TESTIMONY

United States Senate Budget Committee
Field Hearing, Williston, North Dakota
Honorable Senator Kent Conrad, Chairperson
Tuesday, June 1, 1:00 p.m. CST

State of Housing in western North Dakota

After having gone for decades without any significant housing development, western ND has been thrust into an environment that is marked by change and rapid pace growth.

As a non-profit housing developer working in North Dakota, Lutheran Social Services has the opportunity to meet and work with community leaders from all across the state. These individuals are doing what they can to grow their communities, not just for today but for the future.

For many years, economic development was the buzzword for community leaders. Today, after achieving some success in the quest for the holy grail of economic activity and job creation, communities are finding that basic community services – like infrastructure and housing – can prove to be an ultimate limiting factor to continued growth.

In the simplest terms:
Without housing – workers can't work.
Without housing, families can't make a community a home.

With North Dakota being the envy of many states whose economic fortunes are less bright, and with all the economic success this region of the state has seen, do we need to talk about affordable housing? Won't the market just take care of what's needed?

Unfortunately, the answer is no. The market can't address affordable housing in a meaningful way – not without assistance. Not in urban America, and not in rural America either.

Why?

1. Building housing in rural communities can be even more costly than building in more urbanized areas. Projects tend to be smaller in size, which means that it is difficult to take advantage of economies of scale. Proximity to labor and materials is somewhat limited, which can drive up costs.

2. Financing housing projects in rural communities also presents unique challenges. National secondary markets are seldom designed to understand and/or appropriately value rural real estate projects. Appraisal standards make it difficult to identify "acceptable" comparable sales. And lenders often struggle to meet loan to value guidelines because of these gaps in valuation.

In addition to these cost factors, rural markets tend to be less attractive to many in the real estate industry.

3. Economic returns and economies of scale tent to be better elsewhere. The risk/reward ratio does not entice most large developers to enter rural markets.

4. The programs available to assist with financing affordable housing are complex and require a unique business model to successfully integrate them into daily operations. Again, many in the industry shy away from smaller projects in smaller markets because the paperwork burden is the same whether you are building 12 units or 72. And the return on 72 units is much better than it is on 12.

5. In smaller markets, it is also more difficult to maintain appropriate market share. An active developer can quickly come to control a large portion of the rental housing market in a rural community, again introducing unwanted risk for already risk-sensitive investors.

If a project is trying to maintain affordable rents, all this suggests that rural affordable housing projects typically require development subsidies to work economically. In our experience, a project that is striving to offer affordable rents will need at least a 50 percent equity position to make project economics work.

Absent development subsidy, rents will rise to levels that are unsustainable for long term occupancy, and unaffordable for all but the highest income families.

Who needs affordable housing?

The popular perception of oil country in western ND is one of instant millionaires and widespread prosperity. I suppose this is true in a limited sense. Fortunes have turned for many families because of oil revenues and energy-related employment. But for others, the rapid change in the housing market has caused financial hardship and thrown them into personal economic crisis.

1. Housing units that had previously been "affordable" to low and moderate income wage earners and retirees may suddenly become unavailable because they are sold to new owners and re-purposed to meet other housing needs. These families are then required to move and search for housing that often does not exist.

2. Even if physical displacement does not occur, economic displacement often does. Rents are rising in many housing projects that were previously affordable. While there is no doubt that some market adjustment was probably warranted (because rents were too low to be sustainable before), the extreme changes in price seen in many energy sector communities has caused significant financial hardship for low and moderate income households.

3. Housing demand has far outstripped housing supply in most western ND communities. As such, many families who have moved to ND to work are forced to live in marginal conditions, often homeless while waiting for suitable housing to become available.

4. This issue doesn't just affect new arrivals. Individuals who lose housing because they can no longer afford market rents can be thrown into homelessness or an otherwise precarious housing situation because they have no viable options.

Is the western ND housing issue one of availability or affordability?

In other words, if we built more market rate housing would the problem be solved?

In one sense, **Yes**. More housing – of any type – takes the pressure off of the supply side of the market. But since the market will only produce units it can afford to produce, we can't expect this housing to serve everyone's needs. In a roundabout way, all new housing helps alleviate the housing crisis because it affects the availability of housing, thus decreasing overall housing market pressures.

But in another sense, **No**. The risk/reward ratio that applies to housing development in rural North Dakota will not usually create housing that is affordable to the average, main street worker.

This is where the difference between availability and affordability becomes most stark.

The unfettered, unassisted market will not create housing units that are affordable to low, moderate, and middle income households. And most older, low rent units no longer exist because market pressures have forced rents upward. This means that people earning moderate wages ($12/hour or less) will often struggle to make ends meet. Unless they are willing to become homeless, their housing budget begins to overwhelm their overall household budget, and other non-housing expenditures must be curtailed.

In a market like the one in western ND, without housing that is tied to affordability requirements, market pressures will eliminate any latent affordability that does happen to exist. Rental market dynamics will feel more like San Francisco than Stanley. And situations like the one in Mountrail County today, will become more common.

In Mountrail County, the County Housing Authority has had Section 8 vouchers go unused. Not because no one needs the rental assistance, but because the families who need the assistance can't find apartments they can afford to rent and/or that are renting at or near HUD's allowed fair market rents. These housing markets essentially went from semi-depressed to hyperactive in a period of less than two years. Communities that had traditionally seen HUD's fair market rents as a "high rent" are now only able to see rents at those levels in their rear view mirror.

What can the federal government do to help address the housing shortage in western ND?

Put simply, the answer to the hearing topic is that housing markets in western North Dakota have been stressed by the economic activity associated with energy development, and that increased development of affordable rental housing in rural North Dakota is important for continued community success.

With both single family home prices and apartment rents rising rapidly because of an imbalance between supply and demand, there is no single solution that will alleviate the crisis. But there are several things we can do to help bring the market back into balance and I appreciate the opportunity to talk about how federal actions could spur that development.

1. **<u>Continue programs that work for rural housing</u>**

   USDA Section 538 Rental Housing Guarantee is a multifamily loan guarantee offered by USDA Rural Development to provide long term fixed rate financing for multifamily projects in rural communities. The program holds real promise as a mechanism for stable, long term fixed rate financing to support a wide variety of housing project types.

   USDA MPR (Multifamily Preservation and Revitalization) is a USDA pilot program in its fifth year as a demonstration. It essentially allows USDA Rural Development to work with new and current owners of USDA subsidized rental properties to refinance existing debt and re-capitalize aging projects to ensure their long term sustainability and affordability. Seeing this program made permanent would go a long way to helping the USDA stabilize subsidized housing projects all over rural America. Without MPR, preservation of existing affordable USDA 515 housing becomes even less feasible than it is today.

2. **<u>Make existing affordable housing tools work better for rural projects</u>**

   Rural projects often struggle to complete for limited investor resources. As you know, Mr. Chairman, rural North Dakotans are conditioned to help themselves. There are numerous examples of communities that have banded together to invest in their own future success.

   I had the privilege of working with people in the community of Ray, which is 25 miles east of Williston, to build three new single family homes. They wanted to make sure that families who were interested in living in Ray had the opportunity to do so. When we started the project, there was no housing available in the community.

   More than 20 individuals and businesses from that community decided to invest in themselves by buying shares in a community investment pool. They then tasked these resources with the job of creating new housing. Lutheran Social Services worked with First National Bank and Trust out of Williston and CommunityWorks North Dakota out of Mandan to help the Ray investors leverage their resources to get all three homes built and sold. They, like many small town residents, were willing to invest in themselves. In this instance, they had the opportunity to do so.

   This is not always the case for other types of affordable multifamily housing. I would argue that locally-engaged capital sources exist. I believe these resources can be mobilized to create affordable housing in rural communities — if they are given the opportunity to invest.

   The low income housing tax credit program (LIHTC) is arguably the most important tool for creating affordable housing of the last 25 years. Yet LIHTC doesn't always work well in rural areas. There are four program reforms that could directly benefit production of affordable, tax-credit financed housing in western ND.

   1. **Extend the Tax Credit Assistance Program (TCAP) to include 4% credits.** This would open the door to more projects, given the competitive nature of the 9% credit program. 4% credits are more readily available than 9% credits (since they are awarded non-

competitively) and could help smaller projects successfully use this resource to fund affordable housing projects.

2. **Bring more investors into the LIHTC program.** Within the last 5 years, the national pool of tax credit capital has decreased. As traditional equity investors like Fannie Mae, Wells Fargo, and other large national corporate investors, have seen reduced profits and an accompanying reduction in their appetite for an income tax credit, the availability of capital to affordable housing projects has been cut almost in half.

   There are several solid proposals to increase the investor pool and, consequently, the capital available to support affordable housing development. These reforms will lead to better pricing – more dollars per credit – producing more equity, and ultimately making more affordable housing developments—including rural projects—financially feasible.

   a. Allow carryback of tax credits for 5 years. This provision, currently included in S. 3141 and S. 3326 assures investors that they will be able to use the tax credits they are buying, even if their income tax liability is fluctuating from year to year.

   b. Allow people to invest in their communities by creating tax credit certificates for small project investors. Current tax credit regulations only allow real-estate-development professionals to invest their resources in LIHTC projects. This prohibits many sources of local capital (individuals and businesses) from using the tax credit program as a mechanism to help their communities. The provision could be applied specifically to small (ex. projects with less than $1,000,000 in tax credits) or rural projects as a way to boost the availability of equity in smaller projects that often struggle to attract national investors.

   c. Include S Corporations in the list of entities eligible to invest in tax credits. As an example of the impact this change could have on equity sources in rural areas, it is my understanding that roughly 60% of community banks in the Midwest would are in this category and would now be allowed to help their communities by becoming tax credit investors. Another potentially significant source of locally-grown capital made available to investment in affordable housing.

3. <u>Help create new affordable housing</u>

Create the National Housing Trust Fund. The availability of equity is essential to the creation of affordable housing. Minimizing project debt is the only way to help keep rents low. The proposed National Housing Trust Fund could be an important source of equity for both rural and urban affordable housing projects, helping to fill the need for equity that exists in projects that offer affordable rents to low and moderate income households.

Closing

Enterprise Community Partners, the ACTION Network, and many others from around the country have identified tax credit reforms as essential to opening to door to more affordable housing development. They will have a positive impact not only on urban projects, but on rural as well. **More investors bring more capital which opens the door to more projects in places that are otherwise likely to be overlooked.**

Tax credits haven't always been a big source of development capital in small town ND but, I believe the importance of this tool, both the 4% and 9% credits, will increase, given the current market pressures. We are seeing more and more situations where subsidized apartment units are being taken out of their respective subsidy programs (HUD or USDA) so their owners can rent them on the open market.

The owners are making a logical economic decision in that they can realize greater returns in today's housing market by renting the units without rent and income restrictions imposed by the subsidy program. But the impact on low income households is extremely deleterious.

Once these units are lost, they are virtually impossible to replace. Even if we can build new affordable units with LIHTC and other affordable housing programs, the rent subsidy that was previously available to the tenants is gone.

However, I would still argue that replacing lost affordable units is extremely important, and LIHTC can be key funding source for these new affordable housing projects. They will provide a long term guaranteed source of income targeted rental housing that will remain affordable for at least 15-30 years. In a market that is as volatile as western NDs, that assurance of available affordable housing is critical.

People are desperate for housing. They are desperate to reunite their families and make a home together – in rural North Dakota. But living in a camper, or a car, or a room in someone's basement is not a sustainable lifestyle. Good jobs or not, people won't stay if they can't build a life. And safe, quality, affordable housing is an essential component of continued community success.

As a non-profit housing developer working in rural North Dakota, we feel privileged to have the opportunity to engage with communities in addressing these challenges. Lutheran Social Services of North Dakota is committed to strengthening communities and families, and we stand ready to assist North Dakota communities in building a stronger future.

Respectfully submitted,
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