

Changes in IRS Rules Would Add Affordable Housing

BACKGROUND:

Alaska like every state must confront the complex and at times critical challenge of adequate, safe and affordable housing for families in need of assistance due to income status, health problems or other circumstances.

Pitching in to help address this statewide need are local governments, Native corporations, community non-profit and faith-based organizations, business groups and others. The Alaska Housing Finance Corporation has statewide responsibility for many of the policies and programs that seek to address housing needs.

AHFC administers virtually every state housing program and most of the federal ones. This enables the Corporation to coordinate the use of housing resources in Alaska to a higher degree than other states' housing finance agencies. It also allows AHFC to respond quickly to emerging or changing housing needs.

The state-owned housing finance corporation administers close to \$100 million in federal and state grants, and it manages grant funds on behalf of other state and federal agencies like the Alaska Mental Health Trust Authority and the Denali Commission.

AHFC is a contractor with HUD under the Section 8 project-based contract administration program and the HUD technical assistance program for HOME, supporting housing and community housing development organizations. The corporation administers many different programs that benefit seniors, persons with special needs and the homeless; it manages the state-owned public housing facilities across the state; and it administers the Section 8 Housing Choice Voucher Program, which makes it possible for about 4,000 Alaskans to rent from private landlords.

FUNDING SOURCES:

Notwithstanding the coordinated efforts of the many organizations, the many programs, and the tens of millions of dollars directed to help house people in need of assistance, there are still families in Alaska without adequate housing. The federal grant money allocated to Alaska for this purpose is not sufficient to address all the needs, particularly those among the hundreds of remote villages caught between extreme weather conditions, a scarcity of good-paying jobs and very high construction and transportation costs.

AHFC does not receive funding from the state's general fund for its programs or its operations. It looks to its own corporate earnings to help address some of the unmet housing needs.

As a state bonding authority, AHFC issues tax-exempt housing revenue bonds to raise capital, then it invests this capital in home mortgages across the state. About three-fifths of the corporation's assets are in individual Alaskans' home mortgages.

The corporation can earn a profit depending on the spread between the interest it pays on the tax-exempt mortgage revenue bonds it issues and the interest it receives from the mortgages funded with the bond proceeds.

The difference between the interest paid on bonds issued and the interest earned by investing the bond proceeds in mortgage loans is called arbitrage. One way AHFC achieves low interest rates on bonds it issues is by maintaining a favorable bond rating, which AHFC has been successful in doing in recent years.

ARBITRAGE AND THE IRS

Since 1993, AHFC has been able to use surplus earnings realized on certain mortgage portfolios to make zero percent participation loans. To date, AHFC has made use of about \$270 million in these

loans. It has used these loans to blend down mortgage interest rates and benefit low-income families, rural residents, first-time home buyers and sponsors of multi-family housing that rent to low-income families, and provide assistance to the elderly and to persons with special medical needs. They have also been used to provide an incentive to home owners to invest in energy-efficiency modifications.

However, the Internal Revenue Service imposes a number of limits on mortgage revenue bond proceeds. Three are particularly important to Alaska:

- One IRS rule sets a 1-1/8th percent maximum difference between the yield on bonds and the yield on mortgages funded with the proceeds of the bonds. The effect of this rule is to reduce income for housing finance agencies that otherwise would be available for continuing or expanding affordable housing programs.
- Another IRS rule places a 10-year limit on recycling of mortgage prepayments for loans made with proceeds of bonds. The restriction, known as the "10-year rule," requires agencies to compete for the bond cap with other state instrumentalities and as a consequence limits the capital available for housing purposes.
- A third rule of significance to Alaska restricts eligibility of veterans to qualify for the low-interest-rate mortgages provided under the state's Veterans Mortgage Program. Only five states provide this benefit: Alaska, California, Texas, Oregon and Wisconsin. According to the IRS rule, to qualify a veteran must have been on active duty before Jan. 1, 1977 and apply for financing within 30 years of being on active duty. As a result, fewer and fewer veterans today can qualify. The limit imposed by the IRS denies post Vietnam-era veterans an essential benefit that should be available to all veterans.

GETTING CONGRESS TO CHANGE THE RULES

The national bipartisan Millennial Housing Commission created by the U.S. Congress in December 2000, examined the importance of affordable housing to the infrastructure of communities throughout the United States. The panel found housing to be “inextricably linked” to jobs, to the health of a community and to the social behavior of families. “Failure to achieve adequate housing leads to significant societal costs,” the commission declared in its final report. Commissioners reviewed federal programs designed to provide better opportunities for families to secure housing. They found that the programs are not solving the problem because the supply of adequate housing in many areas of the country is inadequate. “The inadequacy of supply increases dramatically as one moves down the ladder of family earnings,” they said, adding that the most egregious problem is for the very poor.

AHFC’s Chief Executive Officer, Dan Fauske, was a member of the commission, which was comprised of 22 national leaders of the housing industry and its related fields. Fauske was one of four members that were heads of state housing finance agencies. He convinced his fellow commissioners to include in their final report the recommendation that Congress repeal the limits set by the IRS on the use of arbitrage earnings for affordable housing and to repeal the 10-year rule on mortgage revenue bonds. He also received commission support for a recommendation that Congress repeal the pre-1977 service date for a veteran to qualify for a low-interest-rate mortgage under a state’s “Qualified Veterans Mortgage Bond” program.

ALASKANS UNITED

Alaska’s congressional delegation has indicated strong support for all three tax rule changes. Fauske has discussed the three issues with Gov. Frank Murkowski and has the governor’s support as well. The governor’s Washington, D.C., office is

now helping to coordinate the effort to get support in Congress to approve these three initiatives. Legislation to amend the Veterans Mortgage Program is pending in both the House and the Senate. Provisions to change the IRS arbitrage and 10-year rules are expected to be proposed as amendments to a forthcoming tax bill.

Progress made on these initiatives will be reported on this web page.