Introduction to Affordable Housing Finance

May 14, 2019

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OVERVIEW

- How is Affordable Housing created/financed?
- What are the barriers to creating affordable housing?
- What are some solutions to these barriers?

Creating Affordable Housing

- Affordable Housing is created primarily by using **capital subsidies (i.e. grants and deferred loans)** to acquire or build housing that can be rented or sold at below-market rents/prices that are affordable to the targeted household population.

Creating Affordable Housing

In general, rents are considered affordable if the combination of rent and utilities are no more than 30% of a household's gross income.

For homeownership, a home is considered affordable if the combination of the mortgage payment (principal and interest) + taxes + insurance + condo fees (PITIC) is no more than 30-35% of a household's gross income.

Creating Affordable Housing

Levels of affordability are generally indexed to the Area Median Income ("AMI") as determined by HUD, and household size:

- "Extremely low income" is up to 30% of AMI
- "Very low income" is up to 50% of AMI
- "Low income" is up to 60% of AMI
- "Moderate income" is up to 80% of AMI
- "Middle Income" is up to 100% of AMI

"Workforce housing" is defined by MassHousing as affordable to working HH's earning between 60% and 120% of AMI

Creating Affordable Housing

For Cambridge, based on the Area Median Income, 2019 **HH incomes** look like this:

	1 person HH	2 person HH	3 person HH	4 person HH	5 person HH
30% AMI	22,650	25,900	29,150	32,350	34,950
50% AMI	37,750	43,150	48,550	53,900	58,250
60% AMI	45,300	51,780	58,260	64,680	69,900
80% AMI	60,350	69,000	77,600	86,250	93,150
100% AMI	75,450	86,250	97,000	107,800	116,400
120% AMI	90,550	103,500	116,400	129,350	139,700

Creating Affordable Housing

For Cambridge, HUD **2019 maximum rents** (including utilities) look like this:

	Studio	1 Bedroom	2 Bedroom	3 Bedroom	4 Bedroom
30% AMI	$542	$581	$697	$806	$900
50% AMI	$943	$1,011	$1,213	$1,401	$1,563
60% AMI	$1,132	$1,213	$1,456	$1,681	$1,876
80% AMI	$1,418	$1,521	$1,824	$2,107	$2,351
100% AMI	$1,563	$1,824	$2,084	$2,345	$2,605
120% AMI	$1,876	$2,188	$2,501	$2,814	$3,125

Creating Affordable Housing

- When creating market-rate housing, a developer calculates how much capital a project can attract based on market rents, projected operating expenses, and the cost of capital.
- When creating affordable housing, a developer seeks subsidy to offset cost, because affordable rents are low and cannot support much capital after paying operating expenses.

Creating Affordable Housing

Rental Comparison	60% AMI	Market
Gross Income - 2 BR	$1,456/mo	$3,600/mo
less utilities	-$112/mo	Paid by tenant
Adjusted Gross Income/mo	$1,344/mo	$3,600/mo
Adjusted Gross Income/yr	$16,128/yr	$43,200/yr
less vacancy @ 5%	-$806/yr	-$2,160/yr
less Operating Expenses	-$9,500/yr	-$11,500/yr
Net Operating Income	$5,822/yr	$29,540
If capital costs, on avg, 5% a 2 BR rental can attract:	$116,440	$590,800

Creating Affordable Housing

Rental Comparison	60% AMI	Market
If capital costs, on avg, 5% a 2 BR rental can attract:	$116,440	$590,800
COST TO BUILD (+/-)	**-$500,000**	**-$500,000**
CAPITAL SURPLUS/(GAP)	**($383,560)**	**$90,800**

Creating Affordable Housing

So, if we want to provide an affordable 2 bedroom rental unit to a 3-person household earning only 60% of AMI, or $58,260/yr:

we have to find over $380,000 in capital subsidy per unit

and/or

we have to use rent subsidies to increase rental income

and/or

we have to find a way to reduce cost significantly

Creating Affordable Housing

With me so far?

Barriers to Creating Affordable Housing

KEY BARRIERS:

- Competition for Land
- Permitting Risk
- High Costs
- Competition for Subsidies
- Unintended consequences of Other Policies
- Economic variables (exogenous)

Barriers to Creating Affordable Housing

Competition for Land:

In Cambridge, per unit land costs have risen 400% since 2005:

2005	$50-75,000 per allowable DU
2010	$75-100,000 per allowable DU
2015	$100-150,000 per allowable DU
2019	$200,000+ per allowable DU

Barriers to Creating Affordable Housing

Permitting Risk:

- Uncertainty
- Carrying costs
- Re-design
- Legal Fees
- Financing delays – especially for subsidies

Barriers to Creating Affordable Housing

High Costs:

- Development/Capital Costs
  - land
  - carrying costs
  - Construction
  - Structured parking
- Operating expenses:
  - RE Taxes
  - Utilities
  - Maintenance

Barriers to Creating Affordable Housing

Competition for Subsidies:

- LIHTC 3:1 means 2 to 3 years to commitment
- One award cycle per year
- $50K per unit limit on most state capital subsidies
- funds forward committed, or running dry

Barriers to Creating Affordable Housing

Economic variables:

- interest rates directly affect ability to raise capital
- capital market "events" like the 2008 financial collapse wiped out the market for tax credits

Barriers to Creating Affordable Housing

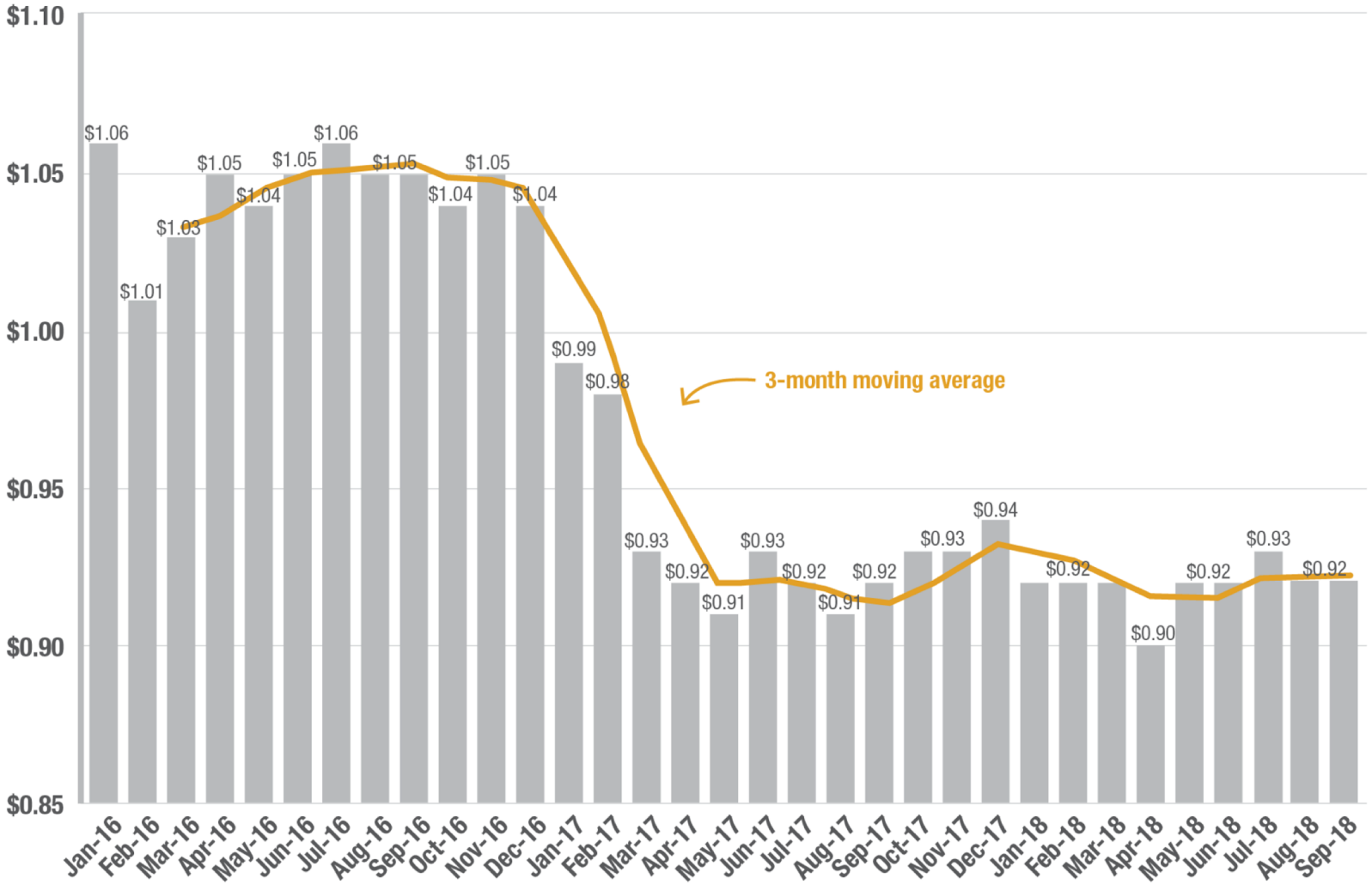
Unintended consequences of other policies

Barriers to Creating Affordable Housing

NOVOGRADAC & COMPANY LLP

Low-Income Housing Tax Credit Equity Pricing per Credit

January 2016-September 2018



Barriers to Creating Affordable Housing

But back to our example…

Creating Affordable Housing

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Creating Affordable Housing

Using Capital Subsidies

Sources of Capital Subsidy include:

- Federal Low Income Housing Tax Credits (allocated by DHCD)
- Other Federal Grants (Neighborhood Choice, 811, 202, etc.)

State Subsidies:

- State HOME Funds
- Housing Stabilization Funds (HSF)
- Commercial Area Transit Node Housing Program (CATNHP)
- Housing Innovation Fund (HIF – for coop's, elderly)
- Facilities Consolidation Fund (FCF - for DDS & DMH clients)
- Community Based Housing (CBH - for MRC clients)
- Workforce Housing Program (for HH's at 60-120% AMI)
- Massachusetts Affordable Housing Trust
- Home Funders (for homeless HH's)
- MA State Housing Tax Credits (up to 60% AMI HH)

Local Subsidies:

- City of Cambridge HOME & CDBG Funds
- Cambridge Affordable Housing Trust (incl. CPA)

Creating Affordable Housing

Using Capital Subsidies

Even in a subsidy-rich state like Massachusetts, due to the affordable housing crisis across the state, and resulting heavy demand, resources are stretched very thin and competition for them is fierce!

- LIHTC, and other state-allocated subsidies, are routinely oversubscribed by a factor of 3:1;
- The State only offers most subsidies one time a year, in competitive rounds;
- Even with great, “shovel-ready” projects, it often takes 2 – 3 years to get a project funded. That adds to project cost!

- AND, most state subsidy programs limit the amount of subsidy per unit to $50,000 (with per-project caps as well) so it takes many sources of funding, layered on top of one another, to make it work!

Creating Affordable Housing

Using Capital Subsidies

To give you an example, you might recognize Putnam Green, a 100% affordable project of local non-profit HRI

Creating Affordable Housing

Using Capital Subsidies

Here's a list of all the sources needed to finance Putnam Green:

- The Cambridge Affordable Housing Trust
- City of Cambridge – HOME funds
- Cambridge Housing Authority – Project-based Section 8
- Commonwealth of MA Affordable Housing Trust Fund
- Commonwealth of MA DHCD – HOME funds
- Commonwealth of MA DHCD – 9% LIHTC
- Commonwealth of MA MassDevelopment – Brownfields Tax Credits
- CEDAC – CBH funding
- NeighborWorks America Grant
- U.S. Department of Housing and Urban Development (HUD) Grant
- Massachusetts Clean Energy Center Grant
- Enterprise Foundation Grant
- Charlesbank Homes Grant
- Conservation Services Group Grant
- NSTAR/LEAN/ICF International Energy Efficiency Rebates
- Citi Foundation Grant
- TD Bank – Construction Financing
- Massachusetts Housing Partnership (MHP) – Permanent Loan

Creating Affordable Housing

Using Rent Subsidies

The effect increasing income using rent subsidies:

Section 8 and **Mass Rental Voucher Program ("MRVP")** rent subsidies increase the rent that can be collected on a deed-restricted, affordable unit, but the payment standard is low compared to the market.

Sec 8 and MRVP Rents are set based on the HUD-determined "Fair Market Rent" which as of April 2019 are:

HUD "Fair Market Rents" for Boston SMSA

Studio	1 Bedroom	2 Bedroom	3 Bedroom	4 Bedroom
$1,608	$1,801	$2,194	$2,749	$2,966

Creating Affordable Housing

Using Rent Subsidies

Rental Comparison with Rent Subsidies	60% AMI	MRVP at FMR
Gross Income - 2 BR	$1,456/mo	$2,194/mo
less utilities paid by tenant (LL pays for heat/hot water)	-$112/mo	-$112/mo
Adjusted Gross Income/mo	$1,344/mo	$2,082/mo
Adjusted Gross Income/yr	$16,128/yr	$24,984/yr
less vacancy @ 5%	-$806/yr	-$1,249/yr
less Operating Expenses	-$9,500/yr	-$9,500/yr
Net Operating Income	$5,822/yr	$14,235/yr
If capital costs, on avg, 5% a 2 BR rental can attract:	$116,440	$284,700

Creating Affordable Housing

Using Rent Subsidies

Rental Comparison with Rent Subsidies	60% AMI	MRVP at FMR
If capital costs, on avg, 5% a 2 BR rental can attract:	$116,440	$284,700
COST TO BUILD (+/-)	**-$500,000**	**-$500,000**
CAPITAL SURPLUS/(GAP)	**($383,560)**	**($215,300)**

There's great potential here, but rent subsidies – especially ones with a high payment standard – are as or more difficult to get than capital subsidies, and are prioritized for HH's up to 30% and 50% of AMI.

Creating Affordable Housing

Reducing Cost

TYPICAL DEVELOPMENT COSTS:

- Land/Building Acquisition
- Acquisition Carrying Costs (RE Tax, interest, maintenance)
- Design & Engineering Costs
- Construction Costs
- Environmental Costs
- Permit Fees
- Legal Costs (acquisition, permitting, financing, contracts)
- RE Taxes and Insurance
- Other Soft Costs (accounting, consultants, title, etc.)
- Financing Costs (origination fees, interest, lender legal)
- Capitalized Reserves
- Developer Overhead/Fees

Creating Affordable Housing

Reducing Cost

DEVELOPMENT COSTS SUBJECT TO SAVINGS via POLICY:

- **Land/Building Acquisition**
- **Acquisition Carrying Costs**
- Design & Engineering Costs
- **Construction Costs**
- Environmental Costs
- **Permit Fees**
- Legal Costs (acquisition, **permitting**, financing, contracts)
- **RE Taxes** and Insurance
- Other Soft Costs (accounting, consultants, title, etc.)
- Financing Costs (origination fees, interest, lender legal)
- Capitalized Reserves
- Developer Overhead/Fees

Creating Affordable Housing

Reducing Cost

Policies that allow **greater density** for affordable projects could make projects more efficient, lowering their per-unit construction costs.

Creating Affordable Housing

Reducing Cost

Policies that **reduce or eliminate permit fees** for affordable projects could provide significant cost savings (= 2% of construction in Cambridge….)

Creating Affordable Housing

Reducing Cost

Policies that provide **real estate tax abatements** for affordable projects could generate significant savings during the development period, but more importantly could **reduce operating costs** over the long term, reducing the need for capital subsidy.

Creating Affordable Housing

Reducing Cost and Risk

Policies that allow **greater density for affordable housing projects** could significantly **lower per unit acquisition costs**.

Such policies could also reduce **carrying and permitting costs**, and make projects more competitive based on their "as-of-right" status.

Creating Affordable Housing

Creating affordable housing is complex, and involves a lot of risk

Creating Affordable Housing

but:

Affordable projects lead on quality and sustainability:

- Emphasis on lower operating costs
- Better quality, more durable construction
- Higher degree of energy efficiency and resource utilization

And in addition to housing those with limited means,

Generates positive long-term results in the community:

- Long-term affordability
- Less turnover
- Stable ownership overtime

Creating Affordable Housing

QUESTIONS?