions after 15 years. In 2012, HUD published a major study of what happens to Housing Credit properties in year 15, "What Happens to Low-Income Housing Tax Credit Properties in Year 15 and Beyond".[4] The study largely found that properties were remaining affordable and no significant public policy concerns were presented. However, shortly after that report was issued, the market changed rapidly. As the difference between market rents and affordable rents widened, multifamily real estate brokers began advising owners of Housing Credit properties to review their documents to determine if they have the right to go through the QC process. This led to an increase in the number of properties going through the QC process and terminating the affordability requirements after only 15 years. **According to the**

[2] Section 42(h)(6)(F)
[3] Section 42(h)(6)(i)
[4] https://www.huduser.gov/publications/pdf/what_happens_lihtc_v2.pdf

National Council of State Housing Agencies ("NCSHA"), approximately 10,000 units of affordable housing are lost each year due to the QC loophole, more than 100,000 since data has begun to be collected.

In response, affordable housing advocates undertook a campaign to eliminate this loophole. With the strong support of the NCSHA[5], an increasing number of states changed their Qualified Allocation Plans to either require a waiver of the QC right for new allocations, or give incentives for credit applicants who agree to such waivers. Today 48 of 54 credit allocating agencies either require or give incentives for developers to waive the Qualified Contract rights in the 9% program. However, in the 4% program only 41 credit allocating agencies[6] require or incentivize owners to waive their Qualified Contract rights. An unfortunate complication is that even after a jurisdiction has changed its policy to prohibit future allocations to take advantage of the QC option, the change in policy does not apply to previous allocations. In effect, there is a 15-year gestation period before the change in policy begins to affect Housing Credit properties.

In addition to efforts to address this loophole at the state level, federal legislation has been advanced to eliminate the QC loophole. In the last Congress, the chairman of the Ways and Means Committee, Congressman Richard Neal, advanced a repeal provision as part of the Build Back Better Act that passed the House of Representatives. In the Senate, the Chairman of the Senate Finance Committee , Senator Ron Wyden, introduced broad affordable housing legislation that included a repeal of the QC provision, the Decent, Affordable, Safe Housing for All Act, S.2820. Both the House and Senate legislation would also change the existing statutory buyout formula for existing properties so that it would be based on the fair market value of the property taking into account the rent restrictions. Because of determined opposition, Congress has been unable to repeal the QC loophole.

Last year, the Biden Administration took important action to discourage use of QCs. Treasury Department regulatory guidance[7], issued with respect to the use of State and Local Fiscal Recovery Funds, provides that such funds cannot be used to fill financing gaps for Housing Credit properties unless the project owner agrees to waive any right to request a QC. **The policy basis for the Treasury Department requiring Housing Credit owners to waive their QC rights when State and Local Fiscal Relief funds are used to support an affordable housing property is based on the premise that valuable government resources provided in conjunction with the Housing Credit program should not be used on properties with limited affordability periods. This same policy basis should apply to affordable housing properties supported by Government Sponsored Enterprises.**

---

[5] The last "NCSHA Recommended Practices in Housing Credit Administration" included a recommendation that housing finance agencies require a waiver of the Qualified Contract right for all allocations and take steps to discourage owners from going through the Qualified Contract process. https://www.ncsha.org/resource/ncsha-recommended-practices-in-housing-credit-administration/

[6] The Florida Housing Finance Corporation incents developers to waive only if other FHFC funds are utilized in the financing of the property

[7] *Coronavirus State and Local Fiscal Recovery Funds Final Rule: Frequently Asked Questions*, Page 35. https://home.treasury.gov/system/files/136/SLFRF-Final-Rule-FAQ.pdf

I urge the FHFA to take the following regulatory action to enable the Enterprises to help preserve affordable housing:

1) Prohibit GSEs from investing in Housing Credit properties unless the owner has agreed to waive its QC rights.[8]
2) Prohibit GSEs from acquiring multifamily loans on Housing Credit properties unless the owner has agreed to waive its QC rights.[9]
3) Prohibit GSEs from acquiring multifamily loans on properties financed with Housing Credits where an owner has taken the property through the QC process and terminated the rent and income limitations on the property.[10]

These three proposals, plus a proposal directed at Federal Home Loan Banks, are also included in a letter that was recently sent to FHFA Director Thompson by 15 national affordable housing associations urging action to protect tenants against rent increases arising from the Qualified Contract loophole.

[8] This prohibition would apply to all forms of Housing Credit equity investing that may be undertaken by a GSE, including investment through a multi-investor fund, a proprietary fund and a direct investment where there is not syndicator.
[9] This proposal is intended to make it more difficult for developers to obtain long-term debt financing for their properties if they have they have the ability, through the QC process, to convert the Housing Credit property to market rental after 15 years of rent and income restrictions. The proposal contemplates that debt financing on the property would qualify for purchase by a GSE only if: a) the regulatory agreement between the developer/owner and the HFA includes a waiver of the right to go through the QC process, or b) the owner agrees to a subsequent, legally binding obligation to meet the affordability requirements throughout the extended use period
[10] This would apply to the purchase of any multifamily loan which finances a Housing Credit property that has gone through the QC process. To be eligible for GSE purchase, the loan on such properties would be required to include an attestation by the borrower that the property has not gone through the QC process.