

THE BUZZ

Producing Housing for the Poor: A Challenge Moving to the Front Burner

By Buzz Roberts, Local Initiatives Support Corporation

Congress recently enacted two laws designed to produce housing for poor families and individuals who by any measure have the greatest affordable housing need, and more programs may be on the way. Policymakers want to combine these programs with equity from low-income housing tax credits (LIHTCs).

The challenge for policymakers and practitioners alike is how to assemble financing and other subsidies to produce deeply targeted housing that will succeed over the long run. It's a question mostly of math. In most cases the poor cannot afford rents high enough to support even monthly operating expenses. In other words, even if government subsidies were to cover the entire development cost, some other ongoing resource would be needed to cover a portion of monthly operations.

Congress approved a national Housing Trust Fund as part of last year's major housing bill, the Housing and Economic Recovery Act (HERA). Most of the funding would be used to produce and preserve rental housing for extremely low-income households – those whose income is below either the poverty line or 30 percent of area median income. Money was to come from Fannie Mae and Freddie Mac, but their federal conservatorship and uncertain future makes them an unlikely funding source for now. So the Obama Administration has proposed \$1 billion to launch the Housing Trust Fund from mandatory accounts independent of Fannie, Freddie and the appropriations process. The U.S. Department of Housing and Urban Development (HUD) is now drafting rules to implement the program.

Earlier this year, Congress approved the Homeless Emergency Assistance and Rapid Transition to Housing (HEARTH) Act of 2009, a major overhaul of the McKinney-Vento homeless housing programs. It calls for the production and preservation of housing affordable to the homeless, most of whom are among the poorest of the poor. Congress is also considering additional legislation to provide housing for homeless veterans, a cause President Obama championed when he was in the Senate.

Because of federal budget constraints, these new programs don't come with long-term commitments for project-based rental assistance or operating subsidies. Under the budget rules, Congress must appropriate up-front the total funds required for long-term subsidy commitments. The average cost of a Section 8 Housing Choice Voucher is about \$8,000 annually. A 30-year commitment would cost \$240,000 per unit, plus inflation and the cost of development subsidies. The high cost is why Congress has not made new long-term subsidy commitments since Jimmy Carter was president and it is not likely to do so any time soon.

There are two basic ways to approach the dilemma: provide ongoing project-based subsidies consistent with budget realities or generate an "internal subsidy" by using higher rents from some apartments to offset lower rents on the deeply targeted units.

The internal subsidy approach is appealing because it appears to avoid the need for long-term project-based rent subsidies, but there are severe constraints. The problem is getting enough extra rent from market-rate (or less deeply

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targeted) units. It is generally not practical to blend luxury tenants with poor tenants. There are relatively few markets where developing middle-income rental housing is feasible as a starting point for mixing in deeply targeted units. In a broad sense, there is greater possibility in considering the inclusion of some deeply targeted units within a 100 percent LIHTC project, but tax credits are seldom high enough to support deep targeting of more than 10 percent to 20 percent of units, and in many markets even that would be hard to achieve. While it may be possible to eliminate debt service entirely by combining LIHTC equity with other development subsidies, the underwriting assumption that operating expenses will rise faster than rents forecasts a severe risk to long-term sustainability. All in all, internal subsidies can sometimes help but they do not offer a real solution.

In this context, it is worth revisiting project-based rent subsidies. If Congress won't commit funding for 30 years, what about a shorter term? Public housing authorities and other voucher administrators can project-base up to 20 percent of their vouchers. In addition to enacting the

Housing Trust Fund and modernizing the LIHTC, last year's housing bill revised how project-based vouchers (PBVs) work. HERA now permits an initial PBV contract term of up to 15 years, concurrent with the LIHTC compliance period, and pre-planned renewal terms of up to an additional 15 years, coinciding with an LIHTC 30-year extended use period. What makes PBVs compatible with budget rules is that Congress must still provide an annual appropriation of funds for the overall voucher program. Sponsors and voucher administrators can negotiate an escape clause if Congress fails to do that, and a transitional reserve fund can be created.

So far, so good, but what about the terms of the Housing Trust Fund? If getting a development subsidy from the Housing Trust Fund requires unconditional long-term affordability for the poor, a sponsor could be stuck if funding for a PBV becomes unavailable, even through no fault of the sponsor. It will be crucial for HUD to write rules to allow alternative income targeting in such cases.

The HEARTH Act, which overhauls McKinney-Vento

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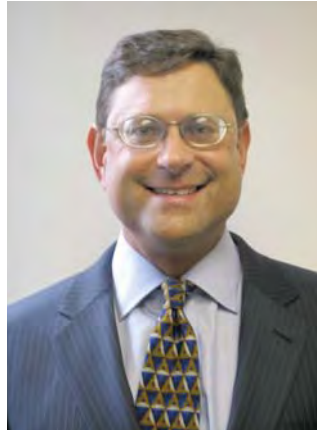
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homeless housing programs, also provides a promising approach that could be applied more widely. HEARTH provides both development subsidies and rental assistance or operating subsidies. The initial term of the rental assistance is 15 years, with the first five years funded and the remainder to be funded from either the project-based Section 8 appropriations account or the McKinney-Vento account. These subsidies may be renewed for terms up to 15 years. The development assistance generally requires a minimum of 15 years use for the homeless, but if the rental or operating assistance is discontinued or homeless needs abate, then LIHTC use restrictions may be substituted.

The HEARTH Act makes sense because it sets public policy expectations and resources to serve a deeply targeted population for an extended term; it works within the budget rules; and it also protects sponsors, lenders and investors in the event that the expected resources

are discontinued. The Housing Trust Fund and other deeply targeted policies can succeed if they reflect the same careful balance. ❖



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