Financing New Low Income (LIHTC) Rental Construction Projects

Action A1 – Have Congress Increase Its Annual Allocation for the Federal LIHTC program (currently $8 Billion) for Hawaii. In 2012, states received a LIHTC allocation of $2.20/person with a minimum small state allocation of $2,525,000 (for 9% Tax Credit). The state allocation limits do not apply to the 4% Tax Credit that is automatically packaged with tax-exempt bond financed projects. Increasing the LIHTC allocation to Hawaii will provide the State with more means to finance low-income rental projects. The states' LIHTC allocation was last increased by Congress in 2001 (≈ 40%).

Technique – Requires identification by HHFDC, HPHA and agencies such as HCDA of financing needs of qualified LIHTC Rental Housing developments and action by the Hawaii Congressional Delegation.

Action A2 – Identify a pool of corporations with an appetite for the LIHTC. Identifying this pool of private equity investment has a national scope as the current pool of local corporations with a significant federal tax burden is limited. Identifying such a pool of interested private equity would enhance the ability of local developers to finance LIHTC rental projects.

Technique – Secure legislative funding for an entity such as HHFDC or HCDA to develop information/prospectus on State LIHTC developments and circulate to national financial institutions and corporations.

Action A3 – Identify qualified LIHTC housing developments and costs. Issue State Tax Exempt Bonds (Hula Mae Multi Family Revenue Bond) to finance in part these LIHTC Rental Housing Developments. This action would increase the amount of private equity investment in qualifying LIHTC Rental Housing Developments.

Technique – Requires identification by HHFDC, HPHA and agencies such as HCDA of the development costs for qualifying LIHTC Rental Housing Projects needing financing and action by the Hawaii State Legislature to appropriate the tax exempt bonds.

Action A4 – Secure Congressional Approval to Increase the HOME allocation to the State of Hawaii. Increasing the HOME allocation will make more money available through the City & County of Honolulu for LIHTC Rental Housing development.

Technique – Requires identification by HHFDC, HPHA and agencies such as HCDA of the development costs for qualifying LIHTC Rental Housing Projects needing financing and action by the Hawaii Congressional delegation to secure the increased allocation and the HHFDC and/or City & County of Honolulu to allocate the HOME funds to the identified LIHTC Rental Housing Developments.

Action A5 – Work with the State ERS to provided gap financing for identified LIHTC or non-LIHTC Rental Housing Developments that can provide a return of ≈ 7.75%. In cases where the return to the ERS is justified, this can provide a source of equity gap financing that could stimulate the production of needed LIHTC or non-LIHTC Rental Housing.

Technique – Requires identification by HHFDC, HPHA and agencies such as HCDA of the development costs and returns for qualifying LIHTC or non-LIHTC rental housing developments and agreement by the ERS Board of Directors to invest in qualifying developments.

Action A6 – HCDA to work with the City & County of Honolulu to establish a Tax Increment Financing (TIF) Mechanism or Community Facility District whereby expected incremental increases in property values will be set aside to provide gap financing for LIHTC Rental Housing Developments in the Kakaako Community Development District.

Technique – Requires HHFDC, HPHA and HCDA to identify prospective LIHTC Rental Housing Developments in need of gap financing and to work with the City & County of Honolulu to establish a TIF or other mechanism to provide gap financing for known LIHTC Rental Housing Developments.

Action A7 – HCDA to amend its administrative rules (HAR) to require that developers of commercial space which employs a majority of workers at 60% AMI or less to provide Reserved Housing Rental units or a cash-in-lieu fee to the Authority to provide such units.

Technique – HCDA to amend its administrative rules on the subjet.

Policy Changes Targeting the Production/Maintenance of Low-Income LIHTC Rental Housing Developments

Action B1 – Amend HHFDC QAP to specify that LIHTC Rental Housing Developments may include 10% of the rental units for families earning up to 80% AMI as well as families earning ≤ 60% AMI and 10% of the rental units for families earning ≤ 30% AMI such that the average median income for the project is 60% AMI. Currently, while the definition of low-income housing provides for participation by families earning ≤ 80% AMI, the LIHTC program does not allow for families earning ≤ 80% AMI to participate. Allowing the 80% AMI to be classified as qualified LIHTC families will increase rental revenue and the amount of permanent financing available to the project.

Technique – HHFDC to amend their QAP appropriately.

Action B2 – HCDA to coordinate any and all administrative rules (HAR) with the HHFDC to ensure continuity and consistency in LIHTC and appropriate qualified income housing policies.

Technique – HCDA and HHFDC staff to coordinate all appropriate administrative rules (HAR) relating to financing, development, qualifying and enforcement of qualified income housing units.

Action B3 – HCDA and the City & County of Honolulu to coordinate the development of rule (HAR), ordinance or code to allow bicycle parking and mechanized parking to substitute for current off/on-site parking facilities requirements for LIHTC Rental Housing Developments.

Technique – HCDA and the City & County to coordinate the development of amended rules (HAR), ordinance or code to implement action.

Policy Changes To Enhance the Production of HCDA Reserved Housing Moderate-Income Housing Developments (Rental or For-Sale)

Action C1 – Amend HCDA rules (HAR) to allow for permitted developments with a requirement to construct Reserved Housing units the flexibility to produce either Rental (≤ 100% of AMI) or For-Sale Moderate Income (100-140%

AMI or as otherwise specified by HCDA rules) units as the market dictates and without the developer having to secure a permit amendment from the Authority.

Technique – HCDA to amend their administrative rules accordingly.

Action C2 – HCDA to amend its rules to modify its Moderate Income Qualifying levels to include households making between 80 and 140% of AMI. HCDA rules currently define the qualifying income/price point as for families earning between 100 to 140% of AMI. The amended rule would require that the developer must produce units according to the following schedule: 25% of the units at 81-100% AMI; 50% of the units at 101-120% AMI; and 25% of the units at 121-140%. While this amendment will not necessarily enhance production, it will ensure that whatever units are produced will be at a lower average price point.

Technique – HCDA to amend their administrative rules accordingly.

Action C3 – HCDA to amend their administrative rule to provide that the Reserved Housing Requirement kick in for any residential project with 10 or more residential units. The Reserved Housing Requirement is currently triggered by development on lot (>20,000 sf).

Technique – HCDA to amend their administrative rules accordingly.

Action C4 – HCDA to amend their administrative rule to establish an incentive for Reserved Housing developers to produce larger units. The multiplier factor may operate on the following suggested schedule.

1. Studio units will be awarded 0.68 reserved housing credit
2. 1 bdrm/1 bath units will be awarded 0.81 reserved housing credit
3. 2 bdrm/1 bath units will be awarded 0.92 reserved housing credit
4. 2 bdrm/2 bath units will be awarded 1.2 reserved housing credit
5. 3 bdrm/1.5 bath units will be awarded 1.4 reserved housing credit
6. 3 bdrm/2 bath units or larger will be awarded 1.5 reserved housing credit

Technique – HCDA to amend their administrative rules accordingly.

Preserving Existing and Future HCDA Reserved Housing Units

Action D1 – HCDA to extend Buyback period for Reserved Housing Units to 15 years.

Technique – HCDA to amend its administrative rules (HAR).

Action D2 – HCDA to work with ERS to establish investment pool of funds to buy back reserved housing units. Reserved Housing Units promising a return of at least 7.5% to be bought back with ERS funds, with all proceeds and profit being paid to the ERS.

Technique – HCDA and ERS to establish appropriate MOU and rules to implement action.

Action D3 – HCDA to amend its administrative rules (HAR) to specify that the regulated period for its Reserved Housing Rental Units is increased from 15 to 30 years.

Technique – HCDA to amend its rules (HAR) accordingly.

Action D4 – HCDA to utilize AMI Indexing Technique to set resale pricing for all Reserved Housing Units that are subject to its Reserved Housing Buy Back Program. Utilizing the AMI Indexing Technique instead of the current Shared Equity Technique will allow for the pricing of re-sold Reserved Housing Units to be maintained at lower price points.

Technique – HCDA to amend its rules (HAR) accordingly.

Action D5 – HCDA to have rental housing management agent verify tenant qualifications at least once a year. Enforcement of income qualification will ensure that tenants of LIHTC Rental Housing units continue to qualify for the unit.

Technique – HCDA to work with rental housing management agents to establish a enforcement/monitoring database program for each rental housing development.

Reduce Development Costs for Qualified HCDA Reserved Housing Rental Units and Qualified LIHTC Rental Housing Developments

Action E1 – Allow HCDA Reserved Housing Units and qualified LIHTC Rental Housing Developments to automatically qualify to use the 201H (fast track entitlements and processing) program. By fast tracking the entitlement process for these types of rental housing projects, the developers saves both time and cost in producing these types of units. As time (and certainty) equals money and opportunity for developers, this will allow for qualified units to be produced more efficiently and quickly.

Technique – The State Legislature must authorize appropriate changes to statute (201H HRS) and the HHFDC must amend the appropriate sections of the Hawaii Administrative Rules (HAR).

Action E2 – The HCDA and the City & County of Honolulu shall update appropriate rule (HAR) and land use ordinance to allow for parking requirements to be unbundled from qualified reserved housing and LIHTC rental housing developments located in transit-oriented development zones (within a quarter-mile or 15 minute walk from a transit or bus station). The HCDA and the City & County of Honolulu shall determine whether the required parking is 62% of the one bedroom and larger units or eliminated entirely. This policy and zoning change will allow developers to let the market determine what level of parking is needed to service qualified income studio, one to three bedroom units. As parking stalls in a structure can cost as much as $40,000/stall, this can greatly reduce the cost of development, especially on a lot as small as 10,000 sf.

Technique – The HCDA and the City & County of Honolulu to amend their zoning and building code to allow for this change in parking policy.

Action E3 - The HCDA, the Department of Education and the City & County of Honolulu shall update statutory provisions (HRS), appropriate rule (HAR), applicable land use ordinance and subdivision rule to provide exemptions for developers of HCDA Reserved Housing rental units and LIHTC rental housing developments from any impact fees relating to the provision of public school facilities or public facility dedication fees. This change would provide incentive and relief for developers of qualified income rental housing units to produce more units.

Technique – The HCDA, the Department of Education, City & County of Honolulu and State Legislature to amend their statute, rule, ordinance or code to allow for the exemption from school and public facility dedication fees for qualified rental housing projects.

Action E4 – The HCDA, the State Department of Taxation, the City & County of Honolulu and the State Legislature shall amend their statute, rule, ordinance or code to automatically provide exemption for HCDA Reserved Housing Rental Unit developments from real property tax and general excise tax until certificates of occupancy are issued for the development. Such exemption will reduce carrying costs incurred during construction of the project and save the developer from added costs.

Technique – The HCDA, the State Department of Taxation, the City & County of Honolulu and the State Legislature shall amend their statute, rule, ordinance or code to automatically provide exemption from these costs for developers of qualified rental housing projects.

Action E5 – The State Legislature to establish statute creating tax credit or deductions for developers achieving LEED silver or higher Energy or Development Status when constructing LIHTC Rental Housing Developments. Establishing tax credit or incentive for achieving LEED silver or better status for Energy or Project status will provide encouragement and opportunity for the developer of a qualified LIHTC Rental Housing Development to offset some of their development cost and produce a more sustainable project.

Technique – The State Legislature to enact necessary changes to the state's tax code.

Definitions

Area Median Income (AMI) – HUD estimates the median family income for an area in the current year adjusts that amount for different family sizes so that family incomes may be expressed as a percentage of the area median income. The 100% AMI divides the income distribution into two equal parts: one-half of the cases falling below the median income and one-half above the median.

The HUD 2014 100% AMI for the City & County of Honolulu for a family of four is $82,600. A rookie police officer ($52,000/year) and a public school teacher [(w/o teaching credentials)($33,000/year)] with two children is an example of a family at the 100% AMI.

AMI Indexing Technique – A resale methodology that maintains the affordability of reserved housing in perpetuity by linking resale prices to the current area median income.

Capital Stack to Construct Low-Income Housing Rental Housing – The capital stack *or Total Development Cost* is defined as the financing plan for constructing low-income rental housing. The typical components of the capital stack include:

- *Hard Debt* – is the bank's loan, normally constrained by a loan-to-value (LTV) ceiling (value = the mortgagable value of the expected rental income)(to increase affordability of a project government might provide favorable terms to lower the cost of capital to the developer – allowing higher leveraging, cheap interest rates);
- *Soft Debt* – is sandwiched in between hard debt and hard equity. Soft debt is typically paid after the hard debt and before the hard equity [(to increase affordability, government offers programs such as the Urban Development Action Grants (competitive federal grant program to cities and urban counties which are experiencing economic distress to help stimulate economic development activity needed to aid in economic recovery)];
- *Hard Equity* – is the developer's/owner's down payment and the owner's appreciation (to increase affordability, government typically offers financial grants and down payment assistance);
- *Soft Equity* – The LIHTC is an example of a program that creates a public-private partnership (P3) that stimulates private investment in a project.

The Capital Stack or Financing Plan for a LIHTC development such as Halekauwila Place (Total Development Cost - $64,618,250) includes:

- A low cost ($1/year for 75 years) lease for the parcel of land issued by the HHFDC *(Hard Equity)*;
- LIHTC Equity *(Soft Equity)* = $26,118,250;
- A permanent loan *(Hard Debt)* = $18,500,000
- HCDA Financing *(Soft Debt)* = $17,000,000
- Deferred Developer Fee *(Hard Equity)* = $3,000,000

Community Development Block Grant (CDBG) Program – Annual grant given by HUD to cities and urban counties to develop viable communities by providing decent housing, a suitable living environment, and opportunities to expand economic opportunities, principally for low and moderate income persons.

Department of Community Services/City & County of Honolulu – The department is a cabinet level agency of the City & County of Honolulu that oversees management of $100 million in State and federal funds to provide services for low-income residents, seniors, homeless, job training, community development, and Section 8 housing vouchers. Also administers the Housing First Program, special needs housing and special projects.

HHFDC **Dwelling Unit Revolving Fund (DURF)** – The DURF uses General Obligation Bonds proceeds for the acquisition of real property, development and construction of residential, commercial and industrial properties; interim and permanent loans to developers; and any and all things necessary to carry out the purposes of the Housing Development Program.

State of Hawaii **Employees' Retirement System (ERS)** – The ERS provides retirement, disability, survivor, and other benefits to more than 115,000 members. Membership is comprised of retirees, beneficiaries, inactive vested members and active public employees working for the State and Counties of Hawaii. In FY 2012, the ERS reported net assets of ≈ $11.3 Billion. The ERS seeks to realize returns on investments of ≈ 7.75%.

Extremely Low Income According to HUD – Defined as ≤ 30% of the Area Median Income (AMI) for a family.

Hawaii Community Development Authority (HCDA) – The HCDA is a corporate instrumentality of the State of Hawaii that is charged with the redevelopment of those districts designated by the State Legislature. The three major functions of the HCDA include:

1. Establishes and administers zoning/community development rules for districts identified by the State Legislature;
2. Develops and implements community development and community infrastructure plans; and
3. Stewards assets assigned to the agency.

Hawaii Housing Finance and Development Corporation (HHFDC) – The HHFDC is tasked with developing and financing low- and moderate- income housing projects and administering home ownership programs.

Hawaii Public Housing Authority (HPHA) – The HPHA helps to provide Hawaii residents with affordable housing and shelter without discrimination. The HPHA focuses on developing affordable rental and supportive housing, public housing and the efficient and fair delivery of housing services to the people of Hawaii.

On Oahu, the income qualifications for applicants for federal public housing

- Household of 1 = $54,850
- Household of 2 = $62,650
- Household of 3 = $70,500
- Household of 4 = $78,300

Federal **Home Investments Partnerships Program (HOME)** Program – The HOME program is a type of assistance provided by HUD to provide decent and affordable housing to low- and very low-income Americans. It is the largest block grant to states and local government designed exclusively to create affordable housing for low-income families. The program provides approximately $2 Billion/year. The HOME program is administered by the HHFDC, who provides an annual allocation to the City & County of Honolulu.

Housing and Urban Development (HUD) Agency – Federal cabinet level agency whose mission is to: Strengthen the Nation's Housing Market to Bolster the Economy and Protect Consumers; Meet the Need for Quality Affordable Rental Homes; Utilize Housing as a Platform for Improving Quality of Life; Build Inclusive and Sustainable Communities Free From Discrimination; and Transform the Way HUD Does Business.

Low Income According to HUD – Defined as ≤ 80 % of the Area Median Income (AMI) for a family.

Low Income Housing Tax Credit (LIHTC) Program – Created by the Tax Reform Act of 1986, the LIHTC program gives State and local LIHTC-allocating agencies the equivalent of nearly $8 Billion in annual budget authority to issue tax credits for the acquisition, rehabilitation, or new construction of rental housing targeted at low-income households. The LIHTC program gives incentives for private equity to be used in the development of affordable housing aimed at low-income households. The LIHTC program qualifies as a "public-private partnership."

The LIHTC program accounts for approximately 90% of all affordable rental housing created in the United State. In Hawaii, the Hawaii Housing Finance and Development Corporation (HHFDC) administers the LIHTC program.

How LIHTC Works

1. A developer proposes and wins a competitive allotment of tax credits for a project from the HHFDC.
2. The developer completes the project, certifies the cost and rents the project to low-income tenants.
3. Investors are found that will make a capital contribution to the developer in exchange for being allocated the LIHTC over a ten-year period.

Mayor's Office of Housing City & County of Honolulu – Oversees, coordinates and direct the development, preparation, and implementation of plans and programs relating to affordable housing, senior housing, special needs housing and homelessness.

Moderate Income According to the HUD Community Development Block Grant (CDBG) Program – A household whose income does not exceed 140% of the Area Median Income (AMI). There is generally no tax credit or government subsidy program such as the LIHTC that targets moderate income families.

Definition and Qualification for **Public Housing** – Public Housing was established to provide decent and safe rental housing for eligible low-income families, the elderly, and persons with disabilities. The formula for determining the Total Tenant Payment is the highest of the following:

1. 30% of the monthly adjusted income;
2. 10% of the monthly income;
3. Welfare Rent, if applicable;
4. A $25 minimum rent or higher amount (up to $50) set by the Housing Authority.

HHFDC **Qualified Allocation Plan (QAP)** – The QAP sets forth the criteria to evaluate and allocate LIHTC tax credits to projects which best meet the housing needs of the State and the preferences required by Section 42 IRC, and the procedure to monitor for compliance with the revisions of the LIHTC program.

HHFDC **Rental Housing Trust Fund (RHTF)** – The Rental Housing Trust Fund provides "Equity Gap" low-interest loans or grants to qualified owners and developers constructing affordable housing units. Funds may be used to provide a loan or a grant for the development, pre-development, construction, acquisition, preservation, and substantial rehabilitation of rental housing units.

HCDA **Reserved Housing** – Residential Developers on lots ≥ 20,000 sf in the Kakaako Community Development District are required to produce qualified income for-sale or rental units equal to 20% of the development's residential floor area.

For-Sale Units. Only households with income between 100 to 140% of the AMI are qualified to purchase these units. The price of the unit is determined by factoring in: mortgage interest rates; property tax; mortgage insurance premiums; and the monthly association of apartment owners (AOAO) fees.

Rental Units. Only households making ≤ 100% AMI qualify to occupy the units. Rents must be set such that the qualifying household shall pay no more than 33% of their gross income for the monthly rent.

Section 8 Housing Vouchers – Section 8 of the Housing Act of 1937 authorizes the payment of rental housing assistance to private landlords on behalf of low-income households in the United States. The program also allows individuals to apply their monthly vouchers towards the purchase of a home. The maximum allowed voucher is $2,200/month.

Section 8 Project Based Rental Assistance Program – Owner of a housing development reserves some or all of the units in a building for low income tenants, in return for a federal guarantee to make up the difference between the tenant's contribution and the rent in the owner's contract with the federal government.

Tax Credit vs Tax Deduction – Provide a dollar-for-dollar reduction in the taxpayer's federal income tax whereas a tax deduction only provides for a reduction in taxable income.

Very Low Income According to HUD – defined as ≤ 50% of the area median income (AMI) for a family.

Veterans Affairs Supportive Housing (VASH) Program – HUD makes available ≈ 10,000 vouchers/year at a cost of $75 million/year to eligible homeless and otherwise vulnerable armed forces veterans.

4% LIHTC Credit/Hula Mae Multi-Family Revenue Bond Program – This credit is generally claimed for rehabilitated housing and new construction that is financed with tax-exempt bonds. The credit is typically claimed over a 10 year credit period. In Hawaii, this credit is typically non-competitive, subject to the availability of the federal tax credit and awarded with tax-exempt bond financing.

9% LIHTC Credit – This credit is applied against the State's annual LIHTC allocation and generally reserved for new construction. Each year for 10 years a credit equal to ≈ 9% of a project's qualified basis (cost of construction) may be claimed. In Hawaii, this credit is allocated on a competitive basis and may offer an award from the State's Rental Housing Trust Fund (RHTF).