STATE OF HAWAII
HAWAII COMMUNITY DEVELOPMENT AUTHORITY
Kakaako Community Development District
Honolulu, Hawaii

July 11, 2018

Chairperson and Members
Hawaii Community Development Authority
State of Hawaii
Honolulu, Hawaii

HCDA Board Members:

SUBJECT
Shall the Authority adopt the recommendations of the Kakaako Affordable Rental Housing Task Force (Task Force)?

SUMMARY
The Task Force was formed at the September 6, 2017 Hawaii Community Development Authority (HCDA) Kakaako meeting to consider and recommend proactive strategies for encouraging low to middle-income rental housing development in Kakaako to expand the range of housing opportunities in the Kakaako Community Development District (KCDD).

The Task Force include members John Whalen (task force chair), Wei Fang, Jason Okuhama, and Phillip Hasha. Member Hasha was added to the task force at the October 4, 2017 meeting.

Permitted interactions of a group of board members is governed by Hawaii Revised Statutes (HRS) § 92-2.5(b) which provides that two or more members of a board, but less than a quorum may be assigned to investigate a matter relating to the official business of the board, provided that:

1. The scope of the investigation and the scope of each members authority are defined at a meeting of the board;
2. All resulting findings and recommendations are presented to the board at a meeting of the board; and
3. Deliberation and decision-making on the matter investigated, if any, occurs only at a duly noticed meeting of the board held subsequent to the meeting at which the findings and recommendations of the investigation were presented to the board.

AUTHORITY
Hawaii Revised Statutes § 206E-4.

BACKGROUND
The Task Force consulted with various stakeholders in the industry including affordable housing developers, the financing community including local banks, and state and county agencies to assess the issues facing development of affordable rental housing. The following is a summary of the Task Force findings.

TABLE 1: Affordable Rental Housing Project Toolbox for HCDA's CDDs					
	Government Agency Offering Incentive				
	C&C of Honolulu	State of Hawaii		Federal	
Affordable Housing Incentives		HCDA	HHFDC	IRS	HUD
201H Exemptions	√	√	√		
HCDA					
Exemption from provisions of Mauka Area Rules					
HCDA Permit Fee Exemption		√			
Density Bonus		√			
Height Increase		√			
Reduced Parking Requirement		√			
Public Facility Dedication Exemption		√			
Building Form Exemptions		√			
City & County of Honolulu					
Exemption from Building Permit Review Fee	√				
Exemption from Grading Permit Fee	√				
Exemption from Trenching Repair & Service Permit Fee	√				
Exemption from Storm Drain Connection Fee	√				
Exemption from Fire Department Plan Review Fee	√				
Deferral of Wastewater Charges until certificate of occupancy	√				
Deferral of water service fee until certificate of occupancy	√				
Free Land		√	√		
General Excise Tax (GET) Exemption			√		
Property Tax Exemption	√				
Low-Income Housing Tax Credit (LIHTC)			√	√	
Rental Housing Revolving Fund (RHRF)			√		
National Housing Trust Fund			√		√
Hula Mae Multi-Family Program (HMMFP)			√		√
HOME Investment Partnerships Program	√				√
Dwelling Unit Revolving Fund (DURF)			√		

- Almost all rental affordable housing projects in Honolulu need some form of local, state, and federal government funding;
- All projects required free land;

- Even with government funding and free land these projects still had a financing gap and required additional financing;
- The state through the Hawaii Housing Finance and Development Corporation (HHFDC) provides the bulk financing for these projects including gap financing. Table 1 below is a summary of local, state, and federal government financing and other incentives available for affordable housing development;
- Most affordable housing projects, including affordable rental housing projects, require additional density (floor area) to make the projects financially viable (Hale Kewalo, Halekauwila Place, Artspace, Nohona Hale, Kapiolani Residences);
- Local banks are willing and eager to finance affordable housing development by purchasing low income housing tax credits (LIHTC). However, local capacity and appetite for LIHTC appears to be limited-in the order of $30 million. The capacity could be increased if several local banks pooled their resources.
- Local affordable housing developers have capacity to develop between 200-500 units annually.
- Locally there is adequate management capacity for affordable rental housing units.
- For most affordable rental housing (at or below 60% of AMI), developers indicate that mixed income projects are not viable because of financing available through LIHTC and other programs are much more attractive than the revenue generated from higher AMI units.
- The Honolulu City Council recently adopted Bills 58 (Ordinance 18-10) and 59 (Ordinance 18-01) establishing affordable housing requirements and financial support for the creation and maintenance of for-sale and rental multifamily housing projects.
- Structured parking, at a cost of $35,000 to $50,000 per stall, has a direct impact on the affordability of a project.

ANALYSIS
Several recent affordable rental housing projects in the Kakaako Community Development District (KCDD) have been financed through LIHTC and other financing provided by the HHFDC. Most affordable rental housing projects outside of the KCDD have also been financed through local, state and federal government subsidy (various Vista projects by developer Gary Furuta and the 7000 Hawaii Kai Drive project by Avalon Development). Out of eleven affordable rental housing projects in the KCDD only one project, the 680 Ala Moana building, was developed without local, state, or federal funding assistance. Kamehameha Schools developed the 680 Ala Moana building without any subsidy by converting a commercial building to a mixed-use project with 54 affordable rental housing units.

There have been 41 major residential mixed-use development projects in the KCDD approved by the HCDA since 1984 consisting of 11,913 residential units out of which 4,184 units (or 35%) are considered affordable. Out of the 4,184 affordable units, 1,774 units (or 42%) are rental units affordable at 100% or below of the area median income (AMI).

A point to note is that except for a small fraction (3%) of these affordable rental units, all required government financing in the form of LIHTC, RHRF and free land. All for-sale affordable housing units were developed using private funding.

TABLE 2: Kakaako Affordable Rental Housing Projects				
Project Name	**No of Units**	**AMI**	**Status**	**Government Funding Source**
Halekauwila Place	204	60%	Completed	LIHTC/Free Land/HCDA Gap Financing
440 Keawe Street	88	100%	Completed	GET Exemption
Artspace	84	60%	Under Construction	LIHTC/RHRF/Free Land
Keauhou Lane	209	100%	Completed	GET Exemption/RHRF
Kamakee Vista	225	60%	Completed	LIHTC/RHRF/Free Land
Kauhale Kakaako	267	60%	Completed	LIHTC/RHRF/Free Land
Pohulani	262	60%	Completed	LIHTC/RHRF/Free Land
Na Lei Hulu Kupuna	76	60%	Completed	LIHTC/RHRF/Free Land
Honuakaha	151	60%	Completed	LIHTC/RHRF/Free Land
Hale Kewalo	128	60%	Under Construction	LIHTC/RHRF/Free Land
Nohona Hale	111	60%	Pre-Development	LIHTC/RHRF/$1 Per Yr lease
680 Ala Moana	54	100%	Completed	Privately Funded

Outside of the KCDD, all affordable rental housing projects and some for-sale housing projects (for example, Kapiolani Residences) have required government financing. It is rather obvious that there will be no affordable rental housing development in Honolulu without government financing and other forms of subsidies such as free land. The HCDA has provided direct financing (Halekauwila Place) or land at nominal lease rent (at $1/year) for developing affordable rental housing projects in the KCDD. In the future, government financing in the form of LIHTC, RHRF and HMMFP will be essential for affordable rental housing projects. Since the enactment of the new federal tax laws in 2017 that reduced the corporate income tax burden from 35% to 21%, there is concern that the demand for LIHTC will decrease and it will also impact the value of LIHTC, creating the need for more gap financing options at the local and state level. This means that other financing mechanisms such as RHRF may need to be increased to keep a constant supply of funding for affordable housing projects.

As it is obvious that government financing and free land is essential for development of affordable rental housing projects, the HCDA can currently make some limited contribution. To continue with encouraging development of affordable rental housing projects the HCDA can use all or some of the money available (approximately $3 million) in the reserved housing revolving fund to provide gap financing for affordable rental housing projects in the KCDD, or alternatively use that money to purchase land in the KCDD. The HCDA could make the land available at no cost for an affordable rental housing project to qualified developers using the request for proposal type of procurement process that was utilized for development of Nohona Hale.

There is a possibility that the HCDA could increase its financial capacity to fund affordable rental projects by leveraging its current and future equity sharing in reserved housing units or allowing for a cash in lieu option to developers instead of providing reserved housing units. The HCDA currently has a substantial amount of money locked up in equity sharing in reserved housing units (see Table 3).

TABLE 3: RESERVED HOUSING HCDA EQUITY SHARING SUMMARY			
Project Name	**No. of Units**	**Regulated Term (yr)**	**HCDA Equity Share Remaining**
Ke Kilohana	375	2-5	$36,683,899
400 Keawe	20	2	$600,000
Keauhou Place	85	2-5	$9,933,600
Symphony	100	5	$9,633,200
Rycroft Terrace	162	10	$6,773,620
Pacifica	124	2-10	$1,670,450
Keola Lai	63	2	$8,673,696
TOTAL	**929**		**$73,968,465**

If the HCDA adopts a policy to allow the owners of the reserved housing units to pay the equity sharing out front (as is allowed by HHFDC), potentially $74 million could be raised that could be reinvested in developing affordable rental housing projects. It would mean that the 929 units that are currently reserved housing units will no longer be reserved housing units, however, $74 million invested in purchasing land and used as gap financing could produce more than the reserved housing units that are lost. These new units will be affordable rental units at lower AMIs and will be affordable in perpetuity since the HCDA will own the land on which these rental projects will be built. Currently, based on the provisions of the Kakaako Reserved Housing Rules, the equity sharing is established at the time of approval of the reserved housing program for a development project and is fixed in value, meaning that the equity sharing amount is fixed and not indexed to consumer price index or other similar indexes. An equity sharing amount of, say, $40,000 today will still be $40,000 in 5, 10, 20 or 30 years from today. So, as time goes by the value of equity sharing gets diluted. From that perspective it makes financial sense for the HCDA to take equity sharing out front and reinvest in affordable rental housing projects. The same concept could be used for future projects that will have reserved housing requirements. Assuming that at full build-out there will be an additional 10,000 residential units in the KCDD (the current number of units developed since 1984 is 11,913), the number of reserved housing units required will be 2,000 units. From Table 3 we can estimate that the average equity sharing for a reserved housing unit could be, say, $80,000. That will generate $160,000,000 in equity sharing over time. That money invested in purchasing land in the KCDD and for gap financing will generate far more than 2,000 reserved housing units. Again, these will be affordable rental units that will remain affordable in perpetuity.

Similar analysis can be made for a cash in lieu option instead of requiring reserved housing units. Depending on the value of market units the per unit cash in lieu amount will vary. However, an educated guess based on the average market value of the current residential units in the KCDD and the cash in lieu formula in the proposed amendment to the Kakaako Reserved Housing Rules would be that the average value of cash in lieu will be closer to $200,000 per unit. At that value, 2,000 units will generate $400,000,000 over time. That is a substantial amount of money to be invested in developing affordable rental housing projects.

That said, we have to keep in mind that availability of land and development capacity may be a limiting factor and since the money from either equity sharing or cash in lieu will not be coming in at one time, the actual number of rental units produced on a yearly basis will vary. The concept is based on a full build out scenario, but year to year production will vary and will depend on cash flow, availability of land, and development capacity. However, this approach has the potential of producing a substantial numbers of affordable rental housing units that are affordable at lower AMIs and will remain affordable in perpetuity. Alternatively, accepting land from developers in lieu of providing reserved housing units will produce the same results as the cash in lieu provision.

Since the new federal tax law will reduce the value of LIHTC in terms of demand as well as actual dollar value of the tax credit, it would necessitate increased financing at the local level in the form of RHRF, DURF and any other gap financing program. It will be necessary to create a broad-based financing mechanism for developing affordable housing.

TABLE 4: BASE VERSUS ACTUAL DENSITY FOR RECENT AFFORDABLE HOUSING PROJECTS

Project	Base Density (FAR)	Actual Project Density (FAR)
Hale Kewalo	3.5	3.9
Halekauwila Place	2.7	3.5
Artspace	3.5	3.8
Nohona Hale	3.5	5.4
Kapiolani Residences	3.5	9.3

Most of the affordable housing projects, including affordable rental projects, require additional density for the projects to be financially viable. Recent examples are Hale Kewalo, Halekauwila Place, Artspace, and Nohona Hale in the KCDD and Kapiolani Residences in the Ala Moana area. Kapiolani Hale required nearly three times the density that was allowed under the City and County of Honolulu, Land Use Ordinance on the project site. Additional density could be another tool, in general, to increase the quantity of affordable housing as well as providing incentive for affordable rental housing.

The HCDA should also explore leveraging its reserved housing revolving fund to improve smaller dilapidated, walkup housing projects already existing within Kakaako. Industry experts, including member Hasha, have shared with the task force that there are several walkup rental housing buildings in the KCDD that have high vacancy rates due to the poor condition of the units. Several of the small walkup buildings are owned and operated by families or small partnerships. As a result, most of the smaller unimproved buildings have gone without repair because of the owners' limited experience and inability to obtain funding for even small capital improvements. To encourage improvement and occupancy of these existing housing units, the HCDA could establish a rental unit rehabilitation micro-loan program where owners of smaller existing walkup buildings within KCDD could receive a short term, low interest loan from HCDA to improve their vacant units in exchange for leasing the improved unit at an affordable rate. This opportunity, in contrast to the redevelopment of an entire site, would require much less time, capital and would utilize Kakaako's existing housing inventory. However, it is likely that the such a program would require a limited term of affordability and therefore would not offer affordability in perpetuity.

RECOMMENDATIONS

The Task Force recommends that the Authority consider exploring the following options for encouraging development of more affordable rental housing projects.

1. Utilize the money in the reserved housing revolving fund to purchase land for development of affordable rental housing projects. Consider competitive solicitations for purchase of land for rental housing projects.

2. Consider cash in lieu or dedication of land option from developers instead of providing reserved housing units. Money collected from cash in lieu can be used to purchase land for affordable rental projects and/or for providing gap financing. Land dedicated by developers can be used for affordable rental housing projects.

3. Consider a policy to allow owners of reserved housing units to pay the equity sharing out front instead of waiting until the resale or transfer of the reserved housing unit. Money collected for early payment of equity sharing can be used for purchasing land for affordable rental housing projects and/or providing gap financing.

4. Explore establishing a rental housing unit rehabilitation micro-loan program to increase affordable housing using the existing KCDD housing stock.

5. Consider increasing zoning incentives (i.e., density and height) within the KCDD, especially in TOD areas and on small lots, for projects that include rental housing. Increased density will increase the number of housing units that can be developed in the KCDD and even keeping the reserved housing requirement at 20% will increase the number of affordable housing that will be produced.

6. Work closely with the HHFDC in prioritizing affordable rental housing projects in the KCDD for LIHTC, RHRF, DURF funding.

7. Work with the HHFDC in lobbying the legislature for a broad-based financing mechanism for developing affordable rental housing projects.

8. Explore the option of developing a public parking structure in the Sheridan and Central Kakaako neighborhood zones. Parking stalls could be offered at a reduced rate for KCDD affordable housing projects. This would take away the burden of building expensive parking for affordable housing projects and significantly reduce development costs.