POLICY BRIEF

UCLA Lewis Center for Regional Policy Studies

Increasing the Duration of Affordability Requirements for New Affordable Housing

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Key Findings and Policy Implications

- Affordability requirements tied to tens of thousands of homes in Los Angeles will expire in the coming decades due to the limited duration of affordability covenants (contracts).
- Affordable homes built in prior decades had covenant durations of only 15 to 30 years; more recently, California and local governments have increased the term length of affordability covenants to 55 years for most new developments.
- Some cities, including Boulder, Colorado, Cambridge, Massachusetts, and Davis, California, have even longer affordability terms, requiring permanent or 99-year affordability covenants on new affordable housing.
- Adopting permanent or 99-year affordability requirements for new affordable housing in Los Angeles and California would help maintain the affordable housing stock while preserving public funds for continued production and acquisition of affordable homes.
- Longer affordability terms should be simple to enact for unsubsidized developments, such as those utilizing density bonuses (including Transit-Oriented Communities incentives) or meeting inclusionary zoning mandates. Longer terms for subsidized housing, such as projects utilizing Low-Income Housing Tax Credits (LIHTC), may require more extensive changes to federal law and/or project financing structures.

While the city of Los Angeles has made great strides increasing its production of affordable homes in recent years, the gains to new housing are partially offset by the loss of older affordable units.

Over the next five years, for example, affordability requirements on nearly 9,000 income-restricted apartments are set to expire (Chandler, 2019). Affordable homes can be converted to market-rate rents when their covenants expire, effectively removing them from the affordable housing market in most cases. Extending the terms of these covenants is an expensive proposition for cities, and property owners are not obligated to negotiate an extension or renewal.

Given the limited funds available for affordable housing locally and statewide, policymakers must find ways to maximize the efficient construction of new affordable housing *and* the preservation of existing affordable homes. By increasing the duration of affordability covenants for new housing beyond the current mandate of 55 years, policymakers can slow the loss of income-restricted homes, minimize expenditures on renewing existing covenants, and devote a greater share of funds toward expanding rather than merely preserving the stock of affordable housing. This reform is available to jurisdictions across the region, state, and nation, and it can, with careful design, be achieved without any negative impact to the continued production of affordable and market-rate housing.

Fleur de Lis, a 40-unit affordable housing development in Koreatown, was placed into service in 1990.
Image source: Google Maps Streetview

Affordability covenants in the United States, California, and Los Angeles

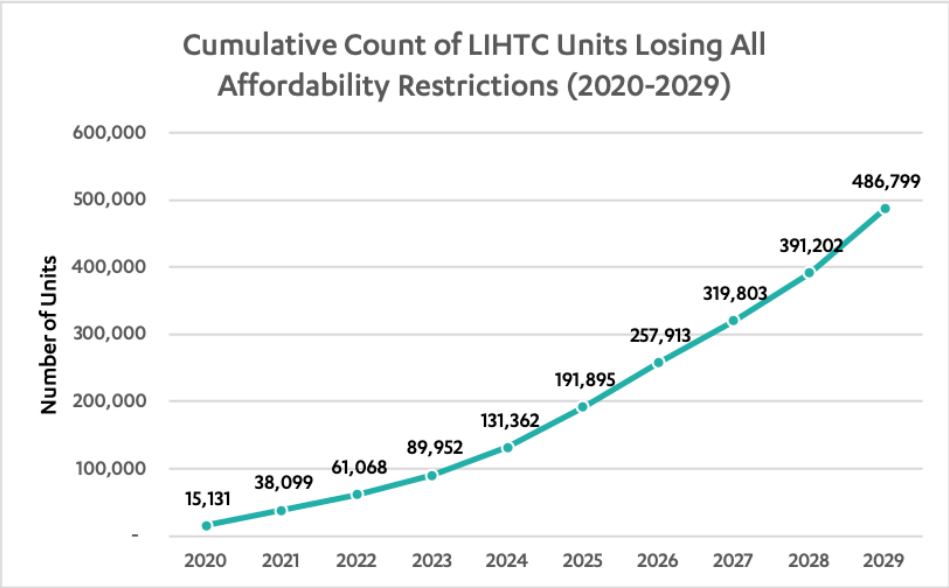
Affordable homes — those built for and restricted to residents who earn below a specified income — are kept affordable through the use of a legal contract known as an affordability covenant. The Low-Income Housing Tax Credit (LIHTC) is the largest affordable housing development program in the nation, and it requires affordability covenants with 30-year terms. (Prior to 1990 the term was only 15 years [Office of Policy Development and Research, 2012].) Property owners are permitted to increase rents on their units to market rates when affordability covenants expire.

Rents in affordable units can cost as little as $400 to $1,200 per month depending on income level and household size. When covenants expire and units revert to market rates, rents can potentially increase to $2,000 or more, far out of reach for low-income households. This leaves fewer housing options for poor individuals and families, contributing to housing insecurity and placing greater demands on the remaining low-cost housing stock, including both covenanted affordable units and privately owned, market-rate or rent-stabilized units.

Nationwide, affordability covenants on over 486,000 LIHTC units are set to expire between 2020 and 2029 (Figure 1; Aurand et al., 2018). According to the U.S. Department of

Figure 1.

Cumulative number of nationwide LIHTC units with affordability restrictions expiring within the next decade.



Source: "Balancing Priorities: Preservation and Neighborhood Opportunity in the Low-Income Housing Tax Credit Program Beyond Year 30," National Low Income Housing Coalition.

Housing and Urban Development's (HUD) LIHTC database, California has built roughly 314,000 LIHTC units since 1987, with affordability covenants on an estimated 89,000 homes turning 30 years old by 2030. (A large share of these units were built after the state increased its LIHTC affordability terms to 55 years, fortunately, so many will remain affordable until at least the 2050s.) As of 2017, the city of LA was home to approximately 29,000 LIHTC units, many of which will also expire in the coming decades. More homes continue to be built, but these losses will partially offset the gains being made.

In addition to federal LIHTC funds, low-income units also usually require upwards of $100,000 per unit in city and/or philanthropic subsidies, meaning the local cost of replacing low-income units in LA alone could be upwards of $3 billion. With median per-unit costs of $401,000 for affordable homes built in Los Angeles between 2011 and 2015 (U.S. Government Accountability Office, 2018), and significantly higher costs today, total subsidies could easily exceed $12 billion in today's dollars.

Until relatively recently, the typical term length of affordability covenants in California was also 30 years — not just for LIHTC and other federally funded affordable developments, but also privately-funded affordable units like those found in projects that utilize state density bonus (Senate Bill 1818) incentives. As a result of changes to the state's Tax Credit Allocation Committee (TCAC), new laws such as Assembly Bill 2222, and local initiatives like Measure JJJ and the Transit-Oriented Communities (TOC) program, covenant term lengths have been increased to 55 years for nearly all new affordable units in the state.

But while 55-year affordability terms are longer than what LIHTC and other federal programs require, they are not the longest terms found in the country. Many cities' affordability requirements stretch much further, including Bouder, CO, Burlington, VT, Cambridge, MA, Davis, CA, and Washington, D.C., which all require either permanent or 99-year affordability covenants. A working paper published by the Lincoln Institute of Land Policy found that, among the more than 300 local jurisdictions with inclusionary rental housing programs, about one-third mandate permanent or 99-year affordability terms (Table 1; Hickey et al., 2014). Because implementation of the American common law tradition varies state to state, it is unlikely that permanent affordability covenants would be legal in all U.S. states. Davis's inclusionary requirements signal their potential legality in California, however, and 99-year terms would be legal in any case.

Affordability Term Length (years)	Rental	%	For-sale	%
0 to 14	37	12%	49	15%
15 to 29	24	8%	31	9%
30 to 49	69	23%	100	31%
50 to 98	66	22%	38	12%
99 or perpetual	**110**	**36%**	**109**	**33%**
Total	306	100%	327	100%

Source: "Achieving Lasting Affordability through Inclusionary Housing," Lincoln Institute of Land Policy.

Table 1.

Among jurisdictions with inclusionary housing programs, about one-third require permanent or 99-year terms for affordable housing.

Impact of longer affordability terms

The high cost of shorter affordability terms is exemplified by a recent housing battle in the city of LA. Hillside Villa, a 124-unit apartment building in Chinatown, was built in 1988 with funding assistance from the former Community Redevelopment Agency. As a condition of public funding it included 59 income-restricted apartments, the affordability covenants for which expired in 2018. The city offered the owner $7.3 million, nearly $124,000 per unit, to extend the affordability terms by just 10 years — an offer the property owner rejected. The city is now considering using eminent domain to force the owner to sell the property rather than risk displacement of the low-income tenants (Matthew, 2019).

Despite the expensive nature of new construction, renewing affordability covenants can be even costlier. Not only is $124,000 per unit a high price to pay to keep aging apartments affordable for just 10 more years, it also fails to leverage other state and federal funds. The total cost is cheaper than developing new affordable units — at least in the short term — but not significantly cheaper for the city. Los Angeles typically invests between $100,000 and $150,000 per unit, supplemented by funding from LIHTC and other programs, to build new affordable housing with 55-year affordability terms.

Longer terms on affordability covenants would keep such units affordable longer, requiring less spending on preservation of existing affordable homes and allowing more to be spent on new construction and/or acquisition. This change would not affect buildings that have already been completed, but future developments would remain affordable for much longer without requiring additional subsidies.

Could there be unintended consequences as well? For example, is it possible that for-profit developers would use the TOC or state density bonus programs less frequently to avoid the higher perceived cost of longer affordability terms?

California already tried this, and, at least in Los Angeles, longer covenant terms don't appear to have hampered affordable housing production. AB 2222, which increased the affordability term for density bonus projects from 30 to 55 years, was approved in late 2014. That year 1,723 income-restricted units were permitted in the city, a local peak. While the number of new affordable units dipped slightly in 2015 and 2016, to 1,429 and 1,322 respectively, it remained well above the number of affordable units permitted in 2013, which was just 805. This variation may have been caused by a surge of applications before AB 2222 went into effect (in order to avoid its provisions, which went beyond extending affordability terms), a shrinking affordable housing trust fund (Alpert Reyes, 2014), or simply year-to-year variance that always accompanies housing development, affordable or otherwise. In any case, the number of affordable units surged after the introduction of LA's TOC incentive program, with more than 1,400 permitted in 2018 and over 2,400 approved in the first 9 months of 2019.

Financially speaking, we shouldn't expect longer affordability terms to meaningfully affect the production of new housing. The reason can be explained by the concept of the "discount rate." Developers, like all investors, are usually seeking a minimum return on their investment, and this expected return can be expressed as the discount rate. The discount rate is a way of adjusting for the riskiness of a given investment, and it tells investors how to value future cash flows (revenues)

Hillside Villa, a 124-unit apartment building built with funding assistance from the former Community Redevelopment Agency and opened in 1988. Its affordability covenants have expired and the city is now considering acquiring the property by forcing the owner to sell. *Image source: Google Maps Streetview.*

relative to present-day investment costs (expenditures). Near-term revenues are of greater value than the same revenues received at a later date — future revenues or investment returns are "discounted" into present-day terms.

Given a 10 percent discount rate, a dollar of revenue received five years in the future would be valued at just 59 cents in today's terms. By ten years this would fall to 35 cents. Another way of putting this: With a discount rate of 10 percent, a developer should invest no more than 35 cents today to receive an extra $1 in revenue in year 10 of their investment. If they invest more than this amount to earn an extra dollar, they'll be earning less than their target return and should invest their money elsewhere.

Discount rates of 10 percent are a good benchmark for real estate, though they can be considerably higher in environments where development is riskier or less predictable. Most importantly for the purposes of this brief, a 10 percent discount rate sharply reduces the negative impact of longer affordability terms. With a 30-year affordability covenant and a 10 percent discount rate, an extra $100 in revenue earned in year 30 would be worth an additional investment of just $4.24 today — roughly 4 percent of the future return. Extending the term to 55 years reduces the present-day value to just 30 cents (0.3 percent of the nominal value at year 55).

Real estate developers expect high returns and affordability covenants last a very long time, so the perceived value of raising rents at the end of their terms is negligible. This is true for projects with 30-year affordability terms and even truer for those with 55-year covenants. It's for this reason that extending covenant terms to 99 years or more should have no appreciable impact on future development decisions or the supply of new housing. Whether the term is 55 or 99 years, the future revenues are too distant to factor into the investment decisions of developers. With such clear upside for renters and public budgets, and no obvious downside with respect to housing supply overall, increasing term lengths for new affordable housing should be a priority for Los Angeles and other U.S. cities.

California already increased affordability term lengths, from 30 years to 55, without hindering affordable housing production. Similarly, extending affordability terms to at least 99 years has no obvious downside and very clear benefits for renters and public budgets.

Additional reform needed for subsidized housing developments

Increasing affordability terms for privately funded housing developments should be simple. Such projects expect profitability shortly after completion and they receive no public funding (development projects become more complex when public funding is involved), so enacting longer affordability terms poses little risk. According to the Los Angeles Department of City Planning, nearly 4,300 affordable units were permitted in the first nine months of 2019, most through the density bonus or local TOC program and many in unsubsidized mixed-income projects, so such developments represent a major opportunity. For subsidized developments, including LIHTC projects, the path to reform may be more complex.

Federal law requires developers of subsidized housing to demonstrate that any debt on a project can be fully paid off or refinanced at the end of its term. For 100% affordable developments, which collect relatively modest revenues throughout their affordability terms — especially from units reserved for extremely low-income or formerly homeless residents — it can be a challenge to pay off debts during the affordability period. Normally, the expiration of an affordability covenant would suffice to demonstrate ability to pay off debts, via a refinance, at the end of the term. With longer affordability terms, debt can't necessarily be refinanced; this then puts affordable housing developers at risk of losing their eligibility for public funding.

This is an important consideration; however, specific reforms needed to enable longer affordability terms for LIHTC and other federally supported projects are beyond the scope of this brief. We encourage their further investigation by public officials, legal scholars, and housing finance experts looking to maximize the benefits of affordable housing investment. The benefits of such reforms are obvious, and California has already established a record of success by increasing its LIHTC affordability terms from 30 to 55 years.

Extending affordability terms to 99 years or perpetuity

Policy discussions about the preservation of affordable units tend to focus on using public funds to renew affordability covenants. While this is an important part of the solution, fewer funds would be necessary if longer affordability terms had been applied to the low- and moderate-income homes built in decades past. In turn, more funding and staff time could be spent expanding the stock of affordable homes, rather than merely preserving what we already have. While we can't turn back the clock to extend the affordability terms of existing affordable housing, it is within our power to mandate longer terms for housing built in the future.

California policymakers should explore extending the duration of affordability covenants to permanent or 99-year terms statewide, including for projects funded by LIHTC and approved by the California Tax Credit Allocation Committee. As discussed above, this may also require federal reforms or state and local financing reforms in the case of publicly funded housing development.

But cities like Los Angeles need not wait for state or federal action: Local elected officials can change local laws to require permanent or 99-year affordability for any privately funded development that includes affordable units. The Transit-Oriented Communities program, for example, only requires that "affordability criteria will be observed for 55 years *or longer*" (emphasis added). Longer affordability terms could be mandated for projects utilizing TOC incentives, in specific plan areas as with the Purple Line Transit Neighborhood Plan, and in community plan areas such as the currently underway DTLA 2040 update. The state's density bonus program and proposed housing production and upzoning bills could also incorporate permanent or 99-year affordability terms.

These changes may raise new legal questions, especially if permanent affordability terms are pursued. Can the state allow affordability covenants that last longer than 99 years? If so, could such restrictions have unintended consequences on the future use of properties 100 or more years into the future? These are questions worthy of future research and debate. If extended affordability terms are approved, public officials will have a very long time to work out the details.

About the Author

Shane Phillips is the housing initiative project manager at the UCLA Lewis Center for Regional Policy Studies

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