



National Association of Housing and Redevelopment Officials

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NAHRO Brief Millennial Housing Commission Recommendations Preservation

Background / Rationale

The stock of affordable housing units is shrinking. Some properties are in attractive markets, giving owners an economic incentive to opt out of federal programs in favor of market rents, and other properties are poorly located and cannot command rents adequate to finance needed repairs. In general, properties with lesser economic value are at risk of deterioration and, ultimately, abandonment, unless they can be transferred to new owners. Changes in the tax code in 1986 eliminated the ability of most investors to deduct losses generated by their properties from otherwise taxable income, and as a result an investor's economic interest in such properties was substantially diminished. Even if an investor is no longer interested in owning a property the investor is discouraged from transferring the property, because s/he will typically have a negative tax basis and be subject to a tax on that negative basis (the "exit tax").

Recommendation

The Commission recommends that states be given the authority to allocate exit tax relief, via a preservation tax incentive, to stimulate the transfer of properties to preservation entities. Such relief would offset the investor's negative tax basis in the property, thereby eliminating a significant barrier to transfer. Since residents of federally assisted properties enjoy true affordability, federally assisted properties should receive highest priority for preservation using this proposed new tool.

In implementing this relief, the Commission recommends that Congress:

- Specify the minimum required elements of transactions eligible for PTI. The Commission suggests a minimum use agreement of 30 years and the following affordability requirements for assisted properties: the new owner must maintain existing federal subsidies; when the affordability period for the existing federal subsidy expires, the new owner may not opt out; they must renew at least 50% of the federally subsidized units, and must also rent at least 20% of the units to households earning no more than 50% of AMI or 40% of the units to households earning not more than 60% of AMI. For unassisted properties, a minimum use agreement of 30 years would also apply and the new owner must make at least 20% of units affordable at 50% of AMI or 40% affordable to households earning 60% of AMI.
- Establish penalties for noncompliance. The Commission suggests the penalty for nonprofits be loss of tax-exempt status; for-profits should pay a tax penalty.

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- Establish general, minimum threshold criteria for an entity to qualify as a preservation entity.
- Clarify that use restrictions, affordability levels, and subsidies can be assumed by other qualified entities.

As described below, states would determine the following:

- Properties eligible for relief would be: assisted properties with negative tax equity, positive-tax-equity assisted properties, negative-tax-equity unassisted properties, and unassisted properties with positive tax equity.
- In qualifying an entity as a preservation entity, the state may, for example, require them to demonstrate previous commitment to affordable housing as well as the organizational and financial capability necessary for long-term, successful management of a mixed-income project. Furthermore, the state should require an entity seeking “preservation entity” status to demonstrate its independence from the seller or its affiliates.
- Preservation transactions will comply with any and all federal requirements and must meet additional state criteria, if applicable. In order to be eligible for exit tax relief under the PTI, the proposed transaction must be certified as economically viable.