



PACIFIC HOUSING ASSISTANCE CORPORATION

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To: Senator Russell S. Kokubun, Chair
Senate Committee in Commerce, Consumer Protection, & Affordable Housing

From: Marvin B. Awaya
Executive Director

Subject: Informational Briefing; January 10, 2008; 1:30 p.m.; Room 229

Thank for allowing me the opportunity to discuss how the State may improve upon the delivery of affordable rental housing in Hawaii.

Background:

There have been statements that housing is being "created out of the reach of the working poor". The development of affordable workforce housing is driven by project financial feasibility. It is not feasible for non-profit and for-profit developers to produce affordable rental housing without financial assistance from the government. With the exception of Federally-assisted public housing, the feasibility of producing affordable housing depends on the private financing (permanent mortgage) obtained. The mortgage amount is limited to amount of income derived from rents charged. If the rent rate is set for a lower income range the greater the need for a government 2nd mortgage to fill the "gap" between the development cost and the mortgage amount.

*The lower the household income targeted,
The lower the rent will be,
Resulting in less income to pay for the mortgage,
Causing a lower mortgage amount, resulting
In a greater financing "gap".*

Therefore, when targeting a lower income group, commensurate assistance must be provided.

The problem statement to consider:

"How do we encourage or direct developers to target their projects to this income level"?

SOLUTIONS

Providing Sufficient 2nd Mortgage Financing Or Grants To Make Up The "Gap":

This solution seems simple but becomes when reviewing the limited State financial resources available and the diminishment of financial leveraging that comes along with investing an amount that is 2 to 4 times greater than the 1st private mortgage amount. Because the State

housing financing programs are competitive, the lower the leverage, the less competitive a project is when it is presented for funding. Competition criteria can give greater "value" to proposals targeting lower income households but it will be at the expense of projects serving workforce or higher affordable income groups.

A quick example of this is as follows. The assumptions are:

Units	100	Two bedroom	
Target Group	80%	median income (\$53,650; 3 persons)	
80% Rent	\$1,341/month	(maximum)	
Interest Rate	7.25%		
Loan Term	30 years		
Debt Service Ratio	1.15		
Development Cost	\$	32,000,000	
Rent Income	\$	1,609,200	
Operating Expense	\$	480,000	\$400/PUPM
Net Income	\$	1,129,200	
Debt Service Ratio		1.15	
Income Avail for Debt	\$	981,913	
1st Mortgage Amount	\$	11,994,900	37%
"Gap"	\$	20,005,100	63%

Tax Credits for Affordable Housing Projects:

- Create a State Affordable housing tax credit program modeled after the Act 221 high technology tax credit program for households with incomes not exceeding 140% of median income.
- Create a State tax credit program targeting workforce housing households; 60% to 140% of median income.

The State currently has a tax credit program that is linked to the award of Federal Low Income Housing Tax Credits ("LIHTC") (IRC Section 42). This program limits household income to 60% of median income. This State credit is set at 50% of the Federal credit awarded to a developer. The use of the State credit is identical to the Federal IRS regulations in that the amount of credit is based on an "eligible basis" and pro-rated and taken by a tax payer/investor over a 10 year period.

While the State tax credit is useful it's "sales price", what an investor will pay for the credit, is in the neighborhood of \$.35 to \$.50 for every \$1.00 of State tax credit. The dollar amount invested as "equity" is less than half of what the Federal credit will bring in. This diminishment of "value" and "marketability" is related to whether the investor pays State taxes (and therefore able to use the credit) and the relatively low corporate income tax rate in Hawaii.

Housing Tax Credit Program Modeled After The Act 221:

Creating a funded (by appropriation) tax credit, investors would be willing to pay more as the return is immediate. It also has the capability of marketing to non-resident corporate and individual investors. Attracting capital to Hawaii and investing in a long lasting resource like affordable rental housing benefits the economy as and housing industry.

State Tax Credit Program Targeting Workforce Housing Households:

A new tax credit program for apartment units whose occupants exceed 60% but make no more than 140% of median income. This can encourage mixed income tax credit projects so that Federal LIHTC/State tax credits can be used for units whose occupants have incomes of less than 60% of median income and provide State tax credits for the remainder. This can work especially well with the 4% LIHTC/Revenue Bond projects as it enhances equity contribution for the entire project.

This new program can be further enhanced by reducing the "delivery period" of the current 10 years to a period of less than 5 years and setting a greater applicable percentage. The shorter the delivery time frame and increased percentage creates greater the value.

I am not sure of the ramifications of revising the current State tax credit program that is linked to the Federal LIHTC program but it would be helpful if the current program's "delivery" of tax credits were reduced from its current 10 year period to less than 5 years.

A new State (unfunded) tax credit program should not have a "cap" on the total tax credits allocated. There however needs to be a determination of the amount of tax credits that can be awarded to a single project. The "amount" can be a percentage of total cost or a portion of total cost i.e. "basis". The federal tax credit programs use an "eligible basis" which are basically the depreciable costs of a project.

It should be noted that in the past the State Department of Taxation has come out against the enactment of tax credits. The argument that the unfunded tax credits are investments that would otherwise not be made seems to have little effect. Also of little effect is the argument that the reduction of revenue from the tax credit is offset by income tax gains from the construction industry.

Thank you this opportunity to share my thoughts and input.