WNC & ASSOCIATES, INC.

Oral Testimony by Wilfred N. Cooper, Sr.
Before the Farm Credit Administration
August 3, 2001 – Des Moines, Iowa

Good Morning. My name is Will Cooper, Sr., the chairman and CEO of WNC & Associates, Inc. located in Costa Mesa, California. The reason I am here today is to discuss the shortage of quality rental housing in rural America. I am also here to urge the Farm Credit Administration (FCA) to establish procedures to enable the Farm Credit System's (FCS) entities to make "equity investments" in properties that qualify for housing tax credits, an existing program under Section 42 of the Tax Code.

Our firm was established in 1971 and is the owner, manager and equity syndicator of affordable rental housing properties. WNC currently has over 650 properties totaling over 25,000 rental apartment units in 40 states throughout the U.S. in its portfolio. The value of the assets that we manage for our individual and institutional investors is over 1.3 billion dollars. Many of these properties are located in smaller communities (under 50,000 population) throughout rural America. WNC currently acts as the sponsor and managing general partner of SEC-registered public and private institutional offerings. To date we have completed over 134 funds which include 59 Low Income Housing Tax Credit (LIHTC) offerings. These properties include new construction and rehabilitation of existing apartments. Each fund owns 10-20 properties in multiple states. The average fund size is approximately $25 million and is structured to maximize geographic diversification. The properties in the funds are financed with between 30%-70% mortgage debt.

The growing need for affordable housing in rural America has been well documented. Recent studies have shown that the demand for affordable rental housing exceeds 6 million apartment units nationwide with a need for more than 500,000 affordable apartment units in rural America. The demand is not only just for new apartments. Many rural rental housing units are approaching substandard conditions with deferred maintenance that will require substantial rehabilitation. Currently the rural rental housing stock includes over 17,000 properties including 450,000 rental apartment units. The predominant government agency that has been supplying the bulk of the financing for rural rental housing from the mid 1970's until the very early 1990's has been the Rural Housing Service (RHS) (Section 515 of the Housing Act of 1949 U.S. Department of Agriculture). This federal funding has dropped from one billion dollars in 1981 to less than 100 million in 1999. Findings by Congress shown below indicate that there is a growing housing need in rural areas (see Exhibit A).

- 2/3 of very low-income rural households do not have access to affordable housing units.
- Substandard housing is a problem for more then 500,000 rural renters.
- 165,000 rental units are over crowded.

Our research shows that the FCA has the authorization to allow the FCS to help in this regard. Authority for the organization and activities of the institutions comprising the cooperative FCS and that operate under the regulation of the FCA is in the Farm Credit Act of 1971 as amended (12 U.S.C. 2001) (See Exhibit B). According to the law, the FCA has as an obligation to modernize and improve the authorizations and means for furnishing such credit and credit for housing in rural areas made available through institutions constituting the FCS and the need to retain earnings to protect borrowers' stock.

The aforementioned comments and references have established the need for affordable rental housing in rural America. The FCS, through its regulator the FCA, is authorized to provide for that need. One method to provide for the housing need is to make "equity investments" coupled with Low Income Housing Tax Credit (see Exhibit C) similar to the housing GSE's Fannie Mae and Freddie Mac.

The LIHTC program became law in the 1986 Tax Reform Act. The Housing Tax Credit is generating approximately 100,000 new and rehabilitated rental housing units per year that is going predominantly to the urban and suburban areas, leaving the rural areas with very little or no investor interest in rural communities. Corporate America tends to turn away from rural areas mainly due to lack of familiarity with these smaller communities and smaller transaction size (which drives transaction costs). A summary of the LIHTC follows:

Low Income Housing Tax Credits
- Permanent reduction of federal income tax
- Provide for investment in qualified rental housing

Investment Benefits
- Dollar-for-dollar reduction of annual income tax liability over 10 years
- Tax savings in the form of depreciation and interest

Tax Credits are Law
- Federal tax credits authorized by Section 42 of the Internal Revenue Code
- Administered by the Department of Treasury and various state agencies
- Annual equity investment exceeds $3.0 billion

Valuable Institutional Impact
- Increase net income
- Increase earnings per share/shareholders equity
- Increase retained earnings

The Congress in its wisdom decided this program is now putting “equity capital” to use with the U.S. Treasury in the role of oversight management. In the last few years we have seen “equity capital” playing a more predominant role in providing for affordable rental housing in America.

The major investors are banks, corporations and the housing GSE’s Fannie Mae and Freddie Mac who are making “equity investments” in funds with large properties located mostly in urban and suburban sites.

Therefore, my question today is twofold:

1. Should the FCS, through its individual entities, as a GSE that focuses on rural America, have an interest in pursuing “equity investments” in Housing Tax Credit funds? I think the answer is dependent on each of the FCS’s various tax paying entities [(i.e., CoBANK, Agricultural Credit Association (ACA), Production Credit Association (PCA)] and their boards’ fiduciary responsibility to their stockholders. Obviously, any investment would be approved subject to adequate due diligence and approved underwriting guidelines of the investing FCS entity.
2. Should the FCA provide new regulatory procedures for an “equity investment” that will in turn increase and maintain the supply of affordable rental housing in rural America?

The FCS is a network of borrower-owned cooperative financial institutions and related service organizations, which have varying tax structures. System institutions make rural housing loans in addition to providing credit for many agriculture purposes including housing. It is the oldest of the GSE’s created by Congress. Other major GSE’s such as Fannie Mae and Freddie Mac have a housing mission that focus predominantly on large urban and suburban properties of the U.S. They are the major secondary lenders in housing and substantial equity investors in Housing Tax Credit funds.

However, since Fannie Mae and Freddie Mac equity investments are in predominately metropolitan areas, there is a void of equity investments in rural communities (under 50,000 population). Therefore, the FCA should provide regulations and procedures to allow the FCS tax paying entities to invest in LIHTC funds. This is a fiduciary opportunity benefiting the stockholders which:

1. reduces their federal tax,
2. increases retained earnings, and
3. provides for affordable rural rental housing just as Fannie Mae & Freddie Mac are doing for urban housing.

EXHIBIT A
DRAFT
Updated April 21, 2001

On March 29, 2001, Senator John Edwards (D-NC) re-introduced the Rural Rental Housing Act of 2001 on the Senate floor. The co-sponsors of this bill, number S.652, are Senators Jim Jeffords (R-VT), Patrick Leahy (D-VT), and Paul Wellstone (D-MN).

Rural Rental Housing Act of 2000

Sec. (A) *Findings* – The Congress finds that –

1. there is a pressing and increasing need for rental housing for rural families and senior citizens –

a) two-thirds of extremely low-income and very low-income rural households do not have access to affordable housing units,

b) over 900,000 rural rental households (10.4 percent) live in either severely or moderately inadequate housing,

c) over 19 percent of rural worst case renters live in housing that is at least moderately substandard,

d) substandard housing is a problem for 547,000 rural renters,

e) 165,000 rental units are overcrowded.

2. the rural rental housing stock provided by the federal government has been depleted over the last ten years, as –

a) federal spending for rural rental housing has been cut by 73 percent since 1994,

b) rural rental housing unit production financed by the federal government has been reduced by 88 percent since 1990;

3. many rural American households live with serious housing problems –

a) 28 percent, or 10.4 million rural American households nationwide live with some kind of serious housing problem,

b) one million rural renters have multiple housing problems,

c) the housing problems include lack of basic water and wastewater services, structural insufficiencies, cost burden, and overcrowding,

4. many renters in rural America are cost burdened, paying more than 30 percent of their income for housing –

a) one-third of all rural renters are cost burdened, paying more than 30 percent of their income for housing costs,

b) 92 percent of all rural worst case needs households are severely cost burdened, paying more than 50 percent of their income for housing costs, and 60 percent paying more than 70 percent of their income for housing.

5. rural economies are less diverse, and therefore, jobs and economic opportunity are limited –

a) factors existing in rural environments, such as remoteness and low population density, lead to limited access to many forces driving the economy, such as technology, lending, and investments,

b) local expertise is often limited in rural areas where the economies are focused on farming and/or natural resource-based industries;

c) banks in rural areas are often limited in size, with restricted lending capacities and a narrow scope of local expertise.

6. rural areas have less access to credit than metropolitan areas –

a) banks and other investors, looking for larger projects with lower risk, seek metropolitan areas for loans and investment,

b) often credit that is available is insufficient, leading to the need for interim or bridge financing,

c) credit in rural areas is often more expensive and available at less favorable terms than in metropolitan areas.

EXHIBIT B
Excerpts from Farm Credit Act of 1971

To further provide for the farmer-owned cooperative system of making credit available to farmers and ranchers and their cooperatives, for rural residences, and to associations and other entities upon farming operations are dependent, to provide for an adequate and flexible flow of money into rural areas, and to modernize and consolidate existing farm credit law to meet current and future rural credit needs, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Farm Credit Act of 1971."

Type: Statute
Statute: 1971 ACT AS AMENDED
Title: Introduction
12 U.S.C. 2001 SEC 1.1 POLICY AND OBJECTIVES

a) It is declared to be the policy of the Congress recognizing that a prosperous, productive agriculture is essential to a free nation and recognizing the growing need for credit in rural areas, that the farmer-owned cooperative FCS be designed to accomplish the objective of improving the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit and closely related services to them, their cooperatives, and to selected farm-related businesses necessary for efficient farm operations.

b) It is the objective of this Act to continue to encourage farmer-and rancher-borrowers participation in the management, control, and ownership of a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit, and to modernize and improve the authorizations and means for furnishing such credit and credit for housing in rural areas made available through the institutions constituting the Farm Credit System as herein provided.

c) It is declared to be the policy of Congress that the credit needs of farmers, ranchers, and their cooperatives are best served if the institutions of the Farm Credit System provide equitable and competitive interest rates to eligible borrowers, taking into consideration the creditworthiness and access to alternative sources of credit for borrowers, the cost of funds, including any costs of defeasance under section 4.8(b), the operating costs of the institution, including the costs of any loan loss amortization under section 5.19(b), the cost of servicing loans, the need to retain earnings to protect borrowers' stock, land the volume of net new borrowing. Further, it is declared to be the policy of Congress that Farm Credit System institutions take action in accordance with the Farm Credit Act Amendments of 1986 in such manner that borrowers from the institutions derive the greatest benefit practicable from that Act: Provided, that in no case is any borrower to be charged a rate of interest that is below competitive market rates for similar loans made by private lenders to borrowers of equivalent credit-worthiness and access to alternative credit.

12 U.S.C. 2002 SEC. 1.2. THE FARM CREDIT SYSTEM

a) COMPOSITION. The Farm Credit System shall include the Farm Credit Banks, the Federal land bank associations, the production credit associations, the banks for cooperatives, and such other institutions as may be made a part of the System, all of which shall be chartered by and subject to regulation by the Farm Credit Administration.

EXHIBIT C
LOW INCOME HOUSING TAX CREDITS

<u>History:</u>
The Low Income Housing Tax Credit Program (LIHTC) was created by the Tax Reform Act of 1986 to help offset the loss of incentive provided by the 15 year deprecation for low income rental housing. It was the first (and only) production program to replace the Section 8 New Construction / Sub Rehab program terminated in the early 1980s.

Under the LIHTC, developers of rental housing must meet certain affordability tests:

1. one-fifth of the units must rent at 50 percent of area median income
2. or two-fifths at 60 percent of area median income

If the standards are met and approval is granted in advance of the project, investors receive a ten year stream of federal tax credits. The value of these credits is usually converted into equity in the project, thereby resulting in reduced debt and more affordable rents. In practice, many tax credit projects are undertaken with 100 percent of the units at 60 percent of median. The minimum affordability period is fifteen years.

Tax credits are allocated to developers and must be approved by the states, usually the state housing development or finance agency. Each state receives an annual allocation of $1.25 per capita. In addition, tax exempt multifamily bond issues also carry the credit with them outside of the cap. The $1.25 cap has not been adjusted since the program was created in 1986, but new legislation increased the state's allocation to $1.75 per resident and index it to inflation. Since demand for the housing credit outstrips supply by more than three to one, passage of the bill should greatly expand available resources for affordable housing.

States must reserve a minimum of 10 percent of the credits for nonprofit developers. The program is administered by the Internal Revenue Service within the Treasury Department. An average of 1,300 LIHTC projects and 56,000 units are placed in service each year. The average project size has increased over the years from 28 units in 1988 to 45 units in 1994.

<u>Present Status:</u>
The LIHTC program has long operated under the threat of short-term "sunset" provisions. In fact, it has been suspended on several occasions while last minute extensions of program authority were approved by Congress. In 1993, Congress approved a permanent extension of the program. That was important to it's success because the value of the credits to a limited partner is based, in part, on the partner's confidence in the program's permanence. Many housing developers believed that the doubt and uncertainty caused the market value of the credit to be diminished, thereby reducing the level of housing subsidy eventually available to tenants. In fact, the price that investors now pay for the credits is twenty eight percent higher because permanence has attracted more investor competition.

The LIHTC is now the only affordable rental housing production program available to developers. At a time when the gap is increasing between the number of poor families needing low cost rental housing and the number of affordable units. (In 1993, the American Housing Survey reported a shortage of six million low cost housing units).

Program Benefits:

The LIHTC program has resulted in the development of nearly 800,000 rental housing units since its inception and actually accounts for a substantial portion of all multifamily development in the United States. The program operates on the popular decentralized model that sends control of the money to the states. A concept that both the Congress and HUD now favor. There is a very small staff at IRS that oversees the program with most administrative and monitoring responsibilities delegated to the states.

The LIHTC helps encourage private investment in affordable housing. Since it's inception, over $10 billion in private funds have been invested in LIHTC projects.

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