Reviewed and Approved by the Executive Director: ________
March 9, 2023

FOR DISCUSSION

I. SUBJECT

Discussion on the Hawaii Housing Finance and Development Corporation Affordable Housing Production Projection, Supply and Resource Challenges, and Strategies

II. FACTS

Established in 2006, Hawaii Housing Finance and Development Corporation (HHFDC) was created to facilitate the development of affordable housing pursuant to Chapter 201H, Hawaii Revised Statutes. Its mission is to increase and preserve the supply of affordable housing statewide by providing financing and development resources. According to the *Hawaii Housing Demand: 2020 – 2030* study (Department of Business, Economic Development and Tourism, 2019), a total of 36,155 new housing units were projected to be needed statewide by 2030 to achieve supply and demand balance in the state's housing market.

III. DISCUSSION

A. HHFDC is one of many public agencies that is charged with addressing the state's housing shortage which is felt across nearly the entire socioeconomic spectrum of state residents. A truly earnest attempt to tackle the problem will require massive public and private investments and necessitate the cooperation and collaboration of all state and county housing agencies to address this complex, long-standing issue.

B. The document attached as **Exhibit A** provides the basis for a discussion of:

1. HHFDC's five-year housing production projection;
2. Non-structural challenges to increasing housing supply in Hawaii;
3. Strategies to incrementally increase housing production; and
4. Metrics to measure HHFDC's progress.

Attachments: Exhibit A – HHFDC Affordable Housing Production Projection; Supply and Resource Challenges; and Strategies.

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HHFDC Affordable Housing Production Projection, Supply and Resource Challenges, and Strategies

Prepared by:
Hawaii Housing Finance and Development Corporation
Department of Business, Economic Development and Tourism

March 2023

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INTRODUCTION

Established in 2006, the mission of Hawaii Housing Finance and Development Corporation ("HHFDC") is to increase and preserve the supply of affordable housing statewide by providing financing and development resources.

Hawaii has a well-known and severe shortage of housing, particularly affordable housing. The Department of Business, Economic Development and Tourism's report *Hawaii Housing Demand: 2020 – 2030* forecasts that a total of 36,155 new units would be needed statewide by 2030 to achieve supply and demand balance in the housing market, and the Legislature has found that "the lack of affordable rental housing requires the concentrated attention of state government at the highest level."[1]

HHFDC is one of many governmental departments and agencies that facilitates the development and preservation of Hawaii's affordable housing stock. HHFDC's programs assist projects that are affordable to a range of households, including:

- Low-income renters earning up to 60% of the area median income ("AMI") as determined annually by the U.S. Department of Housing and Urban Development ("HUD") and adjusted for household size;

- Households earning up to 80% or 100% of the AMI (sometimes referred to as workforce housing); and

- Households earning up to 140% of the AMI (typically first-time homebuyers, or renters by choice).

Responding to Hawaii's housing needs will take the cooperation and collaboration of all state housing agencies, including the Hawaii Community Development Authority, the Hawaii Public Housing Authority ("HPHA"), and the Department of Hawaiian Home Lands ("DHHL"), along with the housing agencies in each county.

The purpose of this document is to present: 1) HHFDC's five-year housing production[2] projection; 2) non-structural[3] challenges to increasing housing supply in Hawaii; 3) strategies to incrementally increase housing production; and 4) metrics to measure progress.

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[1] See Section 2 of Act 127, Session Laws of Hawaii 2016, which created a Special Action Team for the purpose of recommending actions to increase the supply of rental housing.
[2] References in this document to housing "production" (and related forms of the word) mean both the development of new housing units and the substantial rehabilitation of existing housing units, in each case using an HHFDC program or resource as a means for housing production.
[3] Structural barriers to production, such high material costs due to Hawaii's remote location, are considered to be largely uncontrollable.

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FIVE-YEAR HOUSING PRODUCTION PROJECTION

HHFDC's goal is to keep the pipeline of affordable housing development flowing using its existing financing and development assistance programs.

The table below shows the number of new and substantially rehabilitated housing units in projects that are projected to be delivered to the market over the next five years and which are anticipated to use HHFDC resources. The projection is based on HHFDC's internal production forecast and is subject to change as projects progress, experience delays, or require modifications.

This forecast is periodically updated throughout the year and includes:

1. units in projects known to either be in the pre-development phase or under construction; and
2. speculative unit estimated to be produced based on remaining funding sources anticipated to be available after accounting for the projects already known to be in the pipeline.

Based on the current projection, HHFDC expects to facilitate the delivery of 7,227 units over the next five fiscal years. For context, in fiscal year 2022, HHFDC facilitated the delivery of 1,531 rental and for-sale housing units.

FIVE-YEAR HOUSING PRODUCTION PROJECTION

FISCAL YEAR	NUMBER OF RENTAL UNITS	NUMBER OF FOR-SALE UNITS	TOTAL HOUSING UNITS
2023	893	3	896
2024	1,119	366	1,485
2025	1,260	0	1,260
2026	550	1,355	1,905
2027	1,281	400	1,681
TOTAL	**5,103**	**2,124**	**7,227**

SUPPLY AND RESOURCE CHALLENGES

There are numerous structural and non-structural challenges that impede HHFDC's ability to increase the production of affordable housing beyond recent historical levels. Three of these challenges are highlighted below.

PRIVATE-ACTIVITY BOND CAP CONSTRAINTS

Established by the Tax Reform Act of 1986, the federal Low-Income Housing Tax Credit ("LIHTC") program is the primary financing tool used for the new construction and substantial rehabilitation of affordable rental housing in Hawaii, as it is across the U.S. The program provides investors with a 10-year, dollar-for-dollar reduction in federal tax liability in exchange for providing financing to developers to produce affordable rental housing. HHFDC is the State agency authorized to administer the federal LIHTC program and allocate the credits to housing projects.

The federal LIHTC program is governed by Section 42 of the Internal Revenue Code ("Section 42"), with two types of credits available. The 9% LIHTC is designed to subsidize about 70% of unit costs, and the 4% LIHTC is designed to subsidize 30% of unit costs. The latter credit is by far the larger resource.

Under Section 42, the 9% LIHTC is limited by the State's volume ceiling, which the Internal Revenue Service ("IRS") determines annually for each state based on its population. There is no volume ceiling for 4% LIHTC, although there is an indirect constraint on its availability: to be eligible to receive a 4% LIHTC award, at least 50% of a project's costs must be financed with tax-exempt, private-activity bonds. The industry refers to this constraint as the "50% Test". HHFDC is an issuer of tax-exempt, private-activity bonds through its Hula Mae Family ("HMMF") bond program.

Like the 9% LIHTC, the IRS sets an annual ceiling (the "State Bond Cap") on the amount of private-activity bonds that can be issued based on state population. For Hawaii, the 2022 ceiling was approximately $335 million. For the 2022 HHFDC funding round, requests for the use of private-activity bonds exceeded availability by a 3:1 ratio.

Under Section 39B-2, Hawaii Revised Statutes ("HRS"), the State Bond Cap is allocated each year as follows:

1. 50% to the State;
2. 37.55% to the City and County of Honolulu (the "City");
3. 5.03% to the County of Hawaii;
4. 2.04% to the County of Kauai; and
5. 5.01% to the County of Maui.

The State's allocation of the bond cap is assigned to the Department of Budget and Finance ("B&F"), which does not determine the amount of the State Bond Cap that will be available to HHFDC for housing uses until after HHFDC has launched its funding cycle earlier in the year. This process creates uncertainty for developers and possible hesitancy to invest significant time and predevelopment costs in what may otherwise be worthwhile projects.

Under the current structure, HHFDC does not typically know what how much bond cap will actually be available for its use until January of the next calendar year.

In addition to the planning challenges that the current State Bond Cap allocation process creates, the City recently decided to retain its allocation to create its own bond issuance program for affordable housing production. Because of the size of the City's statutory allocation (representing 37.55% of the total State Bond Cap), the City's decision has the effect of reducing the amount of bond cap available for HHFDC to issue and requires careful coordination with the City to manage the limited resource and minimize delays in the financing process.

LEGACY MANAGEMENT AND INFRASTRUCTURE RESPONSIBILITIES

Since its inception in 2006, HHFDC has been burdened with the ongoing management, maintenance, and infrastructure needs of projects that were developed by predecessor agencies. These infrastructure obligations divert HHFDC's financial and human resources away from the agency's core mission of increasing the housing supply. Maintaining and managing the roadways, sidewalks, and landscaping in the Villages of Kapolei ("VOK") and the water system, vacant lots, and forest reserve buffer areas in Waiahole Valley require an inordinate amount of staff time and energy which could otherwise be dedicated to housing finance and development.

Three legacy responsibilities are described below:

Villages of Kapolei Infrastructure. VOK was developed pursuant to Act 15, Session Laws of Hawaii 1988 ("Act 15"). Act 15 provided Housing Finance and Development Corporation ("HFDC", a predecessor to HHFDC) with temporary powers to expedite the development of affordable housing. It authorized HFDC to develop housing projects that were exempt from all statutes, ordinances, and other applicable governmental rules related to planning, zoning, design standards, development of land, and the construction of units; provided that the project met minimum health and safety requirements including those of the Public Utilities Commission, and HFDC conducted a public hearing in the county in which project was located.

The City never accepted dedication of the infrastructure that HFDC developed in VOK, including backbone roadways, curbs, gutters, catch basins, sidewalks, signage and landscaping systems. This has left HHFDC with the responsibility to maintain the infrastructure while the City has enjoyed the benefit of the real property taxes generated

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from the housing and commercial developments that were made possible through the State's infrastructure investments.

The historical infrastructure costs plus estimated costs remaining to be incurred until dedication to the City was last estimated to total approximately $235 million.

Waiahole Valley Lands and Infrastructure. HHFDC owns and manages approximately 595 acres of lands in the Waiahole Valley subdivision and a 1.0-million-gallon potable water system that services the valley. There are 159 lots for residential, agricultural, and commercial use in addition to open space, infrastructure, floodways, and roadways. Approximately $23 million had been spent on land acquisition and capital improvements as of June 30, 2022.

For 93 of the lots, HHFDC is the lessor under long-term ground leases which require active management and compliance monitoring. In addition to roadway-related and open-space maintenance, there are 12 vacant residential and agricultural lots which require ongoing maintenance until a disposition program for them is formulated.

The potable water system that services Waiahole Valley is nearing the end of its service life, and upgrades to the system will be implemented in fiscal year 2023 to keep it operational. HHFDC plans to modernize the system once the environmental and design efforts are completed.

Overall, Waiahole Valley currently costs HHFDC approximately $1.4 million per year to own and operate, including lease administration; land management; and infrastructure operating and maintenance expenses. Lease rents, water-service charges, and other fees cover only about $300,000 of operating expenses, with the remainder subsidized by HHFDC's Dwelling Unit Revolving Fund ("DURF").

Affordable Multifamily Rental Portfolio. HHFDC was created upon the dissolution of Housing Development and Community Corporation of Hawaii ("HCDCH"). In addition to developing and financing affordable housing projects, HCDCH held a property portfolio consisting of the State's public and affordable housing projects. Upon HHFDC's creation, it assumed HCDCH's portfolio of owning and operating 10 affordable multifamily rental projects.

Beginning in 2013, HHFDC began a program to dispose of its affordable rental housing portfolio through leasehold property sales to private-sector owner/operators. The goals of the program are to:

1. free up human resources to focus on HHFDC's core financing and development assistance activities;

2. relieve HHFDC of near-term property renovation programs estimated to cost approximately $100 million; and

3. sunset open-ended project rental assistance commitments fund from HHFDC's Rental Assistance Revolving Fund (RHRF) for which funding was rapidly dwindling.

STRATEGIES

HHFDC has identified the following strategies to help to maintain and increase the production of affordable for-sale and rental housing.

1. ***Optimize Use of Primary Financing Resources***

   HHFDC's most powerful financing tool to produce affordable rental housing is the LIHTC program. Because the 9% LIHTC is subject to the IRS volume cap, the goal is to optimize the 4% LIHTC. However, due to the 50% Test for 4% LIHTC, its use is constrained by the State's bond cap. Unfortunately, past attempts in Congress to expand this resource by either lowering the percentage of a project's costs that must be financed with private-activity bonds or increasing the states' private-activity bond ceilings have been unsuccessful.

   Given Hawaii's significant shortfall of affordable housing units, it is critical that the use of 4% LIHTC be optimized. As previously mentioned, HHFDC is not guaranteed any of the State's bond cap despite its critical importance to the production of affordable rental housing. Furthermore, the City's decision to retain its sizable annual allocation triggers the need for close coordination between the State and the City on the timing of financing of projects using 4% LIHTC since HHFDC is the State's sole LIHTC allocating agency.

   HHFDC has awarded 4% LIHTC, private-activity bonds, and RHRF loans to several Oahu projects (and several City RFP projects) that in aggregate can consume the bond cap of the entire state. To address the issue with City's retention of the bond cap, HHFDC will consider withholding extensions to private-activity bonds and RHRF awards for City projects until adequate cap is returned to the state to cover these projects.

2. ***Demonstrate Ability to Effectively Deploy Legislative Appropriations***

   HHFDC has demonstrated its ability to manage significant sums of monies effectively and responsibly. The legislature, for several years now, has showed its confidence in HFFDC's Board of Directors and the agency by making historic appropriations into HHFDC's financing programs. In 2022 alone, the legislature infused a record $300 million (under Act 236) into HHFDC's financing programs because it believed in the work of the agency to facilitate the delivery of affordable housing. This was preceded by another historic infusion of $200 million (under Act 39) in 2018.

HHFDC is also one of the few state agencies with the ability to award funds to housing projects in the same year it receives an appropriation. In 2022, HHFDC was able to quickly implement a provision in Act 236 that authorized the use of RHRF Tier 2 Program funds to finance projects aimed at the gap income group, which is Hawaii's workforce in the 60% to 100% of the AMI range. These are moderate-income households that may not make enough to afford a market-rate rental or to purchase a home. Based on the IRS's definition of being housing-cost burdened (i.e., households that pay more than 30% of their income for housing), a large portion of Hawaii's households do not qualify for housing under the LIHTC program (which generally serves households earning up to 60% of the AMI) but earn below 100% of the AMI and cannot afford to buy a home.

In December 2022, HHFDC awarded RHRF Tier 2 Program loans totaling $142 million to four projects with 750 units through a competitive funding round.

Especially given that there is insufficient State Bond Cap to meet developer demand for 4% LIHTC and HMMF bond financing (and further complicated by the City's planned startup of its own bond program), HHFDC believes that continued availability of the RHRF Tier 2 Program is particularly important in the near term. HHFDC strongly supports additional RHRF Tier 2 Program funding during the upcoming biennium to continue housing production and will continue to work closely with the Legislature to secure meaningful and consistent cash infusions into RHRF as well as Dwelling Unit Revolving Fund ("DURF") to facilitate the development of affordable housing.

3. *Foster Homeownership*

There simply is not enough government funding to subsidize the volume of housing that needs to be produced to meet demand. HHFDC needs to consider alternatives that do not require LIHTC, RHRF, or private-activity bond financing.

Three alternatives are described below:

Long-Term Leasehold Housing on State Lands Near Rail or Mass Transit. HHFDC will explore developing 99-year leasehold projects on State lands set aside by the governor or leased by any State department or agency to HHFDC. This residential leasehold program will involve for-sale housing units to foster homeownership. The State is the largest landowner of lands along the rail corridor on Oahu and HHFDC will work with other State agencies and the counties to identify potential projects.

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Affordable Homeownership Revolving Fund Program. Established by the Legislature in 2021 and seeded with a $5 million appropriation in 2022, the Affordable Homeownership Revolving Fund Program ("AHRF") is HHFDC's newest financing program. Its purpose is to make loans available on a competitive basis to developers that use the self-help housing model to leverage federal funds from HUD, the U.S. Department of Agriculture – Rural Development; and the U.S. Treasury, Community Development Financial Institutions funds to build moderate-income homes (i.e., households earning up to 80% and up to 120% of the AMI as determined annually by HUD and based on household size).

Administrative rules for the program are expected to be finalized in mid-2023, and HHFDC will have staff available to implement the program in late 2023 or early 2024.

DURF Equity Pilot Program. This represents an out-of-the-box way to address the high demand of for-sale units by Hawaii's residents earning between 80% and up to 140% of the AMI. Developers are unable to sufficiently meet demand at these thresholds because per-unit development costs exceed affordable sales prices. The funds would be placed in a revolving account so that additional households could be assisted further in the future. The State would earn a return on its equity through the shared appreciation in equity required under this program. A bill to establish the DURF Equity Program failed during the 2022 legislative session but was re-introduced during 2023 session as House Bill 677.

4. ***Invest in Infrastructure; Partner with the Counties***

One of the major barriers to housing production is the lack of public infrastructure. Off-site infrastructure like potable water, wastewater, and drainage systems at one time was paid by government but is now expected to be paid by housing developers. This added cost for offsite infrastructure raises housing costs and often makes the development of new affordable housing projects financially infeasible. HHFDC can assist by preparing regional infrastructure master plans and collaborating with the counties to fund off-site infrastructure improvements at mutually beneficial sites (e.g., along the rail corridor on Oahu and within proximity to planned Neighbor Islands transportation hubs such as Lihue Civic Center, Kahului Civic Center, and Pahoa transit center).

The Lima Ola Workforce Housing Development is a good example of the use of this strategy as an infrastructure subaccount was established within DURF, which was then used to fund planning, design, feasibility studies, construction, and materials for infrastructure improvements. This program will provide for the requisite infrastructure capacity needed to support approximately 550 affordable units within Kauai County.

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The Iwilei Infrastructure Master Plan and Environmental Impact Statement (EIS) is an example of a partnership between public agencies (i.e., the Department of Accounting and General Services, University of Hawaii [UH], HPHA, and the City Department of Planning and Permitting) and private parties (i.e., Kamehameha School and Castle and Cooke) to achieve the common goal of modernizing infrastructure systems. The Plan assessed infrastructure that will be needed to accommodate anticipated growth in the Iwilei and Kapalama area. A Chapter 343, HRS, EIS will also be prepared to support the Master Plan. With proper infrastructure planning, this area could potentially support an additional 8,250 housing units. HHFDC has committed $2.5 million of DURF to fund this project.

5. *Make Lands Available for Housing and Leverage Resources.*

The State has a portfolio of vacant and underutilized lands where affordable housing could be built. Working with other State agencies, suitable lands with supporting infrastructure could be identified and assessed. Once the suitable land is acquired, HHFDC could take the lead in funding and completing the necessary environmental work to comply with Chapter 343, HRS, as is required for any projects that use State lands or funds. Once this work is completed, the site would be offered for long-term ground lease to affordable housing developers through a competitive Request for Proposals (RFP) process.

Three RFP developments showcase HHFDC's efforts:

First, the Pohukaina Street Affordable Housing Mixed-Use Project (Pohukaina), Kakaako, Oahu. The 2.17-acre parcel was set aside via Executive Order 4533 to HHFDC for educational and affordable housing purposes. HHFDC initiated the Pohukaina project with RFP No. 21-005-DEV. On September 8, 2022, HHFDC's Board of Directors selected Highridge Costa Development Company, LLC as the successful offeror for the residential portion of the parcel.

The developer proposes to build 625 affordable rental housing units on the approximately 1.52-acre residential portion of the parcel. The balance of the parcel will be reserved for a future, potentially the first-of-its-kind vertical Hawaii Department of Education (DOE) school.

Highlighting the mixed-use nature of this development, the ground-level will include a public plaza, approximately 5,000 square feet of commercial space fronting the public plaza, and other amenities.

Second, the Kahului Civic Center Mixed-Use Complex (Civic Center), Kahului, Maui. The 5.57-acre parcel was set aside via Executive Order 4590 to HHFDC for the development of a mix-used project consisting of 300 multifamily affordable rental housing units, 66,000 square feet Civic Center including 38,000 square feet of State office space, approximately 5,000 square feet of community-oriented commercial space, and a bus hub. HHFDC will release the RFP for the Civic Center project in 2023.

Third, the Northwest Kapolei Corner Multifamily Residential and Commercial Use Project (NW Corner), Kapolei, Oahu. HHFDC owns the approximately 19.5-acre parcel as part of the VOK. HHFDC will seek the services of a developer to plan, design and build the project in an RFP scheduled to be released in 2023.

In addition to RFPs, HHDFC is committed to working with other State agencies to support their mission in delivering housing. In 2022, HHFDC transferred its 9-acre remnant parcel next to Kaupea and Maluohai homestead in Kapolei to DHHL for $8.25 million. This was done in an effort to allow DHHL to development housing for their native Hawaiian beneficiaries.

Explore the Use of 99-Year Lease Authority. Act 191 (2022) exempts non-ceded lands under HHFDC control from provisions under Chapter 171-2, HRS. This effectively gives the agency authority to issue 99-year lease terms, which potentially could provide benefits including:

1. lower development costs (reduction in development costs assuming nominal ground lease is charged to the developer);

2. lower unit pricing to the consumer (potential reduction in home prices proportionate to what would have been charged if market-based land costs had been borne by the developer); and

3. provides an additional development tool to the State (a 99-year ground lease could support affordable rental projects that serves households earning 60% to 140% of the AMI, whereas many State-supported rental developments currently use LIHTC and are limited to serving households up to 60% of the AMI).

In 2023, HHFDC has met with representatives from UH to look at participating on the development of a 20-acre parcel near UH West Oahu to test this new authority. If negotiations are successful, HHFDC would acquire a 10-acre parcel and seek the services of a developer to build for-sale leasehold condominiums. The leasehold condominium product would provide an intermediate step between renting and fee-simple home ownership. The leasehold condominium model could potentially expand equity opportunities for lower- to moderate-income groups.

6. ***Divest the Corporation from Legacy Management and Infrastructure Responsibilities***

Responsibilities relating to the below projects are ancillary to the furtherance of HHFDC's mission and divert enormous amounts of resources away from its core housing finance and development functions. HHFDC is in various stages of exit from these projects.

Villages of Kapolei Infrastructure. HHFDC has rehabilitated all backbone roadways curbs, gutters, catch basins, sidewalks, and signage in VOK. On February 24, 2023, HHFDC formally transferred operations and maintenance responsibilities of all infrastructure to the City per agreed Memorandum of Agreement. Eventually, the ownership of the roadways will be transferred to the City once the necessary easements are established, and title clears the land court system.

Waiahole Valley Lands and Infrastructure. The initial 25-year lease term between HHFDC and lessees will end on June 29, 2023. As required by the terms of the ground leases, HHFDC currently is engaged in rent renegotiations with its 93 lessees who have not had a rent increase in 25 years. It is HHFDC's goal in these negotiations to meaningfully reduce its ongoing operating losses relating to Waiahole Valley.

HHFDC has started to explore the feasibility of disposing the Waiahole Valley leasehold interests to another entity whose mission would be more closely aligned to meet the needs of the community. Potential suitors include a nonprofit or another State agency.

HHFDC is designing a new potable water system with the goal of transferring the modernized system to the Honolulu Board of Water.

Affordable Multifamily Rental Portfolio. To date, eight projects with 1,405 units have been sold in leasehold subject to long-term affordability restrictions. The leasehold sales of the remaining two projects with 104 units are expected to close during 2023.

METRICS

The following performance metrics will be used to measure HHFDC's progress in achieving its goals.

1. Number of units produced or preserved through HHFDC housing finance or development programs.

2. Amount of funds awarded to developers to accomplish the goal.

3. Amount of LIHTC credits each year awarded.

4. Dollar volume in bonds awarded each year.
5. Number of RFPs to generate housing issued.
6. Number of RFPs to generate housing awarded.
7. Lands made available for development of affordable housing.
8. Number of infrastructure improvement projects funded to support housing development.

CLOSING

HHFDC was created to increase and preserve the supply of affordable housing statewide by providing financing and development resources. The *HHFDC Affordable Housing Production Projection, Supply and Resource Challenges, and Strategies* presents:

1. HHFDC's five-year housing production projections of new and substantially rehabilitated housing units in projects that are projected to be delivered to the market and are anticipated to use HHFDC resources;
2. non-structural challenges to that impede HHFDC's ability to increase the production of affordable housing in Hawaii;
3. strategies that can be implemented to maintain and increase the pace of affordable housing production considering very significant challenges that HHFDC is faced with; and
4. performance metrics to measure HHFDC's progress in meeting its goals.