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Community Developments

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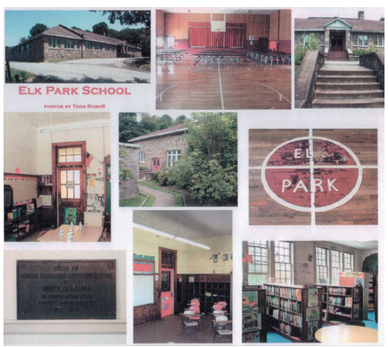
Bank Roles Loom Large in Developing Rural Rental Housing

by Leslie Strauss, *Communications Director, Housing Assistance Council*



This historic school in Elk Park, North Carolina is being renovated into apartments by Northwestern Housing Enterprises – an affiliate of the Housing Assistance Council.

Large apartment complexes probably aren't part of anyone's image of rural America. But multi-family rental units are, in fact, an important part of the rural affordable-housing stock. About 25 percent of rural households rent their homes, and about half of those renters have housing problems. Rural renters have lower incomes than rural owners and are almost twice as likely to live in substandard buildings or to pay more for their homes than the 30-percent-of-income benchmark set by the federal government.

National banks can play a vital role in improving housing conditions for rural renters. Working with nonprofit and for-profit developers, banks around the country have provided construction loans, government-guaranteed mortgage loans, Affordable Housing Program subsidies, low-income housing tax credit purchases, and more. Indeed, there are opportunities to fit any situation.

The Housing Assistance Council (HAC), which is active in rural areas throughout the country, can help banks assess these opportunities and identify appropriate local partners. A national nonprofit founded in 1971, HAC provides many services to help improve housing conditions for low-income rural Americans. HAC makes predevelopment loans, provides structured training and individualized technical assistance, and publishes a variety of educational materials. Based in Washington, D.C., HAC has regional offices in California, Georgia, Missouri, and New Mexico.

Affordable Housing Program and Tax Credits

A bank can play multiple roles in rural rental developments, as Bank of America is demonstrating in its partnership with Northwestern Housing Enterprises, a regional nonprofit developer in western North Carolina. Northwestern acquired a historic school building constructed in the 1930s by the Works Progress Administration in the Appalachian mountain town of Elk Park. At a total development cost of $4.7 million, Northwestern plans to renovate the school and add a three-story wing, creating 40 rental units for very low-income elderly and disabled residents, as well as community meeting and performing arts spaces.

Bank of America will make a construction loan at an advantaged interest rate, will serve as a conduit for a low-interest permanent loan through the Federal Home Loan Bank of Atlanta's Affordable Housing Program (AHP), and will provide equity through the federal low-income housing tax credit and state historic tax credit programs. The North Carolina Housing Finance Authority (NCHFA) will provide a low-interest loan, and other investors will add more equity in exchange for tax credits. Federal rental assistance will help tenants to afford their rents.

Bank of America's construction loan will be used for the historic renovation and will be taken out by a combination of the FHLB of Atlanta's permanent mortgage, NCHFA's loan, and the final equity capital contribution. Northwestern's development arm deferred slightly more than half its developer's fee in order to provide the last small piece of needed financing (see the Project Financing Profile, below).

The AHP used by Bank of America for the Elk Park development is a particularly promising way for FHLB member banks to participate in affordable rural housing development. Each FHLB administers its own AHP competition, providing loans or grants to its members for development projects. Member banks work with private for-profit or nonprofit developers who handle most of the application paperwork. The sponsor banks accept monitoring responsibilities but risk none of their own funds.

Bank of America has played a similar role in a series of multifamily developments in eastern North Carolina, providing construction loans, subsidizing the projects through AHP second mortgages, and also serving as an equity partner under the federal and state tax credit programs. The development process is overseen by GEM Management, Inc., a for-profit developer that combines financing from several sources to develop small properties, averaging around 32 units each, that house families and seniors with annual incomes between $8,000 and $14,000.

The U.S. Department of Agriculture's Section 515 rental housing program provides first mortgages, using special disaster funds available in eastern North Carolina because of the extensive flooding damage that occurred in 1999 in the wake of three hurricanes. Equity from federal and state tax credit programs is also used for these projects, as are grants from the federal HOME program available through the state's housing finance agency.

Although these examples rely on USDA's Section 515 loan program, banks should be able to play the same variety of roles with the Section 514 farm labor housing loan program. For many years, Section 514 loans were used in conjunction with Section 516 farm labor housing grants to provide complete development financing, leaving no role for banks. Now, however, USDA encourages developers to use bank loans, AHP subsidies, and other financing sources. Congress also changed the Section 514 program in 1999, enabling developers to combine these loans with low-income housing tax credits — although these projects are not eligible for Section 516 grants.

Section 538 Guaranteed Loans

USDA's Section 538 guaranteed rural rental housing loan program provides another opportunity for low-risk bank involvement. To date, few developments have been completed under this relatively new program. Citibank supported a 48-unit project in Firebaugh, CA, with a $700,000, 30-year permanent mortgage at 7.57 percent interest. USDA guaranteed 90 percent of the loan. Citibank remains responsible for servicing the loan throughout its term.

Like almost any affordable housing development, this one involved several additional sources of financing. A quasi-governmental redevelopment agency provided a $200,000 second mortgage without a guarantee, and the remaining $3.6 million of the $4.5 million total development cost was raised in equity through the federal low-income housing tax credit program. Rents (including a utility allowance) are set at 30 percent of area median income, or $705 for a one-bedroom apartment and $907 for a three-bedroom.

Preserving existing units

While these examples all involve development of new rental units, banks can also help save existing units. The loss of affordable housing in both rural and urban areas is a significant and increasing problem as subsidized mortgages, which require units to remain affordable, expire or are prepaid. Then owners can convert the apartments to market rent and displace the low-income tenants. In many rural places, nonprofit organizations seek to purchase these buildings and preserve them for their tenants.

U.S. Bank helped one such nonprofit by providing an innovative lending structure for the purchase and rehabilitation of 120 apartments in Kaysville, Utah. The surrounding area was considered rural when the units were developed with USDA Section 515 funding about 25 years ago, but Kaysville has now become a bedroom community for Salt Lake City and Ogden. When the project's owner decided to sell, she assumed a buyer would upgrade the units and charge market rate rents.

Instead, the development was purchased in an arrangement structured by a local subsidiary of Mercy Housing, a nonprofit that develops affordable housing nationwide. Mercy and its equity partners purchased the property for $3.3 million and will spend another $3 million on extensive renovations.

Each of the ten buildings has 12 units, so 12 apartments were not re-rented as their tenants moved out in the normal course of business. The families from the first building have moved into those emptied units while the building receives new roofing, windows, HVAC, siding, carpets, and more. When that building is complete, the 12 families from the second building will move into it so theirs can be refurbished. The process will continue in the same manner, one building at a time, and the entire project is expected to take about a year.

The financing required to make this project work meant that U.S. Bank needed to provide Mercy Housing with the funds to purchase the property upfront. These funds were loaned on a fixed-rate, interest-only basis and will convert to an amortizing, permanent mortgage when the rehab is complete. U.S. Bank is also providing a $2.1 million construction loan that will be repaid by post-rehab investor equity contributions. Debt service levels were sized to keep the apartments affordable for tenants, whose median annual income is $9,500 (see the Project Financing Profile, below).

Further possibilities

Even small-scale projects can provide important opportunities for banks to contribute to rural rental efforts. In South Dakota, for example, Dacotah Bank is working with the Northeast South Dakota Community Assistance Program, which has assumed a USDA Section 515 mortgage for an eight-unit property occupied by elderly renters, to obtain a $68,000 forgivable 15-year loan from the Federal Home Loan Bank of Des Moines' Affordable Housing Program.

This relatively small loan, possibly supplemented by state housing development authority funds, will cover the costs of replacing siding, repairing the foundation, installing new carpets and updated appliances, and repainting. When the work is done, Dacotah Bank will have helped improve life for eight low-income senior citizens — fitting everyone's image of rural America as a place where neighbors help each other.

For more information, contact Leslie Strauss, Communications Director, Housing Assistance Council, at (202) 842-8600 or via e-mail at leslie@ruralhome.org. Web site: www.ruralhome.org

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Kaysville Community Apartments – Summary Sources and Uses

FINANCING

Source	Total	
First Mortgage – U.S. Bank	$2,587.667	6.78%, 30 years
USDA-RD Loan Assumption	$691,000	40 years, 1% interest
Steve Walker Housing Trust Fund	$815,000	Cash Flow at 3% interest
Investor Capital Contribution	$3,442,656	LIHTC Equity
Davis County Housing Authority CDBG	$400,000	Cash Flow loan at 3%
TOTAL PERMANENT SOURCES	$7,936,323	
U.S. Bank Construction Loan	2,074,709	

DEVELOPMENT BUDGET

Description	Total
Purchase Price	$3,300,000
Hard Cost	$3,158,150
Soft Cost	$1,241,312
TOTAL DEVELOPMENT COSTS	$7,936,323
Per Unit	$66,136

HISTORIC ELK PARK SCHOOL
Elk Park, North Carolina
Permanent Sources
as of January, 27, 2003

Source	Amount	Interest Rate	Term	Amortization Period
Annual Debt Service				
• 1st Mortgage, FHLB Atlanta, $28,304 via Bank of America	$556,490	1.50%	20 years	20 years
• 2nd Mortgage, North Carolina Housing Finance Agency $12,800	$881,819	2.00%	20 years	Varies to maintain DCR
• Equity	$2,977,430			
• Managing Member (Northwestern Housing Enterprises) Equity	$2,879			