

## Funding Strategies for Developing and Operating Extremely Low Income Housing

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# HTF Focused on ELI Renters



The national Housing Trust Fund (HTF) is designed to expand supply of rental housing affordable to extremely low income (ELI) households earning less than 30% of area median income (AMI).

- At least 80% of HTF funds must be used for rental housing.
  - At least 75% of the funds used for rental housing must serve ELI households.
- Up to 33% of HTF funds can be used to cover operating costs and/or operating cost reserves.

# Strategies to Cover Operating Costs



- Rents ELI households can afford often do not cover project's operating costs.
- Technical Assistance Collaborative (TAC) and National Low Income Housing Coalition (NLIHC) identified 5 strategies that have been adopted by states and localities to address this issue.

# Cross Subsidization



Cross Subsidization: Blending ELI units and units affordable to higher income households.

- Revenue from higher income households in mixed-income properties help offset lower rents from ELI households to meet operating costs.
- Housing Choice Vouchers (HCV) in Low Income Housing Tax Credit (LIHTC or Housing Tax Credit) units can offer higher payment standards than LIHTC rents.
  - These higher rents cross subsidize rents for other ELI households who do not have HCV.

# Capitalizing Operating Reserves

(part 1)



An operating reserve is money set aside upfront to support a project's operating costs.

- Reserve can be drawn down over time to make up difference between the rent an ELI household can afford and the cost of operating that unit.

# Capitalizing Operating Reserves

(part 2)



The Pennsylvania Housing Finance Agency subsidizes operating costs at LIHTC projects that include set-aside of ELI units.

- Allows for a 5% increase to developer fee if that 5% increment is used to capitalize an operating reserve for ELI units.

Relation to HTF: HTF entities may set aside up to 33% of their HTF allocation to capitalize an operating reserve for HTF-assisted units administered at the project level.

# Rent Subsidy or Operating Assistance (part 1)



Rental subsidies or operating assistance funds:

- Cover difference between the rent (revenue) needed to meet operating expenses and the rent ELI households can afford to pay.
- Administered on ongoing basis to support deficits in operating income needed to meet expenses.

# Rent Subsidy or Operating Assistance (part 2)



- North Carolina Housing Finance Agency's Key Program:
  - Annual appropriations provide project-based rental assistance to ELI units required as a set-aside in all LIHTC projects.
  - Managed at state level (not project level).

Relation to HTF: HTF entities may use up to 33% of HTF allocation to provide operating assistance to HTF-assisted units, administered at state level.



# Reducing Mortgage Debt



Reducing or eliminating mortgage debt lowers the cost of debt service over project's lifespan, enabling more deeply targeted rents.

- City provides below market (or donated) property, reducing capital costs and mortgage debt.
- Philanthropy provides financial aid to reduce debt supporting ELI targeted rents over given timeframe.

Relation to HTF: HTF may be used for capital costs to reduce or eliminate mortgage debt to achieve ELI targeting.

# Layered Funding Streams



Most projects with ELI units use multiple funding sources to achieve deep income targeting.

Relation to HTF: HTF may be layered with housing production subsidies targeted at higher income households (LIHTC or HOME) to help cover the cost of units targeted to ELI households.

# HTF Regulations: Operating Assistance (part 1)



- Up to 33% of state's annual HTF allocation can be used to cover operating costs and/or operating cost reserves.
- May only be provided to units receiving HTF capital assistance, those units acquired, rehabilitated, or newly constructed with HTF.

[§200(a)(1)]

# HTF Regulations: Operating Assistance (part 2)



- Operating Costs: insurance, utilities, real property taxes, maintenance, and scheduled payments to a reserve for replacement of major systems.
- Eligible amount HTF fund per unit for operating cost assistance is based on deficit after monthly rent payment for HTF-assisted unit is applied to unit's share of monthly operating costs.
- Maximum amount of operating cost assistance that can be provided to HTF-assisted project must be based on project underwriting.

# HTF Regulations: Operating Assistance (part 3)



- Written agreement between state and developer may commit, from a fiscal year HTF grant, funds for operating cost assistance for multiyear period, as long as funds spent within five years.
- State may renew operating cost assistance with future HTF grants during affordability period (minimum of 30 years).
- Amount must be based on need for operating cost assistance at time assistance is renewed.

# HTF Regulations: Operating Assistance Reserve (part 1)



- Operating cost assistance reserve may be funded by state for HTF-assisted units when state underwriting determines reserve is necessary to ensure project's financial feasibility.
- If funded with non-appropriated HTF funds (Fannie Mae and Freddie Mac), reserve may be funded for entire affordability period.

[§201(e)(2)]

# HTF Regulations: Operating Assistance Reserve (part 2)



## Preamble to regulations:

- HUD understands need for both capital (replacement) and operating reserves.
- Funding for capital or operating reserves “up front” for present value of entire amount needed for affordability period (minimum of 30 years).
- Could be funded in phases from future HTF grants.

# Eligible Project Soft Cost: Initial Operating Deficit Reserve



Unrelated to operating cost reserve:

- Eligible project soft cost: cost of funding initial operating deficit reserve when HTF used for new construction or rehab.
  - Used to meet shortfall in project income during rent-up (up to 18 months).
  - May only be used for operating expenses, scheduled payments to replacement reserve, and debt service.



# HTF Developer Advisory Group: Three Options to Consider



1. Centrally Managed Operating Assistance.
2. Project-Level Operating Reserve.
3. Using HTF for Project Capitalization.

# Centrally Managed Operating Assistance (part 1)



This is where a state holds and manages up to 33% of its annual HTF allocation for operating assistance to allocate to projects.

- Could operate like HUD Section 202 Elderly Housing Project Rental Assistance Contract (PRAC) administered by state Housing Finance Agency.
- State agencies that administer project-based Section 8 or vouchers probably have capacity.

# Centrally Managed Operating Assistance (part 2)



## Considerations:

- State agencies without experience administering a rental subsidy program should probably not consider this option.
- HTF regulations require HTF \$ be “spent” in five years of original grant from HUD.
- Might limit amount of HTF \$ available for future projects because projects receiving operating assistance likely to need renewed operating assistance past initial five years.

# Project-Level Operating Reserve (part 1)



- Developers use HTF to capitalize a reserve at the project level as part of development budget.
  - Categorized as an operating assistance reserve.
  - Increases ability to leverage other resources.
- Developers would create an escrow account or other form of fund disbursement agreement to manage funds.

# Project-Level Operating Reserve (part 2)



Suggest establishing “flat subsidies” with rents underwritten to a specific AMI threshold, such as 15% or 20% AMI, rather than being subsidized at 30% of household income because:

- They’re easier to administer & involve fewer compliance costs and complexities.
- It’s hard to predict how long the operating assistance reserve will last if project pays difference between the contract rent and 30% of actual income.

# Project-Level Operating Reserve (part 3)



## Considerations:

1. Works best where fair market rents are similar to 60% AMI LIHTC rent levels.
2. Flat subsidy should be low enough that residents are not cost burdened.
3. If you structure operating assistance reserve to last 15 years, you need to plan for what happens after that.

# Project-Level Operating Reserve (part 4)



## Considerations:

4. How reserve is structured as part of development budget and its impact on total development costs per unit (to keep from having high TDC).

- Separating these costs from budget or listing them in own budget line will distinguish the reserve from other hard and soft costs.
- HUD FAQ clearly states that operating reserves are not included in HTF subsidy limits.

# Using HTF for Project Capitalization (part 1)



Use HTF as deeper project capitalization up-front, reducing size of hard debt.

- Capitalization as grant or no-interest loan.
- Provides stronger equity position, making it easier to attract other lenders.
- Use equity as future resource for operating reserve.



# Using HTF for Project Capitalization (part 2)



- If LIHTC assists project, prevent reduction of eligible basis.
  - No-interest loan should have maturity date later than other debt.
  - No-interest loan should not be source of regular cash flow.

# Using HTF for Project Capitalization (part 3)



Two ways to pursue HTF project capitalization approach:

## 1. Cross subsidization:

- Mixed-income projects with multiple funding sources.
- Combine ELI units with higher income units.
- Rents paid by higher income offset lower rents paid by ELI households.

*Cross subsidization continues*

# Using HTF for Project Capitalization (part 4)



## 1. Cross subsidization, *continued*

- Helps meet operating costs of entire project.
- Lowers amount needed for first mortgage debt.
- Works best in higher cost rental markets with very high demand where project can carry market-rate units at 60%-80% AMI rents.

# Using HTF for Project Capitalization (part 5)



Two ways to pursue HTF project capitalization approach:

2. Establish project-based operating reserve funded from:

- a. LIHTC equity, or
- b. Increased developer's fee to cover difference between LIHTC rent levels (50% or 60% AMI) and rents at 20% or 30% AMI for 15- or 30-year term.

# Resources



Available at [www.NHTF.org](http://www.NHTF.org):

- HTF Developer Advisory Group. Available for calls or emails for advice, answers to questions, etc.
- “Funding Strategies for Developing and Operating ELI Housing”
- “HTF Operating Assistance Options and Considerations”

# Resources



- *Aligning federal low income housing programs with housing need*, NLIHC, <http://bit.ly/24qsFBW>.
- *Creating new integrated permanent supportive housing opportunities for ELI households: A vision for the future of the National Housing Trust Fund*, TAC <http://bit.ly/1TKELgY>.
- *Model Approaches to Providing Homes to Extremely Low Income Households*, Center for Community Change Housing Trust Fund Project, <http://bit.ly/1TKELgY>.

# Developer Reflections and Q&A



Two members of the HTF Developers Advisory Group:

- Former Homes for America President and CEO Nancy Rase
- Community Frameworks Senior Housing and Community Developer Ginger Segel

# Become an NLIHC Member



- We urge you to join NLIHC to support our efforts to advocate on behalf of the lowest income people in need of safe and affordable homes: to end housing poverty and homelessness.
- Membership is open to individuals, organizations, corporations, and government agencies – at whatever level you can afford.
- Join NLIHC at <http://nlihc.org/membership>
- Contact [outreach@nlihc.org](mailto:outreach@nlihc.org) or call 202-662-1530, ask to speak to your Housing Advocacy Organizer.