# A Primer on Affordable and Supportive Housing Finance

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As some of you know, through my consulting practice, I have worked with non-profit organizations and community loan funds on affordable housing development projects.

Since I have become involved as a member of the downtown advisory committee in the discussion of alternatives for the Seth Chauncey and Nathan Hale properties, the one question that continually is asked is "Would the $16 million CHFA plans to give to Common Ground for the project be available to projects on other sites in town?"

The purpose of this document is to provide the committee with some information on how affordable or supportive housing developments are financed in today's world, attempt to describe how funds might be used on alternative sites.

In preparing this document, I have reviewed the financial structure of two low-income housing tax credit ("LIHTC") transactions I have been involved in over the last two years, I have reviewed the handouts from Common Ground's June 30 community meeting, and I have reviewed the supportive housing Pilots program information on CHFA's website.

## Financing Programs

According to the June 30 Common Ground handout, they are proposing to create 100 units of supportive housing at cost of $16,000,000 ($160,000 per unit). The $16 million needed for development will come from low-income housing tax credits, HOME funding, the Federal Home Loan Bank's Affordable Housing Program, and a low interest loan from CHFA. They do not detail how much is coming from each program.

Low-income housing tax credits are the primary means of funding affordable housing development in use today. Under this program, the federal government allocates federal income tax credits to each state to be used for affordable housing development, a state agency (CHFA in Connecticut) then allocates the tax credits to individual affordable housing developers (it could be a non-profit agency but it does not have to be) for an individual project. The developer does not want the tax credits, they want money for development, so they sell the tax credits, usually to a tax credit investment fund whose investors include companies like Ford or BankofAmerica. When the process is complete, the affordable housing developer has converted the tax credit which CHFA allocated to it into cash for development, and a company like Ford gets a credit on its income taxes. Tax credits are basically complicated indirect funding from the federal government. Because of the legal structure used, tax credits are considered an equity investment into the project and they do not have to be repaid.

Note that the tax credits have to be used for affordable housing. Also, because of the complexity of the transaction and all the middle men involved, there are economies of scale in tax credit transactions – bigger is better because you get to spread the costs over more units.

CHFA has a finite number of tax credits to allocate each year and they allocate them based on a competitive application process. In my opinion, there is no reason that tax credits earmarked for the Nathan Hale and Seth Chauncey buildings could not be used on other affordable/support housing development elsewhere in town, although the housing authority or a non-profit organization would have to submit an application and have it accepted for funging

The HOME program is federal government grant or loan program for affordable housing development. The federal government allocates a block of money to the states, and a state agency (DECD in Connecticut) allocates the money to individual affordable housing projects using a competitive application process. HOME money is generally thought of as a grant into the project, which does not have to be paid back unless the building is converted to market rate housing or the affordability restrictions expire.

The Federal Home Loan Bank Affordable Housing Program is similar to the HOME program, except the source of funds is controlled by the regional Federal Home Loan Bank in Boston. Again, the money is typically provided in the form of grant. In my opinion, both HOME money and Federal Home Loan Bank money would be available for affordable/supportive housing development elsewhere in town, subject ot a competitive application being submitted.

The only funding Common Ground is proposing that would have to be repaid from the operations of the property (i.e. from the tenant's rents) is the interest loan from CHFA, which I believe would be available for use on projects elsewhere in town.

Comparable Transactions

Having described how the programs work, the next step is to define the percentage of funds that could be expected to come from each of the funding sources. The more debt, the higher the rents have to be. The more equity or grants, the lower the rents can be. The Common Ground documents are silent on how much money is expected to come from each source, but most tax credit transactions are pretty similar.

Presented below are representative development budgets from two real transactions, one completed in 2003 and the other in 2004. Both are in New England, and both involve building rehab and new construction.

| **2003 Project Development Budget** | **Amount** | **Percent** |
|---|---|---|
| LIHTC Proceeds (Equity) | $4,900,000 | 66.1% |
| Historic tax credits (Equity) | $400,000 | 5.4% |
| State HOME funds | $1,200,000 | 16.2% |
| Loan (payment required) | $630,000 | 8.5% |
| Other funds (no payments required) | $285,844 | 3.9% |
| TOTAL | $7,415,844 | 100.0% |
| | | |
| Number of Units | 68 | |
| Cost per Unit | $109,057 | |

| **2004 Project Development Budget** | **Amount** | **Percent** |
|---|---|---|
| LIHTC Proceeds (Equity) | $3,425,191 | 59.8% |
| State/City HOME funds | $825,000 | 14.4% |
| Loan (payment required) | $1,110,000 | 19.4% |
| Other funds (no payments required) | $366,000 | 6.4% |
| TOTAL | $5,726,191 | 100.0% |
| | | |
| Number of Units | 33 | |
| Cost per Unit | $173,521 | |

Based on these two actual transactions, we see that tax credits and grants constitute the bulk of the development funds. Loans are only a small percentage, between 8.5% and 19% of the development budget, implying that the units can be built and kept very affordable.

Using the percentages and the Common Ground project, I have created a hypothetical development budget for 100 units of supportive housing development in Willimantic.

| **Hypothetical Development Budget<br>100 Units in Willimantic** | **Amount** | **Percent** |
|---|---|---|
| LIHTC Proceeds (Equity) | $10,400,000 | 65.0% |
| Historic tax credits (Equity) | $800,000 | 5.0% |
| State HOME funds | $1,200,000 | 15.0% |
| Loan (payment required) | $1,600,000 | 10.0% |
| Other funds (no payments required) | $800,000 | 5.0% |
| TOTAL | $16,000,000 | 100.0% |
| | | |
| Number of Units | 100 | |
| Cost per Unit | $160,000 | |

Market Information

One of the arguments against the Common Ground project is that a cost of $160,000 per unit is excessive in Windham. In comparison, unit costs from the actual tax credit transactions ranged from $109,000 to $173,000, so the Common Ground estimate is on the high side, but still in the range in which tax credit transactions have been done. However, current appraised values for multi-family (4 units and up) properties in Willimantic are approximately $30,000 per unit, so the Common Ground project certainly could be considered expensive in comparison. In reviewing alternative sites, my guess is that a combination of rehabilitated units and newly constructed units could be developed using tax credits at a cost below $160,000 per unit, but probably at a cost still in excess of $100,000 per unit. Tax credit development is expensive.

Another argument I have heard advanced against the Common Ground project states that the rents to be paid by the residents will be too low to cover the cost the monthly mortgage payments. The rents paid by the tenants of any housing development need to be used for two things, first to cover expenses, and then for debt service (e.g. mortgage payments). In the actual development examples cited above, operating expenses are approximately $425 per unit per month and debt service ranges from about $60 per unit per month to over $150 per unit per month. This implies a rent of $500 to $600 per month per unit is needed to breakeven. Because supportive housing units are typically one-bedroom, expenses per unit might be closer to $350 per month, but a rent of approximately $450 per month is still needed to breakeven.

I believe in the Common Ground project there are two methods available to increase income. I am not sure which, if either, of these strategies they are utilizing, but both have been mentioned in the Common Ground material or the CHFA material.

First, of the 100 units proposed, some will be supportive housing and some will be affordable housing. The median income in the community will support an "affordable" monthly rent of approximately $625 per unit per month, so they can blend the lower rents from the supportive units with higher rents from the affordable units, and increase the average rent to a level where costs can be covered. This strategy would work only when development includes both supportive units and affordable units, not if the development included only supportive units.

The second strategy to increase rents involves the use of Section 8 certificates or other rent subsidies. Section 8 certificates and rent subsidies effectively pay the difference between what the resident can pay and the market rent for the unit. These can easily add several hundred dollars per month to the income per unit. Section 8 project-based rental assistance through DSS and HUD Continuum of Care programs are both mentioned under the description of the supportive housing Pilots program on the CHFA website, so presumably these subsidies would be available to any organization developing supportive housing under the Pilots program.

<u>Summary</u>

The information presented shows that it should be economically possible to development any number of affordable/supportive housing units in town using the same sources of financing Common Ground has proposed for their project. It also shows that financing sources are available only for supportive housing and/or affordable housing, but would not be available for other uses downtown such as the renovation of the buildings for commercial uses or market rate housing.