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EXECUTIVE ASSISTANT

LATE TESTIMONY

Statement of
Barbara E. Arashiro
Hawaii Public Housing Authority
Before the

SENATE COMMITTEE ON EDUCATION AND HOUSING

February 8, 2010 1:15 P.M.
Room 225, Hawaii State Capitol

In consideration of
SB 2575
RELATING TO HOUSING

The Hawaii Public Housing Authority (HPHA) opposes S.B. 2575 because Section 3 may be unenforceable in part, and because it may unintentionally interfere with improving public housing.

1. HPHA is concerned that Section 3 does not distinguish between the land and the buildings in the term “public housing.” Because land can be retained while the buildings are transferred to another party, or vice-versa, different rules sometimes are necessary for each.

2. Public housing which has had state funding put into its construction or management must be affordable in perpetuity.

While it is the intent of HPHA to maintain or increase the number of affordable housing units, this may not be enforceable for some properties. State CIP funding has been appropriated for and used on federal public housing in some instances. Regardless of which funds have been used, federal regulation will govern those projects. There may be a conflict between this provision and federal law when actions are necessary in the future.

In addition, sometime in the future HPHA may find it necessary or advantageous to “federalize” one or more state public housing projects, in the sense of converting them to federal public housing. This may be done to gain federal funding for the project, or for other reasons. Any restrictions on the property, such as this one, that conflict with federal regulations may prevent conversion and make it impossible to take advantage of an opportunity that would benefit residents and taxpayers.

Another possibility is that there may be opportunities in the future to exchange state housing land for something that provides a better living environment for residents, thereby limiting the possibilities for future improvement of or increases in affordable housing.

3. Properties redeveloped as mixed use or mixed income neighborhoods should retain the existing number of affordable units.

HPHA agrees with this concept and it matches our intent in current and future redevelopment. However, there are a number of ways of providing housing to low and moderate income citizens, and only two seem to be contemplated here. We are not sure whether this statute would allow for

- converting public housing to Section 8 Site-based housing
- Home ownership programs
- eliminating deteriorated public housing and substituting an equal number of Housing Choice Vouchers

STANFORD CARR DEVELOPMENT, LLC

LATE TESTIMONY

February 8, 2010

Committee on Education and Housing
State Capitol, Conference Room 225
415 South Beretania Street
Honolulu, Hawaii 96813

RE: Testimony opposing and commenting SB2575: Relating To Housing
Hearing date Monday, February 8, 2010 at 1:15 PM
via Capitol website: http://www.capitol.hawaii.gov/emailtestimony/

Dear Honorable Chair Senator Norman Sakamoto:
We are writing to **respectfully oppose** specific provisions of SB2575 (Section 3. Chapter 356D H.R.S.) which require affordability in perpetuity for public housing projects and requirement to maintain the original number of affordable units.

Since the early 1990's, HUD's HOPE VI program has provided public housing authorities with financial resources to address capital improvement and community service needs. This program seeks to improve the living environment in severely distressed public housing through either demolition or renovation of obsolete public housing developments and integrate these communities into the surrounding neighborhood through physical connections and supportive service programs.

Redevelopment efforts typically leverage a multitude of financing sources, including us of the Low Income Housing Tax Credit program ("LIHTC" Internal Revenue Code Section 42). **This program is an integral funding source in the production and preservation of affordable developments and would be an integral component of any successful re-development effort undertaken at Hawaii's public housing developments.** A requirement of affordability in perpetuity would jeopardize a project's ability to use these funds and ultimately require more local subsidies to cover the shortfall. Furthermore, in July 2008, a HHFDC Board task force on long-term affordability reported that requirements to maintain affordability in perpetuity should not be supported. Finally, many public housing authorities continue to own the underlying property during the redevelopment and only convey a long term leasehold interest for redevelopment. By owning the underlying the property's fee interest, the agency can ensure that affordability for perpetuity can be maintained.

The proposed legislation's second requirement to maintain the original number of affordable units could possibly hinder redevelopment efforts by not allowing for a true mixed income community. Obviously, any loss of affordable housing units only adds the affordable housing short fall, however, redevelopment efforts could include replacement of the lost units on underutilized public properties elsewhere so that the overall original unit count is maintained. By integrating a mixed-financed approach (public private partnership) and targeting a mixed-income community, the end result will be a financially stable and diverse community that will ensure long term sustainability.

Thank you for considering our testimony.

Sincerely,

Jesse Wu, Vice President | Special Projects

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LONG-TERM PRESERVATION OF AFFORDABLE HOUSING TASK FORCE
A REPORT TO THE HHFDC BOARD ON FINDINGS AND RECOMMENDATIONS

Background

The Hawaii Housing Finance and Development Corporation (HHFDC) provides tools and resources to facilitate the development of affordable and workforce housing.

Development tools include expedited land use approvals and exemptions from all statutes, ordinances, charter provisions, and rules of any governmental agency relating to planning, zoning, construction standards for subdivisions, development and improvement of land, and the construction of units thereon pursuant to Chapter 201H, Hawaii Revised Statutes. Major resources include the provision of developable land and financing such as the Rental Housing Trust Fund, Low Income Housing Tax Credits (LIHTC), the Dwelling Unit Revolving Fund, and Hula Mae Multifamily tax-exempt revenue bonds.

HHFDC imposes sales restrictions for buyers of affordable for-sale housing developed under the provisions of Chapter 201H, HRS (i.e., a 10-year buyback and sharing of appreciation that extends beyond the buyback period). For the LIHTC and rental housing trust fund programs, HHFDC also provides an incentive for developers to maintain affordable rental units for longer time periods by awarding more points in scoring funding applications.

Given the continuing need for affordable and workforce housing, as well as the State's considerable investment in the provision of such housing, it is reasonable for HHFDC to have a broader policy to maintain the affordability of publicly-assisted or subsidized housing.

Task Force on Preserving Long-Term Housing Affordability

On February 14, 2008, the HHFDC Board of Directors formed a task force comprised of HHFDC board members Charlie King (Chair), Linda Smith, David Lawrence and Charles Wathen. The purpose of the task force was to provide the necessary oversight and direction to recommend a balanced housing policy that would preserve long-term affordability while supporting additional investment in rental or for-sale housing. [For Discussion, February 14, 2008]

Findings

A literature review and interviews with local nonprofit developers and a national expert in the development, financing, and syndication of affordable housing were conducted. Findings are summarized below.

- **Burdensome affordability restrictions will curtail new development of rental housing**
  Tax credit investors are really the owners of LIHTC projects. Investors must show the IRS that there is an expectation of making a profit over the life of the partnership that owns the project. Investors will not invest in rental housing projects if the restraints or limitations placed upon them are overly burdensome.[1]

A Harvard University, Joint Center for Housing Studies paper, *"Designing Subsidized Rental Housing Programs: What Have We Learned?,"* (November 2006) examined the lessons learned from decades of experience with the several programs under which project-based affordable rental housing has been developed (i.e., public housing, project-based Section 8 subsidies, LIHTCs). The Harvard study concludes that a "set it and forget it" strategy has powerful practical drawbacks due to:

- The difficulty of anticipating evolving markets. A property worth preserving today may not be worthy of continued preservation 20 years from now.
- The difficulty of anticipating capital needs past about 20 years. As a property's age approaches or exceeds 50 years since construction, ongoing capital needs will start to include very long-lived systems.
- The substantial cost of providing up-front funding for very long-term capital needs.

Local nonprofits (i.e., the Hawaii Community Reinvestment Corporation, Pacific Housing Assistance Corporation, and Hawaii Island Community Development Corporation) believe that a perpetual affordability requirement would hinder private sector participation in the production of affordable rental housing projects. Some private landowners prefer to lease land rather than sell in fee simple and, therefore, would not make land available for rental housing development if constrained by a perpetual affordability requirement. Perpetual affordability may also stifle reinvestment in the project. It would preclude the option for the developer/owner to redevelop the property at the end of the useful life. Even nonprofits in the business of providing affordable housing may opt to sell a poorly performing project to reinvest in another rental project.

- **Burdensome affordability restrictions will impact the sustainability of housing projects**
  Rent restrictions must be balanced with project sustainability. If allowable rent increases are too restrictive, the owner will have difficulty maintaining the project over the longer term.[2] By reducing the return on investments in rental housing, these restrictions may lead to a deterioration of the quality of housing stock as owners faced with declining revenues may be forced to substantially reduce maintenance and repair of existing housing.[3]

- **A reasonable affordability period for a rental property is the length of the initial mortgage or the useful life of the property**
  Due to insufficient resources to meet the needs of thousands of households who lack affordable housing, it is bad public policy to invest scarce resources in housing that may not remain affordable for a long period of time and not recapture any of what may be substantial gains enjoyed by the fortunate few. A reasonable affordability period for a rental property is the length of the initial mortgage or the useful life of the property.[4] Local nonprofits concur citing the useful life of the property is the limiting factor and questioning to what extent is government able to impose regulations beyond the term of [financing] assistance.

  The Harvard Joint Center for Housing Studies report notes that properties benefit from a financing event – sale, refinancing, recapitalization, intra-partner transfer – roughly every 15 to 20 years. The study recommends a preservation structure that includes a series of 20-year

governmental options to extend preservation, coupled with a "20 year check-up" (and new subsidies) as each option matures.

- **Financing and development incentives are necessary for the development and long-term preservation of affordable rental housing.**
  It has become increasingly challenging to develop affordable rental housing. The usual barriers such as high land costs, the lengthy and expensive zoning and permitting process, lack of infrastructure (or capacity) are exacerbated by rising construction costs and the upheaval in the financial market. The lack of appetite for LIHTCs, particularly the state credit, has affected the value of the tax credits and, thereby, created a need for more gap financing. Without financing and development incentives, there is little incentive to develop affordable rental housing.

- **Strategies for the long-term preservation of affordable housing should be comprehensive, taking into account market forces, the financial market, and the long-term operating costs and capital needs of the project.**
  A policy that simply requires developers to retain project affordability for targeted income groups over a specified time period will not achieve the objective of preserving housing affordability over the long-term. There are many factors that impact project affordability and, therefore, sustainability. Of note is the steady increase in operating costs (especially rising property taxes and energy costs), which necessarily drives up rents or leads to underinvestment in maintenance.[5]

  The Harvard Joint Center for Housing Studies report notes that underwriting standards for LIHTC projects do not fully recognize the extent to which LIHTC operating budgets need to include non-traditional expenses such as computer learning centers, after-school programs, and service coordination. Therefore, while rent adjustments are pegged to increases in local income and are automatic, they may not be sufficient to cover such increases in operating costs as utilities and insurance, which could easily exceed growth in local household income. The report goes on to say that there is limited information about the capital needs of the early LIHTC properties that are now reaching or passing their 15-year compliance period. However, anecdotal evidence indicates that most properties have significant capital needs that cannot be funded from reserves. Many LIHTC properties will need a capital infusion between years 15 and 20 in order to maintain physical and financial viability while continuing to provide affordable housing at LIHTC rents.

Recommendations

Based on the findings, the following recommendations are presented for consideration.

The HHFDC should not require rental housing owners/developers to maintain affordability in perpetuity or impose affordability restrictions that unduly restrict a developer/owner's return on investment. Rental projects that are located on state land have the potential of remaining affordable in perpetuity because the land and improvements revert to the state at the end of the lease term. A more comprehensive and balanced policy

that recognizes the market and operational challenges rental projects face over the long term is needed.

- **A reasonable affordability period for rental projects that are located on private land and for which the HHFDC is providing financing or development assistance is the length of HHFDC's loan agreement or the useful life of the rental property.**

  - The HHFDC should continue its practice of offering financing assistance as projects approach the end of their compliance periods.

  - The HHFDC could explore obtaining a right to purchase the property at the time the affordability restrictions expire. The option price would not be lower than the outstanding debt on the property but not higher than the appraised value of the property constrained by the continuation of the affordability requirements. Joel Rubenzahl of CEI recommends an option price equal to debt plus capital gains tax or the fair market value of the property, whichever is higher.

- **The provision of financing and development incentives is necessary for the development and long-term preservation of affordable rental housing. Evaluate the effectiveness of HHFDC's financing incentives and revise, as needed.**

  The State LIHTC has never had the pricing and demand seen by the federal LIHTC. Historically, we have seen pricing in the $0.35 to $0.50 per State LIHTC dollar range primarily due to competition with other State tax credits; the extended period of time that the credits are taken (10 years); and the lack of entities with large enough state tax exposure to invest. Recently, there has been a decreased demand for State LIHTCs resulting in even lower pricing.

  In comparison, the high technology business investment tax credit (§235-110.9, HRS) provides for a 100% front-loaded income tax credit for up to $2 million per investor. The credit is taken as follows: 35% in the year the investment is made, 25% in the 1st year following investment, 20% in the 2nd year; 10% in the 3rd year, 10% in 4th year. A tax credit for increasing research activities (§235-110.91, HRS) provides for a 20% refundable credit to high tech businesses for qualified research activities. If the tax credit for qualified research activities claimed by a taxpayer exceeds the amount of income tax payment due from the taxpayer, the excess of the tax credit over payments due is refunded to the taxpayer. While these high tech tax credits are effective through December 31, 2010, they are much more competitive than the state LIHTC. Therefore, consideration should be given to restructuring the state LIHTC.

  - The state LIHTC authority could be traded for annual legislative funding for the Rental Housing Trust Fund.

  - The state LIHTC could be restructured, possibly for an interim period such as 5 years, to make it more attractive to investors. For example, the California state tax credit is taken over 4 years; the first year is not prorated. Even though a project may have

been placed in service for 2 of the 12 months, they get the full credit. The fourth year total adds to 30% of basis. The California state tax credit averages 65 to 75 cents per $1.00.

- Another incentive for consideration is to allow a developer to take a larger developer fee up front (vs. relatively small fees in the project cash flow) to help with project feasibility [Rubenzahl]. However, this would typically require more government assistance and must be weighed against the amount of government resources (i.e., RHTF) available.

- **Explore different ways to structure the rental project.**

  - Private developers could satisfy a state or county affordable housing condition by donating land to the HHFDC. The HHFDC could lease the land back to the developer or a private nonprofit selected by the developer for the development of affordable rental housing.

ENDNOTES

[1] Joel Rubenzahl of Community Economics, Inc. a California-based firm established in 1976 to provide nonprofit organizations and public agencies with expert technical assistance in the financing and development of affordable housing. CEI has assisted in the development of over 440 affordable rental housing developments and over 30,300 units. Projects are located primarily in California, and include urban, suburban and rural communities throughout the state. Projects include senior and family developments; special needs housing, preservation of at-risk projects and mixed-use developments (May 19, 2008).

[2] Ibid.

[3] National Multi Housing Council, *"The High Cost of Rent Control"* (January 1, 1996)

[4] Coalition for Nonprofit Housing and Economic Development (CNHED), Center for Practical Research, *"Financing Development of Affordable Housing, Length of Affordability Requirements and Recapture Provisions,"* (June 2004).

[5] John McIlwain, "There Goes the Neighborhood: The Ongoing Loss of Workforce Housing," ULI, November/December 2006.

SEATTLE
SAN DIEGO
HONOLULU

LATE TESTIMONY

Senate Committee on Education and Housing
Senate Committee on Transportation, International and Intergovernmental Affairs
Testimony Regarding SB 2575

Relating to Housing

Testimony Submitted by:	Makani Maeva, Director of Pacific Housing Advisors
Hearing Date:	February 8, 2010
Time:	1:15 p.m.
Room:	Conference Room 225

Dear Honorable Chair Sakamoto, Chair English & Committee members:

Thank you for this opportunity to submit testimony in opposition of SB 2575. My name is Makani Maeva, the Director of Pacific Housing Advisors ("PHA"), a private affordable housing developer. PHA is a private affordable housing developer that owns and manages over 4,600 affordable housing rental units nationwide, including 36 units at Kekaha Elderly Plantation on the island of Kauai. We are a few months away from completing construction on Lokahi Apartments, which will add 306 new affordable rental units to the Kailua-Kona area. Lokahi Apartments is being constructed in phases and we already have 85 affordable units completed and occupied. We expect the project to be fully-occupied by the end of summer, 2010. In the end, all 306 of the units will be rented only to individuals and families that earn 60% or less of the area median income. Construction of these 306 new affordable units was financed, in part, by the sale of federal and state LIHTCs and the Rental Housing Trust Fund.

PHA respectfully opposes SB 2575 because it will serve as a disincentive for the development of affordable rental housing under Chapter 201H, HRS. This measure seeks to preserve affordable housing in perpetuity and ensure the one for one replacement of the housings. However, there are associated negative consequences that must be considered with both of these actions.

Requiring affordable housing that is constructed or managed by state or county funds to **remain affordable in perpetuity** is not a practical alternative for affordable rental housing and will not increase the stock of available affordable housing for the following reasons:

1. Building materials have finite useful lives – None of the materials used to construct the physical structures will last into perpetuity. At some point in time, the owner of the rental property will

have to rehabilitate or replace all of the buildings to make them habitable. This rehabilitation or replacement is inconsistent with a "perpetual" term because rehabilitation and replacement require significant additional capital investments or outlays and, as explained in #2 below, securing said funds will be problematic if a rental property is required to remain perpetually affordable;

2. Financing rehabilitation of affordable housing rental projects becomes extremely difficult, if not impossible, when the property is never "at risk" of converting to market. There are a number of financing options (i.e. Low Income Housing Tax Credits, Rental Housing Trust Funds, CDBG, HOME funds and Federal Home Loan bank grants) that generate capital for rehabilitation when a property is at the end of a compliance period. These financing options increase the affordability terms by conditioning the additional funding in part on the owner's agreement to keep the property affordable for another significantly long compliance period. Thus, if a particular rental property is required to be kept affordable in perpetuity, it is never "at risk" of converting to market, and it is unclear how owners will be able to generate the capital needed to make the necessary repairs;

3. Considering #1 and #2, there is a strong likelihood that imposing perpetual affordable terms on owners of affordable rental properties will result in said properties becoming ghettos. The combination of aging buildings and lack of available capital for improvements will leave affordable housing property owners without the means to adequately upkeep their property;

4. As neighborhoods change and grow, there may come a time when it is entirely inappropriate for a particular parcel to continue as an affordable multi-family project with a specified number of units. SB 2575, assumes that neighborhoods, densities and housing needs/uses will remain the same into perpetuity, which is not a valid assumption; and

5. The current model for providing affordable housing "in perpetuity," is based on the use of a public private partnership and a long term lease of land. This model generally allows for profit, nonprofit and community-based organizations whose mission is to provide affordable housing.

The other element of this bill that we **respectfully oppose** is the requirement that public housing redevelopment **maintain the original number of affordable units on site**. Several of the financing

mechanisms listed above as well as the very successful HOPE VI program which began in 1992, are programs meant to revitalize the worst public housing projects into mixed-income communities. As of 2005, the program had distributed $5.8 billion through 446 federal block grants to cities for the developments; with the highest individual grant being $50 million. One of the most important lessons learned is that Public Housing communities can become a catalyst for revitalization of the larger neighborhood. Sometimes this community revitalization requires adjustment of density, income levels or ownership structures. SB2575 as proposed is not adequately flexible to allow for creative solutions. The requirement of one for one replacement on site could hinder our future redevelopment efforts.

We thank the Committee for considering our testimony and urge you to give it your full support.