TAAHP
TEXAS AFFILIATION OF
AFFORDABLE HOUSING
PROVIDERS

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January 27, 2020

The Honorable Eddie Lucio, Jr
The Texas Senate, District 27
1210 W. Interstate 2, Suite 10
Pharr, Texas 78577

Re: Texas Affiliation of Affordable Housing Providers – Request for Interim Study Consideration

Dear Senator Lucio,

The Texas Affiliation of Affordable Housing Providers ("TAAHP") appreciates the opportunity to submit documentation in response to the following interim charge:

Low-Income Housing Tax Credit Program: Review existing regulations governing the Low-Income Housing Tax Credit Program and the Qualified Allocation Plan to determine whether regulations exist that unnecessarily increase the cost of developing and maintaining affordable housing. Make recommendations to provide regulatory relief and provide greater development of affordable housing in Texas.

Every year, thousands of people relocate to Texas. According to the Texas Association of Realtors - 2018 Texas Relocation Report, *Texas experienced a net gain of 87,656 new residents in 2016*. This equates to 240 people moving into Texas every day. This growing demand exacerbates the already limited housing supply that is affordable, especially in urban, suburban, and rural areas. Additionally, rebuilding efforts by counties affected by major federally declared disasters are proving difficult without the addition of new workforce housing units.

Established in 1987, The Housing Tax Credit program, (HTC), administered by the Texas Department of Housing and Community Affairs (TDHCA), is the primary financing tool for the production and preservation of affordable rental housing. As stated in the Urban Institute's research report, LIHTC – Past Achievements, Future Challenges, this program has been very successful, resulting in new construction or preservation of more than *2.3 million affordable housing units nationally since its creation*. The program provides housing for residents who are middle to low income working families, seniors, and, veterans. In addition, the program provides supportive housing opportunities for those in need of more enriched services, those with special needs, and those at risk of homelessness.

Multifamily renters are constrained on two fronts: (1) The cost of living such as skyrocketing healthcare premiums, student loan debt, and transportation costs, among the current prevailing concerns facing Americans and (2) the rising price of single-family homes. On the supply side, housing prices continue to rise due to increases in land, labor, and material costs as well as the expensive and cumbersome local and state regulations. For example, the National Association of Home Builders states that, nationally, for "every $1,000 increase in the price of a home, about 152,903 households are priced out of the market for a median priced new home." Controlling costs is important to developers and consumers alike.

Conversely, on the demand side, crippling debt is prohibiting moderate income residents from affording the down payment needed for a mortgage or can't meet the stricter mortgage standards in place post the 2007 Great Recession. According to Apartment List, on average, it takes a college graduate with student loan debt 4.5 more years to save 20% for a mortgage down payment versus a college graduate with no debt. These barriers hinder residents from moving to home ownership, limiting new or lower income residents from finding affordable housing. As a result of these barriers, there is a widening housing gap between supply and demand, creating the current housing crisis. It is imperative to keep programs, like the HTC, solvent and flexible to help alleviate resident's current housing burden.

While the housing tax credit program is a consistent resource for affordable housing, there are barriers to increasing the housing supply and equitable distribution of affordable housing. Detailed below are five critical areas hindering the supply of affordable housing which warrant study for possible future legislation. The recommendations to follow will increase the supply of affordable housing, by reducing the cost of development through streamlining regulations, and establishing new resources to address the shortage of supply.

The areas are as follows:

I. Highly Prescriptive 9% HTC Scoring Criteria

Between the state law and the Qualified Allocation Plan (QAP), Texas's competitive 9% HTC tax credit program is one of the most highly prescriptive and complex in the nation. Moreover, it is the <u>only</u> state that couples very high point allocations with support resolutions from municipalities and support letters from state representatives. This means without submitting both these items, an application simply cannot compete for 9% HTC credits in Texas. Section 2306.6710 requires that certain scoring items be prioritized per the statute. Due to program's rules set by state statute, TDHCA is unable to introduce other meaningful point categories to address other policy priorities, such as encouraging developments in the areas with the highest need or areas that create the greatest choice for Texans. In addition to the legislative prioritization of scoring items, Section 2306.6725(b)(2) also instructs TDHCA to incentivize deals in "census tract in which there are no other existing developments supported by tax credits." This one size fits all approach simply does not work in a large and diverse state like Texas. For instance, a census tract in Houston can be geographical small, but population dense and therefore, have a demand for multiple tax credit developments. This restriction encourages developers to seek sites in geographically large, but population-sparse rural census tract which might not have enough of a market demand to support the one proposed tax credit development, or multiple developments.

Such issues, coupled with the 9% HTC program is typically oversubscribed at pre-application stage by 600%, result in a housing distribution problem, where certain census tracts are flooded with 9% tax credit applications, while other areas are essentially redlined. While the City of Dallas has only received one tax credit allocation in the last five rounds, it is not unusual for the 9% pre-application log to show three or four applications on sites across the street from each other in small jurisdictions. In 2016, in Whitehouse, TX, a rural community of fewer than 8,500 people, four applications were submitted and two were funded. In 2014, Alton, TX had a population of less than 15,000 people, but four application were submitted, and three were funded. This result is not the ideal situation for any party involved. Two developments must share the market, resulting in less economically viable developments. The city has a concentration of affordable housing in one spot, and the neighboring cities who want and need workforce housing remain unserved when their entire jurisdiction is simply not competitive, year after year.

These program requirements drive the 9% awards to certain areas over others results in higher costs. Land price regularly increases rapidly when certain census tracts are favored in the tax credit scoring and multiple developers are trying to purchase the same sites. Construction costs are often higher in areas where the process drives 9% awards to certain parts of town over others, particularly if there is insufficient infrastructure. The developer would be responsible for providing adequate infrastructure for each affordable housing development. Commercial sites are often competitive under the 9% program, and those are typically smaller, more expensive sites that can hold fewer units than a more typical residential property.

All these dynamics drive up the cost of development and reduce the effectiveness of the 9% program. While the tax credit ceiling increased 61.7% from approximately $50M in 2012 to more than $75M in 2019, the number of units produced by the program only increased by 12.66% or 632 units—5,009 in 2012 and 5,643. (See Figure 1 in the Appendix.) This is a strong indicator that major cost increases, caused at least in part by the highly regulated nature of the program, are resulting in a less efficient program which is resulting in fewer units than could otherwise be produced.

Recommendation

- In lieu of letters of support and resolutions of support from local municipalities as the most significant scoring items for the 9% competitive program, require a notification and public hearing process similar to the one required for 4% tax credit/tax exempt bond development.
- Alternatively, remove the legislative requirement that prioritizes the letters from state representatives and the resolution of support from municipalities under Section 2306.6710(b)(B) and (J), so TDHCA can determine what weight is appropriate in light of the various policy considerations mandated by that same section.
- Remove Section 2306.6725(b)(2) which requires TDHCA to incentivize developments in "census tracts in which there are no other existing developments supported by tax credits."

II. Regulatory Barriers in the 4% HTC Program

The 4% tax credit/tax exempt bond transactions typically result in large, urban or suburban communities with 200-400 units, meaning this program is the single most important program in creating affordable housing in Texas. However, like the 9% HTC program, the 4% HTC program includes a threshold requirement for community input that has the unintended result of directly reducing the production of affordable housing. Moreover, the QAP has an extensive list of ineligible site features that act as deterrents to 4% housing tax credit/bond deals in urban areas.

While state representative support letters are not required for 4% tax credit transactions, a 4% HTC application must obtain a resolution of no objection from the local jurisdiction, and if it fails to do so, the development cannot even apply for credits, and therefore cannot proceed. Section 2306.07071 requires that the developer provide notice to each governing body and respond to any questions, and that the governing body hold a hearing and affirmative pass a resolution of no objection. While this process is typically not a problem in urban areas, in suburban areas where there is a strong demand for workforce housing, these extensive notification and hearing aspects of this regulation creates a politically charged environment, and as a result, these developments often die on the vine, frequently because of misconceptions about affordable housing and its impact on communities.

On the other hand, the QAP has very rigorous site standards for 4% housing tax credit developments, including, most notably, the requirements that the census tract has less than 40% poverty rate, a low crime rate, and that none of the schools to which future residents would attend have a failing school rating. While TAAHP very much understands and agrees with the underlying policies driving these threshold requirements, the fact that these are threshold requirements (and in certain cases with regard to schools, a non-starter if one of the schools has both a F rating for 2019 and a "Improvement Required" rating for 2018), creates a significant chilling effect on pursuing bond deals in certain areas. The impact of a rule like this works to effectively redline entire swaths of school districts in Houston and Dallas, for instance, that are having performance issues across many of their middle and high schools. Threshold rules about poverty rates and low crime areas have a similar effect. They discourage developers from going into areas where there is a huge demand for affordable housing, purely based on these two census tract factors, which are census tract factors, and not indicative of what is happening in the larger market.

Recommendation

- Require developers proposing a 4% HTC transaction to notify city official, respond to any questions from city staff or city officials, and present at public hearing, but do not require a resolution of no opposition under Section 2306.67071. This will single handedly open many robust secondary markets that need this type of workforce housing for those employees of retail, restaurant, and other service industries.
- Introduce and support legislation that limits the agency's ability to consider school performance as a threshold or scoring issue. Alternatively, focus the consideration of school performance on the elementary school level, which has the most relevance for residents of tax credit development, and remove any and all requirements regarding the performance of middle and high schools.

III. Property Appraisal Process for Affordable Housing Developments

HTC developments are comprised of income limited units that adhere to federal guidelines for the HTC program. Due to the income restriction, per state law, these properties should be appraised by the income method. This appraisal method ensures that an HTC development's property tax burden does not outpace federally imposed rent restrictions. However, the HTC program is generally not well understood by appraisers or appraiser review boards, leading to inconsistent property valuations. For example, appraisal districts have unilaterally increased all appraisal values by 10 percent, including those for LIHTC developments. In other instances, appraisal districts increased developments' appraised value as the actual rental income for those properties have declined. These significant appraisal increases have prompted the owners of LIHTC properties to protest and litigate their valuations, a costly and time-consuming exercise.

To provide better clarity, certainty, and guidance, S.B 1830, and companion bill, H.B. 2993 – both filed during the 86^{th} legislative session, sought to provide the following, not an exclusive list:

- Provides a methodology to appraise HTC properties under construction,
- Uses income method to establish the appraised value of the property in its first year of operation, and
- After the first year of operation, the appraised values are based on the change in the annual net operating income.
- Additionally, appraisal districts are given parameters for using this appraisal methodology, including audited financial statements or TDHCA annual compliance reports.

These changes provide clearer, specific direction for appraisal districts' valuation of HTC developments to ensure consistent annual tax appraisals for affordable housing developments across the state. The Texas Association of Appraisal Districts, Texas Association of Builders, and the Texas Apartment Association supported these bills and consistent tax valuations saves taxpayers money in litigation costs from lawsuits filed by HTC property owners.

Recommendation

- Support and vote to pass S.B. 1830 (or the equivalent filed bill) during the 87th legislative session to help HTC property reallocate funds previously used for litigation costs for maintenance & operations of existing developments or to provide more supply of affordable housing across the state.

IV. State Housing Tax Credit Program

Currently, there are fourteen states that have a state housing tax credit program to provide gap funding or supplemental funding to the federal 9% or 4% HTC programs for new construction, rehabilitated, and/or preservation of affordable housing developments. The requirements for these state programs follow the regulations stated in the federal HTC 9% program. Additionally, some states use their tax program to increase supply of affordable housing for targeted populations. In Texas, a step towards creating a state tax credit program occurred during the 86th legislative session. S.B. 1590/H.B. 1937 were filed to allow eligible HTC property owners to claim a non-refundable credit against the franchise tax and the state insurance tax premium and retaliatory taxes. The credit would be available for any tax year within the 10-year period following the placed in-service date for the affordable housing development. The total amount of credits awarded would be limited to $35 million per year. H.B. 1937 was voted favorably out of the House but was never heard in the Senate. S.B. 1590 was also never considered in the Senate. With Texas, like other states, in a housing crisis, the creation of a state tax credit program can assist with increasing the supply of affordable housing across the state annually.

Recommendation

- Study the state tax credit programs in the fourteen states to understand how their programs are funded, implemented, and provide accountability and compliance for affordable housing developments.
- Determine how Texas can create its own program, supported by a reliable funding mechanism annually, to preserve and increase the supply of affordable housing across the state.

V. Draw-Down Bonds

As mentioned above, 4% HTCs coupled with tax-exempt bonds result in a large supply of affordable housing for Texas. As you know, these mortgage revenue bonds are administered by the Texas Bond Review Board. Currently, in order to access these bonds for financing, a developer must draw the entire bond allocation on the day of closing, even if the developer does not need access to all those funds on the day of closing, because equity is available, interest free. The result is that the developer incurs interest carry on 100% of the bond amount on day one, which adds significant cost to the transaction. Instead, the preferred way would be to only draw those bonds in part as they were needed, thereby reducing the interest rate carry. Other states allow this method of drawing down bonds as needed, but the Texas government code does not allow “draw down bonds.”

Recommendation

- Explore Section 1372.001 of the Government Code to define “closing” as including partial payment for the incremental funding of the bond, to reduce interest carry costs for certain bond users.

In representing over 400 members across Texas, TAAHP extends thanks for the Senate Committee on

Intergovernmental Relations for considering these critical topics it evaluates the need for legislation in the upcoming 87th Legislature. TAAHP is available to provide any additional information or testimony you may require for these issues.

Thank you for your consideration of these comments. Please contact TAAHP Executive Director Roger Arriaga at (512) 476-9901 or roger@taahp.org with questions or concerns.

Respectfully submitted,

Janine Sisak

Janine Sisak
President Elect & Government Affairs Chair

Cc: Daniel Esparza

Appendix

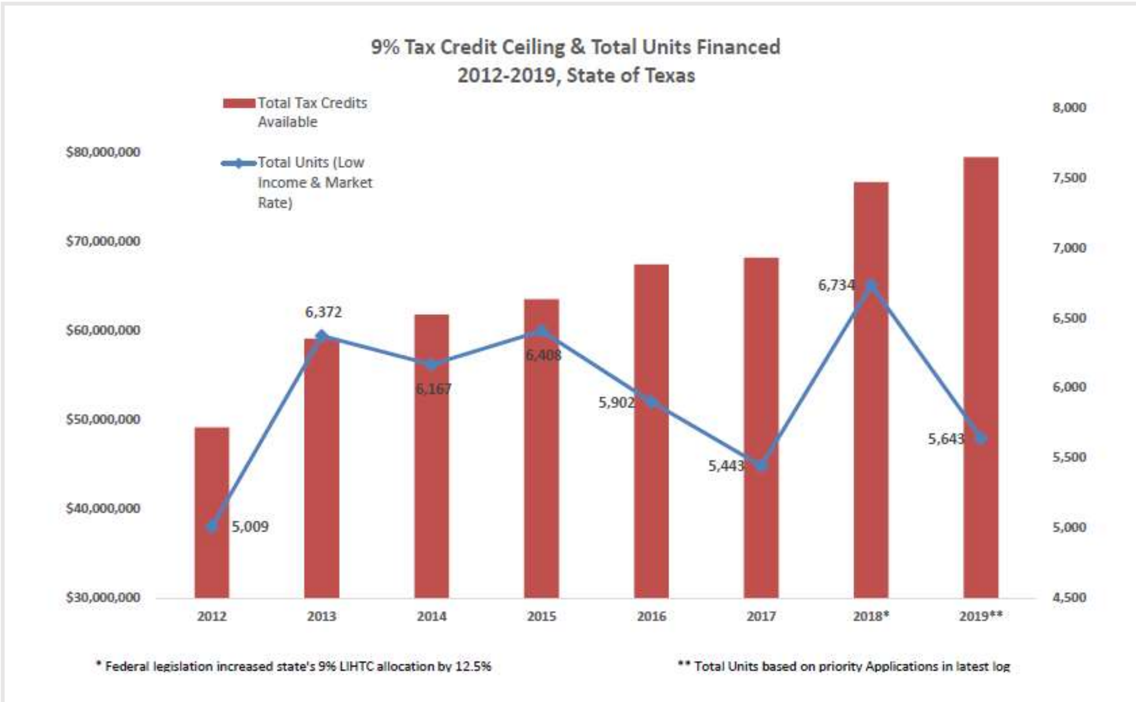

Figure 1. Total 9% HTCs vs. Total Housing Units Funded (2012-2019)
Source: Texas Department of Housing & Community Affairs