

Permanent Affordability: Practical Solutions



An ANHD White Paper
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Affordable housing remains one of the foremost challenges in New York City. Ever since Mayor Koch's first ten-year housing plan, we have recognized the important role the city, state, and federal government play in ensuring New York remains a vibrant and economically diverse city, and affordable to people from all income levels and walks of life. Since 1987, we have had an amazing record of success – developing almost 300,000 affordable housing units and revitalizing entire neighborhoods. Today, however, we confront a new problem: how to ensure this success does not slip away. We are starting to move backward at an increasingly rapid pace as we lose more and more affordable housing units. Unaddressed, this trickle will soon turn into a flood. Now is the time to start moving forward on a permanent solution to this problem.

[This white paper focuses on the expiring affordability crisis in housing developed by city-sponsored affordable housing programs, and proposes a realistic new approach to underwriting and oversight that can protect the long-term affordability benefits.](#)

Since it was founded in 1974, the Association for Neighborhood and Housing Development (ANHD), a trade association for neighborhood-based housing groups in New York City, has worked to ensure the long-term affordability of publicly subsidized housing. In the 1990s, when affordability restrictions that governed thousands of Mitchell-Lama and HUD assisted housing units began expiring, ANHD—in partnership with other advocates, preservation purchasers, and all levels of government—started our efforts to preserve these units. Informed by this experience, ANHD also has worked to convince policymakers to avoid recreating this expiring-use crisis by changing the way government finances the development of affordable housing.

Specifically, we believe that a requirement of permanent affordability for housing financed by the NYC Department of Housing Preservation and Development (HPD) and NYC Housing Development Corporation (HDC) should be a goal of any new housing policy.

ANHD has pressed both City and State administrations to require permanent affordability when public subsidy, tax incentives, or state and city land are used to create and preserve affordable housing. Housing New York, Mayor de Blasio's Affordable Housing Plan, is committed to creating 200,000 affordable housing units over 10 years, including 40,000 for Very and Extremely Low-Income New Yorkers. This commitment is historic and represents a tremendous investment of public resources for affordable housing.

In its last Permanent Affordability Report, ANHD set out to determine both the total number of city-subsidized units developed between 1987 and 2007, and establish how many of those units are at risk of losing their affordability because of expiring regulatory agreements and mortgages. This period covers both Mayor Koch's original Ten-Year Plan that was

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continued by Mayors Dinkins and Giuliani, and the first four years of Mayor Bloomberg's New Housing Marketplace plan.

According to our analysis, 169,561 of these units may be at risk of losing their affordability between 2017 and 2037 due to either expiring affordability restrictions or physical deterioration. This total does not include units developed under the city's Inclusionary Housing program, which requires permanence, or units under the control of mission-driven not-for-profit owners who are committed to maintaining affordability for the life of the building.

However, with minor modifications to the already-improved underwriting standards, which are described in this paper, existing HPD financing programs could require permanent affordability with a substantially mitigated risk for future year's expenditures. These modifications, coupled with HPD's current focus on asset management oversight, professional and responsible property management, and allowing only known good actors as owner/developers, could effect permanent affordability for a vast subsection of affordable housing developed by the agency, preserving tens of thousands of units of affordable housing for our future generations, and saving billions on replacement costs for the affordable units lost.

CURRENT PROGRESS AND STEPS STILL TO TAKE.

It should be noted that both the City and State have taken some steps to extend affordability for new construction and preservation deals in recent years, many of which were based on ideas and advocacy from ANHD. As follows are new city policies put in place since ANHD first started bringing attention to the expiring use crisis and need for permanently affordable housing.

- All 9% State Tax Credit deals now are required to provide a minimum of 50 years of affordability.
- All 9% City Tax Credit deals are required to provide 60 years of affordability, under the condition that the property has a tax exemption which runs for 60 years as well, which is currently the maximum length allowed for the relevant 420c exemption.
- The city has instituted a policy of putting a reverse-amortization mortgage on its debt provided for many of affordable housing programs. This allows the debt owed to the city by a development to grow throughout the term of the affordability restrictions, without requiring more of a debt payment. The result is that it is more expensive for a profit-motivated owner to buy out of a program, leading to a greater possibility of an extension of affordability in the case of a profit-motivated owner.
- The city has substantially increased its asset management capacity, through a new Division of Asset Management at HPD. This allows the city to continually track both the physical conditions and financial health of buildings it has subsidized, in order to make sure the buildings do not lose affordability through a failure of finances or maintenance.
- The city has committed to a new Mandatory Inclusionary Housing policy, and also committed to permanent affordability for all affordable housing developed under it, extending the policy put in place for Voluntary Inclusionary Zoning program.

However, neither the City nor the State has yet committed to embracing a comprehensive policy of permanent affordability in either its new construction or preservation programs that would ensure that the next generation of subsidized housing does not face a similar expiring-use crisis. ANHD believes that there is still a window of opportunity for engaging in discussion and committing to reshape policy around permanent affordability.

ANHD has long been in conversation with housing officials, policy experts and housing developers across the country to determine what policies and programs other jurisdictions have enacted to enable very long-term and permanent affordability. Numerous cities such as Boston, Chicago, Los Angeles, and San Francisco have surpassed New York in this regard. Some options from other cities to effect permanent affordability include:

- Authorizing the state and city to have a “Purchase Option” in any project developed on public land, with public subsidy, or benefiting from a tax exemption or zoning density bonus. Such an option would put the fate of these units back in the hands of the public agencies that helped create them.
- Land leasing, as opposed to disposing of fee-simple, land provided by public agencies for use as affordable housing. This would allow the city to retain control of the underlying land of the development. One public agency in New York, The New York City Housing Authority (NYCHA) has already instituted this policy.
- Disposing of publicly-owned land to non-profit entities or Community Land Trusts. This would ensure a mission-driven organization controls the underlying land, not a profit-motivated entity.
- Legislating a Tax Exemption that could last beyond the current 60 years, allowing projects to commit to affordability in a financially sustainable manner beyond 60 years.

THE SPECIAL CASE OF INCLUSIONARY HOUSING.

As part of the administration's new Mandatory Inclusionary Housing policy, the affordable housing created is mandated to be permanently affordable. This is a major step forward, however this mandate must be combined with legal structures and underwriting standards to make sure there is sufficient incentive and authority to maintain the affordable component in good physical and financial condition in perpetuity.

In developments where the affordable housing is integrated with the market-rate housing in a single building, the cross-subsidization inherent between the high market rents or carrying charges and the affordable component can be expected to maintain the affordable units permanently. However, in offsite projects, where the affordable housing must be maintained in perpetuity in a separate building, additional policies are needed to make sure that the affordable building stays financially stable, and that the owner stays properly incentivized to fund, maintain and operate the building in a responsible manner.

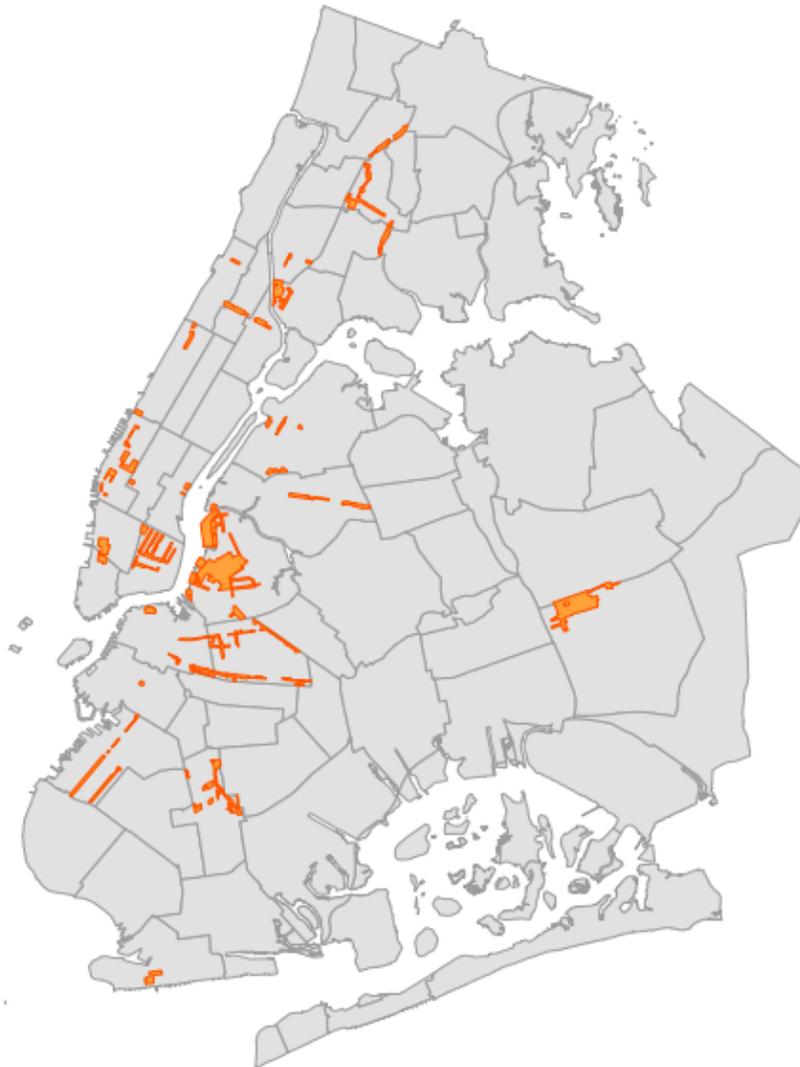
In all cases, some link between the market-rate building and the affordable building must be maintained.

- In the case of an affordable rental building and an offsite rental building, both buildings should be kept in the same LLC or other legal structure, making the market-rate structure legally liable for debts or liens from the affordable structure. This would provide incentive for the owner to properly maintain the affordable building.
- In both condo and rental buildings, a policy of requiring additional market-rate housing in the offsite building could be implemented, in order to maintain cash flow and financial stability. For instance, in the case of a developer constructing a 75 unit market-rate building with an offsite affordable component, instead of requiring a 25-unit affordable building, a 35 unit building with 25 affordable and 10 market-rate units could be required.

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- In both condo and rental buildings, in addition to upfront reserve funding, a certain amount of operating subsidy or reserve replenishing could be required from the market-rate building to go toward the affordable building on an ongoing basis, in order to maintain cash flow on the affordable building.
- In all cases, a responsible nonprofit administering agent, funded by the developer, should be assigned to manage and steward the affordable building.

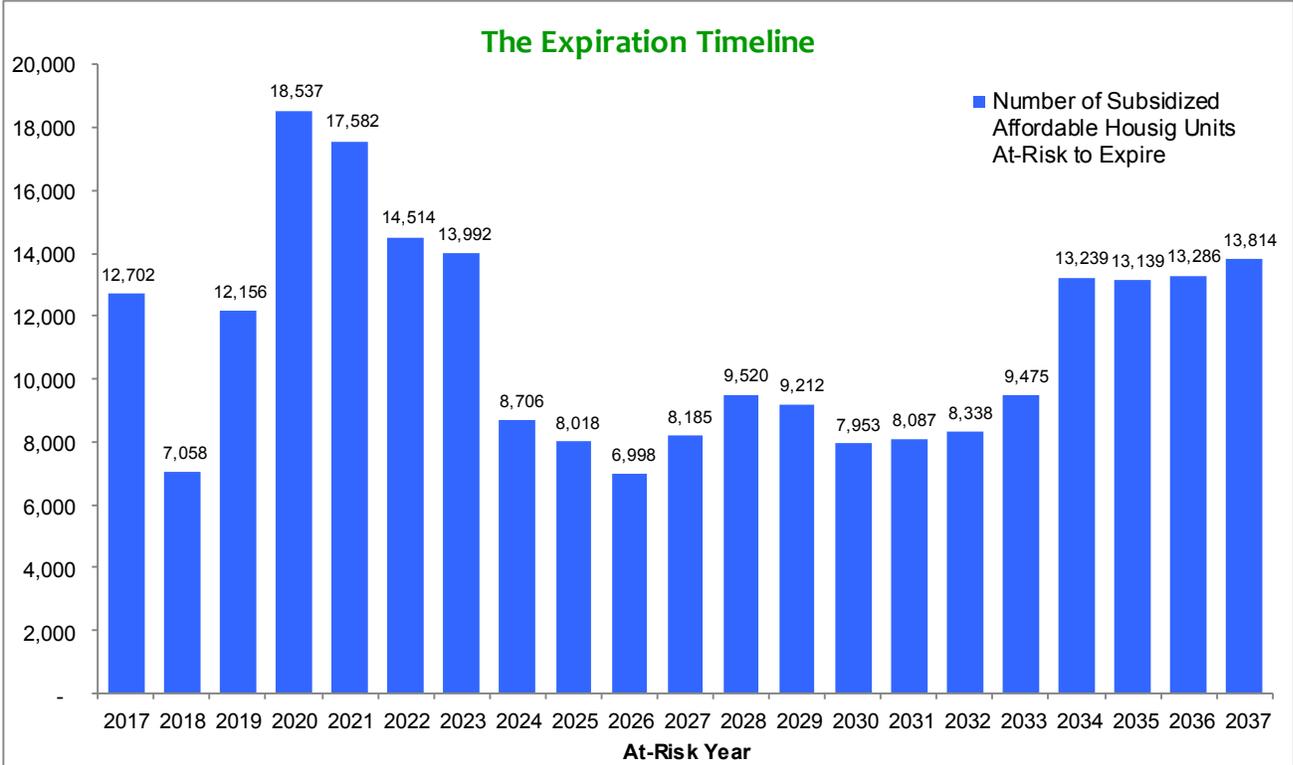
EXISTING NYC VOLUNTARY INCLUSIONARY HOUSING ZONES



THE FISCAL PRUDENCE OF PERMANENTLY AFFORDABLE HOUSING.

We are now on New York’s third housing plan set to produce and preserve affordable housing well in excess of 15,000 units a year. Investment in affordable housing is unprecedented, and is now institutionalized in New York City. The question no longer is if we have an affordable housing program, but how large will it be and what will it build or preserve. And yet, the affordability of housing in New York is consistently at threat. Due to market forces, loopholes in rent regulation, and expiring regulatory agreements in government-sponsored housing, we continually lose more affordable units than we gain. Despite, quite literally, trillions of dollars in government subsidy that has been put into affordable housing over the last three decades, we continue to fall behind. We do our best to stem the tide, but never seem able to reverse it.

From 1990-2005, we lost over 20,000 units of Mitchell-Lama housing – more than a third of the total produced. And the coming decade is set to see over 10,000 units each year of Low-Income Housing Tax Credit developments able to opt-out of affordability restrictions. Already, private affordable housing developers are buying out of their commitments in now-gentrifying neighborhoods, with two portfolios selling for market valuation even before their affordability restrictions expire.



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We must end this revolving door of affordability, which is both bad for our citizens and bad for our budget – instead of creating affordable housing for the short-term, which is then replaced by more short-term affordable housing, we must ensure the housing we subsidize stays affordable permanently.

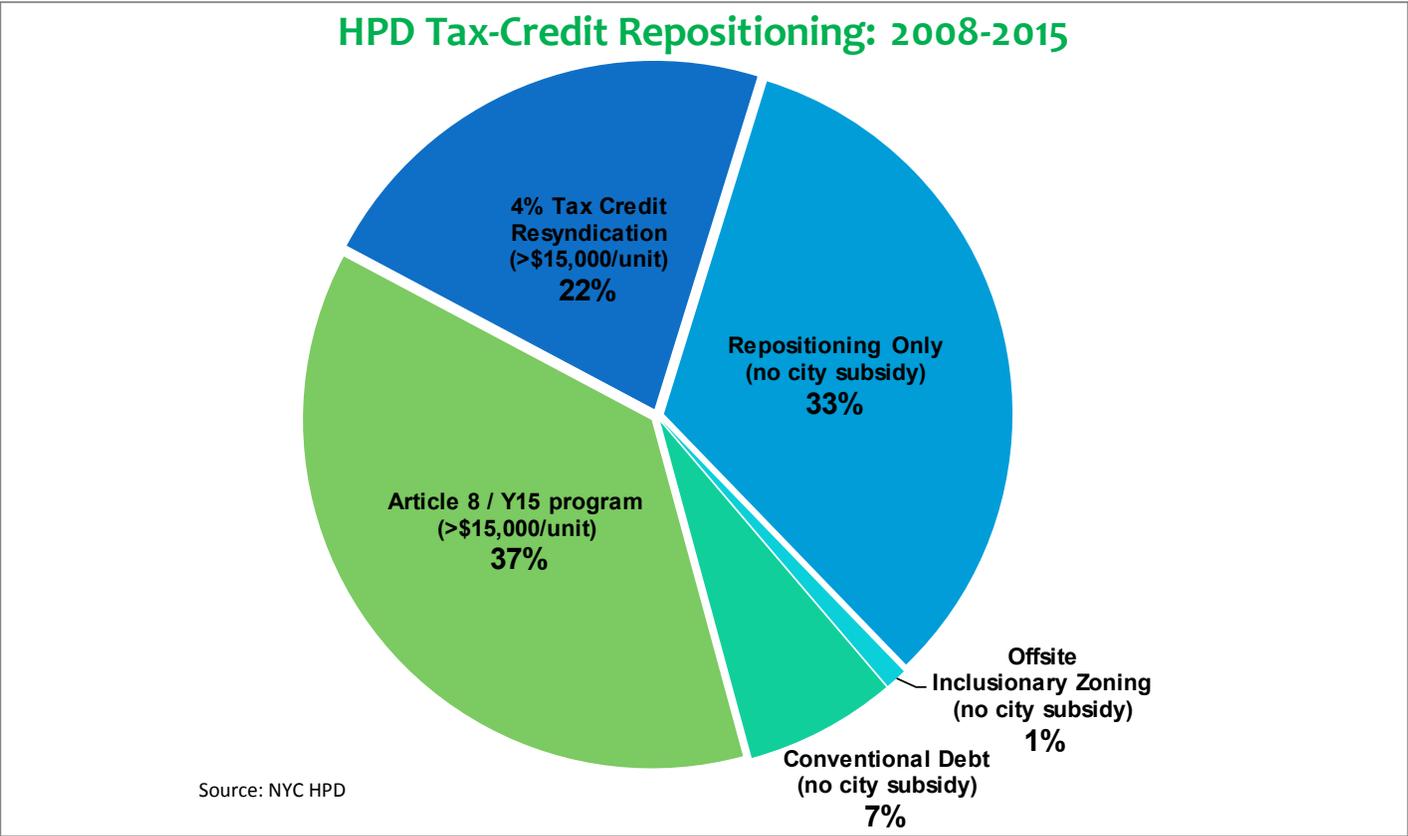
And a policy of permanent affordability would not only preserve our affordable housing stock for future generations, it would also be a means to save money. This would happen in three main ways.

- A policy of permanent affordability would reduce the cost of legal and advocacy protection for households living in expiring-use affordable housing. When regulations keeping an apartment affordable expire, existing tenants who retain low rents are often pressured to move, in order to fully turn over the apartment to market rates. This results in substantial time and money expended by the government combating this process and protecting existing tenants in expiring use buildings.
- A policy of permanent affordability would reduce the substantial amount of government subsidy used to preserve expiring projects. Currently, when a privately-owned affordable housing development's regulatory agreement expires, the owner weighs two options: the value of cashing out and going to market, versus the value the government will provide him or her to keep the property affordable. As a result, up to 30% of HPD and HDC subsidy is spent on preserving the affordability of existing projects. And much of this subsidy is not put toward bricks and mortar renovation, but instead is put toward compensating the building owners for the increased property values, in order to compete with the private market.
- While it is true that maintaining affordable housing often requires a reinvestment on the part of the government, this reinvestment is substantially less than the investment required to build a new unit of affordable housing. And this is especially true in high-value neighborhoods, which still retain some affordable housing from previous projects built when land costs were low or city-owned land was available, but in which high land costs now make constructing new affordable housing a very unlikely proposition.

TAX CREDIT HOUSING: EXISTING NEEDS AND CONDITIONS.

HPD has repositioned over 13,000 affordable tax credit apartments between 2007 and 2015. Repositioning generally takes place between 15 and 18 years after the development was originally built, meaning most of the housing repositioned was originally developed between the late 1980s and the late 1990s. Many of these units were built in neighborhoods that now command substantial market rents, such as Williamsburg, Harlem, and the Lower East Side. And the vast majority of these units were owned and controlled by non-profit entities, meaning that the amount used to preserve them covered only needed renovations and funding, instead of providing additional subsidy to compete against market valuations, as would be necessary with for-profit owned buildings.

In these repositionings, fully 40% did not require any additional city capital in order to be renovated and repositioned. An additional 37% required less than \$15,000/unit in renovations through the existing Article 8/Year 15 rehabilitation program. Less than 1/4th needed significant reinvestment through tax exempt bonds and 4% credits, which allow for more robust renovations.



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\$15,000 per dwelling unit is a very small amount for a rehabilitation project, indicative of a light/moderate rehab. It generally allows for some necessary systems replacements, as well as cosmetic work and light masonry work such as repointing. Even allowing for a similar amount in rehabilitation costs at year 30 (for a total of up to \$30,000), this is still less than 10% of the city subsidy needed to construct a new unit of comparable affordable housing, if the affordability were instead allowed to expire along with the regulatory agreement at Year 30.

The Article 8/Year 15 rehabilitation program does not allow for large-scale rehabilitation or interior apartment work. Projects needing such work are generally portfolios that are physically distressed, and have issues with proper property and asset management. In these cases, HPD has allowed portfolios to resyndicate with Tax-Exempt Bonds and 4% Tax-Credits, allowing for a much more robust renovation, provided the portfolios undergo a change in management. This option is only available to large (300 unit+) portfolios, in order to take advantage of the economies of scale necessary for Bond refinancing.

HPD staff indicated (though precise data was unavailable) that most of the buildings that required additional subsidy were in smaller and older buildings, meaning 30 unit or less pre-WWII buildings. This is a definable subsection of the affordable housing stock. Because of the value of economies of scale, smaller buildings require more per dwelling unit to operate, requiring greater investment. This status that has since been reflected in the underwriting of the current HPD Y15 rehabilitation programs, but was not reflected in the initial underwriting for these projects in the early 1990s, when these projects were originally renovated or gut rehabilitated. In addition, these older projects typically did not have the reserve requirements and cash flow requirements that have since been determined as necessary to maintain stable buildings. However, with minor modifications to the already-improved underwriting standards, existing HPD financing programs could require permanent affordability with a substantially mitigated risk for future year's expenditures.

SOUND UNDERWRITING, THE KEY TO SUCCESS.

There has been some concern that permanent affordability may create an implied commitment of city financing to either renovate buildings or recapitalize operating reserves. However, ANHD has commissioned detailed underwriting scenarios, and found that minimal initial underwriting adjustments to existing programs would substantially mitigate this risk. Owners can be provided not only with sufficient resources to ensure long-term project viability, but also a healthy return on their investment, with some up-front financing changes.

Proposed modifications were developed for three HPD/HDC term sheets: A development based on the 50/30/20 program and a development based on the M2 program, both of which utilize tax-exempt financing, 4% tax credits, and city subsidy; and an all low-income project utilizing 9% Low-Income Housing Tax-Credits and city subsidy under the current ELLA term sheets. These modifications can also be adjusted and applied to other HPD/HDC term sheets for low- and mixed-income projects.

As follows is a summary of the underwriting adjustments we have found would be needed to effect permanent affordability:

Up-Front Reserve Funding.

Bricks and mortar are only part of an affordable housing project. Cash reserves are also considered part of the development, staying in dedicated accounts, with disbursements for building needs often needing permission of the limited partner or governmental oversight entity as well as the owner/developer. Because affordable housing developments have limited ability to increase income to cover added costs, robust reserve funding, in order to make sure a building is able both able to sustain itself operationally and engage in needed large-scale maintenance and rehabilitation, is needed in order to make sure this financial cushion is there to do so as long for as the affordability restrictions last. Underwriting adjustments that would be needed are:

- An increase in the up-front replacement reserves. Replacement reserves are generally intended to be used as a source of funds for large-scale building systems replacements. \$5,000/unit in M2 and 50/30/20 projects would be needed, which are moderate increases from the former \$1000/unit that was typical under 4% tax credit programs. \$15,000/unit in 9% LIHTC deals would be needed as an up front replacement reserve, which is a more substantial increase from former standards of up to \$1,000/unit.

- A solidifying of the commitment to funding current up-front operating reserves. Operating reserves are generally intended to be a source of funds for continuing the operations of the building in situations where income will not cover necessary expenditures for a building. This can happen for periods of time due to collection issues, nonpayment of rent, or higher-than-expected maintenance or operations costs. Four months of Maintenance and Operating (M&O) and Debt Service in M2 and 50/30/20 projects would be needed, which is substantially similar to the current underwriting. Six months of M&O and Debt Service would be needed for 9% LIHTC projects, which is also substantially similar to existing typical underwriting.

Ongoing Reserve Funding.

Cash flow from affordable housing projects is generally small and steady, with limited potential for increase. This cash flow needs to be primarily used to shore up building finances and reserves, rather than be paid out to the developer/owner, or otherwise extracted from the building. Underwriting adjustments that would be needed are:

- A steady and more generous funding of the replacement reserves on an ongoing basis. Reserves need to be continually furnished out of cash flow in order to be substantial enough to cover needed large-scale maintenance. An initial mandatory minimum of \$400/unit/year in Replacement Reserves in M2 and 50/30/20 projects, and \$750/unit/year in 9% LIHTC projects, would be needed. This would be increased by 3% each year for the M2 and 50/30/20 developments, and 5% each year for the 9% developments.
- A steady and more generous funding of operating reserves on an ongoing basis. Operating reserves also need to be continually furnished out of cash flow in order to be substantial enough to cover the times when operational funding is needed. This would be underwritten at the equivalent of 22.5% of annual cash flow in M2 and 20% in 50/30/20 projects, and 50% of annual cash flow in 9% LIHTC projects.
- As part of these adjustments, in some cases the payment of the developer fees would need to be restructured to allow for sufficient cash flow to the reserves.

An extension of tax exemption benefits.

Real Estate taxes for rental properties in New York City can be very costly, up to 1/3 of the building's income in some cases. As a result, virtually all affordable housing developments are granted a substantial, or even full, tax exemption. These tax exemptions have varying lengths, and the length of affordability is not always correlated with the length of the exemption. In many cases, the financial distress of 100% affordable housing developments can be directly traced to the tax burden these

projects face when the exemption expires and tax payments become substantial, but the affordability restrictions remain in place and the building's income stays flat.

In order to effect the changes necessary, new city and state legislation would need to be introduced. These are the only changes in our underwriting models that would need legislative action, as opposed to a simple policy change in the part of HPD and HDC. Underwriting adjustments that would be needed are:

- An extension of 420c benefits for nonprofit controlled ownership for longer than 60 years, which is the current maximum term allowed. A 420c exemption allows for buildings that were currently or formerly developed with Low Income Housing Tax Credits to receive an as-of-right 100% tax exemption, as long as the building is owned at least 50% by a 501c(3) entity. In practice, almost all LIHTC projects, including those owned and managed by for-profit entities, use this tax exemption through a legal work-around in which a technical 50-50 partnership is undertaken with a not-for-profit entity, but ownership and control stay with the for-profit entity.
- This extension of 420c benefits would run in conjunction with a regulatory agreement requiring and governing affordability. Legislative authority to extend the mortgage authority of HPD and HDC may also be pursued in conjunction with this change, as could legislation to properly reserve this exemption for genuine not-for-profit ownership only. Again, it should be noted that the 9% tax-credit Qualified Allocation Plan (QAP) already explicitly links the length of the tax abatement to the length of affordability, requiring 60 years of affordability as long as the 60 year tax exemption is also available.
- Creating a formula-based Payment In Lieu Of Taxes (PILOT) program, similar to the current Article XI exemption, which would be available for mixed-income programs such as M2 and 50/30/20 for the life of the building. An Article XI exemption is a discretionary exemption which must be passed by New York City Council, and is available for developments where the ownership structure is a Housing Development Fund Company (HDFC). A percentage of annual Net Project Cash Flow is paid as a PILOT, which allows for mixed-income projects which end up with substantial cash flow to maintain affordability while also paying their fair share in PILOT payments. Currently, most mixed-income developments utilize a 421a exemption, however this exemption is time-limited and, as it is also available to projects with very little affordable housing, should not be extended permanently.

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Taken together, the above underwriting changes require a slight increase in up-front project subsidies, as well as a commitment to an ongoing tax exemption to run permanently in conjunction with affordability restrictions. However, these would effectively and responsibly enable permanent affordability for HPD and HDC funded affordable housing, with only problem or exception projects requiring future subsidies. And despite the upfront investment, this policy would save a great deal of money in the future due to decreased subsidy for both preservation (to compete against the market when affordability restrictions expire) and new construction (due to less need to replace formerly affordable units whose affordability restrictions have expired and gone to market).

Our own experiences, as well as those of other cities, have taught us that how we can ensure that our affordable housing remains affordable is a problem that can be solved. We possess the mechanisms, knowledge and creativity required to move toward Permanent Affordability. The next step is to find the will to implement these policies so that the affordable housing of today is preserved for the future.

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