Title

Affordable Housing in a Down Cycle: International Solutions for Difficult Times

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POLICY BRIEF

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Issue

In its current state, the Low Income Housing Tax Credit (LIHTC) alone cannot meet the outsized demand for subsidized housing in California. On average, the LIHTC produces less than 20,000 units in the state on an annual basis. Alternatives to LIHTC examine how mixed-income and middle-income housing could be produced with little to no subsidies. Within the existing policy environment, there are a few circumstances in which affordable housing could be developed without a subsidy. More specifically, mixed-income developments, low-interest financing programs, programs that facilitate expedited approval tracks, and density incentive programs all play a crucial role in making these projects feasible.

Given the immense and growing need for affordable housing across California – and the relatively low number of new units produced each year – innovative policies, financing mechanisms and other strategies must be developed. To date, many strategies to increase the production of affordable housing have focused on density or the speed and simplicity of the entitlement process. Despite this progress, increased costs and competition for subsidies threaten to reduce affordable housing production. Additionally, tools like inclusionary zoning will produce less affordable housing due to the same challenges. LIHTC focuses on exclusively producing deeply income-restricted housing. In contrast, the practice of using higher income units to 'cross-subsidize' lower income units in a development is a widely used strategy internationally. Doing so allows developers to borrow more money from banks, thus requiring less private investment and/or subsidy and supporting the efficacy of strategies like low-interest financing, land donation, and expediting permit approvals.[1] Notably, of all policy tools analyzed within this study, low-interest financing products had the greatest impact on overall project feasibility, meaning that with relatively low financial input governments could supercharge the production of mixed-income and middle income housing.

Study Approach

A list of potential policy tools to advance affordable housing production was compiled from extensive research on best practices internationally. Each of these policy concepts was then used to adjust assumptions in financial models for affordable housing development to determine their impact on project feasibility, and quantify how many affordable units could be supported in the development at different income restrictions. The models hold variables such as loan interest rates, construction costs and land costs constant, while adjusting for policy inputs to test their impact on overall development feasibility. Feasibility is determined based on the internal rate of return (metric for return on investment) for the developer as well as the limited partner investor.

Key Findings

» **Without further action, inclusionary zoning in California is in trouble.** Escalating costs show that relatively low development costs per unit are needed to support even 20% of units within a project being restricted at 80% of area median income (AMI), implying that deeper affordability is even less likely.

» **The cost of including parking has substantial downstream financial impacts.** Reducing demand for parking in high-cost metropolitan areas would promote the production of affordable housing.

» **Providing construction, permanent and refinance loans with a 4% interest rate closed the financing gap on every model analyzed in the full report.**

Permanent, construction, and refinance loan at 4% interest				
Parked, .5 spaces per unit				
Project Size	Gap Closed	Affordability Mix	TDC	TDC Per Unit
100 Units	$ 11,561,000	20 units at 80%AMI	$ 64,323,000	$ 637,000
150 Units	$ 14,682,000	60 Units at 80% AMI	$ 89,612,000	$ 593,000
200 Units	$ 18,287,003	80 Units at 80% AMI	$ 123,535,000	$ 612,000
250 Units	$ 21,285,000	113 Units at 80% AMI	$ 152,845,000	$ 607,000
Unparked				
100 Units	$ 6,856,000	45 Units at 80% AMI	$ 56,767,000	$ 562,000
150 Units	$ 7,583,000	75 Units at 80% AMI	$ 80,943,000	$ 536,000

Figure 1.

Pro forma Analysis of Low Interest Financing showing the financial impact of low interest financing how many units within a project could be restricted to 80% AMI without any subsidy

- **Government, philanthropy, or impact equity with an investment period of 10 years or more could have an outsize impact on producing mixed- and middle-income housing.**
- **The models were able to support substantial percentages of units restricted at 60% AMI as an additional option** to restricting units at 80% AMI.
- **Once investment partners are repaid and exit the ownership structure of a housing project, the relatively low debt payment would allow a nonprofit owner to maintain or lower rents for tenants over time.** Alternatively, income from such projects could be used as investment equity in other affordable housing developments in order to fill gaps.
- **Together, the policy concepts in the full report have a much more substantial impact**, reducing per-unit development costs to as low as $399,000.

Recommendations

- **Implement similar low-interest loans and loan guarantee programs to those used internationally.** Low-interest loans are provided by governments leveraging public banking (see the Bauspar program in Austria [2]), government guarantees on development debt (see the loan guarantee program in the Netherlands [3]), or through government subsidies (see the Lirvet A program in France [4]). **Implementing similar strategies to provide low interest loans to affordable housing developers could greatly bolster affordable housing development, especially during economic down cycles**, when the costs of borrowing goes up substantially.
- **Design programs that allow project scale and the ability to refinance at a low interest rate.** Impact equity and other potential sources of investment for unsubsidized affordable housing require repayment within relatively short periods of time.
- **Design funding sources and requirements for affordable housing to include revenue generating projects serving mixed income and middle income tenants.** Presently, many LIHTC developments rely on up to a dozen sources of funding to fill gaps. **The amount of deeply targeted affordable housing projects could increase if developers were able to generate and leverage funds from other projects.** This is already widely practiced in countries with more universal affordable housing systems that serve up to 80% of the population.

For More Information

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