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Saving America's Affordable Rental Housing Stock: The Crisis, and the Appropriate Financial Services Role

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Losing Ground: Why We Need to Preserve Affordable Housing

The United States is experiencing an unprecedented prosperous period. Homeownership hit a record high level last year. Unemployment is at its lowest rate in almost 30 years. Rapid technological innovation has increased productivity and created longer-sustainable economic growth. Demand has grown in all sectors.

However, some of America's citizens are being left behind. Our nation is experiencing a crisis in affordable multifamily rental housing inventory. Ironically, rising real estate markets often translate into an increased potential for the loss of affordable housing rental opportunities.

Rental housing opportunities are also shrinking because the subsidies and contracts on much of this nation's regulated housing supply are about to expire: Consider the following:

- Many owners of HUD assisted affordable housing are actively choosing to exit government-sponsored programs, whether they are motivated by personal lifestyle choice, HUD's increased scrutiny of their actions, or tax considerations. According to data gathered by the National Housing Trust, private owners have already "taken to market" over 100,000 HUD assisted or insured apartments, and 2,000 more such apartments are losing affordability monthly. The average rent hike associated with conversion from "regulated affordable" to market rate is 45%.

- According to HUD, some 1.5 million privately owned, federally insured apartments using Section 8 will have their government contracts expire over the next 5 years alone. The unpaid principal balance on the loans on these properties is well over $50 billion!

- Other potential affordable housing with expiring subsidies include housing subsidized by the Rural Housing Service and Low Income Housing Tax Credits.

The struggle for affordable housing is geographically widespread and includes the working poor: according to Harvard's Joint Center on Housing Studies, in no housing market in the nation -- not Baltimore, not Iowa, not Texas, *nowhere* – can a household earning today's minimum wage reasonably afford a modest two-bedroom rental.[1] While the rest of our nation is well sheltered, the poor and very poor are living in overcrowded or dilapidated housing, or are spending a very large percentage of their discretionary income on shelter, placing rent in competition with other essentials, like food.

In short, structural changes that affect the availability of affordable housing are affecting the lives of those who need it profoundly. Perhaps the National Low Income Housing Coalition gave the most vivid picture of the life these low-income families lead: "Like a high stakes game of musical chairs, the number of poor renters remains the same and they must compete for a diminishing number of affordable places to live."[2]

Nonprofit Housing Acquisition: an Opportunity Emerges

Within the potential loss of affordable housing lies an opportunity for nonprofit, mission-driven ownership. Toward this end, the National Housing Trust and the Enterprise Foundation have created the **NHT/Enterprise Preservation Corporation** ("NHT/Enterprise"), a 501(c)(3) acquisition entity with the sole purpose of preserving affordable multifamily housing that serves very-low-income households. Initially, NHT/Enterprise will focus on government-subsidized apartments. We welcome opportunities to handle a portfolio, especially when no local organization has the capacity to work on a large scale. NHT/Enterprise also plans to purchase tax credit supported homes and unsubsidized apartments.

NHT/Enterprise is unique in several ways:

- The National Housing Trust and Enterprise have provided $1.3 million seed capital to the effort. An additional $1.7 million has been invested by the MacArthur Foundation, Fannie Mae Foundation and Freddie Mac.

- NHT/Enterprise builds on the Trust and Enterprise's experience in acquisition and rehabilitation. The Trust has helped preserve more than 5,000 government-assisted apartments during the past six years. Enterprise Social Investment Corporation (ESIC) has raised more than $2.5 billion in equity from more than 180 different financial institutions to help create approximately 6,000 homes.

- The response to NHT/Enterprise has been overwhelming. Owners of more than 40 properties in nine states have already asked our organization to consider purchasing their properties, which average 80+ units with an unpaid principal balance of approximately $15,000/apartment and rehabilitation costs of less than $5,000 per unit.

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[1] According to the Joint Center for Housing Studies at Harvard, in 1995, almost 3.9 million unsubsidized households spent more than 50 percent of their incomes on housing costs and the wages former welfare households earn – at least initially – are inadequate to cover the cost of a modest two-bedroom rental. State of the Nation's Housing, 1999.

[2] "Out of Reach: The Gap Between Housing Costs an Incomes of Poor People in the United States" (National Low Income Housing Coalition, September 1999).

The Financial Services Role

Lenders can play a crucial role in this process. The new banking modernization laws permit banks and investment bankers to work under one roof. The efficiencies gained could be used to support nonprofit purchases of existing, multifamily housing. Mortgage lenders and investment bankers who now work for the same financial services company can help us achieve our social and economic goals. Consider the following products:

- *Bridge Finance*: NHT/Enterprise and other nonprofits often want to tie down properties through a credit facility. This facility, typically six months to three years in duration, can be paid a market interest rate. The default "take-out" strategy for this type of financing is through a 501(c)(3) bond. For example, NHT/Enterprise Preservation Corp. recently purchased a very well maintained 208-unit community located in Kissimmee, Florida. There, the bridge financing of approximately $8 million, provided by Bank of America below prime, will be taken out by a Standard and Poor's or Moody's senior/subordinate bond debt structure. The rehab costs will come out of the bond.

- *Permanent Financing:* Lenders with investment banking capacity can provide 501(c)(3) "take-out" financing for the bridge loan. Since the property has been underwritten by the same financial services institution, the investment banker and original underwriter should be able to better manage interest rate risk, and bring lower cost financing to the ultimate consumer—in this case, the nonprofit purchaser. To the extent these efficiencies are realized in the marketplace, lower-cost financing should translate into a more affordable multifamily housing product in the form of lower rents. In the Kissimmee example, the bridge loan made by Bank of America, will be taken out by a senior/subordinate bond. The senior bond, rated by Moody's will be publicly traded. The subordinate, unrated bond, will be privately placed with institutional investors.

- *Letters of Credit:* Some lenders are already providing standby letters of credit to help enhance the credit rating of 501(c)(3) bonds. This is particularly useful when used with so-called "Lower Floater" type bonds. The letter of credit can help reduce the interest rate, ultimately reducing the cost of permanent financing and making the transaction more economically feasible. LaSalle Bank, N.A., in Chicago, provided a Letter of Credit to credit-enhance variable rate bonds used for the preservation and improvement of the 268- unit, Barbara Jean Wright Courts located on the revitalizing near West Side of Chicago.

- *Direct Purchase of 501(c)(3) Bonds:* Some financial institutions will privately purchase the 501(c)(3) bonds for their own portfolios, lowering transaction costs. Tax-exempt rates (exempt from federal income tax and state tax) for 30-year 501(c)(3) bonds are currently 6.5 percent. Today's tax-exempt rate on the unrated subordinate bond is approximately 8.6 percent. For example, Fannie Mae directly purchased 501(c)(3) bonds.

- *Purchase of Tax Credits:* Low Income Housing Tax Credits increasingly are being used to help purchase and renovate existing multifamily housing. The same firm that provides the bridge and the take out financing can purchase the property's tax credits. NHT/Enterprise is currently evaluating properties in Houston, Texas, and Washington, D.C., with anticipated funding from private activity bonds and low-income housing tax credits. A financial institution could purchase the tax credits and extend the loans in these situations.

NHT/Enterprise Revolving Acquisition Fund

Using its own project log, NHT/Enterprise Preservation Corporation intends to develop its own bridge product: a "Revolving Acquisition Fund" to make loans or equity investments in properties purchased by NHT/Enterprise or one of its local nonprofit partners. The concept is to "take-down" the asset with the Fund, then "take-out" the fund within three years at the prevailing market interest rate. Take-outs will be facilitated with either 501(c)(3) bond financing or through a combination of private activity bonds and 4 percent tax credits. Financial services firms who can manage interest rate risk and who realize the synergies of both bridge and permanent financing will invest in the NHT/Enterprise Acquisition Fund.

Conclusion

Now that the Financial Modernization Act has been signed into law, lenders need to consider how the law can be used to strengthen community development efforts. No more important social issue exists than the sheltering of very-low-income families and seniors. Intelligent investment in bridge and take out financing, and bond or tax credit equity purchase, can earn a lender the prevailing market rate and harness efficiencies that ultimately benefit low-income renters. Never has the opportunity to harness market forces to do social good been greater. The resources exist. The choice is America's.

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