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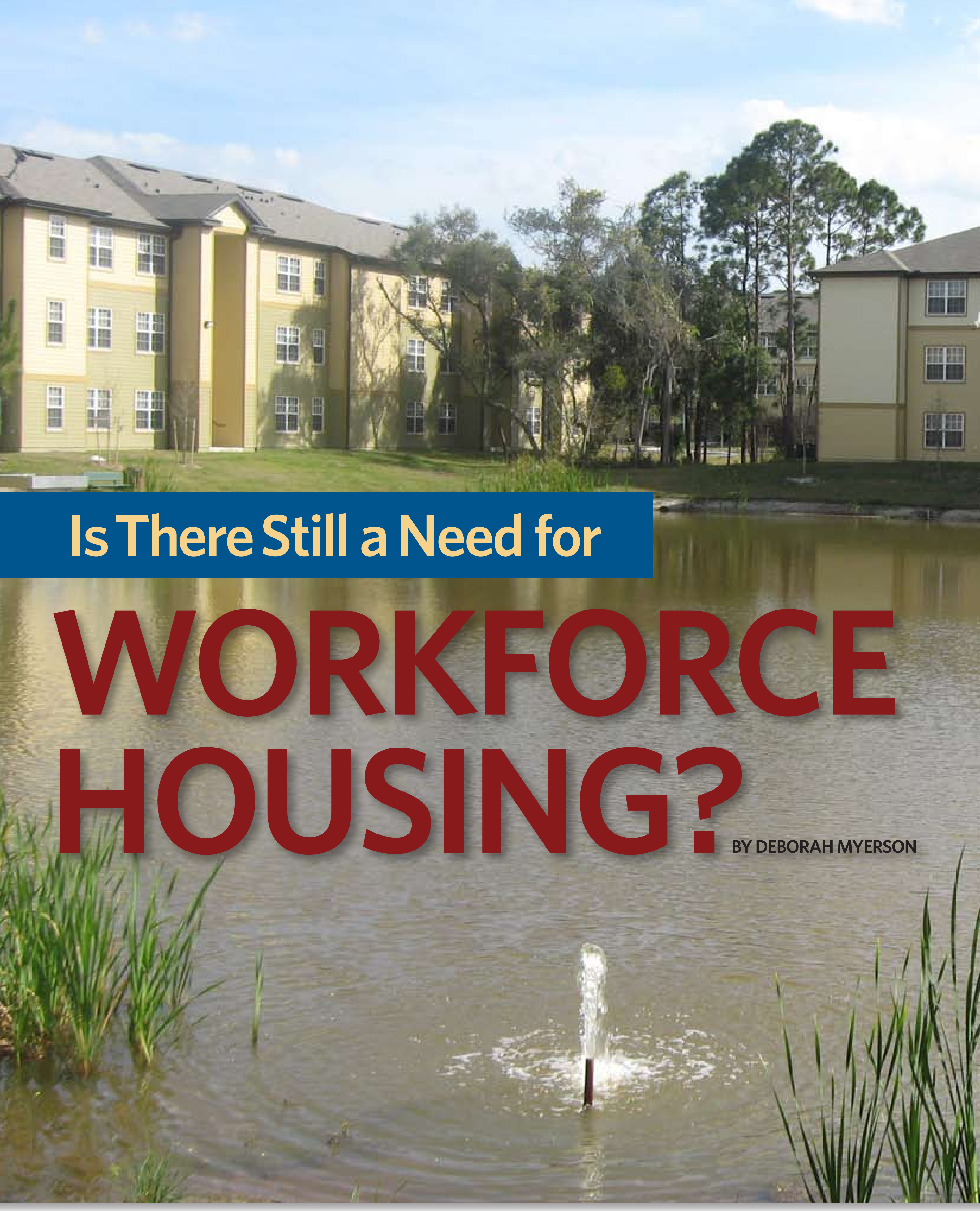
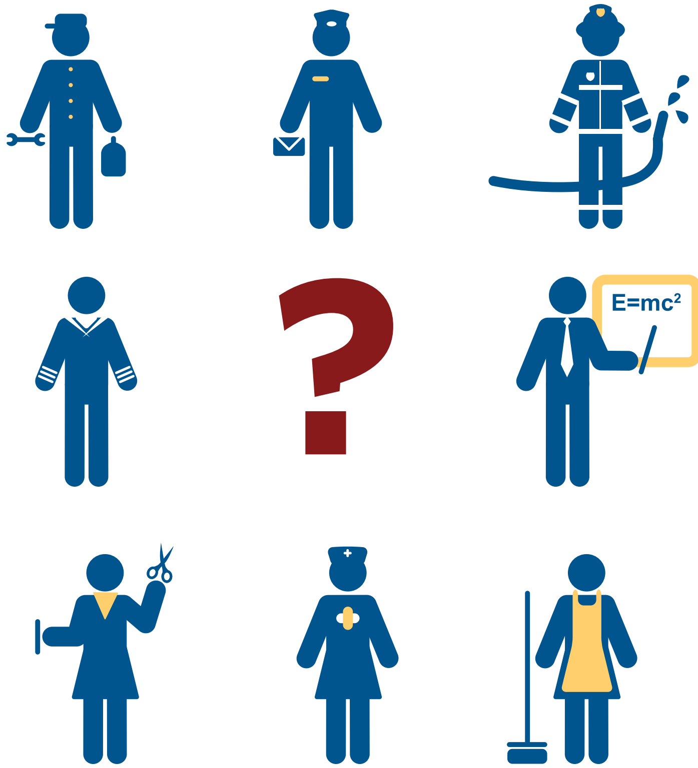


Is There Still a Need for WORKFORCE HOUSING?

BY DEBORAH MYERSON

Seventy percent of the Palmetto Ridge units are reserved for households earning 60 percent of the Area Median Income.

PHOTO COURTESY OF PACIFIC HOUSING NORTHWEST



THE RECENT SHARP DROPS in median housing prices around the country—such as the nearly 35 percent decline between 2007 and 2008 in the San Francisco and Washington D.C. metro areas—had one potential benefit: it appeared to promise some potential relief on housing prices. The boom that pushed housing affordability in the early part of this decade alarmingly out of reach for many teachers, police officers, retail clerks, nurses, janitors, and other working households was slowed.

Before the decline, increasing public awareness of the problem of affordability—which had severely curtailed the ability of these professionals and others to live in the communities they served—fostered emergence of a variety of programs and incentives to encourage creation of workforce housing. Now, with the marked downshift in housing prices in many parts of the country, it seems reasonable to ask: is there still a need to underwrite workforce housing production?

Alas, the data points to a resounding affirmative. High cost markets are still relatively high, while incomes are down and unemployment is rising. For many workers in the U.S.—including those in construction-related occupations that may see a boost from the federal stimulus package—home prices are still out of reach, according to *Paycheck to Paycheck: Wages and*

New markets tax credits were an important part of the financing of Squire Park Plaza.

PHOTO COURTESY OF PACIFIC HOUSING NORTHWEST

the Cost of Housing in America. The study, released in May 2009, compares housing costs in more than 200 U.S. metropolitan areas with wages earned by workers in 60 occupations. It was produced by the Center for Housing Policy, the research affiliate of the National Housing Conference.

One of the events occurring is that: "In some cases, people are moving out of jobs they have been trained for and into other sectors which may not pay a living wage," notes Maya Brennan, research associate for the Center for Housing Policy. In addition, prospective buyers must have a viable down payment, outstanding credit history, and solid job security to meet increasingly stringent general lending requirements in today's market—not the easiest set of hurdles to overcome in a shaky economy. "The income needed to purchase a home did drop, but despite that, homeownership is still unaffordable in the vast majority of markets," Brennan observes.

Also, foreclosures are turning owner occupants into renters. At the same time, *Paycheck to Paycheck* notes that for workers in higher-cost areas or in lower-wage jobs, renting a two-bedroom apartment also is unaffordable.

Finally, the sharp contraction of state and local budgets—which traditionally offered crucial support for producing affordable units—has shelved many workforce housing programs. And the federal Low Income Housing Tax Credits (LIHTC) program, a primary resource for funding affordable rental housing over the past two decades, has also been hard hit by bitter economic winds.

Despite these challenges, workforce housing still offers savvy developers and homebuilders an important market opportunity. New and existing federal sources, including New Markets Tax Credits, Historic Tax Credits, and the Neighborhood Stabilization Program, as well as state and local programs, are emerging as important lifelines to meet this market need.

Tax Credits Beleaguered by Fewer Investors

For the past two decades, the federal LIHTC has been a primary driver of production of affordable rental housing—a program widely considered successful in its mission to attract private investment in affordable housing. Workers in lower-paid occupations, such as retail sales people or janitors, are often income-eligible for tax credit units, which are designated for households earning 60 percent of Area Median Income (AMI) or less.

The federal government allocates the credits, which are then awarded by states to eligible projects. Developers or syndicators sell the credits to investors, who use them to reduce their federal income tax over a ten-year period.

Unfortunately, the recent consolidation and shrinkage of several major financial institutions that are major investors in the tax credits—particularly Fannie Mae and Freddie Mac—caused a sharp drop in demand, which in turn has lowered the value of the credits from 90 cents on the dollar in 2007 to less than 75 cents today. As a result, many affordable housing developers are grappling with a funding shortfall from reduced value of the credits, and in some cases are unable to sell the credits at all.

Gandolf Group, based in the greater Minneapolis area, develops LIHTC properties in 12 states, many in smaller markets in the Great Plains and Midwest, but also in Florida and Arizona. The firm has had to adapt its practices to find tax credit investors for projects. One of the group's strategies is to look for investors that got out of the market because the yields were too low. "In more recent deals, we pitch to investors directly and have to offer a higher yield," explains Roger Peterson, the firm's chief operating officer. Gandolf Group is also courting smaller businesses that may be able to take advantage of the credits.

Peterson also noted that it has become more common for a municipality or state to be involved with educating or attracting prospective tax credit investors. "Previously, the syndicator was the lead party in such activities," he says.

The 2009 federal stimulus legislation included two programs that attempt to revive projects stalled by the reduction in LIHTC investors and the drop in the value of the credits. The Tax Credit Assistance Program (TCAP) provides $2.25 billion in gap financing funds to state housing finance agencies to close projects delayed by the drop in tax credit values. In addition, the Tax Credit Exchange Program (TCEP) allows states to exchange part of unused tax credit allocations for cash grants—up to 40 percent of 2009 tax credits, plus any remaining 2008 allocations—at a reduced rate of 85 cents on the dollar.

Opportunities with the New Markets Tax Credit

The New Markets Tax Credit (NMTC), designed to channel investment into low-income communities, is an increasingly attractive finance tool with applications in both rental and for-sale workforce housing. The program is administered by the U.S. Department of Treasury's Community Development Financial Institutions Fund (CDFI). It defines low-income communities broadly to include about 40 percent of the U.S. and most central business districts. Each year, the CDFI Fund allocates NMTCs through a competitive application process to certified for-profit and nonprofit Community Development Entities (nonprofit entities receiving NMTC allocations are responsible for transferring the allocations to one or more for-profit subsidiaries). The CDFI awarded $3.5 billion in NMTC allocations in September 2008, while the 2009 federal stimulus bill provides an additional $1.5 billion to 32 recipients.

The NMTC, which offers a tax credit equal to 39 percent on investments realized over a seven-year period plus attractive after-tax returns of 7 to 12 percent, has thus far remained in demand with investors. It also can be combined for use with tax-exempt financing, tax increment financing, and historic and energy tax credits. With careful segregation of ownership structures, it can be used with LIHTCs as well.

While the NMTC may be an important tool for addressing the financing gap for workforce rental housing, it applies only to mixed-use developments, since one of the requirements is that those developments must earn at least 20 percent of income from commercial real estate.

A good example of success is Squire Park Plaza in Seattle, a six-story mixed-use project that opened in December 2008 with 59 mixed-income apartments, 5,800 square feet of retail space, 3,200 square feet of office space and 2,100 square feet of commercial loft space, as well as a 17,000-square-foot parking garage with 62 stalls. The project emerged as an excellent candidate for NMTC, fulfilling the city's interest in leveraging the property, which is in the close-in Central Area neighborhood, for both workforce housing and economic development. The project also has served as a catalyst for other development in the area, including construction of 258 units of market-rate apartments across the street.

The City of Seattle, the landowner, transferred ownership of the property in 2005 to the Central Area Development Association (CADA), a community-based development organization. (It had been owned by the Department of Housing and Urban Development since the 1960s, but was a vacant lot.) The transfer of land to CADA at below-market rates came with the condition that 51 percent of residential units be reserved for households with an income of 80 percent of AMI or less and that

The Gandolf Group developed the Palmetto Ridge apartments, a low-income housing tax credit project in Titusville, Florida, Brevard County.

PHOTO COURTESY OF THE GANDOLF GROUP

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Squire Park Plaza in Seattle is a six-story mixed-use project with 59 mixed-income apartments.

PHOTO COURTESY OF PACIFIC HOUSING NORTHWEST

it contain at least 6,000 square feet of commercial space. CADA in turn hired Pacific Housing Northwest, a Seattle-based housing developer that builds affordable, workforce, and student housing in the region. As fee developer for the project, Pacific Housing NW was responsible for the programming, design, permitting, finance structuring, and construction phases of the project.

Tim Abell, a principal with Pacific Housing NW, approached Enterprise Community Partners, a national nonprofit and provider of capital and expertise for community development and affordable housing, to explore using tax credits to help finance the project. Enterprise, one of the largest NMTC allocatees in the country, agreed the project was a good match, and allocated $15.5 million in tax credits, which helped to generate a $4.8 million equity investment from Washington Mutual. This investment was further leveraged by loans from the Seattle-based Washington Mutual Bank, the City of Seattle's Office of Economic Development, the Enterprise Community Loan Fund, NeighborWorks America (a nonprofit specializing in revitalizing neighborhoods) predevelopment funds, and equity from CADA, for a total project development cost of $18.5 million.

Some developers are finding added opportunities to combine the benefits of several programs to produce workforce housing. In addition to LIHTC or NMTC, these programs include using federal and/or state historic tax credits, energy and weatherization grants, historic preservation grants, tax exemptions and abatements, and other state and local incentives.

While that level of funding was certainly key to this project, Abell cautions that: "New Markets Tax Credits work best for projects already set up to be compatible with those program [NMTC] requirements. It may be difficult and risky to change a project to comply."

Other essential elements that contributed to the project's success included the city of Seattle's Multifamily Tax Exemption program, which facilitated a larger loan by reducing operating costs through a 12-year property tax exemption on the residential portion in exchange for maintaining a certain number of units for affordable rents. The city also reduced parking requirements from 1.25 spaces per unit to a 1:1 ratio, and the Seattle City Light's BUILT SMART for Affordable Housing program underwrote additional insulation and upgrading to appliances and lighting fixtures to reduce utility costs for residents.

"We could not have done the project without the city's assistance," Abell observes.

How NMTC Worked in Another Area

The NMTC program itself is focused on fostering economic development in designated census tracts, and it is commonly implemented through a mixed-use project with a rental housing component. However, a provision of the NMTC program also makes it possible to use the tax credits to fund the development of for-sale housing. In essence, lenders can make a loan to a developer located in the qualifying census tract that can leverage the equity NMTC produces with its tax credits. The program mandates that the funds from the loans remain invested in qualified projects for the full seven years of the tax credit compliance period.

In the Washington, D.C. area, City First Enterprises is carrying out that mandate through an innovative $75 million community housing trust operated by affiliate City First Homes (CFHomes). The goal is to create 1,000 units of permanently affordable for-sale workforce housing in that city. CFHomes is leveraging $10 million from a city grant with $65 million in private sources, including roughly $45 million in debt and $20 million in NMTC equity. In the first phase, CFHomes will create a leveraged fund of $10 million to support about 120 permanently affordable homes. The fund helps new homeowners through a second mortgage program to buy houses built in mixed-income neighborhoods throughout the city. Homes will be affordable on average to families earning 80 percent of the AMI, and no more than 120 percent of AMI.

The goal of the initiative is to help homebuyers, such as teachers and local government workers, purchase a home but live close to their jobs. John Hamilton, president of CityFirst Enterprises, explains: "We want to help the buyer who would otherwise need to buy further away from the District or continue to rent." Noting that, like other cities across the nation, Washington, D.C. has current budget constraints, he adds: "The District of Columbia is facing significant financial pressures, but the mayor has made a commitment to investing in workforce housing."

For new construction units (15 percent will be rehabilitated foreclosure homes, the rest are new builds or substantial rehabs), CFHomes identifies developers with a good track record and a compatible housing product. In exchange for reserving a designated number of units for the housing trust, CFHomes becomes a "tenant in common" co-owner with the developer during the construction phase, providing a subsidy of $75,000 per unit that functions comparably to a second construction loan. (First construction loans still come from conventional sources.) As each home is purchased by the buyer, the $75,000 becomes a 40-year, low-cost second mortgage that helps the new owner afford the home.

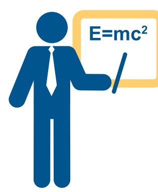
The partnership between developer and CFHomes expands the buyer market for the units, since the subsidy lowers the income needed for purchase and also helps developers meet the District's affordable housing requirements. Sales of the units are conducted jointly using CFHomes' list of prequalified buyers.

As part of the housing trust's shared equity model, when the $75,000 per unit subsidy is converted to a low-interest second mortgage (provided by CFHomes) those buyers exchange

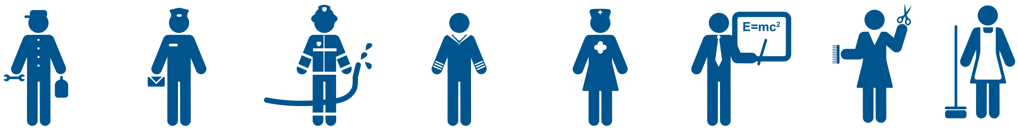
Edgewood Village is a low-income housing tax credit development of single story cottage-style homes in Rapid City, South Dakota.

PHOTO COURTESY THE GANDOLF GROUP

a share of future appreciation. (In the construction phase, the units are co-owned by developer and CFHomes; upon sale of the property, ownership transfers to the homebuyer and CFHomes. Unlike some other community housing trust models, CFHomes is in the chain of title with a deed restriction on the house and the second mortgage on the property, but does not own the land.)



Owners may possess the property as long or as briefly as they like, including passing it on to children as an inheritance. The only two fixed requirements are income eligibility at time of purchase, and owner occupancy of the unit. When homeowners sell their homes, they keep 25 percent of the appraised appreciated value of the property, plus any equity they have accumulated through mortgage payments. The unrealized appreciation then



effectively becomes a grant to the next buyer, which contributes to the home's long-term affordability. The second buyer agrees to the same shared appreciation approach (in exchange for the lower-priced home) and thus preserves the subsidy and the affordability over time. Hamilton points out that, for this reason, the community housing trust offers a crucial step toward building perpetuity into the affordable housing model. "This is a good time to look at how to create workforce housing that will stay that way [as workforce housing]," he says.

Squire Park Plaza was a good candidate for NMTC.

Funding for the first 117 units, located in four sites around the city was scheduled to close in July 2009.

Other Opportunities

Some developers are finding added opportunities to combine the benefits of several programs to produce workforce housing. In addition to LIHTC or NMTC, these programs include using federal and/or state historic tax credits, energy and weatherization grants, historic preservation grants, tax exemptions and abatements, and other state and local incentives.

Many communities also are eagerly eyeing HUD's Neighborhood Stabilization Program (NSP), which was established to help areas threatened by foreclosures and abandonment. These communities see the program as an opportunity to support workforce housing, since one of the conditions to receive NSP funds is that the money must be used for programs that serve households with income no greater than 120 percent of the AMI. Additionally, a quarter of the funds must serve families with earnings of no more than 50 percent AMI. Eligible activities for NSP funds include demolishing blighted structures and redeveloping demolished or vacant properties.

Finally, some homebuilders have found a viable niche by simply identifying market-rate homes they can produce inexpensively and sell at lower price points—thus providing affordable housing to households earning 80 to 120 percent of AMI. For example, Rottlund Homes, a homebuilder in the Twin Cities metro area, targets its products for this market. "Rather than be a builder of all things to all people, we keep ourselves concentrated on the first time homebuyer," explains Michael Noonan, division president for the firm. "We are happy to build more affordable housing—the market base is so much broader. There are simply more people looking to buy their first house at $150,000 than a $1 million house," he adds.

Future Forecast

There's no question that new housing development is going to be more difficult in the short term amid expensive equity and tougher loan standards. However, the serious need for workforce housing remains. Knowledgeable developers and homebuilders can examine how to take advantage of federal programs in conjunction with state and local initiatives to help finance the production of the homes built for the workforce.

While perhaps less widely publicized, local efforts to support the development of a range of housing types are also essential. "Local or state activities have the potential to support or undermine the production of affordably priced housing," observes Noonan, who is also chair of NAHB's land development committee. One of the goals of that committee is to advance measures at the federal, state, and local level to allow builders to build more affordably.

"It is not just what developers and builders do, but rather full commitment and participation of all levels of government. Elected representatives and staff talk of the need for affordable workforce housing, yet when the rubber hits the road, public policy often moves in a totally different direction," he says.

So how can the industry advocate for housing affordable to all members of society?

"It's most achievable when communities support a range of land uses with a mix of densities and the necessary infrastructure," he concludes. **LD**

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