Temporarily Double Low Income Housing Tax Credit Allocations for Preservation

Minnesota Housing Finance Agency **Mary Tingerthal, Commissioner**

From the mid-1970s through the mid-1980s, the federal government's approach to financing affordable rental housing focused on providing project-based rent subsidies. Developers responded to the incentives, and the nation's affordable housing stock swelled. However:

> ***The nation now has a large cohort of 30- to 40-year-old properties needing an immediate infusion of capital for repair and rehab. Making an investment now is essential to preserve these important community assets for decades to come.***

This issue is critical, as demonstrated by the statistics in Minnesota. Decades ago, the state took great advantage of federal programs that produced properties with project-based rental assistance. Minnesota now has over 37,000 affordable rental housing units housed among 550 HUD Section 8 and 570 USDA Rural Development properties.

These properties are critical because project-based rental assistance serves a particularly vulnerable population. For example, in Minnesota Section 8 properties:

- The median household income for tenants is about $11,000. The median household income of all Minnesota renters is $28,000.[1]
- In 2012, more than half of the state's Section 8 households have a member who is elderly or disabled. Among all renter households, 35 percent have a member who is elderly or disabled.[2]

Absent federal rental assistance, these vulnerable households have very few options for decent and affordable housing

Because the cohort of subsidized properties was built in a relatively short period of time, the method of funding the necessary capital improvements can be structured to be available over a relatively short period of time.

RECOMMENDATION:

Support doubling the federal allocation of Low Income Housing Tax Credits for a period of five years, with the incremental amount of credits to be used solely for the preservation of existing properties that receive project-based rental assistance from HUD or USDA.

---

[1] Minnesota Housing analysis of U.S. Census Bureau data from the American Community Survey, 2010.
[2] Minnesota Housing analysis of U.S. Census Bureau data from the American Community Survey, 2010 1 Year Sample and PUMS data.

For the last two and half decades, the federal government's primary mechanism for financing the new construction and rehabilitation of affordable rental housing has been the Low Income Housing Tax Credit (LIHTC) program. From 2003-2009, the LIHTC program helped to preserve over 150,000 affordable apartments across the country. LIHTC generates capital to finance 100,000 housing units each year, including preserved units.

More extensive use of Low Income Housing Tax Credits is the logical means of generating the capital needed to preserve the nation's existing affordable housing stock.

How large an increase in the tax credit allocation is needed depends on the number of projects requiring substantial repair or rehab and the cost of improvements needed.

Minnesota Housing used property age and financial reserve amounts as indicators of physical condition and the scale of investment required. The Agency examined a portion of the state's project-based Section 8 portfolio that includes properties financed in part by Minnesota Housing. The Agency tracks reserve levels for this subset of properties to monitor the state's investments and has reserve data for about 150 properties with 8,109 units of rental assistance.[3]

Low replacement reserves indicate that a property may not be able to generate the cash flow needed to maintain the property's physical condition. This leads to chronic deferred maintenance and upkeep. A 30- to 40-year-old building with low reserves, deferred maintenance problems, and a need for major system replacements (boiler, siding, windows, etc.) is a property that will likely need an infusion of preservation financing.

The table below provides a brief profile of property age and available reserves for the 150 properties analyzed. What constitutes a sufficient level of reserves for adequate preservation is an "it depends" issue. If a property is new or very well maintained, reserves per unit of $2,000 may be sufficient. For properties with extensive repair and replacement needs, $4,500 may not be sufficient.

Replacement and General Reserve Levels for Select Section 8 Properties

Reserves per Unit	Number of Properties	Percentage of Total	Property Age		
			Low	Median	High
Less than $1,500	29	19%	29	32	39
$1,500 to $2,999	26	17%	7	32	40
$3,000 to $4,499	25	17%	9	32	36
$4,500 or greater	70	47%	8	32	42

Source: Minnesota Housing data on 150 Section 8 properties financed in part by Minnesota Housing.

A sizable portion of the 150 properties analyzed have sufficiently low reserves to be of significant concern to the Agency. Minnesota Housing estimates that, to ensure long-term viability, at least 20 to

[3] The 150 properties used in this analysis represent 27 percent of Minnesota's 550-property Section 8 portfolio.

30 percent of the properties in this portfolio are likely candidates for preservation financing. Most of the properties are over 30 years old, and many also have relatively low reserves. For example:

- 29 of the properties (19 percent) have reserves of less than $1,500 per unit. Regardless of property condition, this level of reserves is a categorical concern made more urgent because properties with a median age of 32 years are highly likely to have replacement and upgrade needs.
- 26 of the properties (17 percent) have reserves between $1,500 and $2,999 per unit. These properties also have a median age of 32 years and could be candidates for additional financing.
- Given Minnesota's recent experience with the scale and cost of rehabilitation projects, even properties with reserve levels at or above $3,000 per unit may need additional financing to ensure their long-term viability and affordability.

Even well-managed properties face challenges in maintaining adequate reserves. Howard Lake Apartments is a good example. The property is representative of many smaller developments in Minnesota with project-based Section 8 assistance and a location at the edge of growth and development corridors. The property is almost 40 years old, well managed, and in good condition. Most of the tenants are seniors. Occupancy is generally good, though the property has had cash-flow difficulties in some years. Certain improvements need to be made to the property given its age and general marketability. In spite of this solid performance, Howard Lake's reserves stand at $59 per unit.

Howard Lake Apartments

City: Howard Lake, Minnesota

County: Wright

Initial Occupancy Date: 1974

Section 8 contract expiration date: 09/30/2015

Subsidy/Financing: Project-Based Section 8 rent assistance; Section 236

Units: 24 units; 17 one bedroom and 7 two bedroom

Owner/Management Company: Common Bond

Management Occupancy Review: Satisfactory

Profit or (Loss) from last audited financials, before depreciation: ($3,136)

Rents: Section 8 units: 1 br ($538), 2 br ($677)
Section 236 units: 1 br ($478), 2 br ($592)

Replacement/General Reserves: $1,420 or $59 per unit

Assuming that the 150 properties analyzed for this paper are representative of Minnesota's full HUD and USDA Rural Development portfolio:

Minnesota Housing estimates that at least 20 to 30 percent of the state's affordable housing properties are good potential candidates for preservation financing.

This translates to an estimated 224 to 336 properties and 7,500 to 11,250 rental assistance units that are likely to need preservation financing.[4]

Low Income Housing Tax Credit syndication proceeds of $65,000 per unit are the historical average for Minnesota preservation projects. This assumes a syndication price of 85 cents on the dollar.

Doubling Minnesota's tax credit allocation would take Minnesota a long way toward meeting vital preservation needs.

By doubling Minnesota's $7.7 million Low Income Housing Tax Credit allocation for preservation, Minnesota Housing estimates that the state will be able to preserve an additional 1,000 units per year or 5,000 units over the recommended five year period. This represents about 13 percent of the state's portfolio of federally-funded, project-based rental assistance units. More importantly, it represents decades of decent, affordable housing for 5,000 of the state's most vulnerable households.

[4] Minnesota has about 1,120 properties with project-based rental assistance—550 HUD Section 8 and 570 USDA Rural Development.

This paper has been submitted by Mary Tingerthal, Commissioner of Minnesota Housing – a state agency that has invested more than $10.8 billion and assisted more than 1 million households since its establishment in 1971. Tingerthal previously held senior management positions with the Housing Partnership Network, the National Equity Fund, GMAC Residential Funding and Community Reinvestment Fund and serves on the board of the National Housing Trust.

Minnesota Housing Finance Agency