

Draft Final Report

***The Context for Private Rental
Housing Production in the US***

Prepared For:

**Research Subcommittee
Housing Supply Working Group**

Ontario Ministry of Municipal Affairs and Housing

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Executive Summary

This paper has been prepared on behalf of the Research Subcommittee of the Housing Supply Working Group (HSWG) – a joint government-industry advisory group established to identify rental housing supply problems and solutions. The HSWG is co-chaired by the Ontario Ministry of Municipal Affairs and Housing and industry representatives.

In May 2001, the HSWG released a report, *Affordable Rental Housing Supply: The Dynamics of the Market and Recommendations for Encouraging New Supply*, which called for action to encourage much-needed new rental investment. Among other things, the report identified the belief that, compared to Canada, the US enjoys a proportionately much higher volume of rental development. The HSWG wished to determine if this is true and what factors are responsible.

This report is one of three companion reports intended to address issues raised in the HSWG report. The three parts of the work include:

1. **Options for Changes in Federal Taxes to Encourage new Rental Construction** – development of a framework for the identification and analysis of potential changes to the federal tax system that would strategically improve the climate for new rental investment in Ontario;
2. **The Context for Private Rental Housing Production in the US** – identification of the most significant tax and housing-related program levers impacting new market rental development in the US, how they work, how they generate capital for new market rental housing, and the potential for using such mechanisms in Canada – this report; and
3. **Promoting a Positive Mortgage Insurance Environment for New Rental Construction** – examination of Canada Mortgage and Housing Corporation's underwriting practices and mortgage insurance fees for rental housing, and identification of options for the Province to promote improved access to mortgage insurance for new rental housing projects.

This report first describes rental production trends in the US over the past decade. It then overviews the main programs used to stimulate rental construction and particularly to support affordable rental development. The report develops estimates of the volume of truly unassisted rental development and compares this to the levels experienced in Canada since 1991. The report also illustrates how the main tax-based mechanisms actually work and how they might assist rental development if similar mechanisms were adopted in Canada. The paper concludes with an assessment of the practical potential of such mechanisms in the Canadian context.

Recent Trends in US Rental Housing Production

Reflecting the influence of shifting demographics and somewhat similar to the longer-term trend in Canada, rental completions in the US have fallen from an average of over 314,000 units annually in the 1970s, to 165,000 during the 1990-1999 decade. The last decade was characterized by a recession-induced decline in the early 1990s, followed by a building boom over the latter half of the decade. In both 1999 and 2000, rental apartment completions totalled roughly 225,000.

Over the past decade, rental completions have accounted for more than 16% of total new housing production in the US. The comparable figure in Canada is 9% – and this was heavily influenced by high social housing starts during the early 1990s. So, on the surface, it appears that the level on rental production in the US is significantly higher than in Canada.

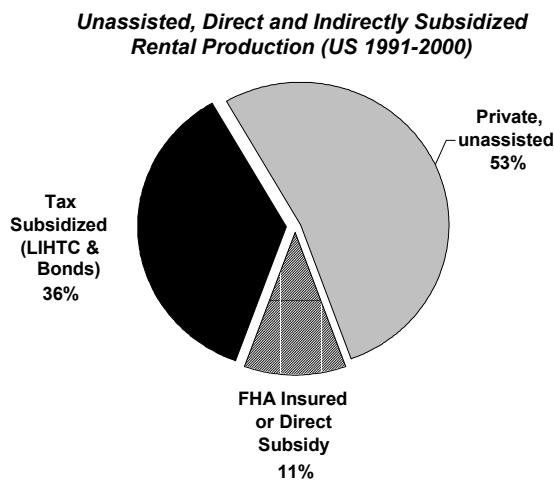
This higher level of production is significantly influenced by a variety of subsidy programs. Although US housing data identify a total volume of ‘private’ rental starts and completions, a substantial number of these units are facilitated with direct (grants and loans) or indirect (tax-based) subsidies under one or a combination of the following programs supported at the federal level:

- ***The Low Income Housing Tax Credit*** – the LIHTC is recognized as the single largest source of support for affordable rental development and rehabilitation in the US. It allocates tax credits which are sold to investors, with the proceeds used to provide equity investment in targeted affordable housing projects. Since inception in 1986, the LIHTC has allocated new credits totalling more than \$300 million each year and has helped to build or rehabilitate 1.15 million rental units – an average of 75,000 each year. Since credits awarded each year continue for a period of ten years, the annual expenditure exceeds \$3.5 billion.
- ***Tax-Exempt Bond Financing*** – under US tax law, state and local governments are authorized to raise capital for various purposes, including housing development by for-profit or not-for-profit corporations, by issuing tax-exempt bonds – generally with terms of 10-30 years. This provides a source of below-market rate-long-term fixed rate financing. Tax-exempt bonds have become increasingly important in the 1990s and, since 1995, have supported the development and rehabilitation of almost 170,000 units (just under 100,000 new construction). In 2000, more than \$1.6 billion in financing from this source supported the development or rehabilitation of almost 55,000 rental units in properties targeted for affordable housing.
- ***The Community Development Block Grant*** – created in 1974, CDBG provides a formula-based federal block grant to localities for a variety of community redevelopment and revitalization activities – although only a small portion is used to assist new rental development.
- ***HOME Investment Partnership Program*** – in the late 1980s, community advocates successfully argued for HOME – a specific and separate mechanism outside of CDBG to fund housing (including new construction and rehabilitation of rental, as well as assisted home ownership programs) with a formula-based allocation similar to CDBG.
- ***Other programs*** – there are a variety of smaller programs that support assisted units and are separately counted in housing production statistics. In addition, the Federal Housing Administration, through HUD, operates a multi-family mortgage insurance program which is used almost exclusively to support financing for affordable housing.

Estimating Unassisted Rental Production

Generally, units developed under the main LIHTC allocation and those with tax-exempt bond financing are mutually exclusive so these two sources are added together in the following chart. Another unique category is those units assisted under direct subsidy programs which often also utilize FHA insurance and tend to be targeted to lower income and special needs groups. Finally, the residual units are estimated – these are considered to provide a rough estimate of the true volume of unassisted new private rental development.

New development, facilitated by either LIHTC or tax-exempt bonds, averaged roughly 65,000 annually for the full decade (roughly 36% of all rental construction and 41% of all non FHA rental production). The remainder (approximately 95,000 units annually) is likely to be a reasonable estimate of the net volume of unassisted rental development during the past decade (roughly 53% of all rental production).



For the later half of the decade, when a stronger economy stimulated a higher level of construction (but volume caps on the two tax programs have constrained these programs from expanding to meet growing demand), the proportion of truly private unassisted rental completions has increased, both in absolute and relative terms, averaging 129,000 units annually since 1995 (about 68% of total rental activity).

Comparison with Canadian Production Levels

Based on relative population size, over the full decade, private unassisted rental production in the US has been 20% higher than that in Canada. This difference increased in the past five years with the US level more than double that in Canada, on a proportionate comparative basis. However, this difference is largely attributable to one specific region of the US – the South, where the fundamentals underlying development feasibility are more favourable than in most other parts of the US.

Understanding the Key Drivers Behind US Rental Production

Significant Subsidy Support

As indicated above, the two major US tax-based programs, in combination with direct subsidy assistance programs, play an important role in supporting overall levels of private rental production – accounting for almost half of all new rental development in the US over the past decade. In total, the four main programs involve annual expenditures in excess of \$10 billion.

More Favourable Income Tax Treatment

While not the primary or only factor facilitating development of rental housing, investors in the US enjoy a more favourable tax treatment than their counterparts in Canada, especially in relation to two elements of the tax system.

- Treatment of capital gains, and more particularly the ability to pool properties. As a result, any sale of a property is treated in terms of the overall pool, not at the level of a single property. In addition, where an investor reinvests in a property of equal or greater value, any capital gain tax liability is fully deferred. This enhances liquidity and creates a source of funds for reinvestment in new development.
- Rental properties in the US are depreciated with a different straight-line method and there is no half year rule as used in Canada.

Alone, changes to income tax treatment are unlikely to make the difference between a viable and unviable project, however in combination with other measures such changes can have a beneficial compounding effect, especially on after-tax rates of return.

Geographic Pattern and Fundamentals of Development

Almost 60% of all rental development has occurred in the southern region of the US – and, thereby, tends to distort the data on overall US rental production. Reasons for the disproportionately higher volumes in the South include:

- The south is a high growth area with substantial population pressure driving production levels. This is a function of both migration and demographic growth.
- Land and development costs in the South tend to be relatively lower than those in other parts of the US and are impacted less by growth controls, which are a large factor in the West and Northeast.
- Even though rental properties in the South command lower rents, these remain sufficiently high, relative to input costs, to make investment attractive.
- There is no rent control in southern states, nor is there any history of ‘on-again, off-again’ regulatory regime that tends to create investor uncertainty.
- Finally, property taxes, a key factor influencing returns and property values, and local development (exaction) fees and charges, appear to be much lower compared to other US regions and particularly relative to those in Ontario.

In short, local housing markets and the fundamentals of development feasibility (various input costs and potential net rental revenue) in the South are a very significant factor influencing the overall unassisted rental production level in the US. Unassisted new rental development in other parts of the US is not proportionately higher than in Canadian centers – largely because, as in Ontario and most of Canada, the fundamentals are not favourable.

Influence on Land Costs From Condominium Sector

In contrast to Canada, among total multiple unit starts (properties with 5+ units) in the US, condominiums account for less than 20% of all units – while rental development is far more significant, roughly 80%. In Canada, multiple starts are dominated by condominiums – which exert an important influence on land values and construction costs but this influence is not a factor in the US.

Again, this reflects a geographic difference. The US population is more dispersed across mid sized towns and cities where ownership goals can be pursued in the single-family market. In addition, ownership opportunity is enhanced by the ability of owners to deduct mortgage interest from their taxes.

Access to Financing

The US is characterized by a more diverse and sophisticated multi-family finance system and is less dependent on the influence of a single entity – CMHC in Canada. There are large sums of funds chasing investments and the market has become very competitive, favouring borrowers. In general, access to financing for unassisted market rent development is not a critical constraint except for smaller properties.

In comparison with Canada, underwriting criteria in the US are mixed. Typically, the maximum loan is based on 80% LTV (rather than the 85% LTV available with CMHC insurance in Canada). Minimum debt coverage is 1.25-1.30 (similar to the new levels recently announced by CMHC). The spread over benchmark government securities tends to be wider since, without insurance, the mortgage rate incorporates a risk premium. However, the loans are typically non-recourse – i.e. there are no requirements for guarantees, as are necessary with high-ratio CMHC-insured loans.

Testing the Impact of Tax-based Measures in Canada

Simulations of rental development, using the existing design of the US LIHTC and tax bond financing, illustrate that US styled tax expenditure measures could provide significant sources of funding support to stimulate new rental development at relatively affordable rent level and with relatively long (30 year plus) compliance periods.

While the associated tax expenditures are very significant (roughly \$34,000 and \$67,000 per unit for a project in Toronto) in tax credits alone, not counting the additional funding required for the tax-exempt bonds, and the other ‘gap funding’, this is not inconsistent with the level of funding that would be required under a direct grant approach in a program similarly seeking to achieve affordable rents.

Overall Conclusions and Lessons for Canada

For the assisted housing system, the research has clearly demonstrated that it is only possible to address affordable housing production with substantial levels of subsidy. Clearly there is an important public policy, and expenditure role for government in this area.

Complementing traditional direct subsidy programs, the US has developed and refined a fairly effective subsidy approach drawing on tax incentives – most notably the Low Income Housing Tax Credit – to leverage large scale private equity investment. This program is unique in capturing the active engagement of private investors and in bringing a competitive market efficiency to the program. It has also implemented an effective way to overcome the failures of earlier programs – loss of affordable stock at the maturing of program restrictions on rent levels. The LIHTC overcomes this issue through a creative incentive and tax recapture approach that motivates investors to sell to a non-profit operator following extraction of tax benefits (10 years), thereby ensuring long term preservation of the public investment.

To the extent that it can lead to significant leverage of private equity investment and if it can be designed to emulate the relative efficiency and ability to ensure long-term preservation of affordable units then further explorations and discussion with the Federal Department of Finance may be warranted. It would also be possible to design a tax credit that includes provincial credits – like labour sponsored venture capital funds, which would share the tax cost between the federal and provincial government.

While access to financing is not generally seen to be an issue with respect to unassisted rental development, it has been a concern in the affordable housing sector. In the US, the federal government has implemented public mortgage insurance with an explicit, and almost exclusive, focus on facilitating financing for affordable housing. This includes both direct subsidy of premiums in a publicly operated mortgage insurance program (FHA Multi-family insurance) and a regulatory framework that has imposed affordable housing goals on private corporations (government sponsored enterprises) requiring them to ensure that mortgage financing is made available for proponents of affordable multi-unit rental development by creating a secondary market for such loans.

In the case of the unassisted component of the system the cost-value equation is fundamental to a viable and healthy production system. There are very significant levels of unassisted production in the southern region of the US, where the fundamentals work – values exceed costs. In much of the rest of the US, more limited levels of unassisted development were identified (and on a proportionate basis, no higher than that in Canada) mainly because the fundamentals do not work – except at the high end of the market.

Again, the public policy framework can play an important role in influencing the outcome of the cost-value equation. Property values are impacted by public matters such as levels of property taxes and rent regulation – both impact the potential net operating income and thus the capitalized value of a property. To the extent that the province of Ontario has enacted the tenant protection act and enabled rents to move to market levels and created the option for municipalities to lower property taxes, there may be limited possibilities for further actions to enhance the valuation of new rental development.

On the cost side, development costs are directly impacted by an array of public levies, fees charges and taxes – including the PST, GST and local development charges. Much attention has been directed at this issue, and especially to the matter of local charges pushing up costs. However consideration of local charges must be viewed in the broader context of relative levels of government taxing capacity, fiscal transfers and service burdens.

The analysis found substantially lower levels of development charges and local property taxes in the US, and especially in the south. Although not extensively investigated in this study, it appears that many US municipalities are able to operate with lower revenues from these two sources because the state and federal government are relatively more generous in providing block grants and fiscal transfers to help pay for the costs of growth. More research is required to fully understand how intergovernmental fiscal arrangements in the US influence the cost issue impacting rental development.

In the Canadian and Ontario context it is questionable whether municipalities should or can lower fees, charges and property taxes to improve the fundamentals of new development, when they are obliged to manage the costs of growth solely from their local revenues.

It may also be worth exploring the option of federal and provincial funding to help pay the costs of growth in the economic engines of the country – local communities. The US model of creating bond room and enabling municipalities to raise capital for growth, housing and infrastructure investment on a tax-exempt basis is an area that should be explored in more detail.

Finally, the tax treatment of rental investment is more favourable in the US, particularly with respect to pooling, rollover provisions and depreciation rates. Alone, changes to tax treatment will not make the difference between a viable and unviable project, however in combination with other measures such changes can have a beneficial compounding effect.

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Wanted: Affordable Apartments	

Introduction

This report has been prepared on behalf of the Research Subcommittee of the Housing Supply Working Group (HSWG) – a joint government-industry advisory group established to identify rental housing supply problems and solutions. The HSWG is co-chaired by the Ontario Ministry of Municipal Affairs and Housing and industry representatives.

In May 2001, the HSWG released a report, *Affordable Rental Housing Supply: The Dynamics of the Market and Recommendations for Encouraging New Supply*, which identified various actions that could assist in stimulating new rental investment. Recommendation 3 (of 12 recommendations contained in the report) states:

It is recommended that the federal and provincial governments consider US type tax incentive systems such as the Low Income Housing Tax Credit ... to promote affordability in a private market.

The HSWG report noted that the level of rental production in the US during the 1990s has been relatively more buoyant than that in Canada. This report examines this initial hypothesis and highlights key differences in the investment environment for rental development in the US that influence production. It identifies the most significant tax and housing-related subsidy and program levers impacting new market rental development in the United States, how they work, how they generate capital for new market rental housing and how they impact affordability. The report also discusses the structure of the multi-family housing finance system in the US, since access to financing is a key part of the production process.

The report assesses which of the tax levers and programs show the most strategic promise, in the Ontario and Canada-wide context, to stimulate new rental housing production, and those that could be earmarked for targeted affordable rentals.

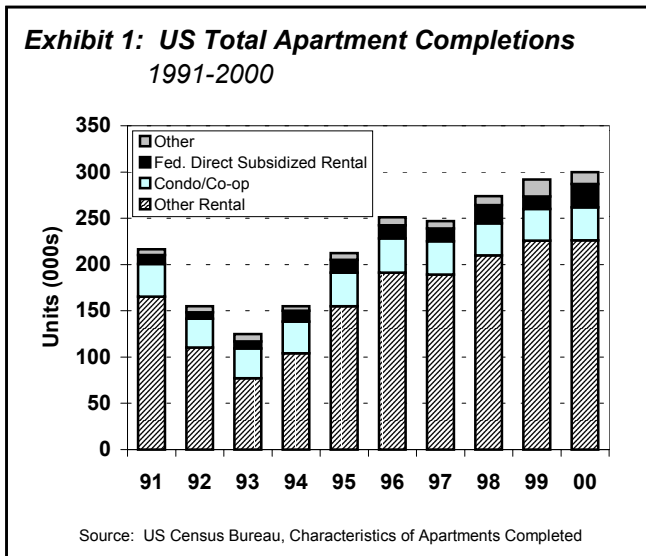
Recent Trends in US Rental Production

A review of housing production statistics in the US confirms a relatively healthy level of rental construction activity. Over the past decade, rental completions have accounted for more than 16% of total new housing production in the US. The comparable figure in Canada is 9% – and this was heavily influenced by high social housing starts during the early 1990s. Since 1995, rental starts in Canada have averaged less than 6% of total starts. So, on the surface, it does appear that US production levels are relatively higher.

Analysis of the rent/own distribution of US apartment completions also reveals a very significant difference from Canada. While apartment starts in Canada are dominated by condominiums, these are not as significant a factor in the US. Exhibit 1 presents a breakdown of US apartment completions (in buildings with 5+ units) during the 1990s into the following categories:

- Federal direct subsidized rental (units built under the HUD programs and FHA rent supplement assisted buildings) – these exclude units assisted under state and local programs and by the various tax-based mechanisms discussed later;

- Condominiums and equity (non-subsidized) coops;
- ‘Other’ – this includes furnished rentals, time-shares, continuing care retirement units, and turn-key housing (projects sold to local public housing authorities); and
- ‘Other rental’ – mainly ‘private’ rental projects, many of which were funded through various tax-based mechanisms.¹



Over the past decade, the ‘other rental’ category (mainly private rental housing) has accounted for 75% of all apartment completions and has averaged 165,000 units annually. Condominium and co-op units accounted for roughly 16%, while the federal direct subsidized activity (plus ‘other’) makes up the remaining 10%.

Following a decline in the early 1990s, overall US apartment completions steadily recovered from 1994 on. In 2000, apartment completions reached their highest level of the decade (300,000 units).

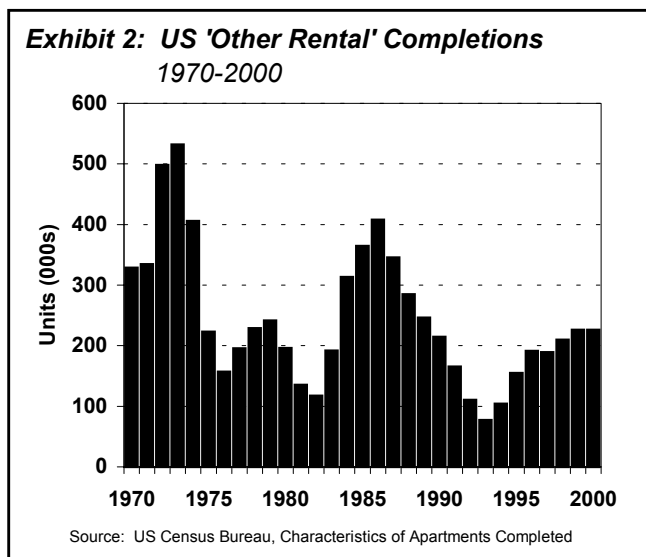


Exhibit 2 focuses only on private rental activity (‘other rental’ in Exhibit 1) – the level of new rental development has fallen from the peaks of the 1970s. Reflecting the influence of shifting demographics and somewhat similar to the longer-term trend in Canada, rental completions have fallen from an average of over 314,000 units annually in the seventies, to 260,000 during the 1980s, and 165,000 during the 1990-1999 decade. In both 1999 and 2000, private rental apartment completions totalled roughly 225,000.

The volume of rental housing activity in the US has fluctuated with the economic cycles. However, government policy has also had a significant influence on levels of rental production in the US (discussed next).

¹ As discussed later, many projects are financed with vehicles facilitated through tax expenditures. They are captured in the general statistics on private rental starts, even though in reality the tax expenditure is equivalent to a significant level of public assistance. Here, they are labeled as ‘other rental’ rather than as private unassisted. Later in the report, the split between truly private unassisted and subsidized (including tax measures) is estimated.

Influence of Public Funding and Policy on Rental Production

Historical Background

US rental construction in the 1960s and early 1970s was heavily stimulated by both favourable tax treatment of rental development and a series of subsidy programs that encouraged private entrepreneurs to build and operate low and moderate income rental housing.

Less favourable tax and program reforms introduced in 1974 by the Nixon administration significantly decelerated the pace of new rental development. This included consolidation of a number of programs and some reduction in expenditure – including a temporary moratorium on new supply programs. However, supply was reinstated and the focus remained largely on subsidies and incentives to induce private developers to build ‘low-rent’ units. Unlike in Canada at that time, there was no policy effort to create or expand a non-profit delivery system.² Instead, a niche of private builders specializing in ‘affordable’ rental began to emerge and remains active today.

This era also introduced other measures, including allowing state and local housing authorities to issue tax-exempt bonds to finance a number of activities, including low and moderate income housing, and a federal block grant program to support local community development, including affordable housing initiatives. Both of these vehicles have continued to support rental housing production to the present time.

The next significant stimulus to rental production occurred in 1981 – in the form of major tax measures enacted in the 1981 Economic Recovery Tax Act (ERTA). These changes significantly improved the tax treatment of rental investment for passive investors and created new opportunities for syndicated investment.

The impacts of these changes are clearly evident in Exhibit 2. However, because this exhibit presents *completions* data (rather than starts), there is a lag in the outcomes of each policy change.

The cancellation of the ERTA tax provisions in 1986 diminished the attractiveness of rental investment. Although this was replaced by new legislation that introduced the Low Income Housing Tax Credit (LIHTC) – a vehicle more focused on modest rent levels – the immediate impact of the tax change is evident in the declining level of activity post-1986.

² This is a significant difference between Canada and the US. Here, the active federal government support for a non-profit sector established a sizeable and active group of stakeholders, often in competition with private sector interests. In the US, there was much more limited support for community-based organizations and no specific support for housing non-profits. Community-based groups that did evolve did so with a much broader mandate linked to civil rights, social justice and inner city race and poverty issues and had a broader community development approach. Many community development corporations (CDCs) ultimately became involved in housing, but this was not their main *raison d’être* or focus. Another important factor is that, without direct government support, CDCs had to be creative and entrepreneurial in securing funding – many sought joint ventures with private partners as a way to access favourable tax treatment – a relationship that was important in advocating for the LIHTC program in the mid 1980’s.

The LIHTC has clearly had an important influence on new rental production since its inception in 1986, and is now, de facto, the single largest rental production program in the US.

More Recent Policy and Program Levers

The analysis of rental completions presented in Exhibits 1 and 2 draws on US Census data that makes a distinction between privately financed and unsubsidized units, and ‘federally subsidized’ units. However, a number of the units labeled ‘privately financed and unsubsidized’ (‘other rental’ in Exhibits 1 and 2) in fact benefit from a number of indirect assistance programs.

Distinct from Canada where government assistance has most often been in the form of a specific program for which the output has been tracked, much of the assistance in the US system is indirect and often multi-layered. So, the number of units assisted under one program or another (e.g. LIHTC, HOME and tax-exempt bonds) cannot simply be added together to determine the total number of units subsidized in one way or another – many projects would benefit from two or more subsidy mechanisms.

As noted, the US Census Bureau tracks units built under HUD-funded direct programs and these can be relatively easily isolated (e.g. in 2000 there were 25,200 federal subsidized units and these have already been identified separately in Exhibit 1).

The other main programs supported at the federal level and included in the larger count of ‘other rental’ units (226,100 units in 2000) are:

- The Low Income Housing Tax Credit (LIHTC),
- Tax-exempt bonds,
- Community Development Block Grant (CDBG); and
- HOME Investment Partnership.

Although funded at the federal level, these programs involve allocations of federal block grants or tax credit room to state and local governments, where they are typically combined with local programs to provide a resource pool to support local affordable housing strategies. There are numerous local programs and additional funding sources, however, these are seldom used in isolation – they are almost always bundled together with one or more of these four major federal programs.

An overview of each of these four key programs (plus the FHA mortgage insurance program) is presented below.

The Low Income Housing Tax Credit (LIHTC)

The LIHTC is recognized as the single largest source of support for affordable rental development and rehabilitation in the US. However, unlike other federal subsidy programs, delivered historically by HUD, LIHTCs are delivered through the federal tax code. Moreover, responsibility for delivery and monitoring is delegated to state housing finance agencies (HFAs).

LIHTCs award a 10-year flow of tax credits to equity investors in qualifying rental properties that are rented to households earning below 60% of the area median family income. The units

must remain affordable for a minimum of 15 years, although this has been extended both by state regulation and through a competitive process – at present, the minimum is 30 years but compliance periods often exceed 40 years. At some point, after the credits have been earned, but usually prior to the end of the longer compliance period, it is expected that the limited partners (i.e. the tax equity investors) will sell their equity shares – and many partnership agreements prescribe the terms of sale such that ownership will transfer to a non-profit corporation and thus ensure long-term preservation of the units as affordable stock. The equity investors will generally have generated their return on investment from the tax savings during the first 10 years of operation.³

The amount of the tax credit is calculated based on the eligible total development (or rehabilitation) cost and the proportion of units targeted to eligible income levels – in practice, most developments are 100% targeted. Total development costs are adjusted by any other federal grant and by any non-depreciable cost, such as land, so the eligible cost is usually somewhat less than the full development cost.⁴ The amount of the annual tax credit rate is roughly 9% of the eligible cost basis for new construction and 4% of the eligible cost basis for acquisition rehabilitation.⁵ This source of equity covers a large part of the capital cost of the development but is also combined with mortgage financing and other sources of funding in order to ensure the project is viable at ‘affordable rents’. An example of the effect of the LIHTC on the economics of investment in a rental project is provided later in the report.

A relatively complex LIHTC delivery system has been created involving state HFAs which allocate the federal credits through a competitive process to developers of qualifying rental projects. The intent of the program is to attract investment in affordable housing while retaining the rigour of a competitive process and private sector expertise.⁶ Participation of non-profit sponsors is both permitted and encouraged through ‘set-asides’ of part of the LIHTC allocation specifically for non-profit charitable sponsors. The minimum set-aside is 10%, although most states have allocated a much higher level and non-profits make up roughly 30% of total unit allocations to date.⁷

The pool of federal tax credits is based on a per capita allocation which, since inception in 1986, has been \$1.25 per capita (a total annual allocation of roughly \$300 million in credits at the outset, rising to \$345 million in 2000). The per capita allocation was recently raised to \$1.50 for 2000 and to \$1.75 effective in 2001. Since each year’s allocation earns 10 years worth of credits, the cost to the federal treasury is substantial (i.e. 10 years x \$300+ million per year = \$3+ billion

³ After 10 years, properties will continue to generate a cash flow and some owners may wish to maintain ownership – however, in most cases, it is expected that limited partner owners will sell their interest in the property and in so doing will attempt to structure the sale to minimize any tax impacts or recapture of depreciation.

⁴ Since any grant from federal sources reduces the eligible basis, projects that also receive assistance from federal programs like CDBG are typically structured as a low interest loan, rather than grant, and thereby avoid this adjustment.

⁵ In reality, the rate used to calculate the annual credit claim is calculated to yield in present value terms a total credit equal to 30% (rehab) or 70% (new) of the eligible cost base – the associated actual annual rates are approximately 4% and 9% and these tend to be used as the label for the two types of credits.

⁶ Jean L Cummings and Denise DiPasquale, ‘The Low Income Housing Tax Credit: the First Ten Years’, *Housing Policy Debate*, Vol. 10:2, 1999 (page 252).

⁷ Katherine O’Regan and John Quigley, ‘Federal Policy and the Rise of Non Profit Housing Providers’, *Journal of Housing Research*, Vol. 11.2, 2000.

annually). After allocation, the project is developed and ‘placed in service’; however, the 10-year stream of tax credits does not begin to flow until units are occupied by eligible households.

It is difficult to identify a precise count of new construction generated by the LIHTC in any one year due to a variety of factors – including: the delay between the allocation process and placing units into service; cancellation or carrying over of credit allocations; and the mix of acquisition/rehabilitation and new units. However, an upper estimate is provided by the count of total LIHTC units authorized. The National Council of State Housing Agencies, the umbrella group of agencies that administer the allocations, estimated that more than 800,000 units were allocated from inception in 1986 to the end of 1995. Since then, an additional 337,000 units have been authorized (to the end of 2000). This brings the total allocation to just over 1.15 million LIHTC units in 15 years – an average of 75,000 units annually.

Exhibit 3 presents the total amount of LIHTC tax credits and units allocated over the past decade. The allocations in any year are based on the per capita allocation, plus returned credits and unallocated carryovers. Allocations include both new units and acquisition/rehabilitation units. The effects of higher costs on the allocations is evident from Exhibit 3 – average numbers of units allocated has fallen from more than 100,000 annually in the early 1990s to 60,000 in 2000. The 40% rise in the per capita allocation from \$1.25 to \$1.75 in 2001 should help to restore the unit output levels to previous volumes.

Exhibit 3: LIHTC Tax Credits		
Year	Total Annual Credits Authorized (\$Million) *	Units Allocated **
1991	314	111,970
1992	319	91,300
1993	323	103,756
1994	326	117,099
1995	329	86,343
1996	329	75,592
1997	335	70,220
1998	338	69,091
1999	342	62,529
2000	345	60,039
Total		847,939

*Each annual \$1 of credit allocation generates a 10 year (i.e. \$10) nominal total of credit claims.
 ** Includes both new and rehabilitation units.
 Source: National Council of State Housing Agencies

Research by Cummings and Pasquale (1999), using a data base containing 150,000 units in LIHTC projects developed between 1986-1996, found that 65% of the units were new construction, with the remaining 35% acquisition/rehabilitation. Using this ratio against the full volume of credits issued since 1986 suggests that the tax credit may account for a total of

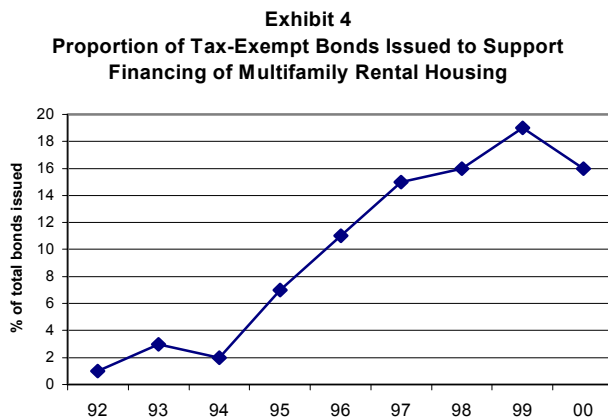
roughly 750,000 units constructed between 1986-2000 – an average of 65,000 annually in the first half of the 1990s and an average of 45,000 annually during the 1996-2000 period.

Tax-Exempt Bonds

Under US tax law, state and local governments are authorized to raise capital for various purposes, including housing development by for-profit or not-for-profit corporations, by issuing tax-exempt bonds – generally with terms of 10-30 years. The interest earned on these bonds is exempt from federal tax liability (and often also state taxes), with the result that interest rates on the bonds are typically much lower than with conventional (i.e. taxable) bonds. This provides states and municipalities with a financing facility to generate capital at below-market rates.

Each state’s annual issuance of tax-exempt bonds is capped. Congress increased the volume cap in 2000 (from \$50 per capita) to restore purchasing power lost to inflation since Congress imposed the cap in 1986. The 2001 cap was \$62.50 times state population (with a minimum of \$187.5 million per state). The cap increased to \$75 times state population in 2002 (with a minimum of \$225 million per state). Beginning in 2003, the cap will be adjusted for inflation on an ongoing basis.

Clearly, with this cap of \$62.50 per capita compared to the \$1.50 (effectively \$15 since it generates 10 years of credits) for the LIHTC, the tax-exempt bond has a much larger impact on capital supply. In 2000, some \$15 billion of tax bonds were issued nation-wide.



Within the overall volume cap, states may allocate funds raised through the tax-exempt bond issues to a variety of specified eligible uses. Tax-exempt bond financing can be raised under the form of mortgage revenue bonds (used primarily to finance discounted mortgages for lower income first-time homebuyers) or ‘private activity’ bonds, which provide below-market rate mortgage funds for multi-family housing, industrial development, redevelopment, and student loans.

The share of tax-exempt bonds issued to support multi-family housing has increased steadily through the 1990s. In the early part of the decade, multi-family bonds accounted for less than 3% of total bond financings raised; however, by the end of the decade, multi-family bonds accounted for almost one-fifth of the total annual bond volume issued – this reflects an ongoing shift in the sources of capital for multi-family mortgage financing in the US, discussed in more detail later.

Tax-exempt bonds have become a very significant and important source of financing for rental housing in the US, and more specifically for affordable rental development and rehabilitation. In 2000, the total proceeds of bonds undertaken in support of rental housing totalled just over \$3 billion. Of this amount, \$1.66 billion was related to new production while the remainder (\$1.4

billion) was used to refinance renewal of existing mortgages or acquisition/rehabilitation project loans. In 2000, this \$1.66 billion in bond financing contributed to the development of 33,000 new rental units, at an average of roughly \$57,000 in financing per unit.

The level of new rental production supported by tax-exempt bonds has increased as the multi-family use share of the bond funding facility has increased. Since 1995, bond financing has supported, on average, 16,000 new rental units annually. A further 12,400 rehabilitated units, on average, have also been financed from this source. As shown in Exhibit 5, there has been a steady increase in the volume of bond-financed units through the decade – and 2000 was a peak year, with 33,000 new units financed.

An important feature of the tax-exempt bond financing is that, once approved for bond financing, the project is also eligible to receive an ‘as of right’ LIHTC allocation for a 4% tax credit. This is over and above any LIHTC allocations made within the annual LIHTC volume cap discussed above.⁸ There is no competition for this 4% tax credit, only for the bond allocation – the tax credits come automatically with the bond allocation. Since 1995, 82% of all bond-financed projects have taken advantage of the potential to access additional ‘as of right’ tax credits.

Since projects financed with tax-exempt bonds have this special access to tax credits, there is very little, if any, overlap in the units funded by this combined tax-exempt bond/4% credit and the units produced with the larger 9% main LIHTC pool of equity. However, bond financing is often combined with other layers of grant or concessionary financing (it is seldom combined with conventional financing).

Exhibit 5:
Tax-Exempt Bond Financing and Associated LIHTC Allocations

	New units			Acquisition and Rehab Units	Total Units
	With 4% Credit	Without 4% Credit	Total		
1995	2,972	1,634	4,606	5,906	10,512
1996	4,626	3,252	7,878	7,325	15,203
1997	6,834	3,144	9,978	8,997	18,975
1998	14,733	1,840	16,573	13,466	30,039
1999	18,475	3,899	22,374	17,832	40,206
2000	29,735	3,227	32,962	21,086	54,048
Avg 95-00	12,896	2,833	15,729	12,435	28,164

Source: National Council for State Housing Finance Agencies

Essentially, the value of tax-exempt bonds is that they provide a key financing source with below-market interest rates (estimated to be typically 100-200 basis points below conventional mortgage rates). In return, the allocating state HFAs require projects to meet specified targeting criteria, similar to the LIHTC – i.e. a specified proportion of units must be affordable to

⁸ This extra allocation carries a 4% credit rate and is similar but separate from the 4% credit available within the regular LIHTC program. In the capped LIHTC volume, credits may be either 9% or 4%. The lower level is used in cases involving acquisition or for projects receiving ongoing federal subsidies.

households at 60% of area median family income and a minimum compliance period is required. Often, these targeting criteria are triggered by other layers of the funding such as HOME as described below.

Community Development Block Grant (CDBG)

The Community Development Block Grant (CDBG) provides a formula-based federal block grant to localities for a variety of community redevelopment and revitalization activities – including housing development, water, sewer and other infrastructure, economic development etc. CDBG was established in 1974 and has been in place consistently since that time. While CDBG funding can and has been used to assist new affordable housing development, it is mainly used as part of neighbourhood revitalization programs and, as such, most housing initiatives involve rehabilitation rather than new construction. A recent report published by the National Association of Housing and Renewal Officials (NAHRO) (2000) suggests that new housing development accounts for roughly 5% of CDBG funds each year. Since the mid 1990s, CDBG has been funded at levels in excess of \$4 billion annually, so a 5% expenditure on new housing implies \$200 million annually, so this is not an insignificant source of funding for rental development.

HOME Investment Partnership Program

While CDBG has provided some funding for housing, there has always been heavy competition (from non-housing activities) for these funds at the local level. In the late 1980s, community advocates successfully argued for a specific and separate mechanism to fund housing with a formula-based allocation similar to CDBG – the HOME Investment Partnership Program was the result.⁹

Established as a federal block grant program in 1990, HOME provides federal grants to state and local levels to assist in implementing housing assistance strategies tailored to local needs for very low income families, the elderly, physically disabled, and homeless. HOME funds can be used for the purchase, rehabilitation, and new construction of affordable housing, and for rental subsidies for low and very low-income tenants.

HOME funds are allocated each year among states, localities, and consortia of local governments. State agencies receive 40% of total HOME funding and localities receive 60% – allocated according to a need-based formula.

States and localities must match every four federal HOME dollars with one dollar of state, local, or private funds, and HOME funds are frequently combined with funding from tax-exempt bonds and/or LIHTC in order to leverage additional public and private investment. States and localities must also set aside a minimum of 15% of their annual HOME allocation for use by Community Housing Development Organizations (CHDOs) – specific non-profit organizations accountable to low-income communities.

HOME funds are highly targeted. No HOME funds can be used to assist families with incomes greater than 80% of the area median. Ninety percent of all HOME rental assistance must go to

⁹ HOME is not an acronym

families with no more than 60% of area median income. HOME developments must rent at least 20% of their apartments to families earning 50% or less. In practice, HOME reaches families at income levels significantly lower than these upper limits. Nearly one in three homebuyers, seven in 10 homeowners, and about nine in 10 renters who obtain HOME assistance earn 50% or less of area median income. More than half of HOME-assisted renters earn 30% or less of area median income.

HOME-assisted properties are monitored by states and localities to ensure their long-term affordability. Rental developments generally must remain affordable to low-income families for up to 20 years, or be subject to recapture of HOME assistance. Assisted owner-occupied properties that are sold within a period of up to 15 years can be purchased by another low-income family, or the seller must repay all or a portion of the HOME subsidy.

HOME is a critical resource for LIHTC projects. It is often used for ‘gap financing’ – i.e. that portion of development cost that makes up the difference between the equity from the tax credit and proceeds from the first mortgage. Gap financing typically takes the form of a deferred payment second mortgage that requires no current debt service payments at initial occupancy, but may require some current payments out of cash flow when certain occupancy and cash flow milestones are achieved. Unpaid second mortgages are repaid at time of sale. One reason gap financing takes the form of a loan and not a grant is that, if it were the latter, it would reduce the basis for calculating the tax credit amount.

Congress funded the program at its highest level ever in fiscal year 2001 – \$1.8 billion. However, the higher level of HOME financing has not kept pace with the increase in either the tax-exempt bond financing or the increase in LIHTC funding available. Since most projects require a combination of funding mechanisms (HOME, tax-exempt bond financing, LIHTC, and other sources of funds), many housing organizations believe that states will not be able to use the 40% increase in LIHTC unless they receive greater access to gap financing – which means bigger increases in HOME will be required to meet the potential levels of LIHTC production.

Much of the HOME funding is used for housing rehabilitation, including owner-occupied rehabilitation, rather than for new construction. As of April 2001, HOME had subsidized the development of nearly 253,000 rental units – 43% of all HOME-assisted units, although a significant proportion of these were not new construction. Since HOME funds used for new rental housing typically provide only one layer of the financing package (in combination either with tax-exempt bond financing or LIHTC), virtually all of the new rental units assisted by HOME are already counted under the units produced in these other two programs.

FHA Insurance

Through the Federal Housing Authority (FHA), the US government provides mortgage insurance to facilitate the financing of affordable rental housing. There are a number of private mortgage insurers in the US and there is a competitive industry in the single-family market. However, the FHA is the only insurer for rental multi-family projects.

For multi-family rental projects, FHA mortgage insurance tends to be focused mainly on loans to private and non-profit developers providing rental housing for low-moderate income households

(defined as those below 80% of area median income). By regulation, the FHA is limited to specified total mortgage caps which effectively limit the scope of FHA insured loans exclusively to affordable housing developments. In general, these types of projects depend on some form of assistance in order to be viable at affordable rent levels. Since the loans associated with LIHTC projects are typically uninsured (large levels of equity and other funding lower the loan-value ratios to acceptable levels without insurance), the volume under FHA insured units and LIHTC are likely mutually exclusive. Thus, statistics of FHA rental activity provide a useful measure of the portion of rental units that are likely developed with some form of (non-LIHTC) assistance.

One area where FHA insurance is combined with other policy initiatives is HUD's HOPE VI public housing transformation program that pioneered mixed income/mixed financing. This program is leveraging public housing capital dollars for modernization and rehabilitation of distressed public housing sites with LIHTC and private equity to create mixed income and mixed subsidy multi-family housing. FHA mortgage insurance is used to credit enhance the private financing portion of HOPE VI mixed finance projects in order to achieve lower mortgage rates.

FHA multi-family mortgage insurance premiums are not sufficient to cover program losses. Therefore, the FHA multi-family programs require a Congressional appropriation of what is referred to as a 'credit subsidy' which makes up the difference between anticipated losses covered by insurance premiums and actual losses. In 2000, for example, HUD ran out of available credit subsidy before the end of the year, and many projects in the FHA pipeline could not be finalized for lack of sufficient credit subsidy.

When making funds available for FHA multi-family insurance, Congress must make two decisions. First, it authorizes an aggregate amount of mortgage insurance permitted to be put in place during a fiscal year. Second, it appropriates a specified amount of 'credit subsidy' for the program. When authorizations for mortgage insurance exceed appropriations for credit subsidies, as they did last year, there are constraints on the volume of FHA mortgage approvals. This is one of the reasons why HUD has proposed increasing the FHA multi-family mortgage insurance premium from 50 basis points to 80 basis points (calculated as a percent of mortgage and payable as part of the regular mortgage payments).¹⁰

Estimating the Volume of Unassisted Private Rental Development in the US

There are no estimates of the volume of unassisted rental housing production in the US. The preceding sections have overviewed the general statistics on rental housing production and also identified the key federal programs that have influenced these production levels; however, given the overlapping nature of many of the US programs, identifying the true volume of unassisted

¹⁰ FHA mortgage insurance premiums are applied differently from the CMHC premiums familiar to most readers. For example, in Canada, premiums are paid up front – e.g. for an 85% loan-to-value (LTV) mortgage, a 4.5% premium is calculated against the face value of the loan (\$100,000 loan premium = \$4,500). FHA premiums consist of an additional 50 basis points (0.5%) on top of the mortgage interest rate. The effect of the apparent difference in premium levels is not large: in Canada, a \$100,000 mortgage with a capitalized 4.5% premium, would yield a total mortgage principal of \$104,500; at 6%, this would result in a payment of \$669/month; in the US, a \$100,000 mortgage at 6% plus 50 basis points results in an mortgage interest rate of 6.5%, and a monthly payment of \$670.

rental production is a challenge. Nonetheless, some groupings of programs *are* mutually exclusive so it is possible to derive a rough estimate of total assisted rental production, tax-based (LIHTC and bond financed with a 4% credit) rental production, and other rental production.

Exhibit 6 presents an overview of total rental production and key federal programs, and develops an estimate of the likely volume of ‘unassisted’ rental production – i.e. the rental production that does not benefit from the key federal programs, including the two large tax expenditure programs.

It must be stressed that these are crude estimates at best. For example, the data reflect inconsistent time frames – unit completions (columns 1, 2 and 3) will not coincide with the issuance of FHA insurance. Also, more significantly, there is a lag between the LIHTC commitments and when units are ‘placed into service’. The 65% LIHTC share for new units is also a rough estimate which will vary from year to year. Therefore, estimates for individual years are not precise. However, it is likely that the totals and averages over the decade provide a reasonable estimate of the overall volume of new unsubsidized rental production in the US.

Exhibit 6: Estimating Volume of New Unassisted Rental Housing Development in the US (Netting out effect of the LIHTC)									
Year	Federal Direct Subsidized (1)	Other Rental (2)	Sub-total All Rental (3)	FHA Insured (4)	Non-FHA Rental (5)	New LIHTC (6)	Tax Bond Financed (7)	Total Tax Based New Rental (8)	Remainder "Unsubsidized Rental" (9)
91	9,600	165,300	174,900	13,058	161,842	72,781	*	72,781	89,062
92	7,000	110,220	117,220	7,823	109,397	59,345	*	59,345	50,052
93	7,700	77,200	84,900	9,321	75,579	67,441	*	67,441	8,138
94	11,800	104,000	115,800	12,988	102,812	76,114	*	76,114	26,698
95	13,700	155,000	168,700	17,113	151,587	56,123	4,606	60,729	90,858
96	14,200	191,300	205,500	23,554	181,946	49,135	7,878	57,013	124,933
97	14,100	189,200	203,300	23,880	179,420	45,643	9,978	55,621	123,799
98	20,000	209,900	229,900	25,237	204,663	44,909	16,573	61,482	143,181
99	13,600	225,900	239,500	30,863	208,637	40,644	22,374	63,018	145,619
00	25,200	226,100	251,300	35,271	216,029	39,025	32,962	71,987	144,042
Total '91-00			1,791,020	199,108	1,591,912	551,160	94,371	645,531	946,381
Average '91-00			179,102	19,911	159,191	55,116	9,437	64,553	94,638
Average '96-00			225,900	27,761	198,139	43,871	17,953	61,824	136,315

* Tax bond Financed units negligible prior to 1995

Examining each column of Exhibit 6 in turn:

1. **Federal direct subsidized rental** – as in Exhibit 1, these are units built under the HUD programs and FHA rent supplement assisted buildings. They exclude units assisted under state and local programs and by the various tax-based mechanisms or HOME.
2. **‘Other rental’** – as in Exhibit 1, these are mainly private rental projects, many of which were funded through various tax-based mechanisms.
3. **Sub-total – all rental** – the sum of columns 1 and 2.
4. **FHA insured projects** – FHA projects are typically targeted (but do not typically involve tax-funded projects such as LIHTC), so they provide a crude proxy for a variety of direct subsidy programs – including those in column 1 plus HOME and other state, local and philanthropic assistance. [It is assumed that to produce units at affordable rents, some form of assistance (and likely quite substantial assistance) is required.]

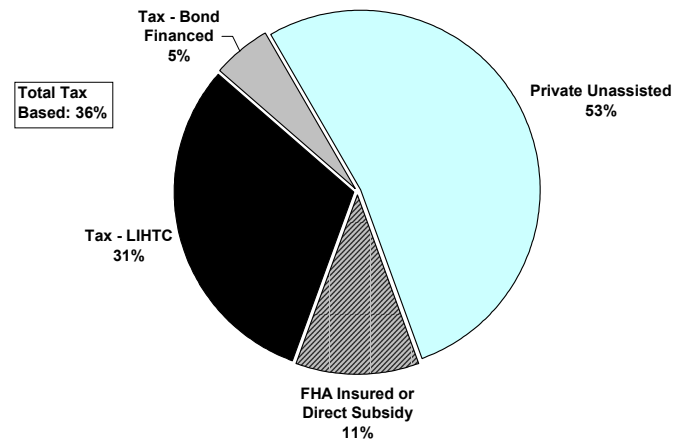
5. **Non-FHA rental** – column 3 less column 4 – effectively, private rental production without direct subsidies.
6. **LIHTC new construction estimate** – this consists of LIHTC allocations (from Exhibit 3) less 35% (the assumed rehabilitation/acquisition proportion of LIHTC projects). The result is a crude estimate of the volume of new units financed by the LIHTC.
7. **Tax bond financed** – total new rental units financed with tax-exempt bond funding. These units benefit from a separate tax credit allocation (4% credit only) and are exclusive to the LIHTC units in column 6. Data are not available for years prior to 1995, but the volume of multi-family tax bonds prior to that date was minimal, so this does not have a significant impact on ten-year total or average level.
8. **Total tax-based new rental** – sum of columns 6 and 7 – estimated LIHTC allocated for new rental plus actual new tax bond financed rental units.
9. **Remainder: ‘unsubsidized rental’** – column 5 less column 8 – a rough estimate of the volume of new rental housing which does not benefit from any subsidies or tax expenditure programs – i.e. it is assumed that HOME, CDBG and tax-exempt bond financed units all are included in either the FHA insured column or the LIHTC/tax bond columns.

The results of Exhibit 6 are summarized below in Exhibit 7. This chart overviews the relative volume of rental units produced under direct subsidy programs, the two tax-based programs and the residual - considered to represent unassisted private production.

Over the past decade, a total of 1.8 million rental units have been produced – an average of 179,000 units annually.

New development, facilitated by either LIHTC or tax-exempt bonds, averaged roughly 65,000 units annually for the full decade (roughly 36% of all rental production) while direct subsidy programs accounted for 11%. The average annual unsubsidized rental production was roughly 95,000 units annually (53% of all rental production) for the decade.

Exhibit 7:
Unassisted, Direct and Indirectly Subsidized Rental Production US (1991-2000)



For the later half of the decade, when a stronger economy stimulated a higher level of construction but volume caps on the two tax programs constrained these programs from expanding to meet growing demand, the proportion of truly private unassisted rental completions has increased, averaging 136,000 units annually since 1996 (about 60% of total rental activity).¹¹

¹¹ With the 40% increase in the LIHTC volume cap (\$1.25 to \$1.75 per capita) since 1999, it is expected that the volume of tax credit assisted development will increase as a relative proportion, most likely back to 36% or higher

In this more recent period, the production attributable to the tax-based programs has fallen to 27% of the total while private unassisted rental has increased, in both absolute and relative terms, to account for roughly 60% of completions.

Exhibit 8: Rental Housing Completions Canada			
Year	Total Rental	Social Housing*	Net Private
1991	9,631	9,273	20,358
1992	29,785	19,621	10,164
1993	21,550	15,718	5,832
1994	17,752	9,886	7,866
1995	10,175	5,271	4,904
1996	7,949	3,659	4,290
1997	7,191	1,997	5,194
1998	6,951	1,439	5,512
1999	8,072	1,090	6,982
2000	9,043	1,030	8,013
Total	148,099	68,984	79,115
Avg 91-00	14,810	6,898	7,912
Avg 96-00	7,841	1,843	5,998

* Social housing assisted or insured under CMHC programs - excludes some provincial or local initiatives, so under counts social housing.
Source: CMHC

In comparison, total rental completions in Canada since 1991 have averaged almost 15,000 units annually, with private unassisted activity accounting on average for just fewer than 8,000 units annually.¹²

The pace of new development is, however, the inverse of that in the US. Rental housing activity in Canada was highest in the first half of the decade, buoyed by substantial social housing activity. Rental completions dropped significantly after 1995, when social housing programs were terminated in Ontario (the CMHC social housing programs ended in 1993).

Total rental development averaged only 7,800 units annually since 1996, with private production accounting for 6,000 of these rental units.

Based on numbers of households, the US is roughly 10 times larger than Canada. Using this crude proportion, the US equivalent total level of rental production for the past decade would be in the order of 18,000 units annually, compared to 15,000 units in Canada. In terms of private unassisted activity, the average total of private completions of 7,900 units in Canada over the past decade would compare with the US equivalent of roughly 9,500 units.

This suggests that, over the past decade, the volume of *truly private rental production* in the US was not dramatically higher on a pro rated basis (20% higher) than that in Canada.

Although there is not a substantially higher level of unassisted rental production in the US over the full decade, the level of production of private rental in the latter half of the decade has been proportionately much higher, averaging roughly 136,000 units since 1996. This compares to only 6,000 units in Canada over the same period. So, on a pro rated basis, US activity (13,600 units at a 10:1 ratio) is more than double the comparable Canadian private rental production.

¹² This estimate of private units is likely overstated as CMHC statistics generally do not correctly identify a project as social housing unless it was assisted under the National Housing Act – provincial unilateral initiatives and, more recently, municipally-funded projects, such as those under ‘Let’s Build’ in Toronto and ‘AccesLogis’ in Quebec are believed to be recorded by CMHC as ‘market housing’.

As discussed below, this higher level of US construction activity may be largely explained by significant regional variations in rental production levels. These regional differences point to the fundamentals of development economics, rather than more generous tax treatment of rental investment as the primary factor influencing relative levels of activity – since the tax effect would apply similarly across all regions.

Clearly, there has been a much larger level of indirect and direct public support for assisted rental production in the US than in Canada – particularly in the latter half of the decade when Canadian social housing production has been curtailed in all but two provinces (BC and Quebec).

Over the last decade almost half (47%) of US rental development is attributable to four key programs – targeted to low/modest income tenants. In addition, the type of support provided in the US has been very different from that traditionally provided in Canada – most of the support in the US has been delivered through the tax system, through programs targeted to modest (rather than very low) income tenants.

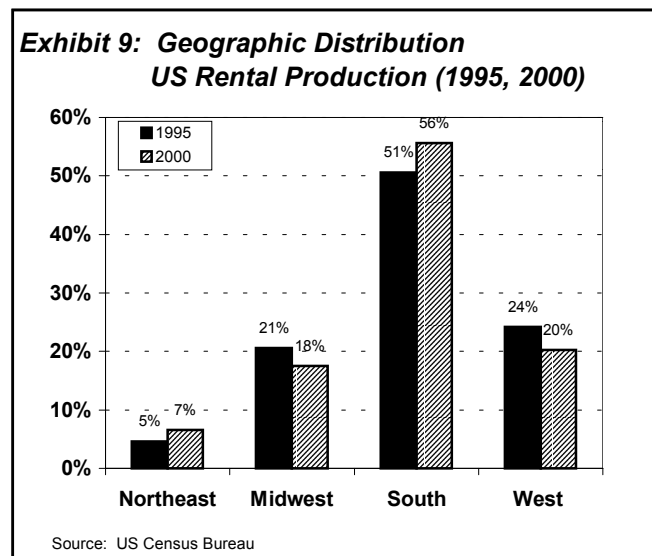
Other Factors Impacting US Rental Production

As discussed, on average, over the past decade US private unsubsidized rental activity has been higher than that in Canada. Over the past five years, the differences have increased: in the US, there has been a marked increase in the volume of private rental production after netting out the effect of subsidized production – this is related to a strong economy and strong rental demand. Although these factors have also been evident in Canada, there has not been a similar upward trend in private rental production levels (although with very low vacancy rates and interest rates, 2000-2001 rental starts have improved slightly and the industry appears poised to build).

Here we investigate some of the other factors that may be influencing US rental development.

Geographic Pattern of Development

An important feature in the pattern of rental production in the US is the geographic focus of activity. Over half of new rental production is concentrated in the South – where input factors – particularly land and labour tend to be substantially lower in cost. Another 20-25% occurs in the West where demand tends to be high. There is quite a low volume of development in the Northeast.



This pattern of development reflects the pattern of population growth in the US, which has been strongly influenced by both immigration and domestic migration patterns to the South and West.

Although 95% of new rental development takes place in metropolitan areas – more than half of this is not in the central city of that metropolitan area. Rental development tends to be located in more peripheral suburban locations – where land is often less expensive. This is especially true in the South, where growth controls tend to be less of a constraint on new development.

A recent research study which focused on projects developed using the LIHTC examined the variation in costs across the country.¹³ This research reported a range in total development costs: from a low of \$36,700/unit in Forth Worth (Texas) to averages of well over \$100,000 in California and the Northeast – costs were especially high in Boston, Philadelphia and New York.

Corresponding to the lower input costs, worker income levels and rent potential also tend to be lower in the South – however, not necessarily on a proportional basis. Overall market median rent levels tend to be higher in the West and Northeast, and lowest in the Midwest and the South.

After peaking in the late 1980s, median market rents trended downward through the 1990s. However, strong demand, especially in the higher rent markets in the West (particularly Seattle, Portland, San Francisco and San Diego) and Northeast, have pulled median rents close to their historic late 1980s highs. Median rents have continued to lag well below historic peaks in the Midwest and South.

Exhibit 10: Distribution of Asking Rent for Private Apartments					
<i>Units Completed in 2000*</i>					
Rent Range	Northeast	Midwest	South	West	US
Total Units	14,900	39,600	125,700	45,800	226,000
Less than \$500	9%	15%	8%	4%	9%
\$550-649	3%	25%	10%	6%	12%
\$650-749	1%	16%	18%	15%	16%
\$750-849	9%	17%	17%	12%	15%
\$850-949	17%	8%	13%	11%	12%
\$950+	60%	19%	34%	52%	37%
Median Rent	\$950	\$712	\$828	\$950	\$839
* Includes units developed with LIHTC					
Source: U.S. Census Bureau, Characteristics of Apartments Completed. Survey of Market Absorption Annual 2000 Absorptions					

The actual rent distribution for recently completed new private rental developments (including LIHTC and other private rental projects) is presented in Exhibit 10. There is a significant variation in the rent distribution – tending toward the higher end in the Northeast and West, and lower in the South and Midwest (again reflecting the broad pattern in development costs).

Nonetheless, even with these (lower) median rents, production of modest rent developments in suburban locations continues to be viable in much of the South. Of course, this overall asking

¹³ Cummings and Pasquale, op. cit. Although only a sample, this LIHTC database does illustrate the dramatic variations in costs across the country.

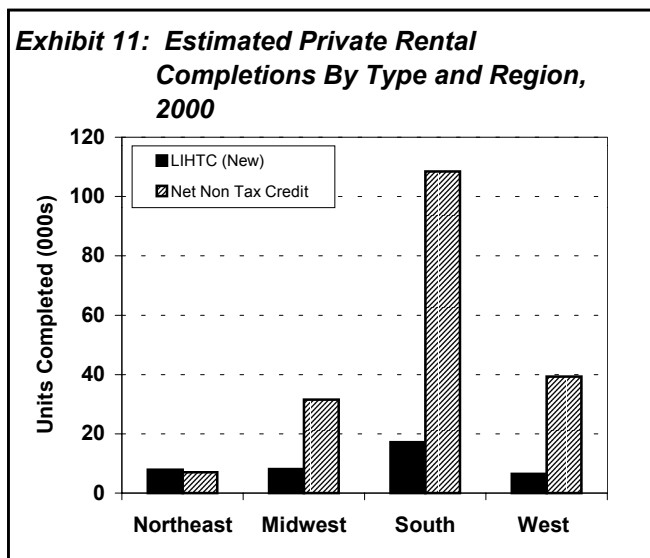
rent distribution is strongly influenced in the lower ranges by the controlled rents required to earn equity investment under the LIHTC program and in tax-exempt bond financed developments. In aggregate, these two tax-based mechanisms would account for practically all units renting under \$750. The important point about the rent distribution figures is that, without the tax credit, there would likely be very little, if any, new rental housing with rents under \$600 or \$700 a unit. Nor would there have been much new rental housing in many northeastern cities, like Boston and New York.

The database used in the analysis by Cummings and Pasquale identifies the distribution of LIHTC units by region. Applying this geographic distribution against the authorized level of LIHTC units in 2000 provides a rough estimate of the comparable distribution of tax credit projects in 2000. Adjusting further for an estimate of new construction (assumed to be 65% of all LIHTC unit allocations, similar to the ratio from 1987-96) provides an estimate of the geographic distribution of the LIHTC units. Actual regional distribution of new tax bond financed units (data from NCSHA by State) are added to the estimate to determine the regional distribution of all units assisted under one of these two tax mechanisms. The net private units are then generated as a residual.

Exhibit 11 clearly shows that the rental production has been heavily skewed to the South. This is true for the LIHTC units but much more so for the unassisted private development, and suggests that local market conditions may be a significant factor – especially the level of total development costs relative to potential rent revenues.

Since the overall rent distribution in Exhibit 10 includes LIHTC/bond financed units, and since these will most likely be in the lower rent ranges, the median rents generated in non-LIHTC private developments are likely well above \$950 in the Northeast and West and probably over \$900 even in the South.

Juxtaposed against lower than average development costs in many southern cities, it is probable that the economic viability for market rent development is stronger in the South.



In the South, it appears that market rents generate property values (based on capitalized income streams) that exceed cost and therefore generate an economically viable opportunity even at relatively modest rents.

In short, the fundamentals for rental investment are far more favourable in this region and underpin the high level of production. To improve the fundamentals in other parts of the country and in Canada requires either lower costs or higher rental property values – options to do this are explored further in a later section.

Limited Influence of Rent Controls

Another factor is the absence of rent controls in much of the US, and particularly across the South. Although rent regulation exists in 200 communities in 6 US states, these are concentrated in the West and Northeast. Not only are controls absent in the South (and most other states), but there is no history of ‘on again off again’ and ongoing revision to controls in place. Unless they are draconian, rental developers can live with rent controls; however, the uncertainty created by endless tinkering with the regulatory system, as has been the case in Ontario, causes investors to be more cautious.

Relative Cost and Value Influenced by Property Taxes

Another major factor behind the lack of new rental production in Ontario (and in parts of the US outside of the South) is the gap between costs and rental property values. Only at the higher rent levels do the potential revenues support property values that begin to exceed costs. In most Ontario markets, land and development costs tend to be high while valuations based on capitalized net operating income (NOI) do not approach these costs – resulting in an uneconomic proposition. A key issue that has raised operating costs and lowered NOI in Ontario is relatively high property taxes on rental properties – both relative to other jurisdictions, and relative to ownership condominium projects.

In the southern US, where land and construction costs tend to be lower, these markets also benefit from relatively low property tax levels. The Phase 1 Ernst and Young report for example identified property taxes for the typical unit examples of \$628 and \$1,225 (Canadian\$) respectively, in Atlanta and Dallas – compared with taxes in Ottawa (Ernst and Young) of over \$2,000 (at the multi-residential rate, which applies to new rentals until the recent legislation creating a new tax class is passed). Clearly, such a large difference has a very significant impact on the viability of new development, especially when combined with market conditions that are characterized by relatively low development costs.

Important Condominium Effect on Land Costs

The brief overview of US multi-unit production trends in the earlier section revealed a very low level of condominium development, compared to rental. This is dramatically different from the situation in Canada where condominium development dominates multi-unit (i.e. apartment and row) construction – although a few large metropolitan centres exert a strong influence on overall national figures.¹⁴

Almost opposite to the situation in the US, in Canada, rental production levels over the past decade have accounted for only 30% of total multiple unit development – and this was a function primarily of social housing programs prior to 1995. Since 1995, rental completions in Canada have accounted for only 20% of all apartment and row completions. In 2000, total completions in centres of 10,000+ population were 124,500. Apartment and row completions totalled 44,000 – of which only 9,000 were rental (and 3,500 of these were in Quebec alone).

¹⁴ In Canada, the 26 Census Metropolitan Areas (CMAs) have a very large influence over total housing production volumes. The US has a much broader range of cities and many more ‘mid sized cities’ where ownership in the form of single-detached dwellings is relatively affordable.

A factor influencing low condominium development in the US is the preference to own a detached home and especially one in the suburbs. This is facilitated by the ability to deduct mortgage interest costs to reduce income tax liability.

The most important consequence of the condominium dominance in major Canadian centres – but also a factor in a few large metropolitan cities in the US – is the effect on land prices. Land values are established as a residual value after accounting for all other development costs and profit margin. Because condominium units command good values and also provide a more immediate return to the developer, they tend to set the land value – and these values are often not supportable with rental development, except for the high-end luxury rental segment.

For example, the Ernst and Young study found land prices (on a buildable square foot basis) to be substantially lower in the southern cities (Atlanta and Dallas), where condominiums are less popular, than those in the North and Northeast (Chicago and Boston).

Income Tax Treatment of Rental Investment

Rental investors in the US enjoy a more favourable tax treatment than their counterparts in Canada. As in Canada the tax environment has fluctuated over time. Various tax measures that existed in the 1970s and temporarily between 1981-1986 have been removed, but two key tax measures remain in place that set the US apart from Canada.

The first is the treatment of capital gains, and more particularly the ability to pool properties. As a result, any sale of a property is treated in terms of the overall pool, not at the level of a single property. In addition, where an investor reinvests in a property of equal or greater value, any tax liability in terms of capital gains or recaptured depreciation is fully deferred. This enhances liquidity and creates a source of funds for reinvestment in new development.

Secondly, rental properties in the US are depreciated based on a straight-line depreciation over 27.5 years (effective rate of 3.64%). Compared with the Canadian approach, based on a declining balance (4% rate, with only half permitted in first year), properties in the US are depreciated at a faster rate and investors are able to shelter more income in the early years when returns are often weakest, improving after tax rates of return (see Section 4.1 of the companion paper, *Options for Changes in Federal Taxes to Encourage New Rental Construction*, for a more complete discussion of the effects of the differences in US and Canadian depreciation systems).

Access to Financing

With the exception of smaller properties/loans (less than \$1 million), access to financing is not a serious issue in the US. Unlike Canada, there is no legislative constraint on loan to value (LTV) ratios – although, in practice, lenders will not underwrite beyond 80% of property value (except FHA which often insures loans up to 90% LTV, with claims subsidized by the federal government). Typically, lenders require a minimum debt coverage ratio (DCR) of 1.25-1.20, which is higher than the CMHC requirement of 1.1, that has been in effect for the past decade,

although CMHC has revised this effective March 2002 to a range of 1.2-1.3, which will be similar to the US level.¹⁵

In addition, over the past two decades, and especially in the last decade, there has been a dramatic evolution in the characteristics of the multi-family financing market in the US. The relative share of deposit-taking savings and loan institutions (once the dominant player) has been reduced as the commercial banks, the government sponsored enterprises (GSEs) and private conduits that have established a large and efficient secondary market.

Government involvement has also shifted from a strong federal role (via FHA insurance) to direct funding through the bond facilities of the state and local level. The mortgage market has transformed from a series of fragmented localized markets to a highly liquid national market (facilitated by securitization) with access to capital from around the world. This has brought greater efficiency to the market and lowered rates – with generally positive outcomes for most rental properties, except small properties which remain relatively poorly served.

Effectively there are five main lending avenues for multi-family rental financing in the US:

1. **FHA insured loans** – generally targeted to low-rent projects and with constrained maximum loan amounts but quite liberal lending guidelines (e.g. LTV up to 90%). Premiums are low, but the FHA is subsidized with a ‘credit subsidy’ by Congress through an annual appropriation for anticipated losses. Last year, this became a constraint when claims exceeded the credit subsidy cap and therefore precluded any additional FHA lending.
2. **GSE loans** – originated by private lenders but within underwriting guidelines established by the government sponsored enterprises (GSEs – Fannie Mae and Freddie Mac are the two largest secondary market agencies that exist to create liquidity in the residential mortgage market). The GSEs dominate the market in multi-family lending (new and refinancing). Underwriting standards typically permit loans up to 80% LTV. The GSEs are active in purchasing both conventional high-ratio loans, as well as loans for affordable housing developments. The GSEs are in fact mandated to meet specific affordable lending goals – a specified percentage of loans purchased must meet affordable lending criteria – a feature of the US multi-family finance system that significantly facilitates financing of affordable developments.
3. **Private Conduits** – investment banking agencies that purchase loans from lenders and assemble pools of mortgage-backed securities (uninsured).
4. **Banks and Thrifts** (deposit institutions) that originate loans for their own portfolio – often stimulated by the requirement to meet minimum community lending ratios under the Community Reinvestment Act.
5. **Life Insurance and Institutional Investors** – typically provide equity financing or debt financing on larger A+ quality developments.

¹⁵ The recent changes to CMHC mortgage insurance underwriting criteria are discussed in the companion paper, *Promoting a Positive Mortgage Insurance Environment for New Rental Construction*.

In the US, the type of financing used for multi-family rental projects varies significantly between the upper and lower parts of the market. At high rents, capitalized values are generally higher than costs, and high-ratio financing is readily accessible. In addition, strong NOI flows through to a healthy return on equity and consequently equity financing is quite feasible.

At moderate and more affordable rent levels, lending values tend to be lower (typically below cost) and this places a constraint on the level of mortgage financing achievable. Even with LIHTC equity in the project, a financing gap often remains. In projects without LIHTC, but seeking to provide affordable rent levels, the financing gap is much more significant. This is why, in the US, a plethora of programs are used to provide gap financing.

The critical issue in securing mortgage financing in the US has related more to the functioning of the broader market and availability of capital to supply financing, than it has to specific underwriting criteria constraints at the project level.

Beyond mortgage debt financing, another element of the financing system which is more developed in the US than in Canada, is access to equity financing via specialized Real Estate Investment Trusts (REITs) – publicly traded real estate equity trusts. These tend to focus on higher quality properties and most of the investment is in existing properties – including various types of commercial property, not just residential. However, REITs also undertake new development and provide sufficient levels of equity that mortgage financing is not an issue.

So, overall, for private unassisted rental development, access to financing is not a serious issue; however, financing terms appear to be no better, and perhaps may be inferior (e.g. lower LTVs) to those in Canada. The situation for affordable housing loans is however significantly more favourable in the US than in Canada.

Conclusions – Relative Levels of Private Rental Investment

This analysis has confirmed that the level of private rental development in the US is higher on a proportional basis than that in Canada. However, the relatively higher level of investment and construction does not appear attributable solely to differing tax treatment of rental investment income. A number of other significant factors appear to be at least as important.

First, there is a significant level of public support for rental development and, more particularly, affordable rental production, and this plays a very important role in the overall US housing system. The two tax-based mechanisms, LIHTC and tax-exempt bonds, together with complementary direct subsidy programs (mainly HOME) have a significant influence on total rental development in the US – accounting for almost one-third of total rental units produced in the past five years.

Once these tax-based and other direct subsidy programs are taken into account, true privately-initiated and unassisted (i.e. excluding tax-based) rental production accounts for roughly 60% of total rental production in the US over the past decade.

On a proportional basis, truly unsubsidized rental production is marginally greater, on a proportionate basis, in the US than in Canada over the full decade. However, in recent years

(since the mid 1990s), the relative levels of production have diverged significantly. US unassisted rental construction since 1995 has been more than double that on a proportional basis than in Canada.

This recent pattern can, however, be explained in large part by significant regional variations in US production levels. The higher levels of unassisted development are recorded mainly in the South – but unassisted new rental development in other parts of the US, and especially in the Northeastern cities comparable to major Ontario centres, is not proportionately higher.

Local housing markets and the fundamentals of development feasibility (various input costs, property taxes and potential net rental revenue) are very significant factors influencing the overall unassisted rental production levels – likely much more important than differences in the US/Canada tax treatment of rental investment (which would result in higher volumes in all regions of the US).

Although the Phase 1 report by Ernst and Young concluded that tax treatment is a significant factor, clearly it is not the only factor (or even the most important factor) explaining variations in the levels of private unsubsidized rental production in the two countries.

In markets with comparable development costs and potential rental income, it is however likely that different tax treatment will impact the attractiveness of investment in rental housing – with the US system providing a comparatively more favourable treatment – especially in terms of increased market liquidity and potential sources of reinvestment.

Financing for private rental development in the US appears to benefit from a significant restructuring in the housing finance market with a consolidation of mortgage funding sources, increased securitization and access to the capital markets. Overall, however, the terms of financing do not appear superior to those under CMHC insured loans in Canada.

However, financing for affordable housing is relatively more favourable than in Canada. In the US, the federal housing agency, the FHA, has an explicit mandate to facilitate financing specifically for affordable housing and provides mortgage insurance on a subsidized basis. By regulation, private corporations (GSEs) initially chartered by Congress to establish a secondary mortgage market, are required to meet specific affordable housing goals in the purchase of loans – thereby encouraging loan originators to initiate loans on affordable housing projects. A dedicated source of financing through the state HFAs also supports affordable rental development with below-market rate financing facilitated by the capacity to raise capital in the bond markets.

It is notable that the US has two separate financing sub-systems – one for the private unassisted sector and another for the affordable sector. This is very different from Canada, where both market and affordable development are treated more or less equally in terms of mortgage financing.¹⁶

¹⁶ CMHC does permit some greater flexibility in insuring loans for projects for affordable housing developed with the involvement of the Centre for Public Private Partnerships in Housing, but does not have a distinctly separate set of underwriting criteria for affordable housing.

This is not to say that US rental production levels, and production of affordable rental housing, are sufficient to meet need. For example, in a number of major cities, especially in the Northeast and the West, there remain serious concerns about the lack of rental production – echoing many of the concerns often raised in Canada. Perhaps the difference in the US is that there is a much larger and more organized institutional structure to lobby for change. For example, in March 2001, a broad-based coalition of lenders and builders forged the ‘Coalition for Affordable Rental Housing’ at a national housing summit hosted by the Mortgage Bankers of America (see Appendix A; ‘Wanted: Affordable Apartments’, an article extracted from *Mortgage Banking*, Nov. 2001).

Potential Impact of US Tax-based Mechanisms on Rental Development Economics

In Canada, tax expenditure measures are not used to attract and compensate equity investment in rental housing. In the US, two tax expenditure mechanisms dominate the new affordable rental supply environment – tax-exempt mortgage bonds and the LIHTC. This section illustrates how these two mechanisms work and their impact in facilitating rental development, especially at affordable rent levels.

Low Income Housing Tax Credit

LIHTC credits are available only for rental units whose tenants have incomes at or below 60% of local area median, with rents adjusted for unit size. The credits that can be earned in a project are calculated on a prorated basis, depending on the proportion of units targeted to affordable rents – in practice, most projects tend to be 100% targeted. The tax credits are distributed to investors over a 10-year period following rent-up. They are earned each year and applied against an investor’s annual tax liability for 10 years. Investors earn dollar-for-dollar credit against their federal income tax liability (i.e. each \$1 of credit reduces tax payable by \$1). The units must remain at defined affordable rent levels for a minimum of 30 years although allocation preference rules effectively result in a longer compliance periods in order to win credits in a competitive allocation process. Failure to maintain the units at defined rent levels could result in retroactive recapture of the tax credit.

Although initially marketed to individual investors, changes in passive loss rules in 1992 lessened the attraction of tax credits to individuals and, since 1993, corporate investors have dominated the market. In addition, LIHTCs are a qualifying investment under the Community Reinvestment Act (CRA), so these credits are attractive to financial service corporations that need to generate CRA investment credits. While it is possible to invest in a specific project (private placement), most investors purchase shares in equity pools that support a diverse set of projects.

Each state must produce a qualifying allocation plan (QAP) reflecting housing need and establish criteria for awarding LIHTC credits to projects. Federal legislation provides some guidance and emphasizes priority to developments serving lowest income residents, projects committed to the longest term of compliance, and those maximizing the amount of each credit dollar that flows directly to bricks and mortar.

The LIHTC equity investor generates a return in the form of credit-reduced tax payments – so rates of return will be impacted by corporate or personal tax rates. In addition, although modest affordable rent levels are established, the combination of tax credit equity and other sources of ‘concessionary financing’ result in a relatively low loan to cost ratio (typically the first mortgage covers less than 40% of the cost), so debt servicing costs are low. The resulting cash flows are distributed to the limited partners – after funding certain required reserves (e.g. a mortgage reserve to cover 2 months payments and roof replacement reserve) and, in many cases, paying deferred fees to the developer.

Projects are structured with a general partner and limited partners:

- The general partner, which may be a non-profit or for profit corporation, typically holds only a nominal share of ownership (i.e. .01%);
- The limited partner (LP) investors hold 99.99% ownership. The LPs are free to sell their ownership interest in the property. While state qualifying rules may require first right of refusal to non-profit buyers, there is no absolute guarantee that the units will remain in the affordable sector beyond the minimum compliance period. However, the LPs may continue to own and operate the building and receive the ongoing cash flow distribution – enhanced by retirement of the mortgage.

Following the contracted compliance period, the rents can move to market rate – although 30 year old, mainly wood frame, buildings built to modest design would likely still remain at relatively low market rent levels.

It is expected that the LP investors will seek to sell their investments after the tax credits have been utilized (i.e. 10 years) without having to pay an exit tax, which would consist primarily of capital gains taxes. Due to the credit recapture requirements in the event units do not continue at affordable rents, the limited partners will be concerned that a new owner may fail to adhere to the targeting restrictions and could trigger a recapture. As a result, vendors will be cautious and selective in whom they accept as a buyer. Because of this recapture risk, there would be a strong motivation to sell to a non-profit entity with a mandate to continue providing affordable housing. In practical terms, this means that the sales price to the non-profit general partner or other buyer would be based upon the unpaid mortgage balances and any capital gains taxes due to the partnership's having taken annual depreciation allowances.

Depending on how the LIHTC is stacked, and whether it is for new construction or rehabilitation, investors earn credits based on either 4% or 9% of the eligible cost basis. The eligible cost consists of the total costs, less non-depreciable costs (such as land) and costs covered by other specific federal grant funds.

Although the credits are earned on a dollar-dollar basis, the full face value of tax credit equity is not invested in the project – there are various transaction costs, including application and prepaid monitoring fees to the state HFA, and fees charged by the syndicator (a specialist intermediary that puts these deals together). More significantly, because the credits are earned gradually over a 10-year period, investors would purchase this stream of tax credits on a discounted present value basis. Recently, the net LIHTC investment in the project has been in the region of 70-78 cents on the dollar – the net yield is driven by a highly competitive process in which proponents

prepared to commit to longer terms at affordable rent levels, and minimal transaction expenses earn the allocation.

Illustrative Example

To illustrate how a tax credit mechanism might affect a typical rental project, the current parameters of the US LIHTC are applied to the base case pro forma presented in the companion report *Options for Changes to Federal Taxes to Encourage New Rental Construction*. Of key importance is that the rent revenue assumptions (in the base case pro forma) have been revised to reflect affordable rent development (a feature of the LIHTC). The main intent here is to illustrate the impact of inducing equity investment – the actual design of a mechanism could be adapted as appropriate and would not necessarily replicate the parameters of the US credits.

Exhibit 12 presents the base case project pro forma and the same pro forma adjusted to reflect the parameters of the US LIHTC.

This is an admittedly simplistic representation – for example, the base case assumes mid-range unit quality reflective of rents of \$1,200-1,450. If built for a more modest affordable rent range, it is likely that the development costs would be somewhat lower. On the other hand, syndication fees, etc. would likely add to the cost. For simplicity (and consistency with exhibits in the companion report), it is assumed the costs are the same.

For the purpose of this illustrative analysis, it is assumed that the existing LIHTC parameters are applied: target rents are based on 60% of Toronto median income of roughly \$50,000, the credit is based on 100% of units and qualifies for a 9% credit. Based on these parameters, and retaining all other assumptions in the base case pro forma, except the rent level and mortgage amount, the pro forma project would have an eligible cost basis of roughly \$123,000 (total costs net of land) and would qualify for annual credits totalling \$11,070/unit.

Since these credits are applied against tax liabilities annually over 10 years (\$11,070 per year, totalling \$110,700), the investor will discount the value to present value. Combined with transaction costs and fees, the net yield to the project (based on an assumption of a competitively bid \$0.70 net of the total tax credits) is \$77,490/unit.¹⁷ This represents a significant equity infusion into the project – reducing the required mortgage financing but with no associated debt servicing.

The equity investor in the tax credit pool generates a return based on tax savings, plus a small return on equity – initially 0.9% (in this example), which will increase over time as rents rise.¹⁸

¹⁷ The vast majority of the difference in credit value (\$110,700) versus investor cost (\$77,490) is due to the discounted present value. At a 6% discount rate, an annual credit of \$11,070 over 10 years has a net present value of just under \$81,500.

¹⁸ In fact, it is typical for developers to obtain their development fee in the form of a credit note against the project cash flow, so most of the cash flow for the initial 10 years, after funding various operating and replacement reserves, actually flows to retire this note – little if any income from the project typically flows to the equity partners.

Exhibit 12:
Effect of a US Style Housing Tax Credit
(\$ per unit)

	Base Case	LIHTC 9% Credit
Development Costs and Financing		
Land	24,400	24,400
Construction	117,000	117,000
GST	6,363	6,363
Project Costs	<u>147,763</u>	<u>147,763</u>
Developer Equity	23,763	0
Tax Credit Investor Equity (1)	0	77,490
Other "Gap Funding" (2)		13,733
Mortgage Financing (3)	124,000	56,540
Mortgage Insurance Fee	5,580	0
Total Mortgage	<u>129,580</u>	<u>56,540</u>
First Year Revenues, Costs and Cash Flow		
Revenues	16,300	9,000
Maintenance & Operations	2,000	2,000
Property Taxes	1,900	1,900
Total Operating Costs	<u>3,900</u>	<u>3,900</u>
NOI	12,400	5,100
Mortgage Payments	10,415	4,250
Cash Flow	1,985	850
Cash-on-Cash Return (4)	8.4%	1.1%
Loan to Cost Ratio	83.9%	38.3%
Notes:		
1 Calculated on eligible basis is cost net of land = \$123,000 x 9% credit x 10 years x net proceeds of .70 per \$		
2 Funding necessary after LIHTC equity and max financing		
3 Max Financing supportable by NOI at a 1.2 DCR (6.5% 30 yr amort)		
4 Return on developers equity in base case; equity investment in LIHTC		

Another key difference from the base case is that the developer's equity has been reduced to zero – this investment is replaced (and increased) by the LP investors. Effectively, the general partner is simply the developer and will generate a builder's fee as part of the cost and ongoing management fees from operations – this could be either a for-profit or not-for-profit developer.¹⁹

Since the tax credit is associated with the provision of affordable units defined by 60% of area median income (here based on the Toronto median from 1996 Census), the rent levels in this

¹⁹ Although there is no developer equity in the project, a considerable level of developer equity is typically required, and at risk, during the development phase – until all LIHTC equity and mortgage funds are accessed.

example fall from an average of \$1,325/month in the base case to an average of \$750/month (\$50,000 median/12 months x 60% x 30%) – or \$9,000 annually.

As shown in Exhibit 12, the lower rents (\$750 versus \$1,325) significantly impacts NOI – and the size of the mortgage which the project could carry. At rents of only \$750, the income stream cannot support a mortgage for the remainder of the cost (\$147,763-\$77,490 = \$70,273). So, in addition to the LIHTC equity, it is also necessary (and typical in US LIHTC projects) to secure additional ‘gap funding’ since, at the lower ‘affordable’ rents, the project cannot support sufficient financing to bridge the gap between the LP investor equity and project costs. With the maximum supportable mortgage, based on the NOI, a required debt coverage ratio of 1.2 and a mortgage at 6.5% over 30 years, gap funding of about \$13,700 is required.²⁰

Since the potential market rent would likely be significantly higher than the \$750 assumed here, the lending value would be higher than the actual NOI might dictate. Based on this assumption, the loan to value ratio would be sufficiently low to eliminate the need for mortgage insurance, saving \$5,580. For simplicity, it is assumed the project qualifies for the same mortgage interest rate as in the base case.

The bottom line is that, with the \$77,490 in tax credit equity and additional grant funding from some other source of roughly \$13,700, it is possible to break even with a modest surplus of \$850 in the first year.

With developer equity displaced by tax credit equity, return on developer equity is not a useful measure of viability – the key is whether the project has a positive cash flow after servicing the mortgage (in this case, as discussed, with low rents of \$750, it would require additional ‘gap funding’ to break even). The project generates a small return on equity which supplements the yield generated from the tax savings – though, typically this surplus is used to pay the developer’s fee, taken initially as a note against the project.

This brief and extremely simplified review illustrates how the tax system (through an LIHTC vehicle) can be used to create a new source of equity investment – with investors entirely compensated through tax benefits, leaving the project to operate with no need to generate any additional return on equity. However, it is clear that this represents a very significant level of subsidy. Typically, in the US as a whole, the per unit tax credit equity level is not as high as illustrated in Exhibit 12, since average development costs are lower; however, per unit tax credit equity levels in this order of magnitude would be generated in some of the higher cost centres, such as New York and Boston.

²⁰ In the US, in order for the project to be viable, the LIHTC is usually supplemented by other sources of equity or low cost financing provided by other public and sometimes philanthropic sources, which effectively lowers the mortgage to a viable level and compensates for no developer equity. Often, these are provided as low interest loans, using federal block transfer subsidies, rather than as grants because grants from other federal subsidy programs reduce the eligible cost basis for calculation of the tax credit. In a ‘made in Canada’ approach, one option would be to encourage some level of developer investment with a minority share and participation in the cash flow – provided that cash flows support this distribution.

Tax-Exempt Bond Financing

Tax-exempt bonds provide an alternative tax-based approach to assist in the development of affordable rental housing in the US. As described earlier, the capacity to issue bonds with an exemption from federal (and usually also state) income tax provides the state HFAs (and some larger cities that have sufficient size and expertise) with a low cost source of financing that can be used to fund loans to developers of affordable rental housing.

Bond purchasers are effectively lending money to the state and local government for an extended period (usually 10-30 years) on the understanding that the loan will be repaid with tax-free interest earnings over the period of the loan. Pricing of these bonds depends on the issuing agency as well as the characteristics of the loans for which the proceeds will be used. The rating agencies grade the bonds against fairly strict underwriting standards. Depending on how the bonds are rated, it is generally possible to secure financing at 150-200 basis points below conventional mortgage rates, although there are no direct comparables, as conventional mortgages would not generally have terms as long as the bond financed loans.

An important feature of the structure of this financing source in the US is that developers qualifying for bond financing have an ‘as of right’ access to a form of low income housing tax credit. The linked tax credit, also allocated by the state, provides a lower credit of 4% (versus 9% for the LIHTC above) but is not included in the legislated cap on the volume of the LIHTC.

Both for-profit and not-for-profit developers can qualify for this source of financing, but the project must meet eligibility criteria and house tenants below specified income thresholds. Typically, bond financing is combined with a layer of the 4% tax credit equity and additional layers of subordinate below-market loans or grants from sources such as the HOME Investment Partnership – a federal block grant to cities.

The process is illustrated in Exhibit 13, using an adjustment to the same base case pro forma as was used in Exhibit 12. All cost and rent parameters remain as in Exhibit 12, except that the tax credit equity is reduced since it is calculated at a 4% rate, instead of 9%; and the private mortgage financing is replaced with below-market interest (here we have assumed a rate of 5% and the same 30-year term as with the LIHTC project in Exhibit 12). As before, an additional layer of financing of ‘gap funding’ is still required.

As illustrated in Exhibit 13

- The level of tax credit equity is much less, \$34,440 per unit
- The required gap financing increases. At the lower 5% rate (30-year amortization) and a 1.2 DCR, NOI from the project can support a maximum mortgage of only \$66,360. This leaves a capital funding gap of almost \$47,000 which must be filled from other sources.
- Assuming the other funding gap sources are available, the project is able to break even with a surplus of \$850.
- As in the LIHTC example (Exhibit 12), the return on equity is marginal and may be used to pay the developer’s fee, taken initially as a note against the project.

Exhibit 13:
Effect of US Style Tax Bond Financing & 4% Tax Credit

(\$ per unit)

	Base Case	LIHTC 4% Credit
Development Costs and Financing		
Land	24,400	24,400
Construction	117,000	117,000
GST	6,363	6,363
Project Costs	<u>147,763</u>	<u>147,763</u>
Developer Equity	23,763	0
4% Tax Credit Investor Equity (1)	0	34,440
Other "Gap Funding" (2)		46,963
Mortgage/Bond Financing (3)	124,000	66,360
Mortgage Insurance Fee	5,580	0
Total Mortgage	<u>129,580</u>	<u>66,360</u>
First Year Revenues, Costs and Cash Flow		
Revenues	16,300	9,000
Maintenance & Operations	2,000	2,000
Property Taxes	1,900	1,900
Total Operating Costs	<u>3,900</u>	<u>3,900</u>
NOI	12,400	5,100
Mortgage Payments	10,415	4,250
Cash Flow	1,985	850
Cash-on-Cash Return (4)	8.4%	2.5%
Loan to Cost Ratio	83.9%	44.9%

Notes:

- 1 Calculated on eligible basis is cost net of land
 = \$123,000 x 4% credit x 10 years x net proceeds of .70 per \$
- 2 Funding necessary after LIHTC 4% credit equity and max financing
- 3 Max Financing supportable by NOI at a 1.2 DCR (5% 30 yr amort)
- 4 Return on developers equity in base case; equity investment in LIHTC

**Conclusions on Potential Transferability
of US Tax Credit Approach to Canada**

The pro forma analyses in Exhibits 12 and 13 clearly illustrate that US styled tax expenditure measures could provide significant sources of funding support to stimulate new rental development at relatively affordable rent level and with relatively long (30-year plus) compliance periods. The associated tax expenditures are very significant – in these cases, roughly \$34,000 and \$67,000 per unit in tax credits alone – not counting the additional funding required for the tax-exempt bonds, and the other ‘gap funding’. However, these amounts are not

inconsistent with the level of funding that would be required under a direct grant approach in a program similarly seeking to achieve affordable rents.

Both the LIHTC and tax-exempt bond financing involve very sophisticated and somewhat cumbersome legal and accounting arrangements, substantial transaction costs, and the creation of an institutional infrastructure capable of implementing the measures – the US already had state HFAs in place when the LIHTC program was introduced in 1986.

In addition, the US has a long history of utilizing private developers as the delivery vehicle for subsidized affordable housing – typically with quite extensive monitoring and compliance rules to ensure long-term affordability. As a result there is a significant cadre of private developers that specialize in building and operating affordable housing and have come to accept a fairly heavily regulated regime.

Canada does not have this history – the compliance and enforcement requirements for Limited Dividend, ARP, CRSP and MURB programs were far less intrusive. Accordingly, it is unclear whether the Canadian private market development community would accept (and thus participate in) a program with similar levels of regulation as those developed in the US – although the relatively large levels of tax benefit would clearly provide an inducement.

That said, the tax-based approach does provide a fundamentally different and interesting model for subsidy delivery. It was conceived on the basis of applying the rigours of the private market with the objective of generating an efficient subsidy delivery system. Most analysts, while initially quite skeptical have now come to accept that this approach has been very effective in a number of ways:

- It is designed to attract significant levels of private sector equity investment in a socially beneficial objective – affordable housing.²¹
- In generating fairly significant tax benefits for investors, the programs are an attractive investment. By allocating the credits on a competitive basis, the market has, over time, erased the initial inefficiencies in this approach. In the early years, investors paid less than 50 cents for each dollar of credit – the market has bid this up to almost 80 cents, almost on par with the discounted future value of the credits.
- A competitive bidding process combined with a point system that rewards extended compliance periods ensures long-term affordability.
- The recapture of tax benefits in the event of non-compliance puts the onus on the investors to monitor and ensure compliance – rather than reliance on a publicly-managed and bureaucratic monitoring process (although this also exists in the form of the IRS and monitoring functions of the equity fund syndicators).

²¹ To the extent that the LIHTC invokes a very substantial level of private equity investment and places this capital at risk, this represents a much more true and meaningful public-private partnership than most that have been pursued in Canada.

- With the compliance period far exceeding (at least 30 years) the period in which credits are earned (10 years), investors that wish to exit the partnership are cautious about selling to investors that might fail to comply and thereby trigger recapture. This fear, together with a provision to offer the property first to a non-profit entity creates an effective way to stimulate transfer of these assets to the non-profit sector and thereby ensure the long-term preservation of affordable housing.

The latter observation is both important and timely. In both the US and Canada, there has been a history of incentive programs that stimulated private investors to build and operate low-rent housing. In these cases, expiry of the operating agreements and release of the owners from restrictions on rent, has meant that units built with public investment no longer serve a targeted need and, in many cases, the investor owners have ultimately been the beneficiaries of either unrestricted increases in cash flow or windfall gains on sale of the properties. The design of the compliance and exiting arrangements in the LIHTC (encouraging sale to a non-profit) appear to be an effective way to reverse this outcome – and explicitly ensure long-term preservation of the affordable stock and maintenance of the original intent of the public investment.

Currently, in Canada, research is being undertaken by a partnership between the Canadian Housing and Renewal Association (CHRA), the Ontario Non-Profit Housing Association (ONPHA), and the community development subsidiary of a private lender (VanCity Enterprises) to investigate the potential to utilize the existing mechanism of tax credits from the labour sponsored venture capital funds to create an investment pool of below-market mortgage funds. This is a less generous version of tax credit that could help to create a pool of lower cost financing, but would not generate the very substantial levels of equity investment that arise under a LIHTC type model (due to the 10 year flow of tax benefits).

To the extent that it might lead to significant leverage of private equity investment, and if it can be designed to emulate the relative efficiency and ability to ensure long-term preservation of affordable units, then further explorations and discussion with the federal Department of Finance may be warranted. It would also be possible to design a tax credit that includes provincial credits – like labour sponsored venture capital funds, which would share the tax cost between the federal and provincial government.

In addition, the institutional infrastructure already exists in Canada for provinces and municipalities to issue bonds for a variety of capital projects – although not with the tax-exempt benefit available in the US. The use of bond financing and access to capital markets rather than reliance on the narrower mortgage market and dependence on CMHC mortgage insurance policies may also be an area worthy of further investigation. This could also have much broader benefits outside of affordable housing – providing a mechanism to enable municipalities to raise low cost capital for a range of infrastructure renewal and growth related requirements.

Overall Conclusions

This analysis has identified two inter-related and complementary rental production systems in the US: one developing market private rental units and the other an affordable housing production

system. Both rely heavily on private sector developers and investors. Over the past decade, each has accounted for approximately half of the total production.

For the assisted housing system, research has clearly demonstrated that substantial levels of subsidy are required to support affordable housing production. Clearly, if the goal is the production of below-market rental housing, there is an important public policy (and subsidy) role for government in this area.

Complementing traditional direct subsidy programs, the US has developed and refined a fairly effective subsidy approach drawing on tax incentives to leverage large-scale private equity investment for affordable housing development, while also designing a way to overcome previous concerns with respect to the loss of affordable stock upon termination of program compliance periods.

While access to financing is not generally an issue with respect to unassisted rental development, it has been a concern in the affordable housing sector. In the US, the federal government has implemented public mortgage insurance with an explicit, and almost exclusive, focus on facilitating financing for affordable housing. This includes both direct subsidy of premiums in a publicly-operated mortgage insurance program (FHA multi-family insurance) and a regulatory framework that has imposed affordable housing goals on private corporations (GSEs) requiring them to ensure that mortgage financing is made available for proponents of affordable multi-unit rental development by creating a secondary market for such loans.

In the case of the unassisted component of the system, the cost-value equation is fundamental to a viable and healthy rental production system. There are very significant volumes of unassisted production in the southern region of the US, where the market fundamentals work – values exceed costs. In much of the rest of the US, there are more limited levels of unassisted development (and on a proportionate basis, no higher than that in Canada) mainly because the market fundamentals are not present – except at the high end of the market.

Again, the public policy framework can play an important role in influencing the outcome of the cost-value equation. Property values are impacted by public matters such as levels of property taxes and rent regulation – both impact the potential returns and thus the capitalized value of a property. To the extent that the Province of Ontario has enacted the *Tenant Protection Act* and enabled rents to move to market levels, and created the option for municipalities to lower property taxes, there may be limited possibilities for further actions to enhance the valuation of new rental development.

On the cost side, development costs are directly impacted by an array of public levies, fees charges and taxes – including the PST, GST and local development charges. Much attention has been directed at this issue, and especially to the matter of local charges pushing up costs. However, consideration of local charges must be viewed within the broader context of relative levels of government taxing capacity, fiscal transfers and service burdens.

The analysis found substantially lower levels of development charges and local property taxes in the US, and especially in the South. Although not extensively investigated in this study, it appears that many US municipalities are able to operate with lower revenues from these two

sources because the state and federal government are relatively more generous in providing block grants and fiscal transfers to help pay for the costs of growth. More research is required to fully understand how intergovernmental fiscal arrangements in the US influence the cost issue impacting rental development.

In the Canadian and Ontario context, it is questionable whether municipalities should or can reduce their revenues to improve the fundamentals of new development, when they are obliged to manage the costs of growth mostly from their local revenues. Capacity to lower this cost element may also be influenced by the trend to ask municipalities to take on increasing responsibility for functions previously funded by the Province.

It may be worth exploring the option of federal funding to help pay the costs of growth in the economic engines of the country – local communities. The US model of enabling municipalities to raise capital for growth, housing and infrastructure investment on a tax-exempt basis is an area that could be explored in more detail.

Finally, the tax treatment of rental investment is more favourable in the US, particularly with respect to pooling, rollover provisions and depreciation rates. Alone, changes to tax treatment will not make the difference between a viable and unviable new rental project; however, in combination with other measures, such changes could have a beneficial compounding effect.

Appendix

Wanted: Affordable Apartments

Extracted article from Mortgage Banking November 2001 illustrating that despite significant levels of subsidy support and tax credits, issues of rental affordability continue to persist in much of the US.

Wanted: Affordable Apartments

(reprinted from *Mortgage Banking*, Nov. 2001)

A desperately short supply of affordable apartments in major U.S. cities has been overshadowed by coverage of the lack of affordable homes on the market. No longer. Efforts to draw attention to the apartment shortfall are starting to make headway.

The New American City is an urban template awash with redevelopment dollars--and it shows. Violent crime and urban poverty are at 20-year lows. Welfare rolls have been drastically trimmed. The one blot on the urban psyche in America is, unfortunately, the suddenly real specter of terrorism--and with it, possibly some second thoughts about living and working in densely populated, high-rise neighborhoods.

Whether the love affair with America's big cities will continue as it has, we don't know. But for the last few years the allure definitely has been there.

Consumers have been spending freely for the past few years, although that is tapering off with the United States on the cusp of a recession. Many believe the economy will right itself sometime next year, especially with the federal government preparing to spend billions to pull it back from the brink and the Federal Reserve cutting interest rates to levels not seen in decades. There is one constant in good times and bad, however: A surprisingly high number of America's working families can't find decent, safe housing they can afford to buy and, especially, rent.

And when they do find such housing, as much as half of a family's household income can disappear into mortgage payments or rent. Families also live in millions of housing units described by housing authorities as severely inadequate, whether they're owners or tenants, trapped in place by a spectacularly skewed imbalance in supply and demand.

Governments are not indifferent. A stream of government funding has been poured into housing. Thousands of imaginative minds have devised ingenious, practical measures, yet the lack of affordable housing is chronic and daunting.

Low- and very-low-income earners are obviously afflicted, but moderate- and middle-income earners, increasingly, find themselves in the same boat. U.S. Census Bureau figures released in February 2001 show the number of moderate-income families who needed affordable rental housing soared by 64 percent, from 433,000 to 711,000 families between 1997 and 1999. The issue is no longer just about the poor.

But that Census data was released nearly two years ago, and the situation has since worsened, given a dramatic drop in the production of affordable housing, natural population growth, immigration and the ingrained urge to live in a better place. The National Housing Conference, Washington, D.C., released a June 2000 study, *Housing America's Working Families*, which noted that four years ago some 13.7 million households with varying incomes--including 7.5 million renters--faced critical housing needs.

No Oscars for affordable housing

If there is a worst-case affordable rental housing scenario in America, it is likely the city of Los Angeles in particular and Southern California in general.

In its July 2000 report, *In Short Supply*, the Los Angeles Housing Crisis Task Force, Los Angeles, convened by the city council, noted the following statistics in the city:

- * There are nearly 150,000 substandard apartments, and the city has a 39 percent homeownership rate--well below the national average of 67 percent.
- * Fewer than one in five low-income families benefits from a housing subsidy--the second-lowest rate among metropolitan areas in the country.
- * There are 153,000 families on a 10-year-long waiting list for federal Department of Housing and Urban Development (HUD) Section 8 rental assistance.
- * The population grew by 65,000 people, or 22,500 households, in 2000--yet fewer than 2,000 new apartments and houses, or one for every 11 families, were built. At least 8,000 new or single-family homes and apartment units need to be built in Los Angeles each year to keep up with population growth, and nearly half of them should be affordable to families earning less than \$26,000 per year for a family of four.

Something had to happen on a national scale, and in March it did. In Washington, D.C., some of the most powerful players in the housing industry--the Mortgage Bankers Association of America (MBA), the AFL-CIO Housing Investment Trust, America's Community Bankers, the National Apartment Association, the National Association of Home Builders (NAHB), the National Leased Housing Association and the National Multi Housing Council, all based in Washington, D.C., and the National Association of Realtors (NAR), Chicago--forged the Coalition for Affordable Rental Housing at a national housing summit hosted by the MBA.

The American dream--or nightmare?

Although homeownership may be the American dream, finding affordable rental housing is often a nightmare for many working families, said former MBA President Andrew D. Woodward at the Coalition for Affordable Rental Housing's founding meeting in the nation's capital in March.

One of the coalition's first--and main--priorities is to persuade Congress to increase, for the first time since 1992, the limits of multifamily mortgage loans insured by the Federal Housing Administration (FHA) by 25 percent.

It was off to a brisk start.

A few weeks after the coalition was formed, HUD Secretary Mel Martinez agreed to include a 25 percent increase in the FHA's multifamily loan limits in his department's fiscal 2002 budget request. (Under those terms, the FHA would be able to raise its insurance ceiling on a mortgage loan on a two-bedroom unit in a building without an elevator in high-cost Washington, D.C., for example, from \$67,000 to \$83,650. The increase would also enable the FHA's housing partners to develop new affordable housing in neighborhoods previously considered too costly for FHA programs.)

Then in June, Senator Jon Corzine (D-New Jersey) introduced a bill in the Senate sponsoring the 25 percent increase, matching H.R. 1629, a bill introduced in the U.S. House by Representatives Marge Roukema (R-New Jersey) and Barney Frank (D-Massachusetts).

The MBA's Woodward urged both the Senate and the House to move swiftly to pass the legislation. Stephen A. O'Connor, the MBA's senior director, government affairs, said in an

interview with Mortgage Banking in early October that the bill was incorporated in a larger Department of Veteran's Affairs (VA), HUD and other departments' appropriations bill already in the congressional approvals pipeline when it was overtaken by the cataclysmic events of Sept. 11.

All the appropriations bills are being delayed in Congress, says O'Connor, but it will probably pass a continuing resolution which will provide an extension of short-term funding until the appropriations bill [including the Corzine and Roukema-Frank bills] is approved-probably before the end of October.

Passage couldn't come too soon.

In the past four years, in my own city, there have been no rental housing units produced by FHA-insured loans, said Akron, Ohio, Mayor Donald Plusquellic, representing the U.S. Conference of Mayors at the birth of the coalition in March.

Dozens of cities across the nation face similar crises. Clearly, there must be an immediate, reasonable, nationwide response, Plusquellic said. The Washington, D.C.-based mayors' conference is a nonpartisan organization representing about 1,100 cities with populations of 30,000 or more.

Not a single new unit of FHA-insured multifamily housing was produced last year in New York City; Boston; San Francisco; Baltimore; Birmingham, Alabama; Cincinnati; Norfolk, Virginia; Oakland, California; Providence, Rhode Island; Rochester, New York; Salt Lake City; San Jose, California; Syracuse, New York; and Tampa, Florida, according to Plusquellic. These are cities in which tens of thousands of working families face a critical housing need (defined as those paying more than half a family's income for housing or living in severely inadequate housing).

And only one such development managed to get built in Dallas, Los Angeles and Washington, D.C., Plusquellic said.

Developers head for greener pastures

In the meantime, land, construction and other costs associated with building new affordable rental housing have risen substantially (construction costs alone by 25 percent). That, together with static loan limits for FHA multifamily projects, has driven developers toward more lucrative projects.

Bruce Smith, president of the National Association of Home Builders and a Walnut Creek, California, home builder, said at the coalition launch, Our builders want nothing more than to be able to meet this great demand--but they are hindered by the FHA loan limits.

Raising the FHA multifamily loan limits will help to jump-start housing production in communities of greatest need, said Steve Coyle, chief executive officer of the AFLCIO Housing Investment Trust, at the March launch of the coalition. The decline in affordable housing production will take time to turn around, but this would be an important start.

A better affordable mouse trap

The Coalition for Affordable Rental Housing stated at the time of its launch that it will also work on other solutions to the affordable housing crisis, including developing a well-capitalized,

market-based new production tool for an affordable rental housing program, designed to do the following:

- * Benefit working families with a range of incomes, in all areas of the country, that are overlooked by other programs.
- * Utilize underutilized market mechanisms, including loan programs, insurance products and tax incentives.
- * Complement existing programs and make more effective use of secondary and capital markets.

The MBA's O'Connor says that one of the coalition's objectives is to support, with the FHA and HUD's involvement, a new multifamily production program geared to helping moderate-income families, who are often overlooked.

Firefighters, police officers and teachers, for example, can't afford decent rental housing in cities such as San Francisco and New York because the costs are too high. We hope to have something we can begin to seek sponsors for in 2002, says O'Connor.

Nicolas Retsinas, director of Harvard University's Joint Center for Housing Studies, Cambridge, Massachusetts, agreed that government intervention is the answer, but said that policy makers are saying, de facto, this isn't a priority that has to be revisited.

Retsinas thinks raising the FHA loan limit would be helpful for moderate-income earners, but not for those at the low end of the income scale, although any increased supply will have a salutary effect on rents, he says.

The public housing gap

Public housing developments are owned and operated by about 3,200 public housing authorities (PHAs) established by municipalities across the country, ranging from a few dozen to more than 100,000 units.

The Council of Large Public Housing Authorities (CLPHA), Washington, D.C., warns that about 5.3 million households across the country have worst-case housing needs. These households earn less than 50 percent of the area median income and pay more than half their income in rent or live in severely substandard housing--sometimes both.

CLPHA is a national nonprofit organization representing 159 of the largest public housing authorities, which own and manage 40 percent of the nation's public housing units. Smaller PHAs account for the rest of the units; all the tenants benefit from Section 8 public housing rent subsidies, according to CLPHA.

Affordable housing is increasingly scarce across all regions of the country and among all racial and ethnic groups, particularly affecting working poor families and suburban households. There are currently about 4.4 million fewer affordable units than low-income renter families, and this gap is expected to widen, stated a CLPHA press release.

The production of decent, affordable housing for low-and moderate-income earning families is dismally inadequate. The jury is still out on how government, lending institutions and the home-building industry will make more strenuous efforts to remedy that shortfall.