



# Expiring Affordability of Low-Income Housing Tax Credit Properties:

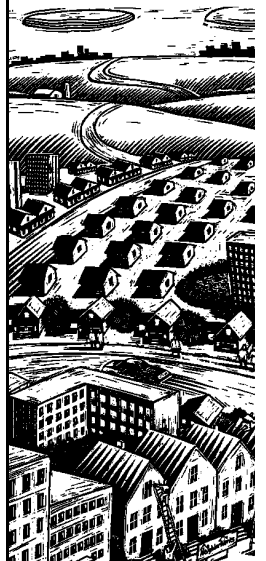
*The Next Era in Preservation*

Fellowship Program for Emerging Leaders  
in Community and Economic Development

October 1999



Neighborhood Reinvestment Corporation  
Joint Center for Housing Studies of Harvard University



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This paper was written under the support of the Neighborhood Reinvestment Corporation's Emerging Leaders in Community Economic Development Fellowship, which provides opportunities for highly-qualified professional students at Harvard University to research and publish applied analytical projects of interest to the community development field.

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## **EXECUTIVE SUMMARY**

Affordability periods will end for the first 23,000 Low-Income Housing Tax Credit (LIHTC) units in 2002. Their expiration will launch a new round of preservation activity. The LIHTC portfolio now stands at approximately 750,000 units, increasing by 62,500 a year. By 2002, the portfolio will include almost one million units – comparable in size to the U.S. Department of Housing and Urban Development (HUD) affordable-housing portfolio now facing its own preservation challenges. Thanks to the preservation awareness prompted by concerns over HUD's portfolio, Congress has promoted tax-credit preservation through a 15-year affordability extension passed in 1989, as have some states through a variety of allocation and financing tools. Yet for these efforts actually to result in preservation of affordable housing, a wide range of players – including state and federal legislators, state housing agencies, local housing administrators, investors and owners – still face the tasks of assessing the economics of preservation and implementing appropriate strategies.

If continued affordability is a goal, it is now time to prepare. This paper outlines the issues – including data availability, monitoring and enforcement needs, financial resources and response coordination – surrounding preservation of tax-credit properties, with the aim of initiating discussion between the housing and policy communities prior to 2002. These issues are already familiar to tax-credit specialists. However the wider range of state and local housing policy-makers at legislative, regulatory and advocacy levels will need to understand them, too, in order to lead preservation measures.

Tax-credit developments face three primary challenges to continued affordability: (a) conversion to market rents; (b) cessation or reduction of targeting to very-low-income households; and (c) need for capital infusion to ensure continued financial feasibility and prevent physical deterioration. These challenges delineate three key decisions for LIHTC sponsors: (a) to maintain or adjust current affordability; (b) to recapitalize or not; and (c) to buy out limited partners or sell. In each property, these decisions will be influenced by partnership requirements, market factors, the property's

financial and physical condition, the owners' affordability priorities, lien-holder requirements, and housing-agency resources.

Unlike any previous preservation portfolio, responsibility for the LIHTC program has been devolved to state and local credit-allocation agencies, which determine allocation priorities in response to regional markets. All developments fall under a federal regulatory umbrella. However property types, financing and regulatory restrictions vary among states and localities, as will the disposition trends these factors will affect.

Because of statutory changes made in the tax code in 1989 and 1990, the LIHTC stock allocated credits in 1990 and after is more likely than earlier stock to have extended-affordability requirements and right-of-first refusal protections. However, housing leaders will learn their first tax-credit preservation lessons from properties allocated credits between 1987 and 1989. These projects will not be representative of the later – and larger – stock of tax-credit units. Therefore, while past and prospective market factors will influence disposition of all properties, housing leaders should take care to avoid improper generalizations from the first expiring properties in designing preservation strategies for the remainder.

Those preparing for expiring use will confront a series of key issues. First, inadequate data on existing tax-credit developments make it difficult to estimate the extent of recapitalization needs, the proportion of projects with extended-affordability and right-of-first-refusal protections, and the details of these requirements. Without this information, it is impossible to assess the real challenges facing preservation of the LIHTC stock. Data collection is thus the first step in considering appropriate approaches to preservation.

Second, while the 1989 statutory changes built in extended-affordability protections for later stock, these protections will be meaningless if no entity is capable of enforcing them. It is assumed that the credit-allocating agencies that currently oversee LIHTC compliance will continue to serve this

function over the extended period. However, credit-allocating agencies will need to expand their capacity to take on additional monitoring and other roles that will be required under expiring use.

Also needed are mechanisms to provide financing for necessary capital improvements after 15 years of use, or to enable nonprofits and other organizations to purchase properties whose owners choose to opt out of extended-compliance periods. Without such resources, entities interested in preservation will not be able to make use of the affordability protections that regulatory and partnership requirements provide.

Furthermore, with the addition of tax-credit properties to the preservation discussion that already surrounds the HUD portfolio, housing leaders will need to devote increased attention to “preservation entities” as a means to facilitate making “preservation” a policy priority equal to “development.” Attention to preservation calls for collaboration between credit-allocating agencies and regional and national intermediaries to build the capacity of actual preservation entities – owners with the mission, scale, financial strength, and asset-management skills to preserve affordable properties far into the future.

Finally, the devolved nature of the LIHTC program, while offering multiple laboratories for developing promising preservation strategies, will also require organized discussion among the 50 states to share best practices and to identify federal statutory needs to support preservation. An effective forum for this discussion remains to be identified.

## **INTRODUCTION**

Evergreen Ridge Apartments houses 150 households, 120 of whom earn less than 60 percent of the area's median income.<sup>1</sup> Evergreen Ridge opened its doors in 1987 as one of the first private housing developments constructed with assistance from the federal Low-Income Housing Tax Credit (LIHTC). Since then, its owners have set aside over 40 percent of the property's units to provide affordable housing, in compliance with the requirements of the tax credit. In 2002, Evergreen Ridge will reach the end of its tax-credit compliance period, and will no longer be required to keep rents affordable. The owners will need to decide about the future of the property. Based on the potential for increased profit under market rents, Evergreen Ridge's owners will likely increase rents on many, if not all, of the property's affordable units.

Evergreen Ridge is one of over 20,000 multifamily developments containing more than 750,000 units that will face this turning point beginning in 2002.<sup>2</sup> While housing leaders may well be prepared to respond, based on lessons learned from preservation efforts involving the U.S. Department of Housing and Urban Development's (HUD) affordable-housing portfolio, design and implementation of LIHTC preservation strategies will involve analysis and action by a wider array of individuals and entities, primarily at the state level. This paper outlines the issues that will surround disposition of tax-credit properties at the end of their 15-year affordability period. To this end, the paper:

- outlines the factors that will contribute to decisions to sell, preserve affordability, and/or recapitalize properties;
- reviews existing data on the tax-credit portfolio as it relates to these factors; and
- presents issues that need to be addressed in advance of expiring use.

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<sup>1</sup> Evergreen Ridge is a hypothetical project, representative of many tax-credit properties.

<sup>2</sup> Calculated from Abt Associates' 1996 LIHTC database. Abt estimates approximately 500,000 units and 13,500 projects placed in service between 1987 and 1994. If rates of production remained consistent through 1998, 250,000 units and 6,750 projects would have been constructed since that time.

Expiration of the first tax-credit properties in 2002 will mark the beginning of the next era in the preservation debate, following the 1991 Low-Income Housing Preservation and Resident Homeownership Act (LIHPRHA) and the 1997 Multifamily Assisted Housing Reform and Affordability Act (“Mark to Market”). Preparation for tax-credit expirations is fast becoming a new priority for housing agencies, owners and policy-makers still grappling with preserving the more than 1.3 million units within the HUD portfolio under Mark-to-Market.<sup>3</sup> Yet tax-credit units already number 750,000. At an ongoing construction rate of approximately 62,500 units a year, tax-credit units will soon surpass the number of HUD properties.<sup>4</sup>

Preparation for expiration of tax-credit properties is further complicated by the devolved nature of the program. Funding (through foregone income taxes) and authorizing legislation were initiated at the federal level, but 54 different state and local credit-allocation agencies – principally housing finance agencies (HFAs) – are responsible for allocation decisions and compliance monitoring.<sup>5</sup> There is no centralized coordination of the program’s housing quality or preservation thereof. The Internal Revenue Service (IRS) has sole federal authority, and is primarily responsible for ensuring that no more credits get allocated or collected than are authorized. The IRS provides significant monitoring during the term of the credits, and, so far, the program has successfully reached those families targeted for it. HUD has no systemic involvement, apart from its ability to condition the amount of HUD assistance for which a project is eligible based on the amount of tax credits it receives.

Devolved authority will place the burden of responsibility for preservation on HFAs. This burden will be all the heavier for states that have been most active in tax-credit property development and thus have the most properties to preserve. Allocations from the five leading states – California,

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<sup>3</sup> Properties in the HUD portfolio were developed between 1968 and 1988 under Section 236, 221(d)(3), and 221(d)(4). LIHPRHA recapitalized 60,000 apartments; Mark to Market seeks to reduce subsidy costs for another 400,000 units (Smith, 1999a).

<sup>4</sup> Calculated from HUD, 1996.

<sup>5</sup> Several states have assigned credit allocation to state or local agencies other than their HFA, or have established new agencies to manage the task. For simplicity, this paper refers to all credit-allocation agencies as HFAs.

Texas, New York, Ohio and Florida – together account for one-third of the total units nationwide (NCSHA, 1998). States that prioritized extended-affordability periods and other affordability protections in their allocation process and land-use restrictions – such as California and Nevada, which require 50 years of compliance, and Utah, which requires 99– will be better prepared to meet this challenge.

Differences between the programs under which LIHTC properties and the HUD portfolio were developed should caution against assuming too much from previous preservation experiences. Yet guiding principles for strategies to manage tax-credit expirations can be derived from lessons of the past. Many now agree that preserving affordable housing is a legitimate aim of public policy. It is also recognized that preservation is not always worth pursuing at all cost. Furthermore, it is acknowledged that future development will not be well served if immediate preservation efforts violate the rights of property owners, and that efforts to indemnify those with contract expectations will increase costs.

Now is the time for more-organized, systematic learning. On the premise that continued affordability of tax-credit properties is necessary to meet housing needs in most states, it is not too early for states, federal policy-makers and other entities to begin to learn about and to prepare for the preservation of LIHTC properties.

## **EVOLUTION OF THE LOW-INCOME HOUSING TAX CREDIT**

### **The Program**

The Low-Income Housing Tax Credit was created under the Tax Reform Act of 1986 to leverage private investment in affordable housing. Investors in the construction or rehabilitation of qualified housing properties receive a 10-year income-tax credit. In exchange, the investors are required to commit to maintaining a portion of the units at affordable rents for 15 years, after which the investors' obligation to the LIHTC is complete. Should an HFA find a property out of compliance with these affordability requirements, the tax credits that have been paid to investors would be recaptured, with interest and a penalty.

### ***Affordability Protections***

A few measures to protect the affordability of tax-credit projects after the initial 15-year compliance period have been put in place at the federal level and by HFAs (*See Exhibit 1*). The prevalence and strength of these measures have grown along with the demand for tax credits, as HFAs have been able to require more from competing tax-credit applicants.

The increased emphasis on long-term affordability began in 1989 when the Revenue Reconciliation Act established a federal 15-year extended-affordability requirement.

<b>Exhibit 1: Legal History of Affordability Protections</b>	
<b>1987</b>	<b>Tax Reform Act</b> Established 15-year affordability period.
<b>1989</b>	<b>Revenue Reconciliation Act</b> Added 15-year extended-affordability period with latitude to opt out at 42(h)(6) qualified contract price.
<b>1990</b>	<b>Omnibus Budget Reconciliation Act</b> Permitted below-market right-of-first-refusals for nonprofit organizations, tenant groups or public agencies at 42(i)7 price without incurring taxes for investors.

If an owner wants to opt out of affordability, the extended-use period can be terminated only if the building is acquired by foreclosure or if the HFA is not able to identify a buyer willing to maintain affordability nor able to present a “qualified contract.” The qualified contract the HFA has a right to present is defined as the sum of adjusted investor equity (cash invested adjusted for cost-of-living increases, as distinct from appraised value) and outstanding debt.<sup>6</sup> Many HFAs have strengthened federal extended-use requirements within their qualified application plans (QAPs) by requiring or prioritizing longer affordability periods with less or no latitude to opt out.

HFAs also have prioritized inclusion of right-of-first-refusal agreements with nonprofit organizations, tenant groups or public agencies – be they the general partner or an outside entity – on the premise that sale to an entity with an affordability mission will reduce the likelihood of market conversion. The Omnibus Budget Reconciliation Act of 1990 expanded the potential preservation power of right-of-first-refusal agreements by explicitly permitting them at below-market rates without investors incurring extra taxes. This below-market, right-of-first-refusal price – documented in section 42(i)7 of the tax code – is equal to a minimum of outstanding debt plus taxes attributable to sale. It does not require return of equity.

Finally, public providers of secondary liens, with their own affordability requirements, also promote long-term affordability preservation. For example, FmHA 515 mortgages require 50 years of affordability. HOME funds require 20. The percentage of properties with these secondary liens has increased as the percentage of projects in urban areas has increased – projects that often have difficulty raising enough funds through tax-credit equity and primary mortgages to cover development costs.

The introduction of extended-affordability requirements in 1989, and the progressive emphasis on affordability protections since then, in effect divide the tax-credit portfolio in two. Each presents important market and regulatory distinctions in forecasting disposition (*See Exhibit 2*):

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<sup>6</sup> The qualified contract price, detailed in section 42(h)6 of the Tax Code, also includes other capital contributions not reflected in equity and debt, and is reduced by any cash distributions from the project.

- *Early Projects: 1987-1989.* Early projects, representing less than 25 percent of tax-credit development through 1998, were characterized by low rates of investment requiring high rates of return; low competition for funding; and a maximum 15-year compliance period for the vast majority of properties. Plans for many of these projects were already under way before the tax credit was initiated, and set-asides targeted tenants with income just under 60 percent of the area median, many projects charging rents not far from market. These developments thus present project and funding characteristics distinct from later developments.
- *Later Projects: 1990-Present.* Later projects represent the vast majority of tax-credit developments. Prices paid by investors per dollar of credit rose and rates of return dropped in response to increased investor comfort with the LIHTC. Development agreements also grew more sophisticated as corporations became the dominant investors, and projects targeted increasingly lower-income tenants as HFAs were able to demand more from competing investors. Most importantly, later projects include extended-affordability protections for a minimum of 15 years, somewhat more secondary liens with affordability requirements, and, in some states, a greater number of right-of-first-refusal agreements.

Thus the early projects, while first to expire and to demonstrate disposition trends, may not be representative of the larger tax-credit portfolio in either market characteristics or affordability protections. If not viewed in this context, lessons from early expirations could misinform strategies for preserving the larger stock of tax-credit properties.

<b>Exhibit 2: Early Versus Later LIHTC Stock</b>		
	<b>Early Stock 1987 – 1989</b>	<b>Later Stock 1990 – Present</b>
<b>Units Allocated Credits That Were Placed in Service:</b>	<ul style="list-style-type: none"> <li>• Approximately 170,000</li> </ul>	<ul style="list-style-type: none"> <li>• Approximately 580,000, growing at rate of 62,500 units per year</li> </ul>
<b>Partnership Characteristics:</b>	<ul style="list-style-type: none"> <li>• High rates of return/ low price per tax credit</li> <li>▲ Individual and corporate investors</li> </ul>	<ul style="list-style-type: none"> <li>• Lower rates of return/ higher price per tax credit</li> <li>▲ Predominantly corporate investors, primarily through syndicated funds</li> </ul>
<b>Project Characteristics:</b>	<ul style="list-style-type: none"> <li>• 30% of units located in urban areas (1987)</li> <li>• Vast majority have 15 years of affordability requirements</li> <li>• Few right-of-first-refusal agreements</li> </ul>	<ul style="list-style-type: none"> <li>• 56% of units located in urban areas (1996)</li> <li>• 15 years of initial affordability plus minimum 15 years of extended-compliance requirements, with latitude to opt out. Many are longer and more restrictive.</li> <li>• Nearly all projects with nonprofit general partners have right-of-first-refusal agreements. Many others do as well.</li> </ul>
<p>Source: Abt, 1996; Cummings and DiPasquale, 1998; EYKL, 1997; GAO, 1997a.</p> <p>Note: Units allocated/ placed in service calculated from Abt 1996 findings on total units placed in service, and NCSHA estimates for units allocated annually. Urban units from Cummings and DiPasquale.</p>		

## **The Players**

Establishment and development of the LIHTC depended on the activities of a number of different entities. Congress established the framework for the program when it passed the Tax Reform Act in 1986. The IRS created the program through its guidelines, and enforced and rewarded compliance. The states, through their HFAs, took responsibility for allocating and monitoring the credits. Investors, finally, created equity by buying the credits.

Just as the activities of these separate entities fit together to make the LIHTC a reality, so, too, will the decisions, actions and interests of multiple players together influence outcomes for tax-credit properties. General partners (project developers) and limited partners (fund managers and tax-credit investors) will be engaged in the sale or buy-out of properties, and, for later projects, will decide whether to opt out of extended-compliance periods. Syndicated funds have been the primary means of identifying investors throughout most of the LIHTC's life. As the conduits through which investors sell off their project interests or opt out of extended-compliance requirements, syndicated funds' policies and priorities will be decisive. Secondary-mortgage financiers – whether city, county or state agencies – will need to explore strategies for dealing with accrued debt on secondary liens, as well as enforcing affordability requirements attached to those liens. HFAs, finally, bear a heavy responsibility for the LIHTC. They already have incorporated compliance monitoring into their explicit credit-allocation and financing roles. Preservation will present new roles of property broker, provider of recapitalization, monitor of extended compliance, and builder of preservation-owner capacity.

## **Review of Existing Research**

No data source provides the information needed to forecast outcomes for tax-credit properties after the end of the initial 15-year compliance period. In fact, no agreed-upon enumeration even exists of properties placed in service, by year or in total. Data are particularly scant for properties developed prior to 1992, when the IRS established monitoring requirements for HFAs. HFAs will have the greatest need for these data in their responsibility for enacting preservation strategies. However, previous research efforts have indicated that HFA data are not always accurate or complete,

particularly for early projects, and that not all HFAs have their data aggregated in ways that facilitate even internal analysis.

General and limited partners maintain the most accurate and complete data on tax-credit properties. As key partners in the preservation process, owners may ultimately prove necessary in aggregating data-for preservation strategies at the state level.

A number of studies since the tax credit's inauguration in 1986 already have sought data from these sources, and have taken strides toward filling the data gap (*See Exhibit 3*). The studies have succeeded in identifying trends in tax-credit development, though specific findings vary. However, no studies have set out with an eye toward investigating partners' plans for post-compliance disposition, or properties' physical and financial condition at that stage. At this writing, the Urban Institute is completing a study for HUD, which includes assessing current disposition plans for a sample of properties placed in service between 1992 and 1994. However, no study provides data in the detail necessary for comprehensive disposition analysis, covering properties from 1987 forward, and representative at the state level to facilitate HFA planning. Those that come closest are not accessible to the public.

<b>Exhibit 3: Major Tax-Credit Data Sources</b>			
<i>Researcher/ Sponsor and Publication Year</i>	<i>Report Title</i>	<i>Sample</i>	<i>Data Utility</i>
<b>ICF Inc./HUD 1991</b>	<i>Evaluation of the Low-Income Housing Tax Credit</i>	104 properties, 3,120 units placed in service in 1987-1988.	Detailed data, but small sample. Findings contradict anecdotal assessments as well as findings from later projects.
<p><b>Data Collected</b></p> <ul style="list-style-type: none"> <li>• Project characteristics (size; structure type)</li> <li>• Syndication and ownership structure (equity raised; syndication expenses; allocation of distributions from cash flow and residuals)</li> <li>• Project financial data (development costs; sources and amounts of financing; credit type and amount; project income and expenses; subsidy sources; tenant incomes and rents)</li> <li>• Developer perspectives and opinions on the tax-credit program</li> </ul>			
<b>Abt Associates/ HUD 1996<sup>7</sup></b>	<i>Development and Analysis of the National Low-Income Housing Tax Credit Database</i>	13,703 projects, 475,029 units placed in service between 1987 and 1994. Incomplete data for early years; analysis of 1992-1994 data only.	The most comprehensive data set and the only publicly available data on properties from across the life of LIHTC. However it includes only very basic data. Early data are also largely incomplete, preventing longitudinal analysis. Available from HUD Web site.
<p><b>Data Collected</b></p> <ul style="list-style-type: none"> <li>• Project characteristics (name and address; size; year allocated and placed in service; structure and construction type)</li> <li>• Ownership information (owner name and address; nonprofit sponsorship)</li> <li>• Characteristics of property location (region; central city, suburb or non-metro; tract population demographics and income; tract housing value and contract rent; tract median income as percent of Section 8 area median; fair-market rents)</li> <li>• Financial structuring (credit percentage; use of tax-exempt bonds; use of FmHA Section 515; credit basis increase in difficult development area or qualified census tract)</li> </ul>			
<b>U.S. General Accounting Office (GAO) 1997</b>	<i>Tax Credits: Opportunities To Improve Oversight of the Low-Income Housing Program</i>	423 projects, 50,000 units placed in service from 1992-1994	The most detailed publicly available data. However, the sample does not allow for state-level assessment or longitudinal analysis. Also surveyed HFAs on tax-credit policies. Available from GAO.

<sup>7</sup> This data set is being updated to include projects extending through 1997, and some projects developed in 1998. The updated data set is expected to be made available in spring 2000.

<p><b>Data Collected</b></p> <ul style="list-style-type: none"> <li>• Project characteristics (name and address; size; set-aside requirements; building type; construction type; targeted population; maximum allowable rent)</li> <li>• Ownership structure (name and address; nonprofit sponsorship)</li> <li>• Financial characteristics (credit rate; development costs and financing sources; other subsidies; reserve levels)</li> <li>• Compliance monitoring (extended-use requirements and documentation; inspection dates and types of noncompliance)</li> <li>• HFA policies (extended-use requirements; documentation)</li> </ul>			
<p><b>Exhibit 3: Major Tax-Credit Data Sources (Continued)</b></p>			
<p><b>Sponsor/ Researcher and Publication Year</b></p>	<p><b>Report Title</b></p>	<p><b>Sample</b></p>	<p><b>Data Utility</b></p>
<p><b>NCSHA/ E &amp; Y Kenneth Leventhall Real Estate Group (EYKL) 1997</b></p>	<p><i>The Low-Income Housing Tax Credit: The First Decade</i></p>		<p>Does not provide primary data on tax-credit properties, but draws from GAO data set, a survey of syndicators and investors, and NCSHA aggregate data.</p>
<p><b>City Research, Jean L. Cummings &amp; Denise DiPasquale 1998</b></p>	<p><i>Building Affordable Rental Housing: An Analysis of the Low- Income Housing Tax Credit</i></p>	<p>2,554 projects, 150,570 units placed in service between 1987 and 1997</p>	<p>Detailed data on a large sample from across the life of LIHTC. Project data were collected from four syndicators and so may not be entirely representative of the stock. Also surveyed investors. Analytic report based on data collected is available; original data are not publicly accessible.</p>
<p><b>Data Collected</b></p> <ul style="list-style-type: none"> <li>• Project characteristics (size; building type; type of construction)</li> <li>• Property location characteristics (region; central city, suburban, non-metro; difficulty development areas and qualified census tracts; neighborhood median income as percentage of HUD Section 8 median; racial characteristics; construction activity; market rents)</li> <li>• Financial characteristics (development costs and funding sources; interest rates; rent levels; vacancy rates; cash flow; internal rates of return; net present value)</li> <li>• Investor characteristics (investor types; stated goals of investment)</li> </ul>			
<p><b>Urban Institute/ HUD In Progress</b></p>	<p>In progress</p>	<p>Sample of projects placed in service from 1992-1994</p>	<p>The only data collected to date on disposition plans. Sample will likely be small, and will be drawn only from projects placed in service 1992-1994.</p>
<p><b>Data Collected</b></p> <ul style="list-style-type: none"> <li>• Development experience and organizational history of general partner.</li> <li>• Owner objectives for development and opinion on development alternatives without tax credit.</li> <li>• Project financing</li> <li>• Property performance summary and future expectations</li> <li>• Back-end plans (extended-use requirements; right-of-first-refusal agreements; original back-end expectations; current back-end expectations)</li> </ul>			

### **Affordable Housing Under the Tax Credit**

While lacking important information on project attributes that will be decisive in property disposition, current research does shed some light on the existing stock of housing constructed with the LIHTC, the market circumstances that surround it, and its preservation needs:

- Approximately 170,000 of the estimated 750,000 units placed in service through 1998 were allocated credits between 1987 and 1989. The vast majority of these units have no extended-compliance requirements, and so will be more likely to lose affordability at the end of their original 15-year compliance period.<sup>8</sup>
- The proportion of units located in central cities rose from 30 percent in 1987 to 56 percent in 1996 (C&D, 1998). These properties were constructed with different financing sources, and will face different market conditions, than metro and rural developments. Preservation approaches will need to take into account these variations in the stock over time.
- Abt found that two-thirds of tax-credit projects were new construction, while the rest were rehabilitated projects, or, for a small percentage, a combination of new construction and rehab (Abt, 1996). The type of construction may have implications for project capital needs after 15 years in service.
- Use of additional subsidies and secondary liens has varied significantly over the years, along with changes in state and federal policy, as well as differing needs of projects in urban, metro or non-metro locations (GAO, 1997a; ICF, 1991). The presence of additional subsidies or secondary liens will have an impact on long-term affordability requirements and property financial and physical condition.
- By all accounts, the South has the largest share of tax-credit development while the Northeast has the smallest – estimated by Abt at 42 and 13 percent of total tax-credit units respectively (Abt, 1996). States in regions with larger numbers of tax-credit developments will face greater preservation challenges.

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<sup>8</sup> Calculated from Abt, 1996. While NCSHA estimated that 900,000 units of housing had been allocated credits through 1997, research has found that not all units allocated credits are placed in service or collect credits (Abt, 1996; NCSHA, 1998).

### **Outcome Categories**

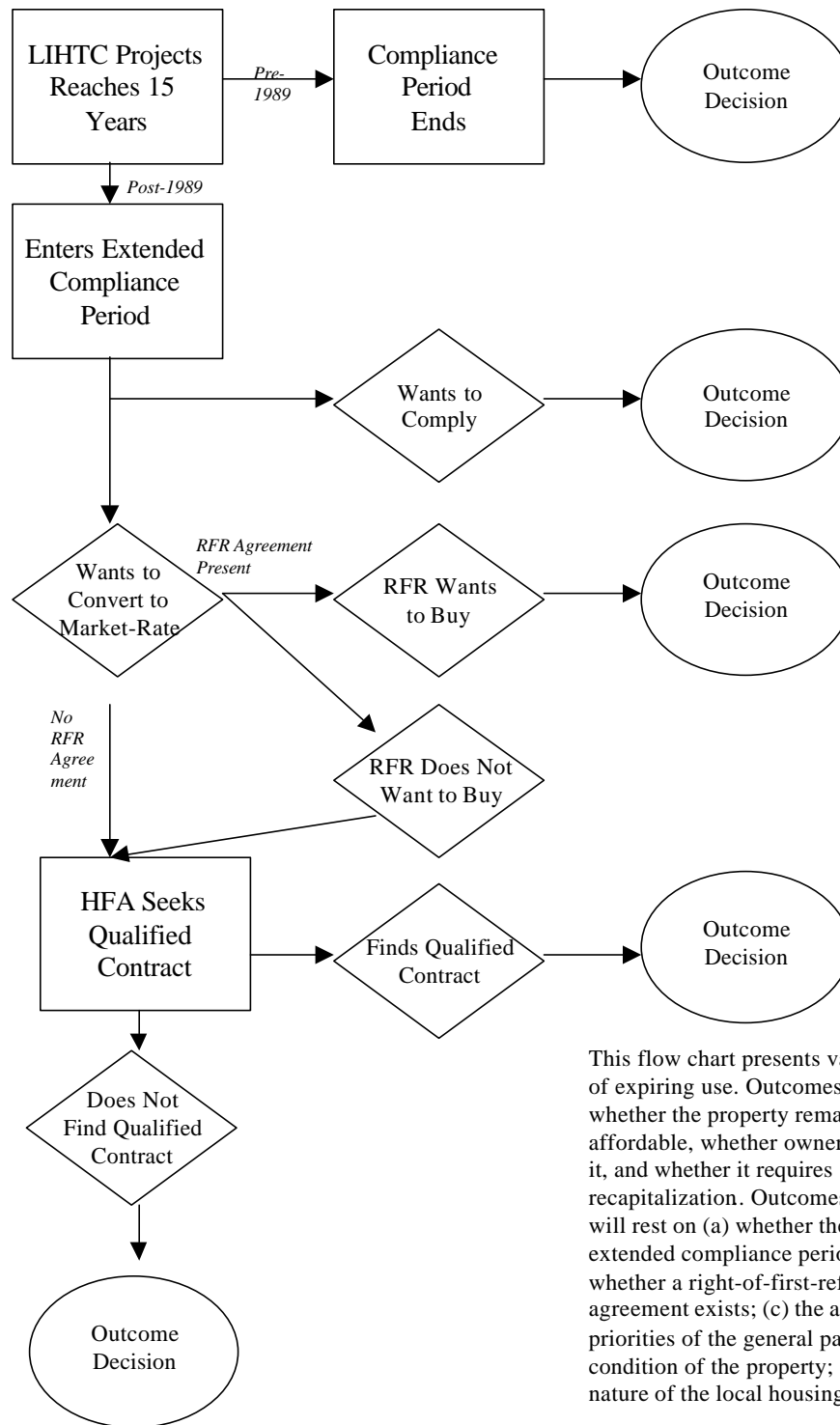
Disposition outcomes for tax-credit properties will fall into five primary categories (*See Exhibit 4*):

- Pre-1990 owners have no obligation after 15 years of compliance, and so convert to market rents or stop targeting lowest-income tenants.
- Owners choose to continue affordability themselves, whether or not an extended-compliance requirement is in place.
- Post-1989 owners opt out of their extended-compliance period, and a nonprofit or other entity that will maintain affordability purchases the property at the 42(h)(6)-qualified contract price.
- Post-1989 owners opt out of their extended-compliance period, but no other entity buys the property and maintains affordability; the owners convert to market or stop targeting the lowest-income tenants.
- Post-1989 owners decide not to opt out of the extended-compliance period, but no entity is monitoring compliance, so the owner stops targeting the lowest-income tenants.

Each outcome may also involve decisions regarding recapitalizing the property to fund 15-year capital replacements and improvements.

It is not yet possible to assess the prevalence of each outcome category. However, some pose large threats to continued viability of tax-credit properties as affordable housing.

**Exhibit 4: LIHTC Expiring Use Disposition Process**



This flow chart presents various stages of expiring use. Outcomes will vary by whether the property remains affordable, whether owners hold or sell it, and whether it requires recapitalization. Outcomes will rest on (a) whether there is an extended compliance period; (b) whether a right-of-first-refusal agreement exists; (c) the affordability priorities of the general partner; (d) the condition of the property; and (e) the nature of the local housing market.

## **FACTORS INFLUENCING DISPOSITION**

Preserving affordability will require assessing the probability of each of these outcomes, as shaped by the following factors (*See Exhibit 5*). These factors include regulatory and partnership agreements; market factors and physical and financial conditions; and owner preferences and priorities. While market and financing factors drive disposition decisions in all cases, extended-affordability requirements inject an opportunity for policy-driven entities (HFAs) to attempt to preserve affordability. The influence of all these factors, as will be discussed below, thus ultimately rests on the resources available to guide the disposition process and provide additional capital where necessary.

<b>Exhibit 5: Factors Influencing Property Disposition: Whether To Sell, Recapitalize, and/or Retain Affordability</b>	
Regulatory and Partnership Requirements	<ul style="list-style-type: none"><li>• Extended compliance period – binding or nonbinding</li><li>• Right-of-first-refusal agreement</li><li>• Existence of other subsidies and secondary liens with affordability requirements</li></ul>
Market Factors	<ul style="list-style-type: none"><li>• Potential to earn higher rents without the affordability cap</li><li>• Past and prospective rent changes</li></ul>
Financial and Physical Condition of the Property	<ul style="list-style-type: none"><li>• Mortgage terms and maturation</li><li>• Level of reserves</li><li>• Deferred maintenance</li></ul>
Owner Preferences and Priorities	<ul style="list-style-type: none"><li>• Return on capital</li><li>• Operating revenues from management fee generation</li><li>• Affordability mission</li></ul>

**Regulatory and Partnership Requirements: Extended-Compliance Periods, Right-of-First Refusal-Agreements, and Secondary-Lien Requirements**

Properties allocated credits after 1989 have greater affordability protections built in under extended-compliance periods, and below- and at-market right-of-first-refusal agreements. Many properties within both the early and late stock also have other subsidies and secondary liens that require their own, extra, affordability restrictions, and affect disposition by adding to the process other players with rights. These preservation protections, however, will not eliminate recapitalization needs, which will be likely in both early and late stock. Nor will LIHTC extended-compliance requirements ensure ongoing affordability. Many extended-affordability agreements leave owners latitude to sell or opt out of extended compliance. If owners choose to sell, a property's future affordability will rest on a state HFA's success in unfamiliar brokerage and preservation roles. Furthermore, as learned from the mortgage-revenue bond program in early years, owners who explicitly agree to hold on to their properties may lower their vigilance in targeting to low-income households, if compliance monitoring and enforcement mechanisms are not in place. The influence that regulatory and partnership requirements will exert on disposition decisions thus will turn on policies that HFAs develop in the next few years to manage expiring properties, as well as on HFAs' capacity to take on their preservation roles.

**Merriwether Apartments,  
San Antonio, Texas\***

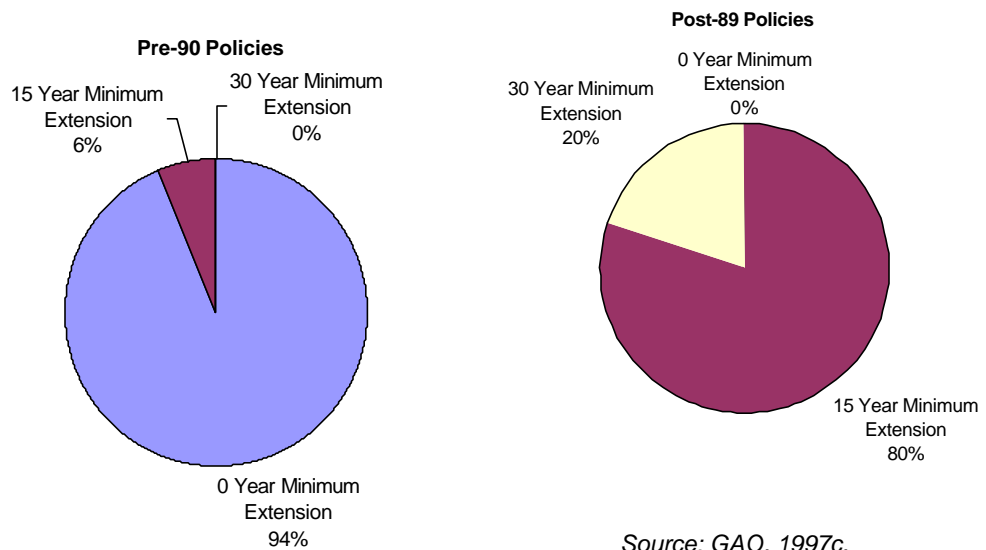
A private developer received a tax-credit allocation in 1996 for rehabilitation of 140 units in 15 walk-up buildings in the city of San Antonio. Merriwether Apartments, placed in service in 1997, succeeded in drawing rental income even higher than anticipated, though operating costs also proved somewhat higher than initially calculated. When the property's initial 15-year affordability period expires in 2012, the general partner would like to convert rents to market rate or sell. However, the property also has a 15-year nonbinding extended-affordability period. Though there is no right-of-first-refusal agreement attached to the property, the HFA will have the opportunity to find a buyer willing to preserve affordability. *If a preservation entity exists capable of presenting a qualified contract, and the HFA can provide financing to assist with any difference between the formula price and the value of the property at restricted rents, then Merriwether Apartments could remain affordable.*

*\* The stories discussed here are syntheses of many different properties examined from Massachusetts and Texas.*

**Data Availability**

*Extended-affordability requirements.* While data on extended-affordability requirements exist within land-use restriction agreements (LURAs) and partnership documents, the information has not been aggregated to identify the number of properties placed in service each year by the length of their extended-compliance periods. Scattered data are available, however, and, in combination with the history of federal extended use requirements and anecdotal knowledge of general trends since 1987, they make it possible to develop a basic framework. The GAO's 1997 survey found that, prior to establishment of federal 15-year extended-use requirements in 1989, only three out of 54 credit-allocating agencies (six percent) required affordability compliance beyond the initial 15-year period (See Exhibit 6). By the time of the GAO survey, all credit-allocating agencies reported requiring a minimum of 15 years of extended affordability (in accordance with federal requirements), and 20 percent required lengthier or more-restrictive compliance periods (GAO, 1997c). This data on state prioritization of extended affordability mirrors findings by NCSHA that 77 percent of all HFAs allocated some or all of their credits in 1997 to properties with extended-compliance periods beyond those required by the federal regulations (NCSHA, 1998). Thus, very few pre-1990 properties have compliance requirements beyond 15 years. All later projects have a minimum of 15 years extended

**Exhibit 6: Percent of HFAs by Minimum Extended Affordability Requirements: Pre-90 Versus Post-89 Policies**



compliance and the vast majority – estimated by the GAO at two-thirds of properties placed in service between 1992 and 1994 – have restrictions beyond those in the federal guidelines (GAO, 1997a).

*Right-of-first-refusal agreements.* No official documentation exists of the prevalence of right-of-first-refusal agreements. Those interviewed agreed that a handful of right-of-first-refusal agreements was established prior to the 1990 amendment confirming their acceptability. even though nonprofit general partners were unofficially presumed to have first rights to properties they developed. Today, when competition for tax credits has increased substantially and HFAs prioritize right-of-first-refusal agreements in the allocation process, nearly all partnership agreements with nonprofit agencies or affordability-oriented syndicators have a right-of-first-refusal attached, as do a large proportion of other partnership agreements.<sup>9</sup>

*Other subsidy and secondary-lien affordability requirements.* Several studies have examined the property-financing structure of LIHTC developments, including the presence of other subsidies and secondary liens. Findings have varied widely between studies, as has the level of detail on subsidy types. Based on the presence of secondary liens alone, later developments are expected to have greater affordability requirements; LIHTC developments with secondary liens rose from 18 percent of properties placed in service in 1987 to 37 percent for those placed in service between 1992 and 1994 (GAO, 1997a; ICF, 1991). States also reported to the GAO that 37 percent of pre-1990 properties were covered by extended-use requirements from other federal subsidy programs (GAO 1997a).

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<sup>9</sup> Affordability-oriented funds include the National Equity Fund (NEF) and the Enterprise Social Investment Corporation (ESIC) as well as state and local equity funds.

**Sagebrush Village  
Houston, Texas**

Sagebrush Village is comprised of 150 affordable single-family homes in the outskirts of Houston. A private developer serves as general partner for the development, which was allocated tax credits in 1988 and placed in service in 1989. The rapid growth of the suburban neighborhood in which Sagebrush is located has brought strong rents to the property, and promises even greater profits at market. There is no extended-compliance requirement or right-of-first-refusal agreement once Sagebrush reaches the end of its initial compliance period in 2004. *Sagebrush Village's general partner will either buy out the limited partner and convert the property to market rents, or sell the units as single-family homes.*

**Bradford Court  
Boston, Massachusetts**

Bradford Court is a 90-unit complex, located in a low-income Boston neighborhood. The property, which was allocated credits in 1988 and placed in service in 1989, will reach the end of its initial 15-year compliance period in 2004. The general partner, a private developer, initiated the project in the belief that the neighborhood would soon be gentrifying. However the partner's calculations proved wrong: neighborhood rents have not increased dramatically and a glut of affordable housing has caused vacancy problems within Bradford Court. The property thus has low reserve levels, serious renovation needs, and a significant debt burden. Without any extended-use requirement, the general and limited partners would be interested in selling the property to the highest bidder. But in this glutted market it is unlikely that an agency would be interested or able to raise the capital needed to buy out the partners' interest and resolve the property's physical and financial problems. *Once the Bradford completes its LIHTC obligation, the property will likely fall into decline.*

**Property Characteristics: Market Factors, Physical and Financial Condition**

Market factors ultimately will be the most powerful and consistent drivers behind disposition decisions for tax-credit properties. These factors include a property's ability to command higher rents at market rates than under the LIHTC affordability cap, as well as prospects for growth in rents within a local market. These in turn depend on demand within the market, both in terms of competition for tenants interested in affordable housing, and also the presence of a sufficient number of tenants who can afford the rent but meet income requirements. Properties capable of turning a higher profit at market rents are likely conversion candidates, either in whole or in part.

Physical and financial condition are thus closely tied to market issues. Poor condition will make a property less desirable for market conversion, but poor condition also will hinder preservation of a property as viable affordable housing. A property's condition is influenced by the degree to which it has deteriorated over 15 years of use and also by the debt burden that has accumulated under multiple layers of financing. These characteristics will determine the market value of a property, its desirability to buyers, and the advisability of necessary recapitalization. It may not make sense for any entity, regardless of its affordability priority, to purchase – much less recapitalize -- a property with more debt than its appraised value.

### ***Data Availability***

While Cummings and DiPasquale assessed property performance at an aggregate level, and HFAs generally track physical condition through occasional site visits, recent detailed and accurate records of individual property condition and performance exist only in the hands of general and limited partners. HFAs will need access to these market and financial profiles to assess the physical and financial condition of the stock. Ultimately, the process may require site visits when a sale is anticipated.

### **Owner Preferences and Priorities**

It has been assumed that ownership by a mission-driven entity, or nonprofit, will encourage affordability preservation. This was the impetus behind the federal requirement that HFAs set aside 10 percent of their credit authority for nonprofit sponsors. This is also the rationale behind federal and state support of right-of-first-refusal agreements, guaranteeing nonprofit general partners or other nonprofits or public agencies first rights to buy out limited partners, if a project goes up for sale.

Nonprofit status of the general partner cannot, however, be viewed as an adequate proxy for an owner's disposition plans after 15 years.<sup>10</sup> Market factors remain influential for nonprofit general partners: If the cost of a property is too high relative to its value, for example, the nonprofit may not be able to buy out the limited partner. Conversely, sale of a property to a new owner interested in converting to market rents may be so profitable that the nonprofit general partner would be better advised to sell and add those profits to its mission-oriented funds. At the same time, a significant number of for-profit developers have found a niche in the affordable-housing market, maintaining a

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<sup>10</sup> Neither does official identification of the general partner as for- or nonprofit necessarily indicate whether a nonprofit agency has determination over property disposition. Many nonprofits set up for-profit subsidiaries for project development; it is not clear that those organizations are always recognized as nonprofits. Nonprofits within joint ventures are at times granted limited authority over property determination. Reports also exist of for-profit entities setting up nonprofit shells to gain preference in the credit-allocation process.

profitable business from developer and management fees. These entities may prove just as likely as nonprofits to opt for continued affordability.

**Valleystream Apartments  
Dallas, Texas**

The Valleystream Apartments in suburban Dallas contain 216 units of affordable housing. The complex, a joint venture between a nonprofit agency and a private developer, received a tax-credit allocation in 1991 and was placed in service in 1993. Median income in the Dallas area is high, so the rents that Valleystream can set under LIHTC are more than sufficient to cover operating costs. Yet Valleystream's new-growth suburban market has been overbuilt, and Valleystream is facing occupancy problems. The nonprofit general partner has a right-of-first-refusal on the property, and would like to preserve affordability beyond the end of the property's initial 15-year compliance period in 2008. However Valleystream's occupancy problems threaten the solvency of the nonprofit owner and sale may be essential, despite Valleystream's long-term market prospects. The property has a 15-year extended-compliance period, which would require an opt-out sale if the owner wanted to reduce current set-asides. *Valleystream's nonprofit owner will either agree to sell its interests to an entity that wants to preserve current affordability levels; buy out the other general and the limited partners' interests under its right-of-first refusal and maintain current affordability, provided it receives financial assistance from the HFA; or, if no one monitors too closely over the extended-affordability period, purchase the other partners' interest and commit fraud by cutting back on income targeting.*

### ***Data Availability***

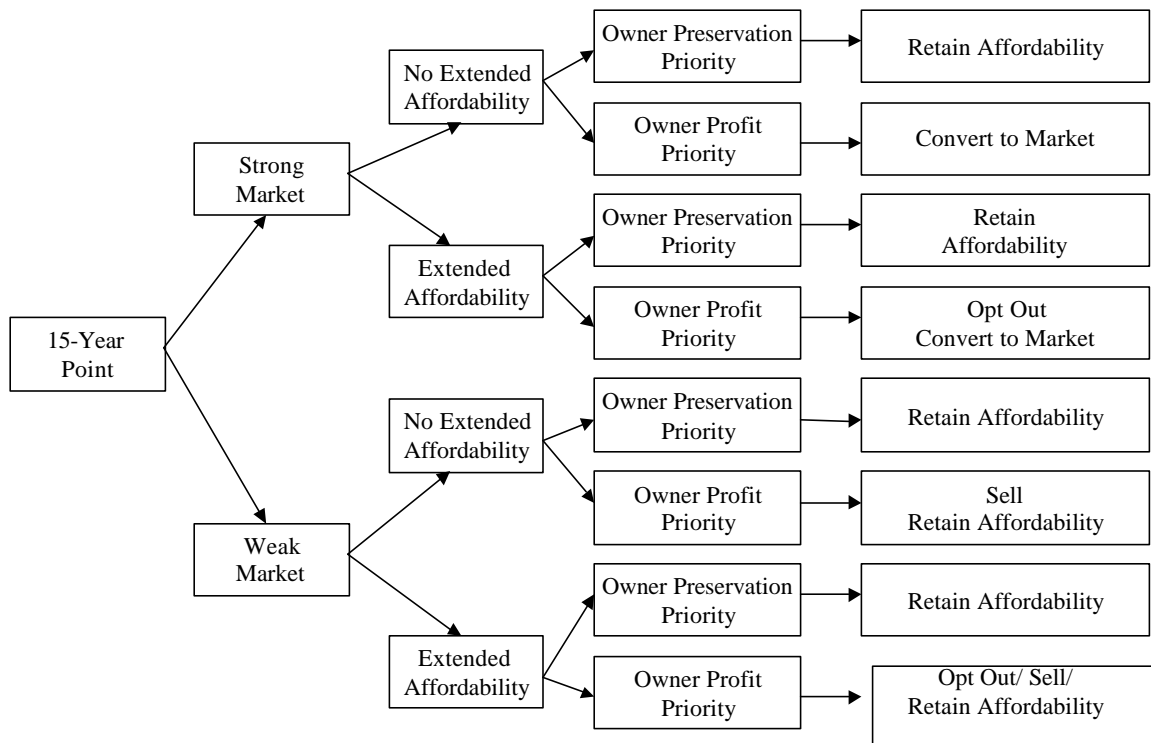
Though the exceptions described above may apply to a number of agencies that are documented as nonprofit sponsors, it is still worth noting that the rate of nonprofit sponsorship is significantly higher in later properties than in earlier ones. LIHTC properties with nonprofit sponsors rose from 9 percent in 1987 to 31 percent in 1995 (Abt, 1996; EYKL, 1997). State agencies also identified an increase in the proportion of joint partnerships between for-profit and nonprofit agencies. No documentation exists of the number of for-profit sponsors that make a regular business from affordable housing, and thus would also be less likely to convert to market rents.

### **Unknowns**

No single factor will in itself determine what will happen to a property; each influence will be moderated or bolstered by other factors (*See Exhibit 8*). It is not yet possible to assess how these factors combine within the stock, and thus to determine how many projects will be sold, how many remain affordable, and how many require recapitalization each year.

To forecast disposition trends across the stock and by year requires detailed data on the above factors at the project level for developments throughout the life of the LIHTC. This type of assessment will be essential if HFAs, policy-makers, owners and preservation entities are to prepare effectively to respond to expiring use. Such an assessment will also promote discussion among states, and facilitate any appropriate federal measures.

**Exhibit 8: Interaction Between Regulatory Requirements, Market Conditions, and Owner Priorities in Determining Property Disposition**



*This chart demonstrates the interrelated influence of market factors/property conditions, regulatory and partnership agreements, and owner priorities in determining disposition outcomes. The outcomes and decisions shown above represent a simplification of an extremely complex process; each outcome may also include a decision to recapitalize or not. Market factors drive all decisions. Extended affordability requirements provide an opportunity to encourage affordability preservation when market factors do not totally contradict it.*

## **THE CHALLENGES AHEAD**

The successful preservation of tax-credit property affordability will depend on the capacity of policy-makers, HFAs, preservation entities and legislators to assess the information outlined above. Their advanced analysis, policy-setting and program development will determine the resources available to encourage and enable property owners to retain affordability. Key resources include, but are not limited to, financing to recapitalize or purchase properties to keep them affordable, and preservation entities to take over properties as needed. The following are challenges that remain to be addressed in advance of the coming surge in expiring-use properties.

### **Data Collection and Availability**

As demonstrated above, the first and foremost need is for more-detailed information regarding the stock of tax-credit properties. The information should be organized in each state by the year the properties were placed in service (determining the year of expiration) and noting the year they were allocated tax credits (determining the applicable regulations). In order to size up likely disposition trends, states will need to assess the following information for at least a significant sampling of properties and ultimately for each property:

- Current partners
- Property condition
- Project balance sheet and reserves
- Partnership capital accounts
- Rents under tax credit versus those possible at market
- Key extended-affordability requirements under the land-use restriction governing the property
- Terms attached to other liens
- Market strength
- Owner intentions

HFAs do not have all this information within their records; even information they do have is not likely to be organized so comprehensive assessment is possible at this time. Given these limitations, an initial sampling of project data might be accomplished most easily by working in partnership with

owners of and investors in projects authorized in the first two years of the program. The sampling should collect and analyze this information and also the owners' and investors' 15-year expectations for the property at least three to five years prior to expiration of the initial 15-year compliance period. However HFAs do not currently have the authority, either under the compliance-monitoring section of the statute or in individual regulatory agreements, to require such information. A partnership among HFAs, owners, investors and the housing community will ultimately be essential, so the information needed to craft preservation programs can be available.

Once data have been collected, the number of properties in each disposition category, by the year of expiration, can be identified. Such an assessment would enable HFAs to determine their programmatic responses, including (a) funding priorities; (b) capacity-building for preservation buyers; and (c) planning HFA staff and procedural structuring to serve as a broker when owners decide to sell.

### **Funding Issues: Refinancing Options**

Strategies will need to be developed for dealing with properties whose owners wish to preserve affordability but are unable either to pay off debt under affordable rents or leverage financing for critical repairs. Financing will also be needed for purchase and repair of properties when owners who choose to opt out of extended-compliance periods put properties in poor condition up for sale. Strategies may include recapitalization, dilution of current investors, debt forgiveness, or workouts. Re-syndication will also be an option, as long as a building has been in service under the same owner for the previous 10 years. Guidelines regarding these means of refinancing will need to be developed to ensure both that tax-credit properties receive adequate prioritization within funding decisions and also that new funds are invested only in worthwhile projects. This process could be well-informed in each state through a "demonstration methodology," whereby HFAs would identify specific properties in each disposition category and then work with the existing partners to draft proposed financing strategies for preservation.

## **Legal Issues**

### ***Preservation-Price Definition***

As stated above, the 1989 statutory price for qualified contracts to purchase properties from owners who wish to opt out of extended compliance is defined as the sum of adjusted investor equity and outstanding debt (*See Page 10*). Interviews with early negotiators of this formula indicated that this pricing was designed to ensure the return of equity to investors through responsible property operation. In practice, investors have frequently obtained a full return of equity through the tax credits themselves during the life of the partnership. However, nothing in the statute prevents a second return of equity at the sale of the property, even though this threatens the preservation of affordability. Existing contracts that provide for this tail-end return of equity need to be respected. However, statutory modifications to clarify this formula could be considered in the future, protecting the investors' return of equity while enhancing preservation of affordability.

### ***Enforcement of Extended-Compliance Periods***

Tax-credit properties that fail to comply with affordability requirements risk credit recapture through the end of the first 15-year compliance period. The legislation specifies no such penalties for noncompliance over an extended-compliance period. The only penalties at that stage would include:

- A lawsuit by tenants;
- HFA legal action for breach of contract;
- Refusal by the HFA to allocate tax credits or other local, state or federal resources to future developments under the same sponsors;
- Refusal by potential project buyers to take on a property that is out of compliance and at risk of legal action.

It is presumed that HFAs currently responsible for monitoring tax-credit compliance will continue to serve that function, just as they have successfully done so to date. However, serving this continued compliance responsibility in addition to monitoring compliance of new production will call for staff and systems-planning by HFAs. While the LIHTC program does not have a history of property owners flouting compliance requirements, as projects cease to be subject to limited-partner oversight and the number of projects under HFA review grows annually, the temptation may increase. HFA

capacity to monitor closely will thus be critical. HFAs will also need to identify a mechanism by which to fund their extended monitoring needs.

## **HFA Capacity**

### ***Internal Capacity for Preservation Roles***

Tax-credit expiration will require HFAs to take on a number of new roles and to supplement their capacity within traditional roles. These roles will include:

- *Monitor* of both pending expiration and continued compliance among properties entering into their extended-compliance periods.
- *Provider of financial assistance* to properties in need of recapitalization.
- *Broker*, linking properties whose partners wish to opt out of extended compliance with preservation entities willing and able to preserve affordability.
- *Property owner and manager*, for states that choose to purchase properties from owners opting out of extended compliance, when no other preservation entity can be identified.
- *Capacity-builder* of preservation entities.

Data collection will launch preparation for these responsibilities by indicating trends likely within each state. However, these new obligations may require significant internal restructuring within HFAs, as the Resolution Trust Corporation (RTC) discovered when it was instructed to transfer a portion of its portfolio as affordable housing. The RTC found that to fulfill this preservation role, it first had to develop new evaluation processes, funding mechanisms and other infrastructure specialized for affordability brokerage.

### ***Balancing “Development” and “Preservation” as Public-Policy Outcomes***

Perhaps even more fundamental to HFA preparedness for expiring use will be each agency’s understanding of its own preservation priorities. Financial packages sought for expiring tax-credit properties will compete for the same financing as new development. Thus each state will have to find an appropriate balance between these competing priorities. HFAs have other tools as well with which to promote long-term preservation. Through their initial credit-allocation preferences, states can reward strong management and affordability priorities among owners by taking the owners’ history with tax-credit properties into account. HFAs also can promote long-term preservation by ensuring

that wherever possible affordable properties are owned and managed by preservation entities. Finally, HFAs continue to have the option to require or prioritize lengthier periods of affordability. Based on this last option alone, states that have prioritized preservation in their credit-allocation process already have succeeded in moderating the preservation challenge they will face beginning in 2002. In contrast, states that have not prioritized preservation may face a much larger preservation challenge.

### **Development of Preservation Entities**

It will fall to HFAs, national and regional intermediaries, local governments and existing nonprofit and other affordable-housing providers that consider preservation a critical goal to ensure that expiring tax-credit properties become the responsibility of “preservation entities” capable of managing a property 50 to 100 years into the future (Smith, 1999b). While it may make financial sense to have an agency responsible for preservation that does not need to present stockholders with profits on a regular basis, a preservation entity does not have to be a nonprofit. Rather, an effective preservation entity requires a combination of the affordability mission of the nonprofit sector with the business acumen of the for-profit sector, together with a recognition of the critical social impact that properties can have within a community.

Preservation entities are characterized by the following attributes (Bratt et al., 1994; Smith, 1999b).

*(See Appendix A: Attributes of A Preservation Entity):*

- Commitment to long-term affordability.
- Operational capacity, including professional property management, asset management and resident-services/neighborhood-enhancement skills
- Familiarity and responsiveness to the community
- Access to financial resources
- Organizational visibility and viability

Focus on long-term preservation is a major shift in public policy, which has historically focused solely on development. This shift also requires a departure from the property-development and short-term management skills at which traditional affordable housers have become adept. Capacity-building will be necessary to ensure the existence of a sufficient number of preservation entities to manage expiring tax-credit properties into the future.

Regional and national intermediaries already have made significant inroads in this kind of capacity-building. Important acquisition models and capacity-building tools already have been developed in response to the preservation demands created by the HUD and RTC portfolios and the asset-management demands created by the tax-credit portfolio to date. Examples that might prove useful include the California Housing Partnership's HUD preservation training and acquisition; the Colorado HFA's acquisition of RTC properties; The Enterprise Foundation's partnership with the National Housing Trust for preservation of HUD, Farmers' Home and expiring tax-credit properties; Southern California Housing Development Corporation's establishment of an acquisition corporation called the National Housing Development Corporation; The Consortium for Housing and Asset Management's (CHAM) asset-management training for individual nonprofit professionals; and the work of the Local Initiatives Support Corporation (LISC) and Neighborhood Reinvestment Corporation in advancing organizational capacity and systems for asset management, demonstrating effectiveness through improved portfolio performance.

Collaboration between intermediaries and HFAs will be called upon increasingly if preservation is to become a dominant public-policy objective. These collaborations will not simply help promote affordability of tax-credit stock. They also will help create the permanent stewards of affordable housing that today's communities need.

### **A National Forum for Tax-Credit Expiring Use**

Though expiration of tax-credit compliance periods will affect affordable housing nationwide, real opportunities to respond exist primarily with HFAs. The devolved responsibility for LIHTC projects will function as a laboratory for preservation strategies. It will also force each state to grapple with potential solutions.

Bringing together the significant knowledge and experience that individuals and agencies have accumulated will be critical. A national forum on tax-credit expiring use could facilitate discussion

and unify state experiences. Such a forum would include not just HFAs but also the wide range of players – legislators, local housing administrators, investors, owners and potential owners – that will influence disposition decisions and be affected by preservation policies. This forum could serve simultaneously to enable states to identify best practices developed by the 54 credit-allocation agencies across the country; to ensure that the rights and interests of property owners are represented and not violated; and to inform the range of other players of steps they can take to support preservation as well. Such a forum also will be essential if federal legislative assistance is needed. While the means by which such a forum is best created are not yet clear, its value and advisability are.

## **CONCLUSION**

Outcome forecasting for tax-credit property disposition is complex. Extended-compliance periods, right-of-first-refusal agreements, and secondary-lien affordability requirements increase the odds of continued affordability. Yet property characteristics, market factors and owner interests will still be influential. They prevent any assumption of continued affordability even where protections are in place. Furthermore, recapitalization needs will be an issue even for properties whose owners wish to preserve affordability.

Outcomes ultimately will depend as much on the financial resources and operational capacity of HFAs to work in partnership with owners and preservation entities as on any other factors. Lack of monitoring or insufficient funds for property repair or purchase will place even properties for which there is interest in preserving affordability at risk of market conversion, reduced income-targeting, or disinvestment and decline. While the multiple players whose interests and actions will influence disposition outcomes may not be able to alter property characteristics, market factors or regulatory and partnership requirements, they can shape outcomes by building preservation capacity and making resources available.

In order to determine the levels of financial resources and regulatory capacity that will be necessary, the likely prevalence of different outcomes within the stock will have to be determined. This assessment will require information on properties' current financial and physical conditions, market conditions and applicable regulatory and partnership requirements – information that is not presently available in any detailed or comprehensive form. Data collection at the state level is a critical starting point from which HFAs, policy makers, owners and preservation entities can determine properties' specific needs and formulate policies accordingly. Data will need to be gathered from the property records, partnership and regulatory agreements of individual projects – sources that will be extremely difficult to aggregate logistically and politically.

Data collection and preservation planning are complicated by the lack of a centralized authority over tax-credit properties. If preservation is a priority, the need for advanced planning and data-collection decisions calls for creation of a national forum on tax-credit expiring use, bringing together the multiple players who will influence disposition. HFAs are likely to bear the brunt of responsibility for coordinated preservation. Yet efforts to collect data, create federal resources or legislative modifications, build preservation capacity and provide adequate financial resources will call also for input and support from property owners and investors, local housing administrators, and state and federal legislators. A national forum would enable coordinated discussions among these players, exchange of best practices, and promotion of any necessary federal measures.

Expiration of the first tax-credit properties is still a few years away. Housing leaders come to this challenge prepared with lessons from the HUD portfolio. Yet acquired experience and perceived time are not a license to hold off on planning for tax-credit expiration. In the past, policy-makers focused on preservation only once a great number of properties reached the end of their viability as affordable housing. Once contracts expired, property owners for whom it made financial sense to convert to market-rate housing did so. This is the greatest lesson to draw from experience to date with preservation.. If policy-makers wish to preserve the viability of tax-credit properties as affordable housing, now is the time to start.

## **APPENDIX A:**

### **ATTRIBUTES OF A PRESERVATION ENTITY**

A preservation entity is a nonprofit or for-profit organization that has the mission and capacity to maintain the viability of affordable housing 50 to 100 years into the future, and to recognize the social role of an affordable property within a community (Bratt, 1994; Smith, 1999b). Following are the specific attributes of a preservation entity.

- ***Commitment to Long-Term Affordability.*** For rents to remain affordable, the operating agency must be guided by a primary mission of providing high-quality affordable housing, not of realizing financial gains.
- ***Professional Property-Management Capacity.*** Property-management skills are required to oversee the day-to-day operations of a property. They include marketing units; collecting rents; identifying, managing and overseeing renovation needs; developing and implementing tenant-selection and eviction procedures; and providing resident services. Property management may be provided through a third party or in-house.
- ***Asset-Management Skills.*** Asset management plans for and preserves a property's well being over the long term (50 years or more). It includes restructuring financing; amending regulatory agreements; planning and implementing capital improvements; dealing with funding and supervising agencies regarding owner decisions about rent increases, subsidies, and portfolio positioning/diversification; and establishing policies at the board level regarding preferred debt loads and reserve-management principles to promote the long life of the property.
- ***Resident Services/Neighborhood-Enhancement Skills.*** Resident services help position a property as an asset in the neighborhood, and enhance the lives of residents and the market appeal of the surrounding neighborhood.
- ***Regular Reporting.*** While usually considered another aspect of asset management, the reporting function of managing entities deserves separate mention in the case of tax-credit projects. Tax-credit property managers must report on a frequent basis to partners and lenders, including all subsidy providers. Many tax-credit property managers identify this duty as the most onerous of their management functions (Bratt, 1994). The task becomes even more complicated

when properties have multiple subsidies from different agencies, each with its own reporting requirements.

- ***Familiarity and Responsiveness to the Community***: Successful preservation entities will recognize a property's role in a community beyond the immediate housing need it fills. This long-term and holistic view of a community not only will strengthen a property's ability to meet neighborhood needs, but also facilitate marketing and tenant relations.
- ***Access to Financial Resources***: In order to fulfill its asset-management duties, a preservation entity will need to know how to find additional capital when it is needed and have the standing to gain access to it.
- ***Organizational Visibility and Viability***: An organization can only preserve affordability if the organization itself continues to exist. This requires that preservation entities adequately assess the management fees required to complete the job, and fund building operations, debt service, renovation and replacement with revenue from rents – not from the general fund that supports the organization. This also requires a sustainable and knowledgeable leadership structure that will survive beyond the personalities of individual staff or board members. This includes a board structure that includes real-estate expertise, community leadership, and a selection process that ensures sustainability, as well as a staff structure and pay scale that enable ongoing attraction of competent staff at both executive and operating levels.

## **ACKNOWLEDGEMENTS**

This research was made possible through the assistance of numerous individuals who contributed their time and their expertise.

### **Reviewers**

Karen Bracey, U.S. General Accounting Office  
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Conrad Egan, National Housing Conference  
Jeffrey Goldstein, Boston Capital  
Bart Harvey, The Enterprise Foundation  
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Cort Gross, Bridge Housing  
Mossik Hacobian, Urban Edge  
Joseph Henefeld, Massachusetts Housing Investment Corporation  
Christine Hobbes, Freddie Mac  
David Keene, Massachusetts Housing Finance Agency  
Jonathan Klein, The Community Builders  
Robert Kuehn, Keen Development Corporation  
Dan O'Dea, Delphi Affordable Housing Group  
Jeanne Peterson, California Tax-Credit Allocation Committee  
Kate Racer, Massachusetts Department of Housing and Community Development  
Carl Riedy, Fannie Mae

Benson Roberts, Local Initiatives Support Corporation  
Bob Rozen, Washington Counsel  
Vickie Vaughn, Enterprise Social Investment Corporation

**Additional Thanks**

Marty Abravenal, Urban Institute  
Edwina Carrington, Texas Housing Finance Corporation  
Sheila Crowley, National Low-Income Housing Coalition  
Dennis Fricke, U.S. General Accounting Office  
Harold Nassau, Metropolitan Boston Housing Partnership  
Sandy Nolden, Abt Associates  
Garth Rieman, National Council of State Housing Agencies  
John Sheiner, Office of Congressman Charles B. Rangel  
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