

**ISSUE: WORKING FAMILY MIXED INCOME RENTAL HOUSING
PRODUCTION PROGRAM USING TAX-EXEMPT BOND FINANCING**

Issue: This proposal addresses three key affordable housing issues:

- **Market Rent Inflation.** Recent rent growth has outpaced income growth for many renters.
- **Market Rate Production.** In many areas, there is a shortage of market rate units.
- **Availability to Voucher Holders.** There is a general shortage of adequate units eligible for the voucher program and whose owners will accept vouchers, especially in low-poverty areas.

Discussion: See the background paper on this topic. This proposal would expand the use of tax-exempt bond financing for multifamily housing, thereby reducing the rents required to support feasibility. Eligible properties will have most units unregulated, with rents at market levels (but at lower rents than would have been the case absent the tax-exempt financing). The remaining units will have regulated rents at least 10% below market, will be available to voucher holders, and will be used to create a mixed income community.

This proposal is intended to stimulate significant new production of apartments, on the order of 50,000 units per year, thereby addressing each of the three issues outlined above.

Recommendations: The Task Force makes the following recommendations, for adoption by the Commission:

1. **Rent and Affordability Provisions.** The Commission recommends the following requirements for eligible properties:
 - 1.1. **Percentage of Below-Market Units.** 20% of units will carry below-market rents. *20% is recommended, to be consistent with mixed income lessons learned.*
 - 1.2. **Rent Level for Below-Market Units.** The below-market units will carry rents at the lower of:
 - 1.2.1. **10% Below Market.** 90% of the market rent currently charged for the remaining units.
 - 1.2.2. **Affordable to Target Households.** HFAs will publish income limit percentages, not lower than 60% and not higher than 80% of AMI, in accordance with housing needs. The percentage may vary by location. The maximum rents (including tenant-paid utilities) will be no higher than 30% times the published percentage of AMI. The percentage in effect when construction is commenced will stay in effect for the duration of the use agreement.
 - 1.3. **Availability to Voucher Holders.** The below-market units will be strongly targeted to voucher holders. See the background paper for a discussion of potential approaches. *Recommended provisions are attached as Appendix 1.*
 - 1.4. **Term of Rent Restriction.** The requirements of this item 1 will apply for a term of fifty years. *50 years is consistent with other Commission discussions of affordability restrictions.*

2. **Allocation of Incremental Vouchers.** The Commission recommends that Congress provide 10,000 incremental vouchers annually, to be provide as “first use” vouchers for occupants of the below-market units in eligible properties as the units are completed. *To provide additional assurance that the below-market units will actually increase the stock available to and occupied by voucher holders.*
3. **Changes to Tax-Exempt Financing Statutes.** The Commission recommends the following conforming changes to applicable portions of the Internal Revenue Code:
 - 3.1. **Private Activity Cap.** Eligible properties will not be subject to existing limits on the issuance of Private Activity Bonds. *To make tax-exempt financing generally available for this type of mixed income development.*
 - 3.2. **Private Activity Bond Rent and Affordability Requirements.** For eligible properties, the requirements under item 1 will be substituted for requirements under existing law.
 - 3.3. **Private Activity Bonds and LIHTC.** For eligible properties, 4% LIHTCs will be available with respect to the below-market units only.
 - 3.3.1. **High-Cost / Tight Market Areas.** For eligible properties in areas with high development costs and tight markets (under criteria to be determined), 4% LIHTCs will be available with respect to all units meeting LIHTC rent and income requirements. *This is intended to include at least New York City, Boston, and San Francisco, and areas with similarly severe housing problems.*
4. **Credit Enhancement.** The Commission recommends that FHA risk-sharing be available for eligible properties but that normal FHA mortgage insurance not be available unless the State pays the “credit subsidy” associated with such FHA insurance (assuming 50 basis points in annual mortgage insurance premiums to be paid by the property).

Other Relevant Factors:

5. **Budget Scoring.**
 - 5.1. **Tax-Exempt Feature.** The “tax expenditure” for each unit created (market and below market) is estimated to be between \$15,000 and \$16,000. Over the federal ten year scoring window for tax expenditures, the creation of 50,000 units per year (500,000 units in the aggregate) under this proposal would have a “scoring” cost of \$7.8 billion in foregone tax revenues.
 - 5.2. **Incremental Vouchers.** At a per-voucher cost of \$6000 per year, the 10,000 incremental vouchers in the first year would require an appropriation of \$60 million. The second year would require twice that amount, plus adjustment for inflation, and so on.
 - 5.3. **Payment Standard.** If, as recommended, the legislation provides that the normal payment standard will be increased to the below-market rents for eligible properties, that provision would require appropriated funds as well. Moreover, the legislation would require a provision that those vouchers would be allocated at the property-specific higher payment standard rather than at the PHA’s normal payment standard.

**APPENDIX 1: RECOMMENDED PROVISIONS FOR TARGETING
BELOW-MARKET UNITS TO VOUCHER HOLDERS**

6. **Project-Based Vouchers.** Project-based vouchers may be used for some or all of the below-market units, at the option of the developer and local voucher administrator. *Whether this is a good idea will vary from property to property.*
7. **Payment Standard.** One of the following two approaches will be followed:
 - 7.1. **Rent Level.** The below-market rent level in item 1.2 above will be amended by adding a new item 1.2.3 equal to the then applicable payment standard for the voucher program. *This approach recognizes full cost up front but will require a complicated provision to protect the owner against future decreases in the payment standard.*
 - 7.2. **Definition.** The payment standard is defined to be the rent level in item 1.2 above, with respect to the below-market units in eligible properties. *This approach is less complex but will result in increased voucher cost for some eligible properties.*
8. **Occupancy Requirement.** If the property does not have a project-based voucher agreement, the owner will agree that a percentage of the below-market units will actually be occupied by voucher holders. *The Task Force recommends this option in lieu of item 9 below, as consistent with outcome-based compliance instead of regulations and top-down enforcement.*
 - 8.1. **Percentage.** The occupancy requirement will apply to fifty percent of the below-market units. *50% is a material requirement but not so high as to invite implementation problems and regulatory complexity. Reasonable arguments can be made for a higher percentage. Higher percentages will, however, call for a ‘best efforts’ protection for the owner in the event voucher holders do not apply or do not select the property.*
 - 8.2. **Owner Protection.** The requirement will be reduced if the number of vouchers in circulation declines. *A necessary protection for owners.*
9. **Alternative to Occupancy Requirement.** If an occupancy requirement is not required, the owner will be required to comply with the following:
 - 9.1. **Nondiscrimination.** With respect to the below-market units, the owner will not discriminate against voucher holders.
 - 9.2. **Rent-to-Income.** If the owner normally requires a minimum income, for voucher holders the minimum income will be based on the portion of rent to be paid by the family instead of the entire rent.
 - 9.3. **Outreach.** The owner will agree to create and maintain linkages with local voucher program administrators. The owner will agree to participate in any local “registries” of units available to voucher holders.
 - 9.4. **Notification of Vacancies.** With respect to the below-market units, the owner will notify local voucher administrators when vacancies occur.

**WORKING FAMILY MIXED INCOME RENTAL HOUSING
PRODUCTION PROGRAM USING TAX-EXEMPT BOND FINANCING
QUESTIONS AND ANSWERS**

Q: Is there a shortage of rental housing that is affordable to working families with incomes above the “very low” range?

A: Nationally, in 1997, roughly 865,000 working families with incomes between 50% and 80% of AMI, and roughly 475,000 working families with incomes between 80% and 120% of AMI, had critical housing needs¹. The degree of shortage varies widely across the country, with some metropolitan areas having problems two to three times as severe as the national average². This program recognizes that we need additional production of moderate-income units as well as additional production of units targeted to those with lower than moderate incomes.

Q: Doesn't research show a surplus of units that are affordable to moderate-income households?

A: Nationally, the absolute number of units with rents affordable to households between 50% and 120% of AMI is greater than the number of renter households with incomes in that range³. However, large numbers of those units are occupied by households with lower incomes who cannot find housing at rents affordable to them, and by households with higher incomes. Moreover, the national-average conditions do not occur in every local market. The result is that, in many areas, moderate-income households have housing affordability problems.

Q: Isn't this program an inefficient way to produce the 20% below-market units?

A: This program is not designed primarily to produce below-market units. This program, instead, is a production initiative intended to produce market-rate units, but at modestly lower rents than would be required if tax-exempt bond financing were not available. Conceptually, if the rents required to make market-rate units feasible were \$950 with normal financing, this program would allow the market-rate units to be feasible at rents of, say, \$900, with the below-market units having rents at least 10% lower (that is, not more than \$810). Accordingly, the Commission envisions that much of the stimulus from the tax-exempt financing will be used to lower the rents on the market-rate units.

Q: Shouldn't the below-market units be targeted to households with even lower incomes?

A: Under the recommended approach, half of the below-market units will be occupied by voucher holders, who are very likely to have incomes below 30% of AMI. The remaining half of households will have incomes below a level to be set by the State HFA depending on the housing needs of the area. The Commission believes that these units will typically be targeted to households below 60% of AMI but also recognizes that in some areas of the country, targeting up to 80% of AMI will be appropriate. The Commission also points out that the overall effect of restricting the

¹ Michael A. Stegman, Roberto G. Quercia, and George McCarthy, “Housing America’s Working Families”, in *New Century Housing*, Volume 1, Issue 1, June 2000. See Table 4.

² *Ibid*, Table 6.

³ See, for example, Kathryn P. Nelson, *Whose Shortage of Affordable Housing?*, *Housing Policy Debate*, Volume 5 Issue 4.

rents on the below-market units is to make the market-rate units less feasible, thereby defeating the prime purpose of the program, which is to produce additional market-rate units. Accordingly, the Commission does not intend for the below-market rents to be driven to very low levels.

Q: Shouldn't there be an income limit for the market-rate units?

A: Nationally, of the 33.9 million renter households, less than 20% have incomes above 120% of AMI⁴, and no doubt many of those households are renting single-family homes rather than apartments. Thus, there is relatively little to be gained by imposing an income limit, even if it is desirable to restrict occupancy. Moreover, the objective of improving housing supply for moderate-income working families will be achieved no matter who actually occupies the market-rate units (if the market-rate units are actually rented by households above, say, 120% of AMI, that serves to relieve pressure on households with lower incomes, who now can rent units that otherwise would be rented by the higher-income households). In this regard, it should be noted that newly produced apartments, almost by definition, will have the highest apartment rents in the local market area, and thus it is logical that some of these newly produced apartments will be occupied by households toward the high end of the local renter population. Finally, developers report that a requirement to certify incomes is a distinct disincentive for market-rate renters; thus, the imposition of such a requirement would adversely affect the feasibility of the market-rate units and undermine the intent of the program.

Q: Shouldn't the HFA and the developer negotiate the below-market rents and targeting for each development?

A: The Commission intends for this program to stimulate the maximum feasible production of market-rate units. A property-by-property affordability negotiation would be contrary to that objective. Instead, the Commission intends that State HFAs will publish, in advance, criteria for the below-market units, with the result that developers will have certainty regarding the criteria, and accordingly the ability to bring their developments on line without delay, and without the need for a property-specific approval from the HFA.

Q: Shouldn't the developer be required to obtain the HFA's concurrence that there is a market for each development, or that the development is being produced in an area where there is job growth, or that working families in the area in fact have housing problems?

A: If the HFA is providing the financing, a feasibility approval will be part of the normal process of approval for financing. If, however, the HFA is not involved in the financing, the determination of feasibility is a matter between the developer and those who are providing the financing. In this regard, it should be noted that if the property fails financially, the below-market units will still be in place, governed by a long-term use agreement that is a covenant running with the land. Moreover, if the projected market rents are not achieved, the below-market rents are likely to be reduced as well (via the requirement that the below-market rents be at least 10% below the market rents). Thus, the public purpose objectives (production of market-rate units, and long-term availability of below-market units) will be achieved regardless of whether the property is a financial success. Accordingly, an HFA approval as to feasibility is not considered appropriate for this program.

Q: How will the HFAs regulate the properties after development?

⁴ American Housing Survey 1999, special tabulation by Cushing Dolbeare.

A: The HFAs will regulate only the below-market units, making sure that (a) the rents are within the program maximums, (b) the required number of units are occupied by voucher holders; and (c) the remaining below-market units are occupied by income-eligible households.

Q: What assurance is there that developers will not simply increase their profits, rather than reduce the rents on the market-rate units?

A: The availability of this program will permanently lower the rents at which new market-rate units are feasible. Accordingly, if developers attempt to charge rents above that level (in effect, pocketing the subsidy rather than passing it through in the form of lower rents), other developers will produce competing properties at the lower rents. The forces of competition (at time of development and later) will therefore insure that the subsidy (the tax-exempt financing stimulus) will have the intended effect⁵.

⁵ It is likely that there will be some price effect on multifamily-zoned land, but this would occur under any program that stimulates multifamily production.