HOUSING

2017 Housing Outlook

In Uncertain Times, Advocacy is Key

Talk about uncertainty. Over the years, those in the affordable housing industry have dealt with their fair share of uncertainty—in the form of budget shortfalls, continuing resolutions, sequestration and more. As 2017 begins to unfold, however, the aura of uncertainty is perhaps stronger than ever as the prospect of tax reform, drastic budget cuts, infrastructure spending and a retired pediatric surgeon taking over the U.S. Department of Housing and Urban Development (HUD) all loom on the horizon. Fortunately, the affordable housing industry has a lot of friends and advocates in Washington and across the nation. In 2017, it's going to need them all to step up in a big way.

Rental Demand Strong, Affordability Crisis Continues

In its recent report, "The State of the Nation's Housing 2016," the Joint Center for Housing Studies of Harvard University details a rental market with strong demand coupled with an affordability crisis. In 2015, approximately 36% of U.S. households, consisting of nearly 110 million people, lived in rental housing. Clearly, the rental market continues to thrive, as the number of rental households increased by nearly 9 million from 2005 to 2015—the biggest jump over any 10-year period on record. It is important to note, however, that although demand increased across all income levels, approximately half of the growth consisted of households making less than $25,000 annually.

The root of the affordability problem is clear—the private market is unable to provide new apartments with rents low enough to reach low-income renters. Unfortunately, the problem keeps getting worse. In its report, the Joint Center for Housing Studies noted that the amount of renters with severe burdens (those who pay more than 50% of their income on rent) rose by 2.1 million to a record 11.4 million last year. Further, although the amount of renters eligible for federal housing assistance has increased to 18.5 million, the number who actually receive assistance dropped by nearly 160,000 due to the loss of project-based units. The problem, in many cases, is that higher-income households are occupying the affordable units, putting pressure on the federal and state governments to find new ways to help low-income renters obtain decent housing.

The Word from Washington

With a GOP-controlled Congress and Republican president, the prospect of tax reform actually passing is more likely than it has been in years. House Ways and Means Committee Chairman Kevin Brady (R-TX) is leading the charge for Republicans, and according to recent reports, he appears to support retaining the Low-Income Housing Tax Credit (LIHTC) program in any reform package.[1] It is also expected that LIHTC advocate Senator Maria Cantwell (D-WA) will reintroduce her bill from last year that calls for an expansion of LIHTC allocation authority. Although that bill is unlikely to pass, her efforts should help draw positive attention to the program.

As for the new figures who will play a key role in tax reform, Treasury Secretary Nominee Steve Mnuchin was non-committal on both the LIHTC and New Markets Tax Credit (NMTC) programs during his hearing. When pressed by senators as to whether he supported the programs, he repeatedly vowed to review the programs but did not signal if he supported or opposed them. New HUD Secretary Dr. Ben Carson, for his part, did make positive remarks about the LIHTC program during his hearing and signaled his support. An early opportunity to hear more of Dr. Carson's thoughts on housing is the National Low Income Housing Coalition Policy Forum, on April 2 to 4, where he has been invited to share his thoughts and hear from affordable housing residents and advocates.

When it comes to Carson and the effect the former pediatric neurosurgeon and presidential candidate will have on affordable housing, the outlook is mixed. A typical initial reaction to his nomination might have been concern that his absence of housing and government experience, coupled with a 2015 column where he wrote that the Affirmatively Furthering Fair Housing Act amounted to a "government-engineered attempt to legislate racial equality," could make him an inappropriate selection.[2] However, he has since made more positive statements about HUD and its programs, calling for a holistic approach and increased public-private partnerships. Some even suggest his political celebrity status

1. https://www.housingadvisorygroup.org/pdf/HAG.12.16.pdf
2. http://www.washingtontimes.com/news/2015/jul/23/ben-carson-obamas-housing-rules-try-to-accomplish-/

will help bring much needed attention to the cause of affordable housing, making the selection a win for the industry.[3]

Another developing storyline from Washington that the affordable housing industry is paying close attention to is the so-called “skinny budget” currently being drafted. Although the details are still unknown, the plan is believed to be modeled after one developed by the Heritage Foundation, a conservative think tank. That plan reduced federal spending by $10.5 trillion over 10 years, eliminates the Community Development Block Grant (CDBG), eliminates the Federal Housing Administration (FHA), and moves subsidized housing assistance programs from the federal government to the states. Any of those changes would have profound consequences for the affordable housing industry, but it is still unclear if any will actually be implemented. A detailed skinny budget proposal is expected in May, with topline figures expected to be released in late February.

Figure 1: Affordability Issue

Banks and other investors would expect to pay affordable housing developers less for low-income housing tax credits under tax reform. Below is a hypothetical scenario:

	Current 35% Tax Rate	25% Tax Rate
Project cost	$14 million	$14 million
Number of tax credits	10 million	10 million
Banks’ payments for tax credits	$10 million	$8.9 million
Amount developer must seek elsewhere	$4 million	$5.1 million

Note: Assumes status quo in rest of tax law; 4.5% to 5% yield for banks.

Source: Interviews, research from Novogradac & Co. http://www.nationalmortgagenews.com/news/origination/prospect-of-tax-reform-upends-affordable-housing-finance-1094782-1.html

In regard to any potential dramatic cuts to affordable housing programs, it is important to note that the authors of the skinny budget are far removed from the appropriators who would have to make the decision to eliminate subsidies. There are real people attached to those subsidies and while certain members in Congress would agree with the elimination of some programs, there are also plenty in Congress, on both sides of the aisle, who would flat out oppose such plans. The hope for many is that clearer minds will prevail once the budget reaches the Senate.

Infrastructure funding is another hot topic these days that could affect the affordable housing industry. Senate Democrats revealed their infrastructure plan in late January. The $1 trillion plan mentions the affordable housing industry as one potential recipient of low cost loans and loan guarantees via a new infrastructure bank to be started with $10 billion in seed money. Of course, any Democratic plan is not going to pass under the current administration, but it is possible that aspects of the plan will be included in whatever infrastructure legislation the GOP eventually settles on.

2017 Market Outlook

The prospect of corporate tax reform is perhaps the biggest dark cloud hanging over the affordable housing industry, as its negative effects are already being felt. Since the election, there have been reports of delays in bank financing for affordable housing projects because of the concern that the value of tax credit equity will fall if the corporate tax rate falls (Figure 1).[4]

“Corporate tax reform is the biggest threat to the lending market, no question,” said David Lacki, managing director of Lancaster Pollard’s housing group.

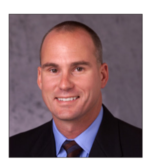
Once there is more clarity as to what tax reform will look like, banks might again be more active, but the current uncertainty is likely causing some to take a pause.

As for the interest rate environment, Lacki anticipates changes in the near future.

“I think short term rates will increase and long term rates will remain largely unchanged, creating a flatter yield curve than what we saw in 2016,” he said.

“Because of that flattening yield curve, coupled with the uncertainty in the LIHTC market, I expect to see the agencies picking up a larger portion of the market share in 2017 as higher leverage will be sought-after,” he added.

As 2017 progresses, those are some of the issues to keep tabs on in what is sure to be one of the most eventful years the affordable housing industry has seen in a while. The government has changed. What that means for the affordable housing industry remains to be seen. But thanks to all those involved in the industry and their tireless advocacy, there is reason to be hopeful.



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3. http://www.housingwire.com/blogs/1-rewired/post/38607-questioning-ben-carson-as-hud-secretary-heres-the-silver-lining-for-housing
4. http://www.nationalmortgagenews.com/news/origination/prospect-of-tax-reform-upends-affordable-housing-finance-1094782-1.html