

**AIMS Washington Update
NAA/NMHC Joint Legislative Program**

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HOUSING BILL REPRESENTS VICTORY FOR APARTMENT SECTOR

After months of negotiations, Congress finished work on what many are calling the most significant housing legislation (H.R. 3221) in a generation last week; President Bush signed the measure into law on Wednesday. The bill has been one of our top priorities this year, and we are happy to report that as a result of our aggressive multi-month campaign, the final version represents a tremendous victory for the apartment industry and NAA/NMHC's Government Affairs program. The measure includes several important victories for the apartment industry and represents what NAA/NMHC have long called for—a balanced approach to housing policy. Specifically, the measure trims several homeownership incentives and balances new single-family incentives with expanded rental housing incentives.

Homeownership Incentives Trimmed

Most importantly, NAA/NMHC successfully persuaded lawmakers to significantly trim a number of homeownership incentives included in earlier versions of the legislation. Even where the bill does create new homeownership incentives, such as a one-year standard deduction for property taxes paid by non-itemizers, it pays for it by eliminating some tax breaks currently allowed for owners of second houses.

- *FHA Zero-Down Rejected.* The final bill ends a multi-year effort by the Administration to create a federally insured zero-downpayment program. Instead, the final bill actually raises the FHA downpayment requirement from 3.0 percent to 3.5 percent.
- *Seller-Financed "Charitable" Downpayments Banned.* The measure also bans seller-financed downpayment programs, such as the ones offered by Nehemiah Corp. and AmeriDream, as of October 1, 2009. NAA/NMHC have long opposed these programs because of abuses in them. The FHA has twice attempted to ban the programs through regulatory action, noting that they produce loans that are three times as likely to go into foreclosure. Such seller-assisted loans now account for one-third of the agency's portfolio.

Michael Rehaut, an analyst with JP Morgan, has written that the elimination of these charitable downpayment programs "represents a material negative for the [single-family] housing market and hence the overall bill could result in more harm than good near term." Rehaut reports that such loans accounted for one-third of the mortgages originated by single-family builder Lennar, 20 percent of loans for Ryland Homes and 10 percent of loans for Pulte Homes in the second quarter.

- *Homebuyer Tax Credit Trimmed Significantly.* Lawmakers also wisely rejected calls for a \$15,000 tax credit for people who buy foreclosed houses. NAA/NMHC joined critics from the right and the left arguing that such a credit likely would have increased foreclosures, accelerated house price declines and done nothing to increase housing demand. Instead, the final measure includes a temporary \$7,500 tax credit for first-time home buyers, which we believe will have a limited impact on the housing market or apartment demand because of the way it is structured. It is only available to households below certain income levels, it must be repaid, and it expires July 1, 2009.
- *Miscellaneous Provisions.* A controversial change to net operating loss (NOL) tax laws that was heavily criticized as a giveaway to the home building industry was also dropped, and a proposed \$15 billion grant program to states to buy foreclosed properties and rent or sell them was trimmed to just \$4 billion.

Rental Housing Provisions Included

In addition to trimming back the homeownership incentives originally proposed, the bill also expands and improves the Low-Income Housing Tax Credit (LIHTC) program and temporarily increases the tax-exempt private-activity bond cap for multifamily and mortgage revenue bonds by \$11 billion for 2008.

The package also includes comprehensive GSE reform (see “GSE Reform” below), an NAA/NMHC priority for more than six years that took on new urgency given rising investor fears over the financial health of the GSEs. NAA/NMHC-supported language blocking the U.S. Department of Housing and Urban Development (HUD) from increasing the multifamily mortgage insurance premium until October 1, 2009 was also included. The Department has tried unsuccessfully to increase the premium for the past two years.

The measure also creates the first national affordable housing trust fund, funded by a percentage of profits from the GSEs. In its first years, the trust fund will cover costs of any defaulted loans in the FHA foreclosure program. After that, the fund will be used to produce, preserve and rehabilitate housing that is affordable to extremely low-income households, with 90 percent dedicated to rental housing. NAA/NMHC successfully opposed earlier versions of the trust fund that would have used surplus FHA revenues as a funding mechanism, arguing that such a diversion of program funds could ultimately create shortfalls in the FHA multifamily mortgage insurance program.

Finally, the package also incorporates language from the REIT Investment Diversification and Empowerment Act of 2007 (H.R. 1147), which is designed to change tax law to allow REITs to better compete with other real estate companies in domestic and international markets.

A detailed summary of the final measure is posted at <http://tinyurl.com/5myq7d>. This week's *Tax Update* provides a detailed summary of the tax-related provisions in the bill. Throughout our lobbying effort on this bill, NAA/NMHC urged Congress to rethink our national housing policy in light of the foreseeable and preventable single-family meltdown and to adopt a more balanced housing policy that encourages a vibrant rental market along with a functioning ownership market. We will continue to work with Congress to enact a more balanced housing policy that better meets our country's evolving housing needs and preferences.

NAA/NMHC ADVOCACY AD: DROP THE OBSESSION WITH HOMEOWNERSHIP

As part of our outreach effort on the omnibus housing bill that passed Congress last week, NAA/NMHC unveiled a hard-hitting new ad urging lawmakers to learn from our country's past mistakes and adopt a more balanced housing policy. The ad features quotes from journalists and housing policy experts essentially urging elected officials to “drop the obsession with homeownership.” We are running the ad in publications targeting Congress. The ad, including high-resolution files for members who would like to use the ad locally, can also be downloaded at www.nmhc.org/goto/4811.

IRS ISSUES FINAL LIHTC UTILITY ALLOWANCE ESTIMATE REGULATIONS, INCLUDES ALL OF NAA/NMHC'S SUGGESTIONS

On July 29, the Internal Revenue Service (IRS) published long-awaited final regulations that change the way rents are adjusted on Low-Income Housing Tax Credit (LIHTC) properties when residents pay for their own utilities (73 FR 43863). The changes go into effect immediately.

NAA/NMHC led the industry effort for such a change since 2004. Tax credit rents include a utility allowance for resident-paid utilities; however, the methods the IRS currently allows owners to use to estimate resident utility costs tend to overestimate them. This, in turn, reduces the gross rent received by owners and threatens the financial viability of many LIHTC properties. The new regulations are a significant victory for affordable LIHTC owners, developers and investors.

The IRS regulations, which are largely based on a proposal submitted to the IRS by an NAA/NMHC-led coalition, increase the sources of data that owners can use to calculate resident-paid utilities. Under the new rules, owners can now use estimates provided by state LIHTC allocating agencies (typically state housing finance agencies) and estimates produced by a new HUD utility modeling program. Thanks to NAA/NMHC comments and testimony on the proposed rule, the IRS amended the final rule to allow owners to seek certified engineering studies to estimate utilities, and it allows such models to include water and sewer costs. Finally, the rules clarify how to handle estimates for properties in deregulated energy markets where multiple providers serve the community.

In addition to the procedures to set utility adjustments, NAA/NMHC secured a provision to allow properties to obtain a

stabilized occupancy before rents are adjusted at newly developed properties. The provision sought by NAA/NMHC would require rents to remain unadjusted for a period of one year, or until the property has achieved 90 percent occupancy for 90 consecutive days, whichever comes first. The final regulations are available online at <http://edocket.access.gpo.gov/2008/pdf/E8-17268.pdf>.

GSE REFORM

Among other things, the comprehensive housing bill (H.R. 3221) signed into law this week creates a new regulator for the Government Sponsored Enterprises (GSE) and provides a federal backstop for Fannie Mae and Freddie Mac. Enacting GSE reform has been an NAA/NMHC priority for more than six years.

The final version of the legislation creates a new Federal Housing Finance Agency (FHFA) to oversee the GSEs' financial safety and their affordable housing mission. The FHFA replaces the Office of Federal Housing Enterprise Oversight and HUD. The FHFA will be headed by a director appointed by the President and confirmed by the Senate for a five-year term. The new regulator has enhanced authority to set limits on Fannie and Freddie's combined \$5.4 trillion portfolio based on safety and soundness operations and to set higher capital requirements for the GSEs.

The new regulator will also have a greater say over GSE portfolio holdings by conducting periodic reviews of assets and obligations, both on- and off-balance sheet. It also would have expanded authority to conduct audits, order internal controls, and restrict executive pay.

The measure also includes provisions added at the request of Treasury Secretary Henry Paulson to restore market confidence in Fannie Mae and Freddie Mac. In the event of a financial crisis, the bill gives the Treasury Department unlimited spending authority to increase the GSEs' line of credit with the federal government or to purchase equity in the two. If the assistance is utilized, both the Treasury Department and the Federal Reserve would be granted new oversight powers to consult with the FHFA in setting the GSEs' capital standards. Those provisions expire in December 2009.

Thanks to NAA/NMHC's efforts, the bill does not contain onerous provisions from earlier versions that would have severely restricted the GSEs' ability to purchase multifamily loans. As a result, even with the stronger regulator, multifamily lending by the GSEs is expected to operate as business as usual. With little, if any, multifamily defaults on their books, the two mortgage giants will continue to serve as a steady source of debt capital for the apartment sector.

Over the past 10 years, the two GSEs have helped the apartment industry withstand two financial market meltdowns and have protected the values of the multifamily real estate that is home to millions of Americans. The new regulatory frame-work should strengthen the two quasi-public companies, which will in turn benefit the apartment industry.

HUD STREAMLINES FHA AND LIHTC PROGRAMS

On July 22, the U.S. Department of Housing and Urban Development (HUD) issued a memorandum (FHA Mortgagee Letter 2008-19) streamlining the processing of Federal Housing Administration (FHA) multifamily insurance applications with LIHTCs. The new policy makes four program changes that will provide flexibility, cut upfront and overall transaction costs and

make FHA a competitive financing source for LIHTC properties.

Specifically, the policy permits the deferred submission of full plans and specifications, which will allow FHA to commit on loans much earlier in the development cycle and will allow borrowers to lock rates earlier. The changes also reduce the amount of tax credit equity that must be funded at the time of HUD's initial endorsement from 100 percent to 20 percent, with the remainder to be paid in over the development period comparable to most conventional financing. This will allow developers to raise more funds through higher pricing on the tax credits.

The policy requiring HUD-2530 clearance to be obtained prior to FHA initial endorsement has been relaxed, and each Multifamily Hub and Program Center is now required to designate an LIHTC Coordinator to work with credit allocation agencies and developers to better synchronize tax credit funding cycles with FHA's application process.

In addition to these changes, the omnibus housing bill (H.R. 3221) signed into law this week includes additional provisions streamlining FHA and tax credits. The bill eliminates the need for subsidy layering reviews of FHA-financed projects that have gone through LIHTC subsidy layering reviews and allows HUD to rely on tax credit allocating agency compliance monitoring for the purpose of periodic inspections of FHA-insured multifamily properties. The bill also requires HUD to establish a pilot program for a streamlined review of FHA multifamily mortgage insurance loan approvals, through the appointment of a chief underwriter at FHA. The FHA Mortgage Letter is available at <http://tinyurl.com/6ctpzw>.

CARD CHECK LEGISLATION

NAA/NMHC are closely following legislation pending in Congress that would significantly and adversely change the employer-employee relationship. Most importantly, the measure, known as the Employee Free Choice Act (S. 1041, H.R.800) or informally as the "card check bill," would change the rules governing the formation of unions to allow public rather than private balloting. Such a change would potentially subject employees to impermissible coercion by union organizers and pro-union co-workers.

The bill also seeks to change the rules governing initial collective bargaining agreements (union contracts entered into after representation is approved for the first time) and increase fines and other remedies against employers for unfair labor practices (while not obligating corresponding penalties for union violations). It would also force employers into mandatory binding arbitration procedure under certain circumstances. Supporters of the proposed legislation claim that the current system of private balloting favors employer interests, hinders union victories in workplace elections, and results in employee terminations.

The measure was approved by the House of Representatives on March 1 by a 241 to 185 vote, but it died in the Senate on June 26, 2007 on a 51 to 48 vote when it failed to garner the 60 votes needed to overcome a filibuster. Although the measure is not expected to pass this year, it is expected to be considered again next year. If Democrats increase their majority in Congress, particularly in the Senate, and win the presidency, this bill is likely to be a priority for the next Congress. NAA/NMHC will continue to follow this situation and analyze its potential impact on the apartment industry.

RENTER CREDIT QUALITY IN A VOLATILE HOUSING MARKET

Dispossessed house owners have not been flocking to the apartment sector, according to new research by NMHC. As a result, the credit quality of prospective renters is holding steady, suggesting that the foreclosure crisis is not spilling over to threaten the financial health of the apartment sector.

The research, conducted by Bruce Innes of Innes Works Consulting and presented in a new NMHC white paper titled *Renter Credit Quality in a Volatile Housing Market*, finds that evicted house owners only represent between two percent and six percent of apartment applicants.

The primary effect of the housing downturn on apartments is not a flood of former house owners into apartments, but rather a dramatic slowdown in the number of renters leaving to become owners. This, in turn, is raising the credit quality of rental applicants and helping insulate the apartment sector from the financial woes the single-family sector is currently experiencing.

The report examines whether the overall quality of apartment applicants has declined because of the increasing number of households with some kind of “mortgage stress” in their credit history and finds that only 5.4 percent of rental applicants had a record of being 90 days or more past due on their home loan or in default on their mortgage.

Apartment firms have an economic incentive to accept as many applicants as possible, and the research shows that firms are using a variety of techniques to manage the risks associated with rental applicants who have foreclosures, including the widespread adoption of automated risk-based screening programs. Many firms are also finding ways to accept applicants with mortgage stress and protect the properties' net operating incomes, such as requiring additional deposits. Through these practices, rental housing providers are able to accept between 85 percent and 92 percent of applicants. In addition, the research finds that bad debt ratios remain basically unchanged, indicating that renter defaults have not increased.

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