Testimony, SB 339
Lenny Jurden, Friends of Historic Preservation
Senate Committee on Taxation
February 15, 2012

Mr. Chairman and Members of the Committee – I am Lenny Jurden, representing Friends of Historic Preservation, a coalition of preservation advocates, developers, architects, engineers and investors who are working to revitalize Kansas downtowns and redevelop historic properties. I am here in opposition to Senate Bill 339's impact on Kansas' historic tax credit program, and in support of maintaining the program in its current form.

Our Governor has challenged Kansans to make this decade the decade of economic growth and job creation. Our state's historic tax credit program is an efficient and effective engine of job creation, a vital catalyst to attract capital to our state and a critical driver for rural development.

Because historic preservation is 50% more labor intensive than new construction, historic rehabilitation projects create more jobs – jobs that cannot be out-sourced. During the most recent recession, when new construction virtually ceased, a growing number of rehabilitation projects created much-needed private-sector jobs. The projects would not have moved forward without Kansas' historic tax credit. In the past decade, the Kansas historic tax credit program has created nearly 15,000 jobs and had an economic impact of approximately $700 million. In 2011 alone, the historic tax credit program was directly responsible for 2,000 or 18% of the 11,000 net private-sector jobs created in our state

Historic tax credits are also an engine of capital investment and rural development. In towns and cities throughout Kansas where market rents are low, rehabilitation projects are not financially feasible. The Kansas historic tax credit attracts the capital necessary to allow the projects to get done.

Included with this testimony is a summary of the projects that we have completed in Kansas. None of these would have been feasible without the Kansas historic credits. We are also currently working on two projects in Pleasanton and Colby that could be adversely affected if the historic credit program is changed.

In its current form, the Kansas historic tax credits can be used against income, privilege and premiums taxes. As proposed in Senate Bill 339, the historic tax credits could be used only against corporate income tax. Because the vast majority of the end users of historic tax credits are not corporations, the Governor's plan would reduce the efficiency and effectiveness of the credits for most projects. Limiting the credits to corporate filers would not only drive down the demand and price for credits, hurting most the market for smaller projects. In its current form, the historic tax credit program is a great tool for attracting capital to our state, creating much-needed jobs and making rural development feasible.

Thank you for your consideration. Please do not hesitate to contact me should you have any questions or need additional information.

Sn. Assmnt & Tax
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Attachment # 25

..plement to Testimony on SB 339
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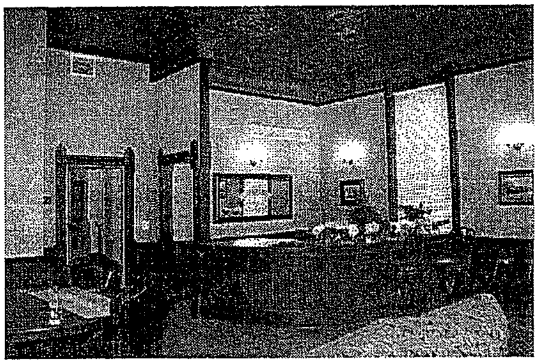
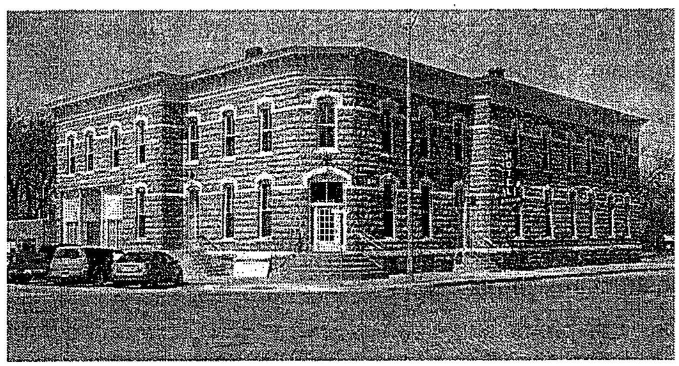
HISTORIC TAX CREDITS SPUR INVESTMENT IN RURAL KANSAS

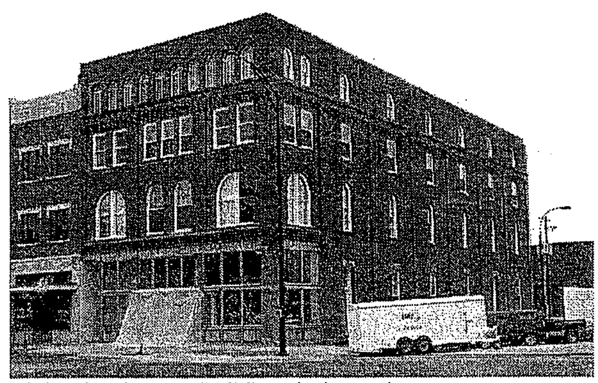
Cohen-Esrey is an affordable housing developer with projects completed across the Midwest. They currently have four projects in various stages of development in small communities in Kansas. All of the communities were very supportive and passionately behind the efforts to provide affordable housing. Each of these projects relies on the federal and state historic rehabilitation tax credits as part of the financing package to make these projects a reality.





Woodson Hotel in Yates Center

- **Maple Senior Residences in Hiawatha, Kansas** – Completed in February 2011, this was a $2 million project that converted a vacant grocery store and adjacent café in downtown Hiawatha to ten senior apartments.
- **The Woodson Hotel on the Courthouse Square in downtown Yates Center, Kansas** – This $2 million project converted the vacant hotel to nine senior apartments returning a building recently threatened with demolition to the local tax roles. The grand re-opening was held in April 2011.
- **The Union Implement Building in downtown Independence, Kansas** – A $4 million investment will convert this vacant building (formerly damaged by fire) into eighteen senior apartments. The first four residents moved into their apartments in December 2011.
- **The Gold Dust Hotel in Fredonia, Kansas** – This recently completed project involved an investment of $2 million converting this vacant historic hotel into nine senior apartments. The project was completed in December 2011.



Union Implement Building, Independence

All of the projects utilize existing vacant properties that are eligible for listing on the National Register of Historic Places and the historic tax credits are essential to the projects' success. The construction projects alone will return nearly half of the value of the state tax credit to state coffers in the form of sales taxes on construction materials and income taxes on construction labor (generating an estimated $220,000 on a $2 million construction project; the value of the Kansas Rehab Tax Credit would be $500,000). The projects will provide affordable housing in the local communities, provide a viable new use for a vacant historic building, and return the building to local tax roles.

Gold Dust Hotel, Fredonia

AFFORDABLE HOUSING FINANCE

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IN THIS ISSUE:

- › FANNIE MAE LOOKS AHEAD AT 2012
- › FHA TO ROLL OUT TAX CREDIT PILOT PROGRAM

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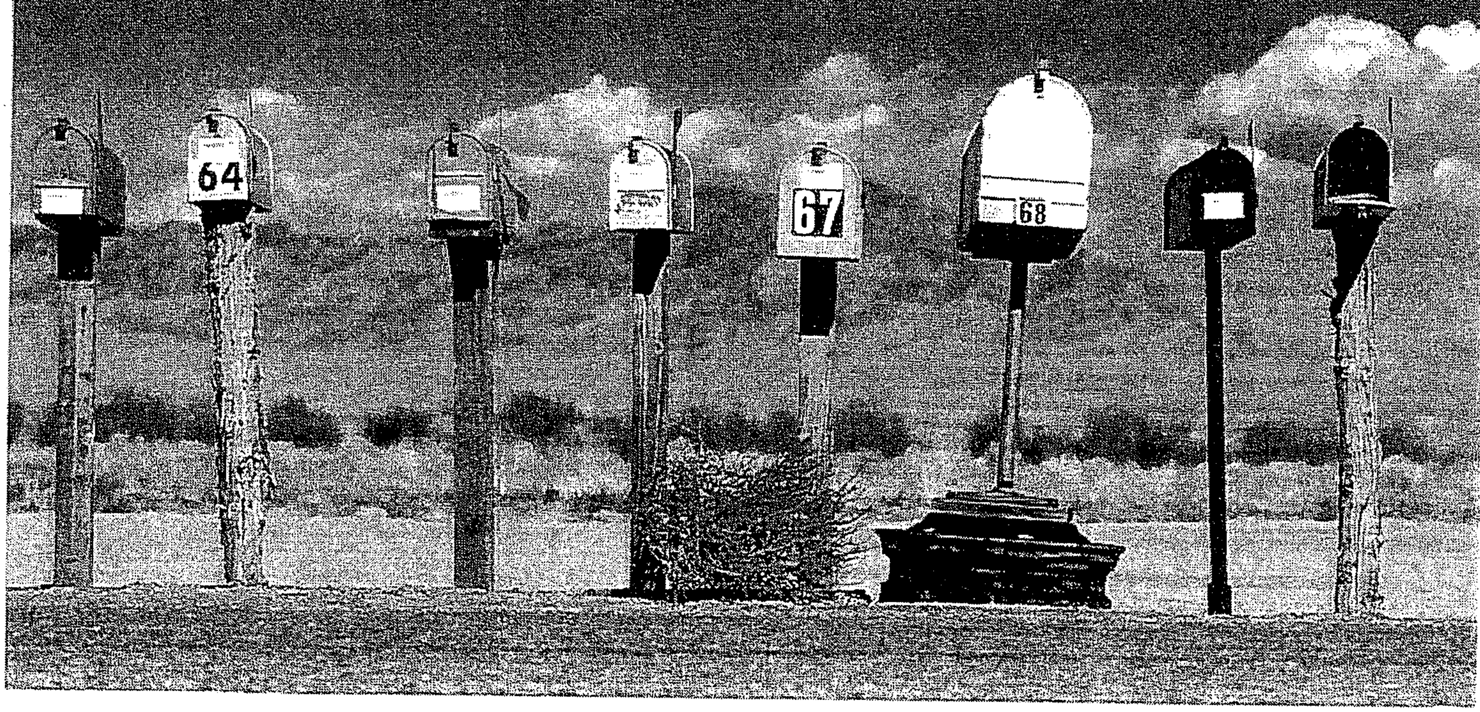
SERVING RURAL AMERICA

Developers are overcoming challenges to provide housing in the nation's small towns

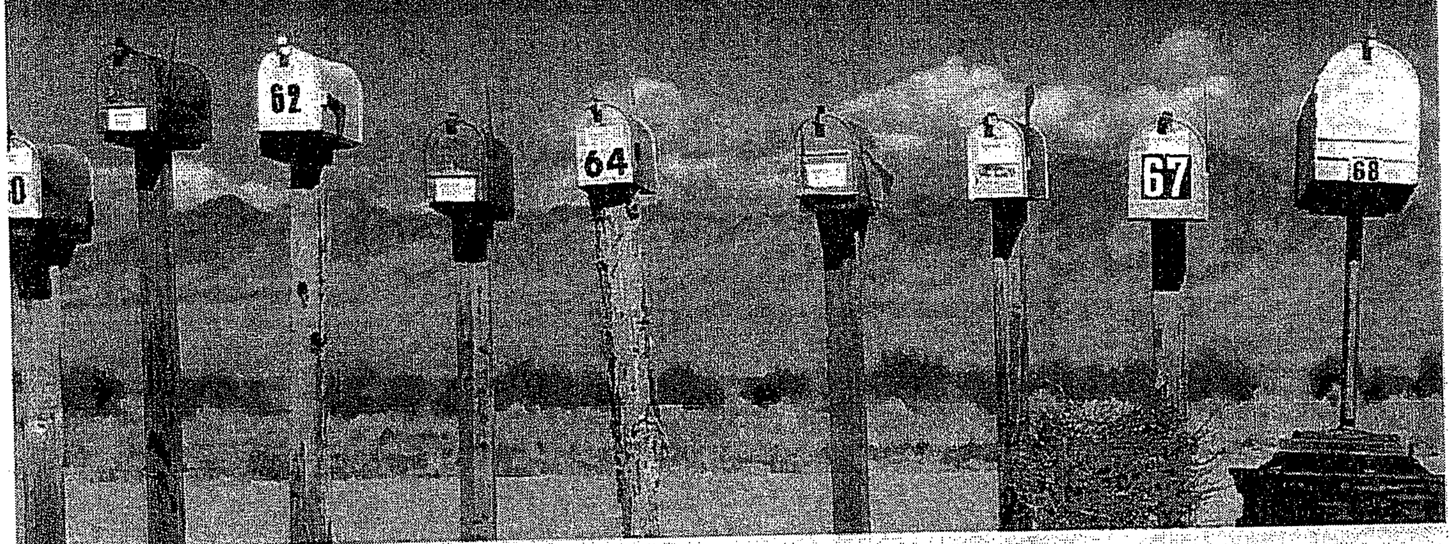


25-3

SERVING RURAL AMERICA

Although these small towns present challenges, developers are overcoming them to provide housing

BY CHRISTINE SERLIN AND DONNA KIMURA



Yates Center, Kan., population, 1,417.
Welsh, La., population 3,226.
South Pittsburg, Tenn., population 2,992.

These are just a few of the small rural communities where affordable housing developments have recently opened.

"Small towns are still small towns. The thing that has become more challenging are the resources that are available to make these deals work in small towns," says R. Lee Harris, president and CEO of Kansas City-based Cohen-Esrey Real Estate Services, LLC.

Rural housing projects are often smaller than developments built in other markets. Although it may seem like a small deal would be easier to put together and finance, it's usually the opposite. They're harder to do.

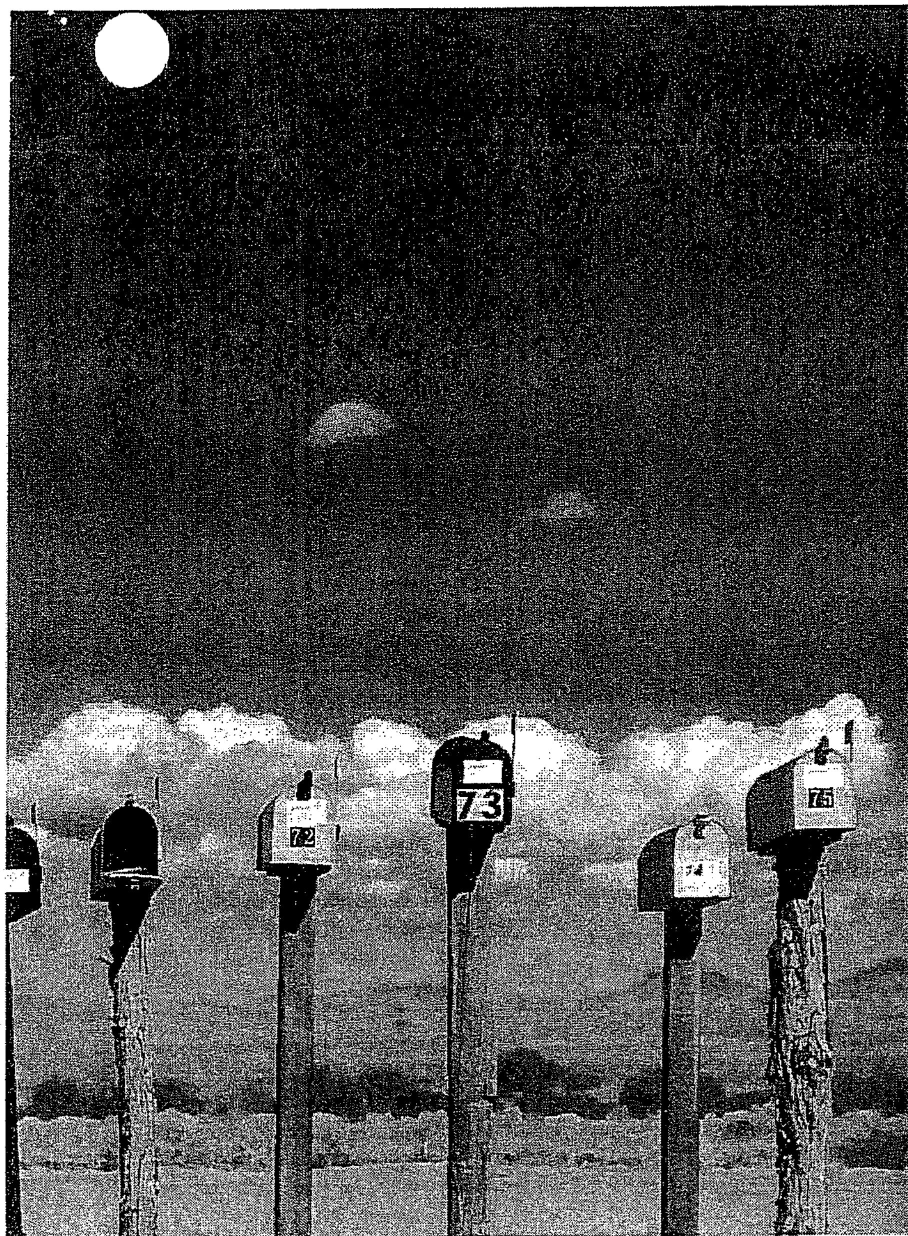
There are funding programs aimed specifically at building or renovating affordable housing in the rural areas. However, just like everything else, these funds have become fewer and harder for developers to obtain.

According to Colleen Fisher, executive director of the Council for Affordable and Rural Housing (CARH), challenges in the rural development arena started back in the mid-1990s, when some negative perception surrounding the U.S. Department of Agriculture's (USDA's) Sec. 515 program surfaced. Negative articles came out in the press, and there were some obvious budget issues at the time. As a result, Sec. 515 was looked at as a program that could be substantially cut to fund other USDA programs.

"The program itself never really recovered from some of those articles and the decisions that were made at that point," she says.

At that point, the low-income hous-

25-4



ing tax credit (LIHTC) became a more important tool for developers working in these rural areas. There was also a need for a lot more subsidy layering—rural developers worked to get other sources of financing, such as HOME funds, Federal Home Loan Bank Affordable Housing Program funds, and state housing trust funds to make their deals work.

Harris says initially tax credit syndicators had interest in the smaller towns, but that interest has become less intense over the years. The fund sizes are much larger today than they were in the mid-1990s, and those larger fund sizes make smaller projects less attractive. It costs them as much money to underwrite smaller deals as it does larger deals, so the small deals don't get quite the same attention.

And when the financial markets imploded about three years ago, the rest of the country now had to operate the same way and layer even more different sources of funding. "Welcome to the world of rural," says Fisher.

The LIHTC market meltdown had a big impact on rural deals. There had been a limited number of investors who would invest in the rural deals. But after Fannie Mae and Freddie Mac imploded, a void was left. The larger banks didn't get involved with smaller deals, unless they needed to meet their Community Reinvestment Act (CRA) obligations. Some of those banks would invest, but it was strictly on a regional basis.

"Getting investors to invest has always required a lot more work on the part of the rural builders, developers, and owners," says Fisher. "The ability to attract investors continues to remain an issue."

Banks, which are the major LIHTC investors, like to focus their activities in regions that help them meet their CRA requirements. For large national banks, that's the country's urban centers on the East and West coasts, not rural regions.

Another issue for rural developers has been the financing from USDA Rural Development. "The support within the administration on rural housing has been minimal at best," Fisher says.

The multifamily side of the equation has been a real issue for CARH, and the organization was able to save a program that was on the chopping block—the Sec. 538 loan guarantee—for fiscal 2012. The program, which has evolved and become popular in the preservation arena, will now be fee-based. "We had to fight tooth and nail," Fisher says, adding that it's now a no-cost program in 2012.

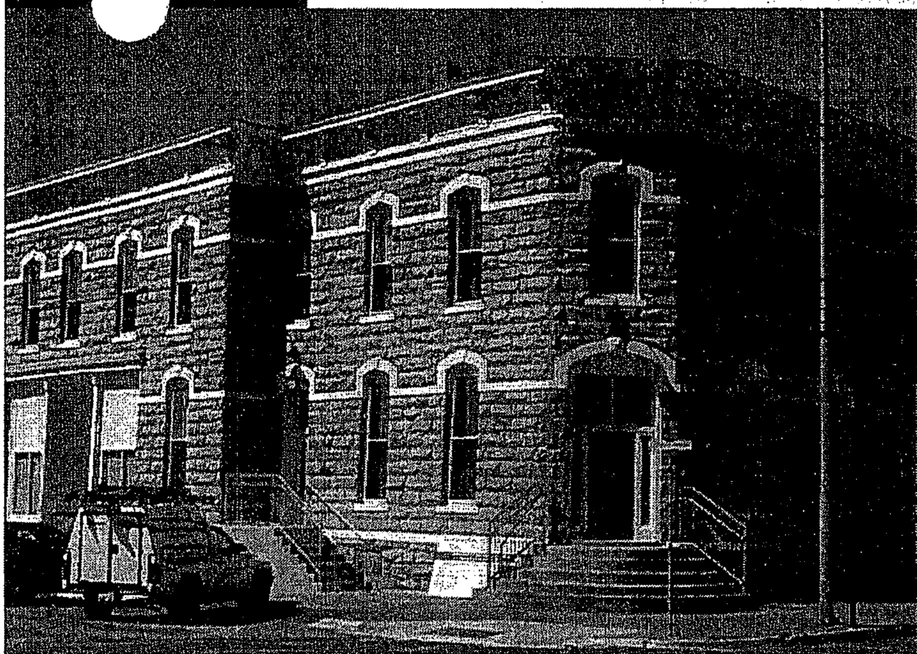
"We are constantly in the battle within USDA fighting for scarce resources," she says. Fisher says within the USDA, there's a lot of emphasis on the single-family side, and resources for multifamily housing programs are being weighed against other major priorities for the agency, such as rural business loans and broadband development.

Financing may be the biggest hurdle for developers, but it's not the only one.

The availability of skilled labor to build projects in the rural areas is also a challenge. "Contractors during the downturn have fallen by the wayside since they couldn't make it," Harris says. "What we're left with are larger established contractors, which are more expensive and not as easy to get into small towns." He adds that it's also been hard to find multiple subs who are qualified to bid on the projects.

However, developers are overcoming these challenges with some creative models.

25-5



Cohen-Esrey used both federal low-income housing tax credits and historic tax credits to complete a historic rehab on Woodson Senior Residences in Yates Center, Kan.

Serving seniors in small towns

Cohen-Esrey has a long history in the rural housing business, starting with managing projects in the 1970s and then developing in rural areas under the LIHTC program starting in the 1990s.

As times have changed, Harris says the company has created a model for developing in these rural small towns.

"We've been successful going into the market and looking at the seniors demographic," he says. "There are hundreds and thousands of small towns around the country where the population is stagnant or declining, but the number of seniors is increasing. Safe, decent affordable housing for seniors in small towns in decline is very difficult, but [these towns] are their homes."

To address the affordability issues in these areas, the company strives to eliminate debt from its projects so it can drive the rents even lower. "If you're going to accommodate seniors in a small town, the rental rate needs to be in the $400 to $450 range," Harris says, "and you can't do that if you have debt."

Since the traditional LIHTC debt doesn't work in these communities, he says it's hard to build new developments so the company has turned to historic renovations to utilize both historic tax credits and federal LIHTCs.

One example of this model is the Woodson Senior Residences in Yates Center, Kan.

The building was originally built in 1886 as a hotel, where Jesse James, Teddy Roosevelt, and Wild Bill Hickok all once stayed, and Cohen-Esrey turned it into 10 seniors units financed with 9 percent LIHTCs as well as federal and state historic tax credits.

However, the project, which was completed in April 2011, did run into some trouble. Although there was huge interest in the project and the market study showed a capture rate of 4 percent, lease-up was slow because many prospective residents were overqualified.

"This is part of the challenge of working in small towns," Harris says. He adds that when you have a county where the area median income is so low, there are even seniors on Social Security whose income sources are too high to qualify.

Cohen-Esrey worked with the state to open the project up to all ages and, since the community has a long waiting list for Sec. 8 vouchers, instituted its own interim

SMALL DEALS ADD UP

A large number of rural developments are in need of recapitalization and rehabilitation. The challenge is many of these projects are small, making each very difficult to finance on its own.

To help solve this problem, Merchant Capital has been bundling multiple small rural deals into single large bond transactions since 2008 to make these deals more feasible. It first pooled 20 projects that were scattered across 15 counties in South Carolina into a $29 million bond issue through the State Housing Finance and Development Authority, says John Rucker, executive vice president at the firm.

The projects involved were almost all under 100 units.

Since then, Rucker has closed a second pooled deal in the state involving 41 properties in 23 counties. He's also done similar transactions in Florida and North Carolina and is in the early stages of a new package in Georgia.

"These are existing Sec. 515 Rural Development deals originally financed in the 1970s and in need of rehab," Rucker says. One of the keys to make the transaction work is to subordinate the existing debt on the project.

The deals have utilized 4 percent low-income housing tax credit (LIHTC) equity and short-term tax-exempt bonds. Merchant Capital has also been able to bring in bank letters of credit or cash collateralized bonds on its short-term structures and is working with the Rural Development Sec. 538 program and Fannie Mae on projects where longer-term debt is needed.

An advantage of using the bonds is a developer doesn't have to compete for 9 percent tax credits. The 4 percent credits come automatically with the bonds. However, deal structuring can be more complicated because a developer has to coordinate with more sources, including the state Rural Development Agency, the bond issuer, the state housing agency on the equity side, the bond underwriter, and bond counsel. The costs involved make small deals of say $1 million or so very difficult to pencil out. However, multiple projects pooled together can share in the costs to make the bond issuance work and make the transaction more attractive to LIHTC equity providers.

25-6

voucher program through funds available from the capital stack to help the lease-up.

The company's vertical integration has also made it easier to work in these communities.

Developing with Sec. 538

Madison, Miss.-based Arrington Developers has developed 35 affordable housing developments in rural areas, of which 28 are single-family home properties and six are elderly properties.

The firm recently completed 32 single-family rental homes in Welsh, La., using 9 percent LIHTCs, Tax Credit Assistance Program (TCAP) funds, and USDA's Sec. 538 permanent financing. The equity provider is Alliant Capital. Arrington Developers also completed a 40-unit single-family development in South Pittsburg, Tenn., using Sec. 1602 funds and Sec. 538 permanent financing.

Sec. 538 loans have been used on 19 of the firm's rural deals in Arkansas, Louisiana, Mississippi, and Tennessee. The program is critical because it provides rural multifamily developments with 40-year loans at below-market interest rates. USDA provides a loan note guarantee for 90 percent of the permanent loan amount, which coupled with equity from the sale of LIHTCs creates a sound financial transaction. "It makes a lot of deals hum," says President Dale Lancaster.

Every project, whether it is rural or urban, has its own challenges. "Most of the time rents will be lower, reserves will be higher, and LIHTC pricing will be lower for a rural deal vis-à-vis an urban deal," Lancaster says.

It's not uncommon for rural developments to require $100,000 to $120,000 in replacement and operating deficit reserves. Consequently, there is more often than not a need for some "soft money." "In Welsh, we were able to obtain TCAP funds. In South Pittsburg, we used 1602 funds. Several of our developments have HOME funds," Lancaster says.

The small size of rural deals presents another big challenge—managing the property. The developments are often not large enough to have a full-time manager or maintenance staff. Project sizes are routinely 24 to 48 units. Ideally, a property can share a manager with another in the area.

"It's been a lot of fun developing rural projects," Lancaster says. "All of the USDA agencies in the states we work have bent over backward to cooperate, and the mayors of the towns seem to really appreciate what we do."

What's ahead

In 2012, CARH's Fisher says she is hoping that the Sec. 538 program will be looked at a lot more by developers since it's a valuable tool. The organization is also still trying to push to get the House Financial Services Committee and the Senate Banking Committee to pass some preservation legislation that will provide more tools for rural developers.

And it is looking at continuing to promote and lobby for the LIHTC, its role in rural transactions, and the need for the program to continue.

"There's no question of the fact of what further deficit reduction would mean in terms of tax reform," she says. ■

RURAL BRIEFING

WHERE DOES RHS FIT?

Some lawmakers are wondering if Rural Housing Service (RHS) should become part of the Department Of Housing and Urban Development (HUD). RHS has long been within the U.S. Department of Agriculture (USDA).

A subcommittee of the House Finance Services Committee has held recent hearings on the possible move.

Carol Galante, acting assistant secretary and Federal Housing Administration commissioner at HUD, testified last September that HUD and USDA have been working to align their rental programs. She said the administration believes it makes sense to continue to focus on those efforts rather than a more extensive reordering of the programs.

USDA officials also want to keep RHS program under their wing. "While RHS and HUD share an important commitment to meet the housing needs of rural America, we believe that the mission and delivery of programs in RHS and HUD are different and distinctive," said Tammye Treviño, RHS administrator.

REDUCING RED TAPE

Six states will pilot programs that aim to reduce regulatory burdens and avoid duplicate inspections for rental housing that is subsidized by more than one federal agency. Michigan, Minnesota, Ohio, Oregon, Washington, and Wisconsin are taking part in the initiative that seeks to better coordinate the policies of HUD, USDA Rural Development, and Treasury.

When developers use funding from multiple agencies, they have regularly faced duplicate requirements and extra paperwork.

In 2009, HUD, USDA, and state housing agencies performed close to 24,000 separate inspections on about 11,000 properties.

N.D. CONTINUES SURVEY

The North Dakota Housing Finance Agency (NDHFA) will continue to fund its Housing Market Survey Grant program that encourages rural communities to conduct a needs analysis before undertaking new housing developments.

The Industrial Commission voted in November to provide an additional $50,000 to the program.

Communities of 20,000 or fewer people or nonprofits representing or partnering with such communities are eligible for the grants, which reimburse up to half of the out-of-pocket costs of a survey, not to exceed $5,000 per community.

Since launching the program, NDHFA has provided more than $185,000 in matching grants to 16 countywide and 24 community studies of housing needs.

25-7