

**Testimony of John Henneberger, co-director before
the Texas Senate Intergovernmental Relations Committee
on the committee interim charge**

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Increasing the effectiveness of the Texas Department of Housing and Community Affairs' (TDHCA) Housing Tax Credit (HTC) Program. Examine potential rule changes to the HTC Program's Qualified Allocation Plan to give owners of mixed-income projects seeking low-income housing credits the same opportunity to receive credits that low-income projects have, thus helping cities address the problem of a lack of adequate quality affordable housing while enhancing central city revitalization.

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The Texas Low Income Housing Information Service¹ supports the economic and ethnic and racial integration of housing. We also support the creation of more affordable housing opportunities in central cities. Each of these have proven difficult and elusive goals to achieve through the Low Income Housing Tax Credit (LIHTC) program.

We offer three observations regarding this committee charge:

1. The ability to promote more mixed income housing is severely constrained by market realities.
2. There are limited means available to the state to use the LIHTC program to enhance the supply of housing within the central city but these will come at the price of lowering the number of affordable housing units developed in the state.
3. There is an opportunity available to the state to use the LIHTC program to further economic and racial housing integration through a change to a state statute.

¹ The mission of the Texas Low Income Housing Information Service (TxLIHIS) is to support low-income Texans' efforts to achieve the American dream of a decent, affordable home in a quality neighborhood.

TxLIHIS was founded in 1988 by public and private housing providers, low-income people and other community leaders who subscribe to the national goal of decent, affordable housing for all Americans and who believe there must be an organized, concerted effort to achieve that goal in Texas. TxLIHIS is Texas' foremost supporter of housing for the poor and for neighborhood preservation, and is one Texas' primary source of research on low-income housing.

Mixed income housing

The federal laws that govern the Low Income Housing Tax Credit program require, at a minimum, that housing developments receiving tax credits provide housing provide that at least:

- 20% of the renters in the development have incomes less than 50% of the area median; or
- 40% of the renters in the development have incomes less than 60% of the area median.

In order to keep rents affordable to lower income families, the housing developments are restricted as to the maximum rent they may charge tenants at each of these income levels. The rents that can be charged are adjusted, based on a formula, so the rents charged to a family earning 50% or less of the mean income are less than the rents that can be charged to a family earning 60% of the median.

To put this in context we can look at the income levels of the targeted tenants and the maximum rents they can be charged in some Texas cities.

Tarrant County LIHTC limits - 4 person household		
Family income as a percentage of are median family income	Maximum income (2008)	Maximum rent (2008)
50% of median	\$32,300	\$807.00
60% of median	\$38,760	\$969.00
80% of median	\$51,700	no limit

Dallas County LIHTC limits - 4 person household		
Family income as a percentage of are median family income	Maximum income (2008)	Maximum rent (2008)
50% of median	\$33,250	\$831.00
60% of median	\$39,900	\$997.00
80% of median	\$53,200	no limit

Harris County LIHTC limits - 4 person household		
Family income as a percentage of are median family income	Maximum income (2008)	Maximum rent (2008)
50% of median	\$30,550	\$763.00
60% of median	\$36,580	\$916.00
80% of median	\$48,900	no limit

Each developer applies for housing tax credits on only those units the developer agrees to set aside under the rent restrictions for a minimum of 15 years. At a minimum, the developer agrees to set aside at least 20% of the units for families earning no more than 50% of the median income or 40% of the units at 60% of the median. The rest of the apartments may be rented at market rate rents, without restrictions on the incomes of the tenants. Under federal law the units not set-aside (or "income restricted" to use the industry terminology) for lower income families (earning < 60% of the median) are not eligible to receive housing tax credits.

Now let's look at the form that housing tax credits take. The tax credit is available to the development for ten years. Developers always sell the tax credits to investors who give the developer money up front to invest into the development as equity.

The amount of tax credits each state receives is limited based on a formula. There is a larger demand for tax credits than there are tax credits available. So, it is in the interest of the state to be fiscally prudent in the award of tax credits.

The State of Texas through its housing agency (TDHCA) has wisely sought to control the amount of tax credits a development may receive. This limit is placed on the developments through the awarding of extra points to applicants who do not request more than a certain amount of tax credits per square foot of residential space. The number of points in this category is quite large, thus providing an overwhelming incentive to developers not to exceed these limits.

The points are awarded if hard construction costs of the development does not exceed approximately \$85 per square foot of residential space.² (The actual rules are extremely complex and this is a simplification, see the footnote for details).

² (8) The Cost of the Development by Square Foot (Development Characteristics). Applications may qualify to receive 10 points for this item. (§2306.6710(b)(1)(H); §42(m)(1)(C)(iii)) For this exhibit, costs shall be defined as construction costs, including site work, direct hard costs, contingency, contractor profit, overhead and general requirements, as represented in the Development Cost Schedule. This calculation does not include indirect construction costs. The calculation will be costs per square foot of net rentable area (NRA). For the purposes of this subparagraph only, if the proposed Development is an elevator building serving elderly, a single room occupancy Development, or a high rise building serving any population, the NRA may include elevator served interior corridors. The calculations will be based on the cost listed in the Development Cost Schedule and NRA shown in the Rent Schedule of the Application. Developments qualify for 10 points if their costs do not exceed \$85 per square foot for Qualified Elderly, single family design, transitional, and single room occupancy Developments (transitional housing for the homeless and single room occupancy units as provided in the Code, §42(i)(3)(B)(iii) and (iv)), unless located in a "First Tier County" in which case their costs do not exceed \$87 per square foot; and \$75 for all other Developments, unless designated as "First Tier" by the Texas Department of Insurance, in which case their costs do not exceed \$77 per square foot. - page 51, 2009 Housing Tax Credit Program Qualified Allocation Plan and Rules

On a 1000 square foot apartment a developer would receive a maximum government housing tax credit subsidy of \$85,000 (1,000 square feet X \$85) and still be eligible to receive the scoring points.

We must examine the real world economics of the LIHTC program to appreciate the reason most developers elect to develop apartments with 100% of the apartments restricted to tax credit income eligible (<60% of median income) tenants.

The first and main reason is the one just detailed. A developer can get a large equity subsidy for each income restricted apartment they build. The market rate units do not receive a subsidy. This is a requirement of federal law.

The second reason is the expense, complexity, time consuming and highly competitive nature of the LIHTC application process. Most developers of market rate units will not endure the time, expense, and uncertainty of the tax credit competition to secure a subsidy on a few apartments. They either choose to go “all in” or stay out of the tax credit application process.

The final reason why market rate apartment developers do not participate in the tax credit program is the additional operational restrictions the acceptance of the LIHTC imposes on the development. Once again, these are federal restrictions. A developer must agree to frequent compliance reporting and housing quality monitoring by TDHCA. Additionally, acceptance of tax credits imposes a requirement that the development not discriminate against Section 8 Housing Choice Voucher holders. Many apartment owners unfortunately do not want to rent to Section 8 tenants.

Downtown housing

The pattern of residential development in downtown neighborhoods has been one of higher-end condo and apartment development.

A few LIHTC funded developments have been built in downtown areas. These exceptions include in a mixed market rate/Single Room Occupancy development in downtown Dallas, an affordable family mid-rise and a mixed residential and commercial/residential development near downtown Austin.

Each of these LIHTC development have not depended solely on LIHTC as a form of subsidy but have brought in other equity form local governments and foundations to make the development economically viable. The requirement of additional equity makes these type of developments more difficult to do.

There are three main factors, all related to project costs, that require these developments to bring in additional equity beyond the housing tax credits:

- downtown land prices are higher;
- high-rise construction costs are 30%-50% in excess of traditional multifamily development costs; and
- downtown developments require the construction of parking structures which can easily add \$30,000-\$40,000 per apartment to construction costs.

Recall that existing tax credit developments outside of downtown areas are effectively limited by the state's point structure to \$85 per square foot subsidy. To provide a developer additional equity as an offset for the increased costs of downtown development this limit would have to be significantly raised. The effect would be to reduce the number of apartments created each year under the LIHTC program in Texas.

Racial segregation

The Texas Low Income Housing Information Service is deeply concerned with the increasing isolation of LIHTC developments in lower income and minority neighborhoods.

According to a U.S. Department of Housing and Urban Development study, 64% of the tax credit units in Texas are located in census tracts with 50% or greater minority population. Only Connecticut, California, New Mexico, Washington, D.C. and Hawaii had higher percentages of LIHTC units in census tracts with 50% or greater minority populations.³

In the city of Dallas, 19% of all renter occupied units are in 70% or more white census tracts, but only 2.9% of TDHCA's LIHTC units are in such tracts. Contrasting, 51% of all renter units are in 70% or more minority tracts, compared to 85% of LIHTC units in such minority concentrated tracts.

This situation is a direct result of the statute adopted by the Texas Legislature governing the allocation of Low Income Housing Tax Credits. The statute attaches the second highest priority in the scoring of the applications of tax credits to "quantifiable community

³ Office of Economic Affairs, U.S. Department of Housing and Urban Development, Office of Policy Development and Research, "Updating the Low-Income Housing Tax Credit (LIHTC) Database Projects Placed in Service Through 2003," 2006 pages 76-78, 130.

participation". In essence this gives people who do not want to allow tax credit funded developments in their neighborhoods a veto over applications from developers.⁴

In the face of this reality developers have avoided proposing developments in areas with good schools, access to jobs and higher quality of life and have turned to more marginal locations, areas already over saturated with multifamily developments or proposed to construct developments restricted to occupancy by elderly households who draw fewer objections from organized homeowners associations.

⁴ § 2306.6710. EVALUATION AND UNDERWRITING OF APPLICATIONS. (a) In evaluating an application, the department shall determine whether the application satisfies the threshold criteria required by the board in the qualified allocation plan. The department shall reject and return to the applicant any application that fails to satisfy the threshold criteria.

(b) If an application satisfies the threshold criteria, the department shall score and rank the application using a point system that:

(1) prioritizes in descending order criteria

regarding:

(A) financial feasibility of the development based on the supporting financial data required in the application that will include a project underwriting pro forma from the permanent or construction lender;

(B) quantifiable community participation with respect to the development, evaluated on the basis of written statements from any neighborhood organizations on record with the state or county in which the development is to be located and whose boundaries contain the proposed development site;

(C) the income levels of tenants of the development;

(D) the size and quality of the units;

(E) the commitment of development funding by local political

subdivisions;

(F) the level of community support for the application, evaluated on the basis of written statements from the state representative or the state senator that represents the district containing the proposed development site;

(G) the rent levels of the units;

(H) the cost of the development by square foot;

(I) the services to be provided to tenants development; ...

Added by Acts 2001, 77th Leg., ch. 1367, § 8.01, eff. Sept. 1, 2001. Amended by Acts 2003, 78th Leg., ch. 330, § 22, eff. Sept. 1, 2003.