Public Financing for Creating Affordable Housing Options in the United States

BY WINTFORD THORNTON

INTRODUCTION

This article will explore how to build affordable housing through using Low-Income Housing Tax Credits (LIHTC), Tax Incremental Financing (TIF), Homeownership Mortgage (HOME) Investment Partnership Act Program, Homeownership for People Everywhere (HOPE VI), and the National Park Services' (NPS) Federal Historical Preservation Tax Credits (HPTC). The Wisconsin Housing Economic Development Authority (WHEDA) is used as an example of how other state tax credit programs work throughout the United States. This article explores the use of tax credits as they are an essential part of the government's programs to encourage affordable housing. Subdivisions, condos, and apartment units can be built with these various sources of alternative financing. According to Malpazzi and Green (2002) there is no evidence that Section 42 developments in particular have a negative influence on surrounding property values, they may in fact enhance values even though they are perceived as a negative housing externality (26-28).

According to (HUD, 2006a, 26), in the third quarter of 2005, national homeownership rates for all households were at 68.8% and minority households were at 51.2%, revealing a nearly 18% gap. Rental vacancy rates at 9.9% versus homeowner's vacancy at nearly 2%, showing a significant shortfall of nearly 8% (HUD, 2006a, 26). Median rent was $922, which is a 10% decline from the previous year (HUD, 2006a, 19). In comparison, the 2006 Department of Housing and Urban Development's maximum fair market rent limits at the 60% level of the county median income, which in Dane County, Wisc., is $988 for a two-bedroom (Wheda, 2005b). Nationally, the apartment absorption rate was at 65%, which is a 27% decline from the previous year (HUD, 2006a, 19). Conventional fixed-rate 30-year mortgage are at 5.76%, a 2% decline from last year (HUD, 2006a, 21). According to (HUD, 2002c), there is an average of about 1,300 LIHTC projects and 90,000 units were placed in service in each year of the 1995 to 2002 period. Whereas the national housing inventory tallied in at 108,431 occupied units, which were placed in service in the 3rd quarter 2005, 74,588 were

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owner-occupied and 33,843 were renter occupied, leaving 15,688 vacant units (HUD, 2006a, 25). Affordable housing start-ups are lagging demand.

This article will examine the process, practice, and politics of increasing the supply of affordable housing through these programs. Realistically, most affordable housing would not be built, if government financing were not available at the local, state, and federal level.

WHY USE INNOVATIVE FINANCING?

Besides finding another way to use other people's money to fund real estate deals, there are other benefits some of which (Vandell, 2006) mentions as investor's objectives and constraints such as:

- Making projects more dynamic and lucrative in terms of partnerships
- Putting less of your own equity in the deal
- Maximizing profit
- Making the project feasible
- Satisfying investment constraints (i.e., legal, cultural, ethical, availability of alternatives, wealth, and risk acceptance)
- Managing risk appropriately
- Obtaining non-pecuniary returns (social capital, prestige, respect, self-actualization)
- Maximizing tax shelters and capital gains
- Acquiring financing with less points
- Using the public financing process to secure political support and ownership
- Building community
- Acquiring assets and cash flow
- Receiving administrative expediency from the planning and development department
- Owning the building at reversion
- Providing supply and service utility
- Leveraging existing equity and debt

Using innovative financing that serves the same market demographic as your existing client bases and target audiences is a great benefit.

These are some of the solid and intangible, direct and indirect awards of using an innovative financing venture. With the advent of 60, 80 or 100% of the area median income stipulations for residents and homeowners in LIHTC- and TIF-funded projects, the client base is excellent for servicing new single and married teachers, police, social workers, and government workers, which make up the persistent middle class. With rising mortgage interest rates, labor mobility, and redevelopment succession these class and occupational groups will continue to drive the demand side of affordable housing.

THE NEED FOR AFFORDABLE HOUSING

On the other side of the demand-side picture, the persisting poor also need adequate housing outside of the existing and depreciating housing stock. The lack of affordable housing and the loss of employment precipitated and caused homelessness (Wood, Valdez, Hayashi, & Shen, 1990, 1050; Mills & Ota, 1989, 487; Johnson, 1989, 30-32 cited in Tusan, 1997). To prevent homelessness, affordable housing is necessary. Because welfare grants, women's wages, and child support payments are often insufficient to pay for rent (Zorza, 1991, 421 cited in Tusan, 1997), affordable housing is a crucial safety net to prevent homelessness. Fifty percent of women and children in the United States become homelessness when they flee domestic violence and many are turned away by overcrowded shelters and thereby forced to return to their abusers (Tusan, 1997, 29). Affordable housing could provide these women with shelter. Often Section 8 voucher holders cannot find affordable housing because of discrimination; voucher price ranges are lower than the market rate rent cost, and landlords' fear that Section 8 tenants will cause crime and property damage. Tusan (1997) states that nationwide 56% of poor renters spend at least 50% of their income on housing (26). Tusan (1997) asserts that "it would be unrealistic to assume that the job market can absorb all homeless and extremely poor individuals at a wage sufficient to meet current housing costs" (59). Tan (2000) says 64% of families receiving four or more types of assistance are single female high school dropouts with children under 18 (34). These single mothers spent 70% of their assistance on housing, food, and clothes (Tan, 2000, 33). Hence, increasing affordable housing stock is paramount.

CONTEXT

The National Park Service (NPS) is promoting affordable housing through its subsidy, the Federal Historical Preservation Tax Credit Incentives Program (HPTC). The HPTC is a partnership among the NPS, State Historical

Preservation Officers, and the Internal Revenue Service (IRS). This housing subsidy for low- and moderate-income people is a pittance compared to other housing subsidies like mortgage interest deduction. In 1995, the IRS distributed 82.5% of $58.3 billion of housing subsidies (mortgage interest deduction) to people with incomes over $200,000 (Dreier, 1997, 7). These tax subsidies are three times the 1996 budget for HUD, 23 times the private investments leveraged for HPTC in 2000, and 97 times the combined average annual $60 million budget (Gay, 1996, 39) for programs involving historic tax credits. This results in a budget inequity that reflects a political bias against low- and moderate-income people. This bias is codified in the tax code and in national housing priorities.

An example of creating a more equitable housing policy was attempted in the mid 1990s. Sen. Robert Packwood, Rep. Richard Armey, and former Presidential Candidate Steve Forbes wanted to limit the regressive and inequitable mortgage interest deduction (Dreier, 1997, 21). They were unsuccessful, but other tax policies in the past have encouraged affordable housing while preserving historic housing stock.

President Ford signed the first legislative act for tax credit incentives and gave the NPS through the Department of the Interior, the responsibility to review and approve of rehabilitation projects that maintained the historic character of a building. This tax reform was called the 1976 Tax Reform Act. It was passed by the Congress to preserve historic buildings through a five-year tax write-off of building rehabilitation cost.

Because these tax incentives were minimal, Congress made additional changes in the law in 1978, 1981, and 1986. In 1981, the Economic Recovery Tax Act boosted the usage of historic preservation tax credits from about $600 million in 1981 to approximately $2.5 billion in 1984. However, the 1986 Tax Reform Act reduced the amount of tax credits preservationists could receive, therefore the volume of HPTC projects dropped.

Today, an average of 30,000 buildings is added to the National Register of Historic Places annually. In 2000, affordable housing creation with the usage of historic preservation tax credits (HPTC) peaked at its highest point since 1976. Affordable housing accounts for 44% of the total HPTC units created since 1997. Between fiscal years 1992 and 2000, the number of HPTC applications doubled and historic tax credit investments increased by a multiple of 5. In the 18-year period between 1978 and 1996, Wisconsin had $300 million in HPTC investment work and 400 projects (Sewell & McCormick, 25). Comparatively, between 1995 and 2000, HPTC investments in New York, Pennsylvania, and Louisiana accounted for an average of $440 million in spending in each state. Since 1976, $30 million in HPTC was used in the City of Madison (Landgraf, 2002) for 134 buildings (NPS, 2006b). "Since 1976, the Historic Preservation Tax Incentives have rehabilitated more than 32,000 historic properties, stimulated over $33 billion in private investment, rehabilitated more than 185,000 housing units and created over 140,000 housing units, of which over 75,000 are low- and moderate-income units" (NPS, 2006a).

TAX CREDITS

Tax credits reduce federal tax liability on a dollar-for-dollar basis. For example, if an entity has a net tax liability of $1 million and possesses $1 million in tax credits, it can apply the $1 million in tax credits to create a zero net tax liability for itself. In comparison, a mere tax deduction only offsets gross income by the tax bracket (e.g., 31%, 39%) of the entity (corporation, partnership, or individual). Hence, a dollar of tax deduction is only worth the amount of the tax which the deduction saves on a dollar of income (e.g., 31% tax bracket equals .31 tax deduction per dollar of taxable income). This ability of a direct dollar-for-dollar offset by using tax credits has sophisticated investors, banks, insurance companies, investment companies, and other large businesses buying tax credits from affordable housing developers. These tax credits will improve the earnings statements of such investors, banks, and other large businesses.

First, the developer is awarded tax credits from the NPS and/or WHEDA to finance the housing construction. Second, the developer uses the tax credits as equity and sells the tax credits to a financial institution. Currently, HPTC sell at 95 cents to 99 cents on the dollar and LIHTC sell at about 78 cents on the dollar. The marketplace of supply and demand determines the price of tax credits. Financial institutions use tax credits to reduce their tax liability.

The following will show how tax credits raise money/equity from the National Park Service's HPTC and WHEDA's LIHTC. An example of a financing structure for making affordable apartments out of a historic building in the City of Madison is shown in Appendix 1.

For example, the rehabbing of a building suitable to house 100 people could cost at a minimum of $1.2 million in total or $12,000 per unit. The developer using LIHTC from WHEDA that qualified for a 9% credit would receive $1.2 million * .09 to create $108,000 in equity per year for ten years for a grand total of $1.08 million in additional funds. For example, that same developer can also use a 20% HPTC package from NPS and apply it to the qualified rehabilitation expenses, for example, $1 million * .20 to generate $200,000 for a total $1.28 million. According (Primoli, 2006) the IRS Qualified rehabilitation expenses are:

> Any expenditure for a structural component of a building will qualify for the rehabilitation tax credit. Treasury Regulation 1.48-1(e)(2) defines structural components to include walls, partitions, floors, ceilings, permanent coverings such as paneling or tiling, windows and doors, components of central air conditioning or heating systems, plumbing and plumbing fixtures, electrical wiring and lighting fixtures, chimneys, stairs, escalators, elevators, sprinkling systems, fire escapes, and other components related to the operation or maintenance of the building. In addition to the above named "hard costs," there are "soft costs" which also qualify. These include construction period interest and taxes, architect fees, engineering fees, construction management costs, reasonable developer fees, and any other fees paid that would normally be charged to a capital account.

Eighty percent of affordable housing creation has come from tax credit deals, which are considered to be more conservative, stable, and predictable than the unsubsidized rate of the multifamily (apartment) housing market (Bergsman, 2002, 41). When big businesses buys tax credits, they do not want to capture the rental income from low to moderate properties, nor do they want to own it. The developer possesses the cash flow from the property's rental income. Tax credit investors agree to revert the property to the developer for pennies on the dollar at the end of the WHEDA's mandatory holding period of 15 years (Landgraf, 2002). Big business is only interested in keeping the apartments running to avoid having to give back the tax credits to WHEDA that they bought from the developer.

HISTORICAL PRESERVATION TAX CREDITS

The use of the HPTC program has made it possible to rehab buildings that give towns and cities a sense of place and pride, and special character. Factories, schools, hotels, apartments, churches, warehouses, and office structures have to be restored in a manner respecting their historic nature. The HPTC program creates jobs for specialized craft people and journeymen because rehab work is 75% labor and 25% materials (Landgraf, 2002). Indirectly, the use of HPTC can increase property values and property tax revenues (NPS, 2006a; Gay, 1996, 40). Gay (1996) states rehabbing "builds strong neighborhoods," reverses "population decline," attracts "role models" and creates "thriving cities" by "attracting the middle-class back to the city" (40). The awarding of HPTC encourages developers to rehab when additional funding is needed to complete a development. Gay contends that rehabbing does not “gentrify the neighborhood” (Hutch, 2002, 12) but reverses segregation because it is not just an “interest only to white people” (Gay, 1996, 40), however several others believe that the displacement of old standing residents creates a segregated community by race, income and class (Adelman, Smith, and Cheng, 2003; Turetsky, 2003; Gotham, 2005; Knoff, 1990; Hamnett, 2000; Abu-Lughod, 1994; Anderson, 1990; Atkinson, 2000).

In order to access HPTC, a rehabbed building must be approved or "certified" as a historic structure or located in a historic district. The rehabbing must be consistent with the historic character of the building. The NPS mentions the rehabbing "must not damage, destroy or cover materials or features, whether interior or exterior, that help define the building's historic" nature (NPS, 2006a). The rehabbing projects must met the 10 Standards (36 CFR Part 67) to be eligible for HPTC and certification. The NPS mentions that "the Standards apply to historic buildings of all periods, styles, types, materials, and sizes" (NPS, 2006a). They apply to both the exterior and the interior of historic buildings. The 10 NPS Standards also encompass related landscape features and the building's site and environment as well as attached, adjacent, or related new construction (Appendix 2). Developers should apply for historic certification before beginning work. Work undertaken before approval can compromise certification.

Developers can quickly identify potential historic buildings through their State Historic Preservation Officer (SHPO) which has a list of potential and historic buildings in the state. The SHPO will go out with a developer to look at property if it is not on their historic property possibilities list. For example, in the City of Madison, the SHPO office is in the State Historical Society Library at the University of Wisconsin-Madison. The process of getting a building listed for affordable housing purposes involves getting the SHPO to nominate the property. The SHPO is usually enthusiastic when developers want to rehab and will fill out the nomination forms and route them for review at the state board. The state board will make a recommendation and if it is approved, and the current owner does not object to the nomination, then it is forwarded to the NPS for further consideration.

HPTC are allocated at 20% for the certified rehabilitation of certified historic structures and 10% for the rehabilitation of non-historic, non-residential buildings built before 1936. A HPTC of 20% means that 20% of the total eligible rehab cost will be given back to the developer in the form of a tax credit, which can be sold to a financial institution for equity financing. A 10% HPTC works the same way. The 20% HPTC can be used to rehab commercial, industrial, agricultural, or rental properties, but is not available for exclusively owner-occupied dwellings. In order to qualify for the 20% HPTC a building must be depreciable (income producing) and rehabbing must be substantial as shown in exceeding $5,000 in cost or the adjusted basis of the building during a 24-month period. However, rehabbing can occur on a 60-month schedule if the work is completed in stages with plans and specs. The property must be placed in service (used) for at least five years and it must have at least a Part 1 (evaluation of historic significance) preliminary certification determination. This means that the building does not have to be listed on the National Register of Historic Places to claim the HPTC; the building just has to be eligible (Landgraf, 2002). For Part 1, Part 2 and Part 3 of the Historic Preservation Certification, a developer would hire an experienced architectural firm to seek the certification. Most importantly, the rehab expenses that are not eligible for HPTC funding are the costs of acquiring or furnishing a property, new additions that expand the existing property, new building construction, parking lots, sideways, and landscaping. Only the work undertaken to rehab the building, professional fees, site survey fees, and reasonable and related construction costs that add to the basis of the property are eligible for HPTC. HPTC can be claimed on IRS Form 3468 before (when the substantial rehab test is met) or after the year the building is utilized. If the developer does not receive certification in 30 months after claiming the credit, then the historic assessment can be extended or the credit recaptured. HPTC can be delayed being used for one year or carried forward for 20 years. One way to use the 10% HPTC for affordable housing is to rehab the target property to use as commercial space, then wait until the placement in service period expires in five years, and then convert the commercial space for affordable housing use. The benefit of using the 10% HPTC is that there is no formal review process for rehabbing non-historic buildings. However, in the initial rehabbing three requirements must be adhered to: one, at least 50% of the building's existing walls are retained in place as external walls; two, at least 75% of the building's current exterior walls are kept as internal or external walls; and three, 75% or more of the properties existing internal structural framework remain in place (IRC Section 47(c) (iii)).

WHEDA AFFORDABLE HOUSING TAX CREDIT PROGRAM

"Created by the Tax Reform Act of 1986, the LIHTC program gives States the equivalent of nearly $5 billion in annual budget authority to issue tax credits for the acquisition, rehabilitation, or new construction of rental housing targeted to lower-income households" (HUD, 2006b). "There are nearly 22,000 LIHTC projects and more than 1,141,000 housing units placed in service between 1987 and 2002" (HUD, 2006b).

WHEDA's affordable housing program operates under Section 42 of the Internal Revenue Code of 1986 to allocate, award tax credits to developers. These developers must also independently qualify under Section 42. This program allows developers and Community Housing Development Organizations (CHODO) (PLGP, 2000, 247) to have equity access to finance affordable housing projects. Nationally, the government increased the availability of tax credits to 40% (Hutch, 2002, 12). In 2005, WHEDA will have approximately $10.2 million of tax credit authority. It is based on the $1.85 (2005) per capita figure which is adjusted for inflation with the consumer price index. WHEDA divides this pool of tax credits into five set-asides: general fund at 35%; non-profit fund at 10%; preservation at 40%; and rural set-aside is 10%, with a reserve set-aside is 5% of the total tax credits allocated. The maximum tax credit allocation per development is $725,000. Currently, scoring a minimum threshold of 175 or higher points is needed. In 2005, the score ranges were 196-308 points in the general category, 225-314 points in the non-profit category, 200-305 points in the preservation category, 244-292 in the rural category and 219-314 in the additional credit category (Ash and Boerigter, 2005, 7). The cutoff scores by set-aside in points for general was 278, non-profit was 275, preservation was 257 and rural was 244 (Ash and Boerigter, 2005, 8). Applications need to demonstrate market strength via a market study by a WHEDA-approved market study consultant and passing an initial application review and meeting with WHEDA. In order to win the tax credits, a developer's plans will change according to what WHEDA expects and values. These expectations that promote quality housing are given more points in the application screening process. This competitive process is similar to other state administered tax credit programs across the U.S. The average credit amount for projects moving forward is $384,291 and the average amount per unit is $8,264 (Ash and Boerigter, 2005, 4). A successful developer will submit a self-scoring exhibit to WHEDA (Appendix 3).

According to IRS revenue ruling (2004-82):

> Section 42(h)(6)(A) provides that no credit will be allowed with respect to any building for the taxable year unless an extended low-income housing commitment (as defined in § 42(h)(6)(B)) is in effect as of the end of the taxable year. Section 42(h)(6)(B)(i) provides that the term "extended low-income housing commitment" means any agreement between the taxpayer and the housing credit agency which requires that the applicable fraction (as defined in § 42(c)(1)) for the building for each taxable year in the extended use period will not be less than the applicable fraction specified in the agreement and which prohibits the actions described in subclauses (I) and (II) of 42(h)(6)(E)(ii).

The extended period is 30 years. The IRS is mandating the review and renegotiation of thousands of non-compliant extended use agreements with state allocating agencies better know as land-use restricted covenants on low-income housing tax credit projects. State tax credit authorities are following suit; "[o]wners of developments funded with competitive [LIHTCs]" cannot have an opt-out provision from the mandatory 30-year holding period (Wheda, 2005a, 5). This law helps preserve the supply of affordable housing stock.

HOPE VI

In 1993, the HOPE VI Program was created by the Department of Housing and Urban Development (HUD). HOPE VI permits public housing authorities (PHA) to use a combination of private financing, LIHTC, private mortgages, other local/state funding and public housing development funds to develop public housing units owned by an entity other than the PHA. The goal of mixed-finance development is to maximize the leveraging of other funds (e.g., TIF, LIHTC, & HPTC) both public and private to create mixed-income communities (HUD, 2001d, 1). Since 1993-2005, HOPE VI has made 231 revitalization grants totaling approximately $5.7 billion to 132 housing authorities in more than 37 states plus the District of Columbia and Puerto Rico (HUD, 2004f; 18, HUD, 2004h; HUD 2005g). Unfortunately, some developers avoid using HOPE VI, because of the time investment to complete the administrative paperwork, the scarcity of funds, and the fact that awarding HOPE VI is political (Landgraf, 2002). HOPE VI rules state "at a minimum, the Public Housing funds provided for construction may only be used to construct and/or rehabilitate units that will function as public housing and a pro rata share of their common area costs" (HOPE VI, 2001, 4). Prospective Section 8 tenants do not have a federal preference; the local PHA can adopt a different admission process for renting in the rehabbed housing. The PHA can provide capital and/or operating assistance to privately-owned development units. The privately-owned units must be available for use as public housing by low-income families for a minimum of 40 years. Turestsky (2003) lists several needed improvements to HOPE VI such as, replacing the high density public housing units with low-density units on a one-to-one basis when HUD works with developers to revitalize house stock; desegregating housing; involve residents in their community redevelopment; and penalize PHAs that allow their properties to deteriorate to receive a preference in the HOPE VI selection process (8). Building mixed-income communities will provide the opportunity to desegregate housing.

THE PROCESS OF SUCCESS BETWEEN DEVELOPERS AND THE CITY

Developers should seek local government assistance beyond possible zoning problems, because they have "much to offer in [development] arrangements, including site control, development approvals, equity, and financing" (PLGP, 2000, 247). Developers should observe a community's neighborhood plan and cooperate and compromise with the wishes of the city's planning department and neighborhood groups. Briggs (1997) says the working for the collective good necessitates "trust and understanding" and "requires ties among disparate groups and individuals, built up over time"(113). Local government planners have to decide on where and how to best investment public monies because "only about one dollar of housing subsidy is currently available for every three to four dollars of housing need" (PLGP, 2000, 257). This housing subsidy used for affordable housing can come from Tax Incremental District (TID) or loans from the Community Development Authority (CDA). Therefore, it is important that public input from members of general public and power brokers is sought out. The developer and planners can do some consensus building to create options and alternative solutions with the community so that the affordable housing is viewed as an acceptable use of a rehabbed historical building. One process to involve the public in deciding how an affordable housing apartment is going to fit in the neighborhood is to involve interests as early as possible to prevent a backlash that will kill the housing project (PLGP, 2000, 430-431). This participation process should do the following: be tailored to citizens' needs, include the affected parties, identify and nurture shared interests, share credible information, provide impartial and collaborative leadership, maintain momentum (time is money for the developer), and involve the media (PLGP, 2000, 432-436) to mold public opinion. The Practice of Local Government Planning (2000) book outlines that "when participants trust each other and recognize the legitimacy of their respective goals in the context of ongoing dialogues, promises, [and] trade-offs . . .taken to build agreement, the formal definition of agreement often proves less important than the process" (427).

Briggs (1997) mentions that:

> Cities with affordable-housing systems rich in social capital will be the 'winning horses' in an era of increasing competition ushered in by devolution. These better-functioning cities are the cities where housing developers and managers, government agencies, foundations, and intermediary groups are connected by a variety of dense ties, including overlapping board memberships, career paths. . . that span the system-ties that facilitates trust, high-skill cooperation and even appropriate risk taking that depends on close coordination and trust to make scarce dollars go a long way .

Since "there is rarely consensus regarding how scarce housing subsidies should be allocated . . . decisions [made] the cost of operating the program . . .amount of leverage . . .likelihood of success, cost of the program, and the availability of long-term local political support" cooperation among developers, planners and the communities where affordable is built is paramount to managing risk and getting the project built (PLGP, 2000, 256; Grasskamp, 1981).

Table 1—Municipal Financial Assistance for Residential Development

Specialty street lighting	Terrace landscaping
Improved intersections	Traffic calming
Waste receptacles	Burial of utilities and pedestrian lighting
Acquisition of property such as entire parcels, rights-of-way, & air space	Razing of building
Construction site preparation	Environmental remediation
Intensive landscaping of sites	Parking lot screening
Seating areas	Canopy trees with or without tree-grates
Architectural and engineering work to the preparation of development plans for properties	

Source: City of Madison (June 3, 2002). "Project Plan for Tax Incremental Finance District #30: East Washington Avenue at Hawthorne." Department of Planning and Development. Community and Economic Development Unit, 1-4.

TAX INCREMENTAL FINANCING

Developers who want cooperation in building affordable housing need to be involved in the community. In Wisconsin, the TIF duration period is 28 years (as of 2004); previously it was 21 years. The municipality using a TIF will float a public bond issue to initially finance the TIF. This debt financing is provided to a developer for a period of 12 years (as of 2004); previously it was 7 years. This public debt investment is offered by the municipality to stimulate economic growth and development for a specific geographic area, such as a neighborhood, a zip code, or corridor. Specifically, the development project offered TIF will throw off sales and/or property tax revenue to pay off the original bond issue so that other projects (department stores, regional shopping centers, even housing developments) can borrow funds generated by the TIF Developers. TIF negotiations can yield outstanding benefits and significant cost reductions. For example, finding a historic building in a Tax Incremental District (TID) in the City of Madison to rehab for affordable housing could result in the developer acquiring grants, loans or direct assistance (City of Madison, 2002, 1-4) in the areas listed in (Table 1).

Eligible developments must demonstrate that without TIF assistance, the project could not occur or be financially feasible. The former benefits could be provided by the city because affordable housing development satisfies the TIF objectives, stimulates rehabilitation of dilapidated building, and creates mixed-use in-fill redevelopment, and follows the recommendations of adopted neighborhood plans. The City of Madison's TIF policies also concur with affordable housing, which are to assist in the revitalization of historic or architecturally significant or deteriorated buildings. In the City of Madison, TIF assistance is granted to housing developments if residents' households are 80% or lower than Dane County's median income, adjusted by family size and have a component of rent not exceeding 30% of monthly gross income. The affordable housing will generate property taxes to pay off the debt to finance the development project. It is important for the developer to get into a new tax incremental district whenever possible to get the maximum increment benefit.

COMMONALITIES IN PROGRAM REQUIREMENTS OF LIHTC, NPS, HOME, HOPE VI, AND TIF THAT MAKE AFFORDABLE HOUSING WORK

1) HOME Loans and LIHTC tax credits can be used together and can qualify for the 9% tax credits if the HOME funds come from Community Development Block Grant (CDBG) funds (Landgraf, 2002, 320).

2) LIHTC and Historic Preservation Tax Credits can be used together (WHEDA, 2005, xvii; NPS, 2006a).

3) HOME Loans require 40% of units be at least 50% of County Median Income (CMI) and LIHTC require that 40% of units be at least 60% of CMI or 20% of units be 50% of CMI. Choosing a tenant mix that makes 40% of units at 60% of CMI would satisfy the requirements for both programs. For HOME funds to be used in the eligible basis of the 9% or 4% tax credit, 40% of the units would be at least 50% of CMI.

4) Also if HOME loan is used to acquire/rehab a building, the development can receive both the 9% tax credit and extra 30% of basis for being in a Qualified Census Tract (QCT).

5) After five years, a building rehabbed using HPTC can be put to any use, the building can even be demolished, which is unlikely to occur. This could occur if the developer wanted the land underneath the building to be developed or sold. The developer would need petition for the city to change any historic preservation easement restrictions. Only after a mandatory five-year in-service period (NPSa 2006), a developer that received a 10% basis for the HPTC can rehab a building to use it as a rental property. Otherwise during the first years, a developer that receives the 10% basis for HPTC cannot use the building as a rental property (NPSa 2006). In this particular situation, after the mandatory five-year period has expired, the developer can apply and use LIHTC and HOME Loan funds to renovate and adapt the historic building to be used for rental property.

6) Under the 20% HPTC rule, LIHTC and HPTC can be used together to acquire/rehab a historic building for rental property use.

7) All affordable housing using subsidy programs can accept Section 8 vouchers, which could quickly be used to lower vacancy rates. Section 8 tenants can satisfy the 20% of low-income residents at 50% or less of County Median Income (CMI) or 40% low-income residents at 60% or less of CMI.

PROBLEMS DEVELOPERS ENCOUNTER

■ The proforma statement for the development must take in several considerations with government financing.

■ Projects receiving post-1989 tax credit allocations, the low-income rent cannot exceed one-half of the average gross rent for non-low-income units (Landgraf, 2002, 328).

■ The 30% increase in tax credits for developments in a QCT does not apply where the developer elects to use a 9% basis for tax credits in tandem with below-market loans under the HOME program (Section 2.02 (B)(2)(a)) (Landgraf, 2002, 347).

■ The IRS will exclude state and local grants from eligible basis (Section 8.04), therefore these grants can be structured as loans from a non-profit or housing authority whenever possible (Landgraf, 2002, 347). If the developer is working with a non-profit, the non-profit can apply for a grant for the project and then loan the grant to the developer (Landgraf, 2002, 306).

CONCLUSION

Public-private partnerships with the developer being the general partner and the government finance bureaucracy being the limited/silent partner can yield new housing stock for the community and cash flows with attractive Internal Rate of Returns for developers. Even with the time invested to prepare long government documents and the opportunity cost of pursuing tax credits in a state-wide competition, the process is worthy of being considered because of the present value of the financial awards gained through innovative financing. These alternative and innovative mixed-financing public-private partnership programs do work, but housing units financed with these funds are not keeping up with demand and are not crowding out supply (depending on local price elasticity of supply and demand, income elasticity of demand).

On December 30, 2005, President George W. Bush authorized $11.5 billion of out of $55 Billion Gulf Coast aid package through HUD's Community Development Block Grant Program to specifically assist efforts for the long-term recovery and rebuilding of several Gulf Coast states: Alabama, Florida, Louisiana, Mississippi, and Texas. Fifty-five percent of the funding was allocated toward unmet housing needs in areas of concentrated distress (HUD, 2006e).

This is an opportunity for public financing of private residential real estate ventures for the reconstruction of damaged and destroyed housing stock after Hurricanes Katrina, Rita, and Wilma for the coastal areas of Mississippi and Louisiana, and through out the plethora of areas where evictees relocated and resettled. Rather than building in areas that are economically and racially exclusive.

Government and housing does not have to mean minority and poor, but often it has. The government fosters racial housing integration through mixed income housing guidelines to house tenants with household incomes between 60 to 100% of the Area Median Income, but it also offers an extra 30 percent financial incentive for development in low income areas using LIHTC, which in effect fosters *de jure* racial segregation. This is because some development is in areas where middle and higher income populations have resisted living, with the exception of gentrification. The racial housing patterns today, as in past, reflect high racial dissimilarity (Quinn and Pawasarat, 2003). In the 1930s, there was a pervasive fear that if one or two Black families moved in a predominately white neighborhood, property values would decline (FHA, 1938; Adelman, Smith, and Cheng, 2003). See the play *A Raisin in the Sun* for a better understanding of housing discrimination. After lobbying and testimony by from representatives from the American Institute of Architects (AIA), the National Association of Real Estate Boards (NAREB), and lending industry on the Federal Reserve Board of Governor Member Marriner S. Eccels' subcommittee (Pope, 2002), the 1934 Federal Housing Administration (FHA) Underwriting Act passed and it codified racial segregation perceptions and language into law and it became widely accepted and adopted by the realty and development community. This was done to deter blacks from living in white communities, which excluded low-income areas and neighborhoods that have reached the tipping-point. To illustrate this point, Vandell (1995: 302) quotes directly from the 1938 FHA Mortgage Underwriting Manual, secs, 911, 929, 937:

> Areas surrounding a location are investigated to determine whether incompatible racial and social groups are present, for the purpose of making a prediction regarding the probability of the location being invaded by such groups. If a neighborhood is to retain stability, it is necessary that properties shall continue to be occupied by the same social and racial classes. A change in social or racial occupancy generally contributes to instability and a decline in values.

The 1934 FHA Underwriting Act created and preserved predominately white neighborhoods through provided funding and underwriting in order to get residential mortgages in urban and suburban areas. "Local and national real estate boards followed the lead of the FHA in adopting a code of ethics stating 'a Realtor should never be instrumental in introducing into a neighborhood … members of any race or nationality . . .whose presence will clearly be detrimental to property values in that neighborhood'" (Gotham, 2000, 19 cited in Helper, 1969, 201). The space development community (e.g., banks, appraisers, developers, realtors, agency officials) institutionalize the FHA racial preferences through assigning an evaluative hierarchy that ranked all-white neighborhoods as having the highest appraisal values, with racially integrated communities having second highest appraisal values and all-black and latino neighborhoods having the lowest appraisal values (Gotham, 2000, 19). Between

1934-1962, $120 billion in residential home loans were made, of which Black households accounted for 2% (Adelman, Smith, and Cheng, 2003).

The property appraisal method used by the real estate community asked several evasive questions on the race, occupation, and income of residents and applicants (Adelman, Smith, and Cheng, 2003; Pope, 2002). The application of this criteria in property valuations created a disparate impact and treatment on blacks, Jewish and Latino populations, which consequently resulted in the redlining of neighborhoods with the making of Residential Security Maps that were placed in City Survey Files and Realtors and appraisers offices and were used by the lending industry to establish real estate values (Adelman, Smith, and Cheng, 2003; Pope, 2002). Restrictive covenants were placed on express easements, deeds, titles or incorporated by reference to subdivision plans by dedication to bar selling to blacks, Jewish and Latino persons. Neighborhoods were graded A with the color green, B was assigned blue; C was reserved for yellow, and red was dedicated for D (Adelman, Smith, and Cheng, 2003; Pope, 2002). Black neighborhoods were rated as a moral risk with the letter D as the lowest rating, hazardous.

Despite the new housing opportunities provided through HOPE VI, NPS, LIHTCs, and TIFs; racial and spatial residential segregation persists (Dawkins, 2004; Rosenbaum and Argeros, 2005; McClure, 2005). Malpazzi asserts that ethnic and cultural segregation has several causes such as "whites prefer to live with other whites," overt discrimination in real estate brokerage and finance, and black home-sellers receive lower home purchase prices versus white home owners (2003: 163-170). Turetsky (2003, 9) pointed out that "many multifamily properties designated for the LIHTC are in segregated neighborhoods. The LIHTC should not amount to a government subsidy of segregation. As the program expands, HUD should work with residents and localities to ensure that the tax credit works in a way that both provides housing opportunities and desegregates communities." The danger of a "government subsidy of segregation" is also demonstrated by the fact that 54 percent of the tax credit units are focused in high urban minority and high poverty census tract areas, 26 percent in poverty stricken suburban areas and 20 percent in rural hinterlands (Turetsky, 2003, 6-7). History does not have to repeat itself. Although the government offers an incentive of 30% extra basis for LIHTC projects, these financing programs can be used anywhere, including high income areas to build subdivisions, condos, and apartment buildings. Developers should build public-partnership residential housings in proximity to water, scenic areas and universities, in locations with high demand; where development is already well established; near to high-quality competition and in walking distance from commercial activities which will increase property values rather than in isolation with concentrated clusters minority and low-income residents.■

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Appendix 1—Project Financing for Affordable Housing

PROJECT FINANCING	
Total Cost of Project	
Acquisition	$1,950,000
Rehabilitation*	$13,375,237
Total	$15,325,237
Total Rehab Cost Per Unit	$111,052
**Represents total costs-not just qualifying costs*	
SOURCE OF FUNDS	
Grants/Subsidies	
Energy grant-Madison Gas & Electric	$200,000
DEBT FINANCING	
Total Amount	**$15,325,237**
Bank One WI-Land Development Loan	$1,508,000
Bank One WI-Construction Loan	$3,850,000
City of Madison-Community Development Authority-TIF Loan	$1,338,800
City of Madison-Community Development Authority- Development Fee Loan	$1,038,000
WHEDA-Low cost gap loan	$213,437
HOME Loan at 4 percent Interest Rate	$3,400,000
Bank One Community Development Authority-Tax Credit Equity	$3,777,000
What If Analysis	
HISTORIC REHABILITATION TAX CREDIT (HPTC)	**Project**
Total Development Costs	$15,325,237
Total Qualifying Expenditures	$10,000,000
Rehabilitation Tax Credit percent	0.20
Total Rehabilitation Tax Credit percent	$2,000,000
Equity Yield for Rehabilitation Credit	0.95
Equity raised from Rehabilitation Credit	$1,900,000
LOW-INCOME HOUSING TAX CREDIT (LIHTC) ANALYSIS	
Project Financing	
Total Development Costs	$15,325,237
Total Qualifying Expenditures	$15,300,300
Less Rehabilitation Tax Credit	[$1,900,000]
Eligible Basis	$13,400,300
Low-Income Bonus QCT Proportion	130 percent
Qualifying Basis	$17,420,390
Annual Credit percent	9 percent
Annual Credit Amount	$1,567,835
Total Low-Income Housing Tax Credit	$15,678,350
Equity Yield for Low-Income Credit	0.78
Total Equity Raised from Low-Income Credit	$12,229,113
Total Combined Equity	$14,129,113

Notes:
WHEDA LIHTC was sold for 78 cents on the dollar to a bank.
NPS HPTC was sold for 95 cents on the dollar to a bank.
LIHTC total is.$17,420,390 (eligible cost of development -combined equity and debt)*.09(annual credit percent)*10 (years).
Total Combined Equity=Total Equity from LIHTC + Equity raised from Rehabilitation Credit

Source: (1999, September 23). Community Development Authority of City of Madison. This financial data from is the Waunona Wood-Monona Shores Revitalization Project. The data has been adjusted to reflect the effect of using HPTC on rehabbing this project. The format of the financial information was taken from the NPS Affordable Housing Case Studies website. http://www.cr.nps.gov/hps/tps/Affordable/index.htm

Appendix 2—National Park Service Historical Preservation Tax Credits: 10 Standard Qualifications

NPS 10 STANDARDS

1. A property shall be used for its historic purpose or be placed in a new use that requires minimal change to the defining characteristics of the building and its site and environment.

2. The historic character of a property shall be retained and preserved. The removal of historic materials or alteration of features and spaces that characterize a property shall be avoided.

3. Each property shall be recognized as a physical record of its time, place, and use. Changes that create a false sense of historical development, such as adding conjectural features or architectural elements from other buildings, shall not be undertaken.

4. Most properties change over time; those changes that have acquired historic significance in their own right shall be retained and preserved.

5. Distinctive features, finishes, and construction techniques or examples of craftsmanship that characterize a historic property shall be preserved.

6. Deteriorated historic features shall be repaired rather than replaced. Where the severity of deterioration requires replacement of a distinctive feature, the new feature shall match the old in design, color, texture, and other visual qualities and, where possible, materials. Replacement of missing features shall be substantiated by documentary, physical, or pictorial evidence.

7. Chemical or physical treatments, such as sandblasting, that cause damage to historic materials shall not be used. The surface cleaning of structures, if appropriate, shall be undertaken using the gentlest means possible.

8. Significant archeological resources affected by a project shall be protected and preserved. If such resources must be disturbed, mitigation measures shall be undertaken.

9. New additions, exterior alterations, or related new construction shall not destroy historic materials that characterize the property. The new work shall be differentiated from the old and shall be compatible with the massing, size, scale, and architectural features to protect the historic integrity of the property and its environment.

10. New additions and adjacent or related new construction shall be undertaken in such a manner that if removed in the future, the essential form and integrity of the historic property and its environment would be unimpaired"

Source:http://www.cr.nps.gov/hps/tps/tax/brochure2.htm#The%20Secretary%20of%20the%20Interior's%20Standards%20for%20Rehabilitation. Last assessed on Internet on February 28, 2006.

Appendix 3—WHEDA Self-Scoring LIHTC Exhibit

Points Earned	Total Possible Points in Scoring Category	Scoring Category	Answer	Reason
15	15	**1. Lower Income Areas**	■ Qualified Census Tract (QCT)	■ Locating the development in a QCT gets the project 30 percent more in tax credits (TC)
40	40	**2. Location**	■ Attach site map, land use plan, & dated plat map. ■Use certified surveying (ATSM).	■ Less expense to city (Hutch 3), taxpayers & developers than sites without sewer/water lines.
27	27	**3. Local Support**	■Letters of favorable support on official letter-head or form from Mayor, City Planning Director, neighborhood group, community leaders, County Supervisor, & Alderperson. ■Also letters from city showing substantial government-funded offsite improvements (e.g., streets, streetscape, utilities) that will benefit the development. ■Must be a minimum of 5 percent of development budget	■Must be a minimum of 5 percent of development budget ■This shows community approval and that essential background work was done. ■This shows a public-private partnership, the city's investment and goodwill in the project.
35	35	**4. Mixed Income Incentive**	■Set-aside low income (LI) units and show the percent of subsidized units to the total of non-subsidized units. Select either a 20 percent LI at 50 percent or less of County Median Income (CMI) or 40 percent LI at 60 percent or less of CMI. ■IRS states at the time the building is placed in service this select is an irrevocable election (Landgraf 329).	■Mixed income developments have the potential to have lower maintenance cost, crime (Hutch 2), and social welfare costs (Hutch 2) than majority low income developments. ■Shows potential project to be financially stable. ■Decrease racial isolation and promote integration (PLGP 239), and stabilize residential neighborhoods (PLGP 256; Wilson 512) & prevent slum creation (DuBois 58). ■Mixed income apartments help to decrease development costs and prevent higher rents (DuBois 58), because LI housing has low profit margins.
12	12	**5. Serves Large Families (3-bedroom or larger units)**	■Plan to have units with 3 bedrooms and justify their market need with Census data. Three bedroom units should not be the majority of apartments.	■ Accommodates families with children.
45	45	**6. Serves Lowest-Income Residents**	■Depending upon what income mix is financially feasible using your Net Operating Income (NOI), the Debt to Loan ratio (DLR) and Loan to Value (LTV) ratio choose the number of units in each CMI category (30 percent-60 percent) that will maximize profits and comply with federal program preferences.	■Housing stock for very low income people is decreasing. The developer has to find an income mix by CMI that will allow the building to not only pay back the debt but also be attractive to tax credit equity investors. These investors do not want the development to fail before they receive their expected/promised tax credits.
20	20	**7. Resident Populations with Special Needs**	■Need a service plan which must in included in the marketing plan. ■Someone on the developer's team must be experienced with this type of housing or service delivery. ■Architectural features must reflect serving the population.	■Some people not work due to a disability or illness, which may be the cause of them qualifying as low income tenants. ■The resell/reversion of the property may be higher when handicap amenities are added. ■The developer could use the property as an elderly condo or living lease property after the required number of years in low income service has passed.
24	24	**8. Small Developments**	■ Qualify if historic building is 24 units or less.	■Less money to borrow and tax credits to acquire and distribute. ■More manageable than large buildings.

Appendix 3, continued—WHEDA Self-Scoring LIHTC Exhibit

36	36	**10. Market Appeal**	■Meal Services (Excluding Meals on Wheels) ■Laundry Services ■Beauty/Barber Services ■Public bus transportation on-site or near site. ■24 hour on-site manager/security ■Banking/Financial Services ■Emergency call system ■Exercise room ■ Most of these services can be contracted out by third party vendors. These will be placed in visible sections on the first floor for safety concerns. ■Community space ■Washer/dryer in units ■Playground/Recreation area ■Both dishwasher and garbage disposal ■Garage ■High-speed internet access in units	■To attract and retain residents. ■To create sense of place. ■To create revenue. ■To create a better quality of life for residents. ■To enhance market appeal ■To promote long-term project viability
20	20	**11. Accessible Design**	■Handrails on both sides of common area hallways ■Automatic door openers at the main entry ■5 foot turning diameter in kitchen and bathroom ■Switches for garbage disposal, fans, and receptacles mounted on the front of cabinets or on an end wall ■Adjustable height countertops and cabinets ■Roll in showers ■Closets with adjustable rods and shelving	■ Architectural features that increase accessibility will broaden the market for many units
40	40	**12. Financial Participation**	■ Written conditional financial commitment for permanent financing from one or more of the following: ■ Tribal, federal, state, county, or city government ■ Public housing authorities ■ Tax-exempt bonding authorities ■ Unaffiliated public or public foundations ■ Unaffiliated nonprofits ■ Federal/State Historic Tax Credit	■ More partners to share the risk and support the financial needs of the development
6	6	**13. Ownership Characteristics**	■ 51 percent owned and controlled by a minority group member	■ Create diversity-ownership opportunities
60	60	**14. Project Development Team**	■ Past performance of team members	■ Reduce financial risk
15	15	**15. Readiness to Proceed**	■ Developments with permissive zoning	■ Reduce political, regulatory, and legal risk
395	395	**TOTAL SCORE**		