Fall GFOA Presentation

Parker Poe Adams & Bernstein LLP

WHAT IS AFFORDABLE HOUSING AND HOW IS IT FINANCED?

Emily Luther and Ray Jones

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I. What is Affordable Housing?

- Commonly, the term "affordable housing" encompasses several different types of housing developments.
- Some people use the term "affordable housing" to mean "workforce housing." Others may use the term to describe projects financed with low-income housing tax credits. The term is also used to describe developments which are covered by Housing Assistance Payment contracts available under Section 8 of the U.S. Housing Act of 1937 ("HAP Contracts").
- Ultimately, "affordable housing" includes any housing which is restricted in some way. It could be that the housing is restricted so that:
    - only individuals and families earning at or below a certain income threshold live at the development;
    - the rents that are charged to the tenants living at the development are capped at a certain percentage of the tenant's income; or
    - both the income levels of tenants that may live at the development and the rents charged to those tenants are restricted.
- Whatever the restrictions or whatever the type of project, determining affordability is based on a standard called the area median income ("AMI") of the county or metropolitan statistical area in which an affordable housing development is located.
- The AMI of an area is calculated and published annually by the U.S. Department of Housing and Urban Development ("HUD").
- HUD's AMI tables are also adjusted for family size.
- Determining the percentage of the AMI that individuals or families occupying the project earn will determine the type of affordable housing project.
    - For example, "workforce housing" serves individuals and families that earn between 80% and 120% of the AMI for an area.
    - Projects financed with low-income housing tax credits or tax-exempt bonds most frequently serve individuals and families which earn 80% of AMI or less, with additional specific reservations for individuals and families earning either 50% or 60% of the AMI.
    - Projects which are covered by HAP contracts frequently serve individuals and families which earn below 50% of the AMI.
- In order to ensure that affordable housing developments serve the intended populations, restrictive covenants are often executed and recorded in the real property records of the county in which the affordable housing project is located.
    - Sometimes – like when an affordable housing project is bond-financed – the covenants are executed with the issuer of and trustee for the bonds.
    - Other times, the covenants may be self-imposed by the owner and operator of an affordable housing development.

II. Need for Affordable Housing (2021 SC Housing Needs Assessment Report)

- 40 out of 46 counties a basic 2 bedroom apartment was not affordable
  - Meaning that the average hourly wage for that county would not allow a person to rent a 2 bedroom apartment without spending more than 30% of gross income
  - Average wage required to rent a 2 bedroom apartment at 30% gross across the state is $17.30, but average wage of renters across the state is only $13.52
- Among the 30 most common jobs in SC, 20 have hourly wages less than the $17.30/hr noted above
- 24% of renters are "severely cost burdened" (spend more than half their gross income on rent)
- There are only enough subsidized housing units (captures HUD loans and LIHTC) to serve 20% of low-income renters
  - Greenville, Charleston and Richland had the most low-income renters in unsubsidized units
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III. Methods of Financing Affordable Housing Projects

- General
  - Affordable housing may be financed with tax-exempt bonds.
  - Tax-exempt bonds that are issued to finance affordable housing are either bonds issued under Section 142(d) of the Internal Revenue Code or under Section 145 of the Internal Revenue Code (which are more commonly known as "qualified 501(c)(3) bonds").
  - Local Housing Authorities may issue Essential Purpose Bonds to finance assets owned by the authorities.
  - Affordable Housing may also be conventionally financed.
  - Affordable Housing finance can be combined with State and Federal Tax Credits and often depends on a property tax exemption.
  - Local programs and incentives may also contribute to affordable housing.
- Section 142(d) Bonds
  - Tax-exempt bonds issued under Section 142(d) of the Internal Revenue Code are conduit bonds and are issued by conduit issuers – like the Jobs-Economic Development Authority, the South Carolina Housing Finance and Development Authority, or local housing authorities.
  - The proceeds of the bonds are loaned by the issuers to private entities which acquire, construct, develop, rehabilitate or improve the affordable housing development.
  - The bonds are repaid solely from the revenues generated by the affordable housing development. The credit and resources of the conduit issuer are not pledged or available for the repayment of the bonds.
  - Bonds to be issued for affordable housing projects under Section 142(d) require an allocation of the state ceiling of volume cap (also known as "Volume Cap") in an amount equal to the amount of tax-exempt bonds.
  - In South Carolina, the State Fiscal Accountability Authority ("SFAA") controls the allocation of the Volume Cap. The SFAA determines the amount and time the Volume Cap is available for tax-exempt bonds issued for affordable housing projects.
  - Affordable housing projects which are financed with tax-exempt bonds issued under Section 142(d) are required to place restrictions on the project to ensure that the appropriate population resides at the development.
    - The restrictions must require that at least
      - 20 percent or more of the residential units are occupied by individuals whose income is 50 percent or less of AMI, or
      - 40 percent or more of the residential units are occupied by individuals whose income is 60 percent or less of AMI.
- Qualified 501(c)(3) Bonds

- Like tax-exempt bonds issued under Section 142(d), qualified 501(c)(3) bonds, are conduit bonds. However, as the name suggests, qualified 501(c)(3) bonds may only be issued for projects 100% owned by charitable organizations that are exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code.
- Unlike tax-exempt bonds issued for affordable housing projects under Section 142(d), qualified 501(c)(3) bonds do not require an allocation of the Volume Cap before the bonds are issued.
- Certain affordable housing projects which are financed utilizing qualified 501(c)(3) bonds must also put restrictions in place in order to ensure that the project is serving the appropriate population.
- Most often the restrictions are based on the Internal Revenue Service's Revenue Procedure 96-32 which establishes the "safe-harbor" criteria that an organization providing affordable housing must meet to qualify as a charitable organization under section 501(c)(3) of the Internal Revenue Code. These criteria are:
    - At least 75% of the units are occupied by individuals or families earning 80% of the AMI or less; AND of those 75% at least,
        - 20% of the units are occupied by individuals or families earning 50% of the AMI or less; OR
        - 40% of the units are occupied by individuals or families earning 60% of the AMI or less.

- Low Income Housing Tax Credits
    - In addition to tax-exempt bond financing as described above, affordable housing projects are also financed using state and federal low-income housing tax credits ("LIHTCs").
    - LIHTCs are used to finance projects through equity investments in the partnership or limited liability company owning the affordable housing development.
    - There are two types of LIHTCs available for affordable housing projects – the 9% credit and the 4% credit.
        - The 9% credit is not typically paired with any debt financing.
        - However, to utilize the 4% credit, at least 50% of the costs of acquiring, constructing or rehabilitating an affordable housing project must be financed using tax-exempt bonds issued pursuant to Section 142(d).
        - As mentioned above, tax-exempt bonds issued under Section 142(d) must receive an allocation of the Volume Cap prior to issuance. This includes tax-exempt bonds issued in connection with the 4% credit.
- Essential Purpose Bonds
    - South Carolina law permits local housing authorities to issue revenue bonds for its corporate purposes known as Essential Purpose Bonds, or "EPBs".
    - EPBs are limited obligations to be repaid solely from revenues of the project and secured by a mortgage on the project. No other assets or credit of the housing authority are pledged.
    - The housing authority owns the project financed with EPBs.
    - The project is exempt from taxation because it is owned by the housing authority.
    - Projects financed with EPBs do not have the same income or rent restriction requirements of Projects financed with other types of bonds.
    - This means the housing authority can decide what restrictions it wishes to impose (e.g. 75%-150% of AMI or lower levels such as 50% or 60% of AMI) so long as the restrictions are in line with the housing authority's purpose.
- Property Tax Exemption
    - South Carolina Code Annotated section 12-37-220(B)(11)(e) grants a complete exemption from *ad valorem* property taxes for certain property owned by a nonprofit housing corporation or an instrumentality of a nonprofit housing corporation.
    - To be eligible for the exemption, three criteria must be satisfied:

        - The nonprofit housing corporation, or an instrumentality of the nonprofit housing corporation, must own the property;
        - The devoted use of the property must be the provision of housing for very low or low income residents; and
        - The nonprofit housing corporation must satisfy the safe-harbor provisions of Revenue Procedure 96-32.
- H-Tax and A-Tax
    - Recently amended to add affordable housing the development of workforce housing as an allowable use of state and local accommodations taxes and hospitality taxes.
    - Workforce housing is defined as housing for rent or sale that is appropriately priced for rent or sale to a person or family whose income falls within 30% and 120% of the AMI.
    - Bonds may be issued secured by these taxes.
    - Housing initiatives could also be funded directly
- Local Programs
    - Counties may adopt programs granting special source revenue credits to promote affordable housing.
    - These programs may designate varying AMI brackets to target "workforce housing" (think 80-120% AMI) or "affordable housing (think 30-80% AMI).

IV. The Shortage of Affordable Housing and Challenges to Financing

- In 2020, to help address a deep need for affordable housing in the State, the South Carolina General Assembly enacted a state low-income housing tax credit ("State Credit") which provided a state tax credit equal to the federal low-income housing credit for an eligible project. Other states, such as Georgia, had enacted similar credits and had seen the availability of a state tax credit act as a powerful driver of affordable housing development. The budget impacts prepared in connection with the enactment of the legislation predicted a modest number of projects would utilize the State Credit.
- In 2021, South Carolina became one of the most active states in the country for new affordable housing development.
- In 2022, the General Assembly, fearing the fiscal impact of the new program, made sweeping changes in the applicable statutes that now make financing affordable housing with the State Credit practically unworkable and virtually stripped local housing authorities, previously key players, of any power to participate in the process. Meanwhile, almost every community in SC is clamoring for solutions on the affordable/workforce housing front.
- Current Barriers
    - LIHTC limited
        - Annual allocation of LIHTC limited to $20 million.
        - LIHTC may only be used as a financing "gap-filler."
        - LIHTC now must be competitively awarded by SC Housing with oversight from the Joint Bond Review Committee ("JBRC").
    - Volume Cap allocation has been modified extensively
        - Each year there is an allocation plan setting maximum percentages of Volume Cap that may be allocated to a category of bonds
        - No allocation of Volume Cap may be made to a request exceeding 10% of the total Volume Cap for industrial or economic development projects or 5% of the total Volume Cap for any other category without justification and substantial findings of significance
        - JBRC involved in Volume Cap requests for affordable housing
        - Currently only SC Housing has Volume Cap