Financing Strategies to Develop Affordable Housing Working Group
November 9, 2004, 9:00 a.m., HCDCH Boardroom

Present: Craig Hirai (Chair), Gail Kaito, Laura Theilen, Betty Lou Larson, Vito Galati, Sandi Miyoshi, Mavis Masaki, Janice Takahashi, Darren Ueki.

<u>Authorize a percentage of General Excise Tax (GET) collections on residential rents to be deposited into the Rental Housing Trust Fund (RHTF).</u>

The State Department of Taxation (DoTax) estimated that FY 2004 GET general fund tax collections on residential rents were $86.6 million. There are at least a couple of administrative hurdles to track the exact amount of residential tax collections. The DoTax would have to revise the General Excise Tax (GET) forms and create a computer line entry. The earliest that can happen is calendar year 2006 since the GET forms have already been prepared for 2005. At this point, it is unknown how difficult this is or how much it will cost.

1. In the alternative, why not look at capturing a percentage of tax collections on total rents? Total rents include equipment rentals and commercial leases, and as such, there is no clear nexus.

2. Given the uncertainty of how much will be collected, what about a straight dollar amount instead of a percentage of GET collections? From a budget standpoint, it is easier to justify particularly when collections decrease.

How much is needed in the RHTF to satisfy housing development activity? Approximately $5-10 million is needed each year to effectively leverage the low income housing tax credits. Funds from the RHTF could also be leveraged with Community Development Block Grant, HOME Investment Partnerships or Federal Home Loan Bank funds. Project-based Section 8 rent subsidies really improve project cash flow and allow the RHTF loan to be repaid faster. In theory, the RHTF could put money in any rental housing project to enhance its feasibility. While there is no ceiling on RHTF loan amounts, RHTF policy has been to leverage RHTF funds as much as possible. The largest RHTF loan amount was for approximately $4 million; the average has been between $1.5 million and $2.75 million. The level of development applications has also been driven by what is available in the RHTF. Approximately $7 million in RHTF funding is needed annually to leverage the 9% federal low income housing tax credits available for the State of Hawaii.

If the Legislature was to authorize 25% of GET collections on residential rents, this would amount to approximately $20 million each year for the RHTF. With an additional $5 million from conveyance tax collections, the RHTF would have a total of approximately $25 million annually. Historically, leveraging of the RHTF with the 9% low income housing tax credits resulted in approximately 250 units per year. With additional funding for the RHTF, approximately 150 additional rental units could conservatively be developed each year. This is based on a development cost of $200,000 and the following leveraging ratios: a 15% conventional first mortgage and 85% from the RHTF and other sources. This would result in the

total production of approximately 400 rental units per year or 4,000 rental units over a ten-year period.

The justification to enact legislation to capture a percentage of GET collections for residential rents should include a comparison with income tax benefits for homeowners.

What is the estimated revenue loss on the State General Fund of income tax deductions for homeowner payments of real property taxes and home mortgage interest? DoTax estimated that in 2002 at a 6% effective State income tax rate the revenue loss because of homeowners' mortgage interest deductions was $100 million and the revenue loss because of homeowners' real property tax deductions was $8 million, or a total estimated tax benefit to homeowners of $108 million.

Authorize GET exemptions for planning, design, financing and construction of affordable housing units (up to 140% of the area median income) for a period of 5 years.

Developers in the Streamlining Working Group did not believe the GET exemption for rental units for families earning up to 80% of the area median income was enough of an incentive to stimulate the development of affordable rentals. The GET exemption should be viewed in combination with other incentives. Additionally, developers felt that an income tax credit was preferable to the GET exemption. In reality, DoTax did not allow developers take the tax credit, as there was no mechanism to pass the benefit on to the homeowner. As such, the Financing Working Group felt the GET exemption should be legislatively pursued. However, the GET exemption should be expanded to include for sale housing units for those earning up to 140% of the area median income to address the underserved. There is a need to increase the overall supply of housing units. It is easier to build for the higher end of the affordable housing spectrum (e.g., 140% of median v. 50-80% of median income) and it takes the least amount of incentive. The strategy should be to put the largest number of units on the market at the fastest rate possible. That would free up units at the lower end of the income spectrum although not at a 1:1 ratio given the extent of households doubling up. At the same time, we cannot lose sight of the need to focus on low income rentals particularly since the overall cost to the community is great. The amount spent on the homeless population and the instability that homelessness causes is great. By providing permanent affordable housing, those costs are reduced.

The GET exemption should apply to affordable housing projects of 5 or more units inasmuch as it is not particularly cost effective for either owners or the HCDCH to administer GET exemptions for extremely small projects, and it was felt that the residential loan cutoff of 4 units would be appropriate in this case. It was also felt that a 2-year exemption period would be too short given the lengthy time period to obtain government approvals, and that an exemption period of 5 years would be appropriate.

Legislation should authorize the HCDCH to collect reasonable fees to administer all GET exemption programs.

Counties should allow a developer to satisfy an affordable housing condition by building affordable rental housing units off-site in an area acceptable to the county including on Hawaiian home lands.

The previous strategy under consideration by the Financing Working Group was to allow developers to build the affordable rentals outside of the developer's development plan area **anywhere in the county** or on Hawaiian home lands [emphasis added]. In retrospect, rental housing should be suitably located as determined by the counties. The county planning directors should be consulted on this recommendation.

Authorize an increase from 25% to 50% of conveyance tax collections that are diverted to the RHTF.

Draft legislation.

Utilize Community Reinvestment Act funds to augment the RHTF.

Banks have a CRA that may be satisfied in many different ways. In 1992, the banks with assistance from the State and City established the Hawaii Community Reinvestment Corporation (HCRC) to address the CRA requirement. Until 2004, the banks controlled the HCRC board and it operated much like a mini-bank. Major changes were made in 2004 to enable the HCRC to bring in people involved in the housing community and renew its commitment to rental housing.

Consider Authorizing RHTF Funding for HUD Mixed-Finance Public Housing Development.

Under the HUD Mixed-Finance Public Housing Development program, public housing units may be intermixed with non-public housing, low-income, and/or market rate housing units to create a mixed-income development. Homeownership opportunities for public housing residents and others within a mixed-finance/mixed-income development may also be allowed. If a mix of public housing units and non-public housing, low-income, and/or market rate rental housing units are to be constructed or rehabilitated under this program, consideration should be given to authorizing RHTF funding for such developments.

Next meeting: December 7, 2004 at 1:00 p.m. at HCDCH. (The meeting was subsequently rescheduled to December 13, 2004 at 9:00 a.m. at HCDCH.)