Office of the
Comptroller of the Currency

Community Developments
Investments

March 2017

Preserving Affordable Housing
Innovative Partnerships

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Innovative Partnerships

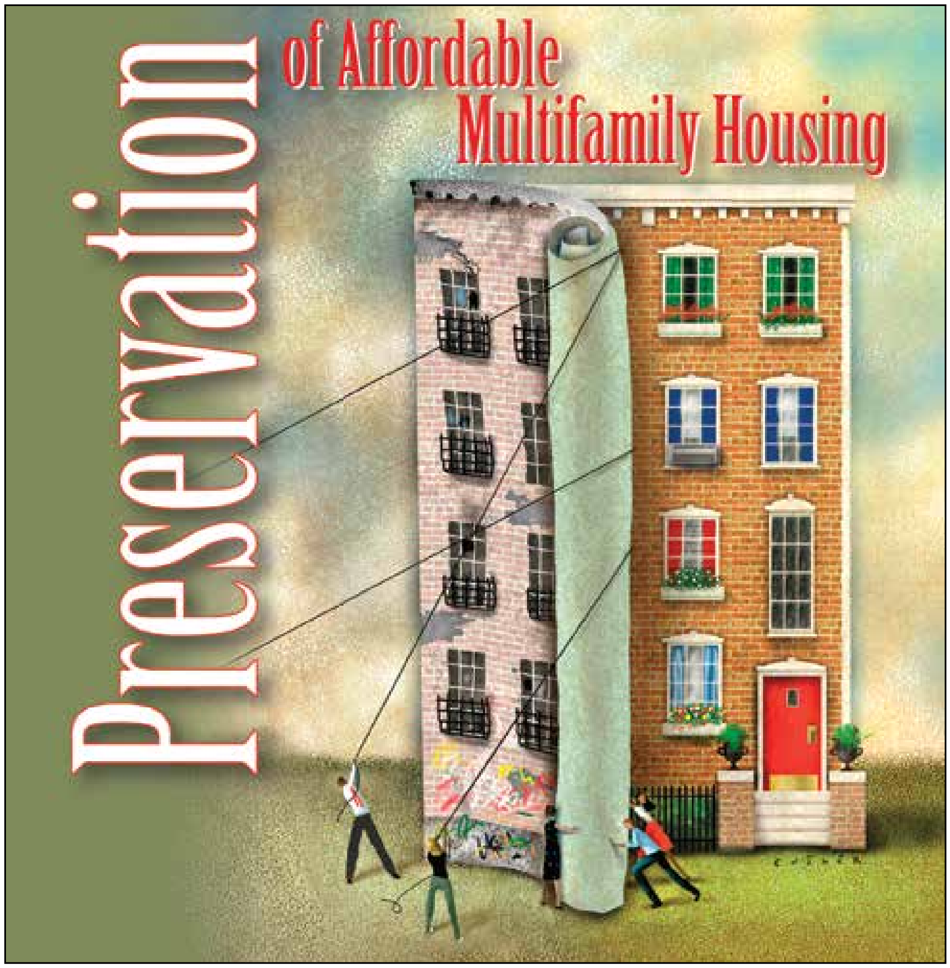
What's Inside

A Look Inside ...

Barry Wides, Deputy Comptroller for Community Affairs, OCC

While the demand for affordable multifamily housing continues to grow, the number of such units at risk of loss or conversion to market-rate units is also growing. The resulting shortage of affordable multifamily housing has created increasing financial hardship for low- and moderate-income (LMI) households.

According to the Joint Center for Housing Studies of Harvard University, there were 18.5 million low-income renter households in the United States in 2013, but there were only 18 million rental units with rents these households could afford.[1] Affordable housing units for rental households are units with rents equal to or less than 30 percent of household income. Low-income households are those with annual incomes of 50 percent or less of their area median incomes.



Preserving existing affordable multifamily units has become a priority for housing policymakers. In most cases, when compared with newly constructed multifamily rental units, a more cost-effective approach is to preserve and rehabilitate existing multifamily housing units that are at risk of being demolished or abandoned. Rehabilitated units may be available for occupancy sooner than newly constructed units. An important benefit of preserving affordable multifamily properties that are at risk of conversion to market-rate housing is that these properties often are located in vibrant communities that offer LMI households better services and job opportunities.

This edition of *Community Developments Investments* examines regulatory and transactional issues related to preserving affordable multifamily properties. The articles explore how national banks and federal saving associations (collectively, banks) use subsidy programs and other investment tools to preserve affordable multifamily housing in urban and rural areas.

To provide context about the challenges facing the supply of affordable multifamily housing,

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On the cover
Clockwise from top left: R Street Apartments, residents of the St. Dennis Apartments, St. Dennis Apartments, and Galen Terrace Apartments, all in Washington, D.C. (Photos courtesy of the National Housing Trust)

1 Joint Center for Housing Studies of Harvard University, "America's Rental Housing: Expanding Options for Diverse and Growing Demand," 2015, pages 28–29.

the National Housing Trust (NHT) describes the growing gap between the number of cost-burdened households and the available supply of affordable multifamily units. The NHT explains why the existing stock of affordable rental housing is at risk and highlights how banks could increase their support of affordable multifamily preservation efforts. The NHT also describes several financing transactions, ranging from predevelopment financing to new debt products and a mission-driven real estate investment trust investor.

Several articles in this edition of *Community Developments Investments* highlight federal affordable housing programs that banks can leverage to preserve subsidized affordable multifamily housing, such as the U.S. Department of Housing and Urban Development's Rental Assistance Demonstration program. The OCC examines issues associated with low-income housing tax credit properties after the initial 15-year compliance period. Robyn Bipes of the Twin Cities Habitat for Humanity shares her experience preserving properties financed under the U.S. Department of Agriculture's Section 515 Rural Rental Housing Loan Program and how banks have participated in preserving affordable multifamily properties in rural areas.

Preserving the supply of affordable multifamily housing presents unique challenges. This edition of *Community Developments Investments* also includes articles from financial institutions that are developing innovative financing approaches to rehabilitate and finance affordable multifamily housing. PNC Bank's Todd Crow explains how the current high demand for multifamily housing is leading investors to purchase and convert affordable rental properties to market-rate developments, and describes the fund that PNC has established to address this trend. In addition, Fannie Mae and Freddie Mac highlight their efforts to enhance liquidity for affordable multifamily housing by securitizing loans. These concerted financing efforts are necessary to address the threat of a diminishing supply of affordable multifamily housing.

National Housing Trust

R Street Apartments, a low-income housing tax credit (LIHTC) property located in Washington, D.C., has 124 affordable housing units and six market-rate units. In addition to LIHTCs, the project received financing from historic tax credits, a private activity bond, and a loan from the city.

Because these properties are providing affordable housing to low-income households and in LMI areas, loans to and investments in this housing meets the definition of community development under the Community Reinvestment Act guidelines if properly documented. The OCC's Vonda Eanes describes how this documentation can be accomplished.

We hope that by sharing various preservation financing efforts in which banks have engaged, this edition of *Community Developments Investments* will contribute to the collective effort to preserve affordable multifamily housing in the years and decades ahead.

Preserving America's Affordable Rental Housing: The Role of the Nation's Banks

Ellen Lurie Hoffman, Federal Policy Director, National Housing Trust

Preserving affordable rental housing is vital to addressing the United States' rental housing affordability crisis. The National Housing Trust (NHT) preserves and improves affordable housing to ensure that rental housing remains sustainable and affordable. Using the tools of real estate development, rehabilitation, finance, and policy engagement, the NHT has helped to preserve more than 25,000 affordable homes in 41 states by leveraging more than $1 billion in financing.

The recipe for preservation success is the combination of policy innovation, mission, and low-cost financing. Often the need for preservation emerges when a private owner decides to sell a property or convert the property to market-rate housing. National, regional, and community banks can play essential and profitable roles in housing preservation.

National Housing Trust

The preservation of St. Dennis Apartments, a Washington, D.C., historic low-income housing tax credit property with 32 units and eight Section 8 project-based voucher units, was financed by several sources, including national bank construction loans, a grant from the Federal Home Loan Bank of Atlanta, and a subordinate loan from Washington, D.C.

Affordable Rental Housing Needs Grow

Today, the nation faces a rental housing affordability crisis, as rent levels climb faster than median household incomes. Housing units considered "affordable" are those units with rents equal to or less than 30 percent of households' incomes. In 2014, however, more than 26 percent of all renter households nationwide paid more than 50 percent of their incomes for housing.[1] Further, 66 of every 100 units that low-income renters can afford are either inadequate or unavailable to them.[2] A large percentage of the units affordable to low-income renters are leased to higher-income households, and low-income households often are left with no alternative but to lease units with affordable rents that fail to meet physical standards for decent, safe, and sanitary housing. This situation has seriously challenged the lowest-income households.

In the United States, a person would have to earn $19.35 per hour and work 40 hours a week for 52 weeks a year to afford the average rent for

1 Joint Center for Housing Studies of Harvard University, "America's Rental Housing: Expanding Options for Diverse and Growing Demand," 2015.

2 Ibid.

a two-bedroom unit. This national average is more than 250 percent of the federal minimum wage and 52 percent higher than it was in 2000.[3] Meanwhile, the loss of affordable multifamily rental units has resulted in fewer households receiving housing assistance compared with those eligible for it.

Congressional funding to subsidize rent for the lowest-income households has not kept pace with need. Despite a 16.4 percent increase in the number of very low-income households, from 15.9 million in 2007 to 18.5 million in 2013, funding for U.S. Department of Housing and Urban Development (HUD) rental assistance remains below 2008 levels when adjusted for inflation. Just over one in four (26 percent) eligible households received assistance in 2013.[4]

Existing Affordable Housing at Risk

As stated earlier, the volume of affordable rental units does not meet the demand for households whose incomes have not kept pace with the rising cost of market-rate housing. With declining public sector subsidies and rising development costs, preserving the existing stock of affordable housing has become more urgent than ever. Between 2015 and 2025, 2.2 million privately owned, federally assisted apartments will lose their affordability restrictions, at which point the property owners can convert these units to market rents.[5]

Nearly 60 percent of the rentals with expiring subsidies are low-income housing tax credit (LIHTC or housing tax credit) units. In many cases, these units can be retained in the affordable housing inventory if the property receives other subsidies with affordability restrictions or the owner obtains a new allocation of LIHTCs to fund capital improvements.[6]

Apartments subsidized with HUD's project-based rental assistance (PBRA) account for more than a quarter of the subsidized rental housing stock that is approaching the end of its affordable-use period. Properties with PBRA house over 1.2 million low-income households and are a critical source of affordable housing in many communities. PBRA properties are in privately owned developments with rents subsidized under federal contracts. Once those contracts expire, property owners can opt out and raise rents. More than 446,000 (33 percent) of the approximately 1.34 million active PBRA units are at risk of losing their affordability status.[7]

Owners with developments in high-rent neighborhoods earning below-market rents for their assisted units have the most incentive to opt out. This pressure is greatest in coastal markets experiencing gentrification, including neighborhoods in New York City, San Francisco, Calif., and Washington, D.C. In these high-priced markets, as well as certain second-tier cities all over the United States, confidence in the multifamily rental market places pressure on property owners to opt out of federal rental assistance and convert their properties to luxury apartments or condominiums.

The aging of the nation's public housing stock is also a concern, because more than half of the units were built before 1970. Public housing authorities need a staggering $26 billion to finance capital replacements and improvements. Preserving small multifamily rental housing helps meet some affordable housing needs. Apartments in older, smaller multifamily buildings are typically less expensive than rentals in large multifamily buildings.[8] More than a third (38 percent) of apartments in buildings with two to four units rent for less than $600 a month. These properties tend to be older, and because of their age, a high percentage are in poor condition. Preservation and recapitalization of these smaller buildings will help prevent further loss of needed affordable housing.

Preservation Is Necessary

Preserving affordable housing is the obvious first step in addressing our nation's affordable rental housing crisis for the following reasons:

- For every new affordable apartment created, two are

3 National Low Income Housing Coalition, "Out of Reach 2015."

4 Joint Center for Housing Studies of Harvard University, "America's Rental Housing: Expanding Options for Diverse and Growing Demand," 2015.

5 Ibid.

6 Ibid.

7 Urban Institute, *Urban Wire*, "How to Keep Affordable Housing in High-Opportunity Neighborhoods," 2015.

8 Joint Center for Housing Studies of Harvard University, "America's Rental Housing: Expanding Options for Diverse and Growing Demand," 2015.

lost because of deterioration, abandonment, or conversion to more expensive housing. Without preserving existing affordable housing, we fall two steps back for every step forward. In distressed neighborhoods, preserving affordable housing can spark the public-private investment needed to catalyze the revitalization of an entire community. Saving decent, affordable housing is a cost–effective means of protecting a critical community asset in rapidly revitalizing and economically healthy communities.

- Preserving an existing home is significantly less expensive than constructing new affordable housing. Rehabilitating an affordable apartment can cost one-third less than building a new one. In more expensive communities with high land costs, the cost of building new affordable housing could be as much as double that of preserving existing housing. Nationally, in 2013, preservation projects using LIHTCs required 50 percent less housing tax credit equity per unit than new construction developments.
- Preservation protects the billions of taxpayer dollars already invested in affordable rental housing.

National Housing Trust

The National Housing Trust helped the tenant association of Galen Terrace, a deteriorating property with 84 affordable homes in Washington, D.C., purchase the property while making substantial renovations. The property's financing later included a loan from the Washington, D.C., Department of Housing and Community Development, supported in part by federal Community Development Block Grant funding.

How Can Banks Support Housing Preservation?

Lenders play a critical role in affordable housing preservation, and banks' investments in the projects located in their assessment areas or the broader statewide or regional areas that include their assessment areas can receive Community Reinvestment Act (CRA) consideration during examinations. Banks can participate in the following ways.

Sharing in predevelopment financing. Predevelopment is the most difficult phase of pursuing preservation projects. To evaluate the financial feasibility of preservation plans, studies must be completed and professionals must be engaged. Often, nonprofit organizations do not have sufficient capital to conduct such predevelopment work.

Both banks and nonprofit developers would benefit if they shared in this risk. Banks could agree to provide predevelopment dollars for a particular project, matched in part by nonprofit developers, in exchange for more substantial or longer-term participation in permanent future financing of projects. Lenders' more substantial roles might include direct purchase of tax-exempt bonds or housing tax credits, or providing construction loans.

Investing in intermediaries such as community development financial institutions (CDFI). CDFIs also raise funds to finance predevelopment and interim development loans at below-market rates to local nonprofit developers.

Banks provide key investments to CDFIs to help capitalize these funds.[9]

For example, the National Housing Trust Community Development Fund (NHTCDF) is a flexible source of predevelopment and interim development funds for mission-aligned development organizations working to purchase, rehabilitate, and preserve affordable housing. The NHTCDF has made more than $35 million in loans in 28 states and Washington, D.C., to preserve over 11,000 homes. These loans have leveraged more than $1 billion of private and public financing to fund affordable housing preservation. The NHTCDF recently launched a new product for energy retrofits and renewable energy. Major investors in the NHTCDF include Bank of America, PNC Bank, E*Trade, Trinity Health, the Novogradac Rivers Foundation, the S. Clement Swisher Trust, TD Bank, and Wells Fargo, as well as the U.S. Department of the Treasury's CDFI Fund.

Other CDFIs that finance affordable multifamily housing include the Enterprise Community Loan Fund, the Low Income Investment Fund, and the Mercy Loan Fund. Community Housing Capital and NeighborWorks Capital are two CDFIs that lend exclusively to members of the NeighborWorks network.

State and local housing agencies' roles. As Congress cuts federal assistance for affordable housing, rents rise and owners of existing properties opt to profit from market-rate conversions. Many states, cities, and counties are increasing resources dedicated to affordable housing preservation and development.

For example, nearly all states now prioritize preservation of existing affordable rental housing in their competitive LIHTC qualified allocation programs. For instance, Michigan offers both a 25 percent set-aside of housing tax credits exclusively for preservation and additional incentives in its allocation plans for projects involving the preservation of rental properties with existing subsidies. Oregon, on the other hand, offers substantial incentives for preservation activities but no set-aside. In 2014, both states allocated over 70 percent of their housing tax credits to preservation, illustrating the various ways that states successfully support and incentivize the preservation of existing affordable housing.

Similarly, nearly all state housing trust funds support preservation activities, and many funds prioritize them as preferred activities. At the local level, some cities and counties dedicate tax revenues to affordable housing preservation. For more information on state and local preservation policies, visit the NHT's online preservation catalog.

Many banks invest in LIHTC projects to acquire and renovate existing multifamily housing. The same lender that provides the bridge and take-out financing can invest in the LIHTC project and purchase a property's housing tax credits. Recently, 48 percent of all LIHTCs allocated went to preservation projects. By investing in housing projects in jurisdictions that prioritize the use of LIHTCs for preservation projects with expiring subsidies or use restrictions, banks support critical preservation activity. LIHTCs are the investment vehicle of choice for multi-investor funds in which community and regional banks invest.

Preserving naturally occurring affordable housing by sponsoring a real estate investment trust (REIT). A REIT is an investment vehicle created by Congress in 1960 to provide a means for small-scale investors to invest in income-producing commercial, industrial, and residential real estate. Some REITs purchase or develop properties directly, some acquire equity positions in properties, some offer private debt, and some pursue a blended approach, combining debt and equity investments with direct development.

Lenders can help preserve naturally occurring affordable housing by sponsoring a mission-driven REIT. These REITs allow affordable housing developers to compete for unsubsidized properties with market-rate buyers by providing a single source of capital that can be quickly deployed and used for the entire purchase. For example, the Housing Partnership Equity Trust (HPET) was formed as a social-purpose REIT sponsored by the Housing Partnership Network, a business collaborative of housing

9 National banks may make investments that are primarily designed to promote the public welfare under the investment authority in 12 USC 24(Eleventh) and the implementing regulation, 12 CFR 24. This authority allows banks to make investments if those investments primarily benefit low- and moderate-income individuals or areas, or other areas targeted by a government entity for redevelopment, or if the investments would receive consideration under 12 CFR 25.23 (the CRA regulation) as a "qualified investment." Examples of public welfare investments include those supporting affordable rental housing and CDFIs certified by the U.S. Department of the Treasury's CDFI Fund.

and community development nonprofit groups. The HPET provides a source of long-term, low-cost capital, enabling its 12 mission-driven nonprofit partners to quickly and efficiently acquire so-called "naturally occurring" affordable properties.[10] The NHT/Enterprise Preservation Corporation is one of HPET's 14 nonprofit members. To date, HPET has raised $85 million in equity and has used it to purchase 11 properties in six states, totaling 2,605 homes.[11]

NHT/Enterprise, in partnership with Homes for America, acquired the Bradford Apartments, a 418-unit unsubsidized apartment community in Hagerstown, Md. The property provides affordable housing to a workforce population and very low-income households. All necessary funding was provided by the HPET, which layered debt and equity returns into a single product that allowed NHT/Enterprise and Homes for America to quickly purchase and preserve the property.

The Community Development Trust (CDT) is another mission-oriented REIT that provides financing for the production and preservation of subsidized affordable housing. The CDT works with local and national partners to make long-term equity investments and originates and purchases long-term mortgages that support the development and preservation of affordable housing for low-to-moderate-income families. The CDT seeks a market return, depending on the location. As a long-term investor, the CDT looks for opportunities that generate a consistent return as the basis for paying its investors. In addition to supplying the capital needed to restructure a property's ownership, address capital needs, and replace major systems, the CDT provides such amenities as recreational facilities and community centers. The CDT has invested more than $1.2 billion of debt and equity capital in properties in 44 states, creating or preserving over 40,000 units while earning a market-based yield for institutional investors.

National Housing Trust

The National Housing Trust and the Enterprise Preservation Corporation helped revitalize a deteriorated neighborhood in Baltimore, Md., by financing the redevelopment of 111 affordable units with low-income housing tax credits, bond financing from the state of Maryland, and city of Baltimore gap financing.

Preserving naturally occurring affordable housing with debt products. The NHTCDF is working with several banks to develop a multifamily loan product that would provide a single fixed-rate loan with loan-to-value ratios of up to 95 percent by using bank funds for the first 70 percent and its own funds for 25 percent. The remaining 5 percent would come from the developer's own equity. The basic structure would be similar to the HPET structure in that it would allow a developer to quickly purchase a property by avoiding the need for multiple layers of financing. Banks can work with CDFIs to make investments with similar structures.

As the nation confronts a growing rental housing affordability crisis, banks have the opportunity to tap a steady source of revenue and earn positive CRA consideration by participating in efforts to safeguard hundreds of thousands of affordable units that serve as the foundation of vibrant communities.

For more information, visit the National Housing Trust web page or contact Ellen Lurie Hoffman at ehoffman@nhtinc.org.

Articles by non-OCC authors represent the authors' own views and not necessarily the views of the OCC.

10 "Naturally occurring" affordable housing is housing that meets federally defined rental affordability standards without being supported by public subsidies.

11 Center for California Real Estate, *Journal of Case Study Research,* "Preserving Existing Affordability Through a Social Purpose REIT," page 40.

HUD's Rental Assistance Demonstration Program Creates Opportunity

Virginia Flores, Recapitalization Specialist, U.S. Department of Housing and Urban Development

The U.S. Department of Housing and Urban Development's (HUD) Rental Assistance Demonstration (RAD) program was created to give rental housing owners the opportunity to preserve and rehabilitate vulnerable affordable housing properties. HUD estimates that every year an average of 10,000 public housing units are lost to disrepair or demolition.

RAD allows public housing agencies to access private capital to address a $26 billion nationwide backlog of deferred maintenance. RAD also provides private owners of rental projects assisted under three HUD "legacy" programs—Rent Supplement, Rental Assistance Payment, and Section 8 Moderate Rehabilitation—the opportunity to enter into long-term contracts that facilitate the financing of improvements.

Through RAD, public housing developments and privately owned legacy properties are able to convert their HUD assistance to long-term Section 8 rental contracts. These long-term contracts provide more stable funding and enable owners to leverage additional financing to complete capital repairs. Public housing conversions are limited to 185,000 units, but demand for the program continues to grow. Two recent RAD deals highlight the involvement of large banks in helping to preserve affordable housing resources for families across the country.

Freddie Mac

Fort Henry Gardens, in Arlington, Va., is a Rental Assistance Demonstration program project financed by Freddie Mac. Its units are restricted to households earning no more than 60 percent of the area median income.

San Francisco's Re-Envisioning Plan

In 2013, the city and county of San Francisco engaged HUD staff to re-envision the future of San Francisco's public housing developments, culminating in the San Francisco Housing Authority's (SFHA) Public Housing Re-Envisioning Plan. City and SFHA staff met with more than 70 organizations and 20 city departments during this process to discuss the importance of preserving and improving these developments to better serve residents and the community.

Through RAD, the SFHA plans to transform 1,400 public housing units in partnership with Freddie Mac and Bank of America Merrill Lynch, the lender and low-income housing tax credit (LIHTC) investor. The Public Housing Re-Envisioning Plan, which is Bank of America Merrill Lynch's largest affordable housing investment, will provide financing for seven development partners across 15 projects. Financing totaling almost $760 million will comprise the following:

- $362 million in construction financing
- $285 million in LIHTC equity
- $20 million in subordinated, forgivable debt
- $2.2 million to provide services to public housing residents
- $5 million for predevelopment loans
- $83 million in permanent financing from Freddie Mac

In November 2015, the SFHA closed on the first phase of its RAD transactions including Holly Court, a 118-unit public housing development built in 1940 (one of the oldest public housing developments on the West Coast), and 990 Pacific, a 92-unit development built in 1969 that serves primarily Chinese-speaking senior residents. Both developments were in need of extensive rehabilitation that far exceeded SFHA's available funds, including mold remediation and seismic retrofit. Financing secured through RAD will enable the SFHA to make these repairs and many others to ensure that these properties remain affordable housing resources in San Francisco's tight rental housing market.

The SFHA closed on its second phase of RAD transactions in late 2016. For more information about the SFHA transaction, see "Freddie Mac's Role in Preserving Multifamily Affordable Rental Housing" in this edition of *Community Developments Investments*.

HUD

Hunters Point East/West Apartments, a 62-year-old San Francisco Housing Authority project, was renovated with funds from the Rental Assistance Demonstration program and other sponsors.

Using New FHA Products in Kentucky

Centre Meadows, in Lexington, Ky., formerly known as Pimlico Apartments, was one of the first RAD transactions financed with a Federal Housing Administration (FHA) 221(d)(4) mortgage—FHA's mortgage insurance program for new construction or substantial rehabilitation of rental housing. The 206-unit apartment complex receives rent subsidies through a project-based voucher contract, and the Lexington Housing Authority (LHA) renovated the development.

The property had significant capital needs and was so deteriorated that, at the time of the RAD application, it was thought to be housing of last resort for people who had no other housing options. Approximately 20 units were in danger of losing federal subsidy due to poor physical condition. Without RAD, it was quite likely that the property would have been demolished. Through RAD, the LHA obtained an FHA-insured mortgage from Wells Fargo to finance physical improvements and preserve the complex as long-term affordable housing.

The $30.3 million development budget was funded by cash collateralized tax-exempt bonds (with the FHA-insured loan from Wells Fargo as the permanent first mortgage), 4 percent LIHTCs, seller financing, LHA funds, and funds from HUD's HOME Investment Partnerships Program, which provides grants to states and localities for affordable housing. The loan leveraged significant funds to undertake the comprehensive rehabilitation that the property desperately needed. Improvements included new drywall, fresh paint, new kitchen cabinets, new windows, heating and air conditioning system upgrades, and a complete exterior transformation that is expected to be a catalyst for the neighborhood's revitalization. Wells Fargo has also partnered with the Cambridge Housing Authority in Massachusetts and the Southern Nevada Regional Housing Authority in Las Vegas in their RAD preservation efforts.

For more information on RAD, please visit the RAD program web page or contact Virginia Flores at virginia.flores@hud.gov.

Articles by non-OCC authors represent the authors' own views and not necessarily the views of the OCC.

How Affordable Housing Qualifies for Community Reinvestment Act Consideration

Vonda Eanes, Director for CRA and Fair Lending Policy, OCC

Affordable housing is a core component of community development under the Community Reinvestment Act (CRA) regulations. National banks and federal savings associations (collectively, banks) may receive CRA consideration for loans, qualified investments, and community development services with a primary purpose of providing affordable housing, including multifamily housing for low- or moderate-income (LMI) individuals.

Under the CRA, the OCC evaluates a bank's record of helping to meet credit needs in the communities where the bank has deposit-taking facilities. This evaluation includes considering the number and dollar amount of bank loans used to purchase, develop, refinance, or improve multifamily residential properties. Unlike loans for other purposes, loans related to multifamily housing that primarily benefit LMI individuals or families may be considered retail loans under the lending test as well as community development loans. For banks evaluated under the OCC's large bank procedures, community development loans are considered under the lending test. For intermediate small banks and wholesale and limited purpose banks, community development loans are considered under their respective community development tests.

Community development loans include loans that support affordable housing to benefit LMI persons. Community development loans also include loans that help to revitalize or stabilize LMI areas, designated disaster areas, or areas defined by the OCC, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation as underserved or distressed nonmetropolitan middle-income areas.

National Housing Trust

Friendship Court, a 150-unit low-income housing tax credit property in Charlottesville, Va., received grants from the city of Charlottesville, the Federal Home Loan Bank of Atlanta, and others to maintain the property as affordable housing.

The "Interagency Questions and Answers Regarding Community Reinvestment (Q&A)," dated July 25, 2016, provides guidance on how to determine whether a project is considered affordable housing for LMI individuals. The guidance notes that the concept of "affordable housing" hinges on whether LMI individuals benefit, or are likely to benefit, from the housing. It would be inappropriate to give CRA consideration to a project that exclusively or predominately houses families that are not LMI simply because the rents or housing prices are set according to a particular formula.

Examiners review demographic and economic factors as well as market data to determine the likelihood that housing primarily accommodates LMI individuals. Such a review is useful for projects that do not yet have occupants and for which the income of potential occupants cannot be determined in advance—or for projects where occupant income is unknown. For example, examiners may look at median rents of an assessment area compared with the project; median home values in the assessment area and in LMI geographies compared with the project; affordability based on incomes for LMI families in the area of the project; and the past performance record of the organization or organizations undertaking the project. Such a project could receive CRA consideration if there is an expressed bona fide intent of community development, for example, in the project prospectus, loan proposal, or related community action plan.

Banks also can receive CRA consideration for loans to or investments in organizations that provide services primarily to LMI populations. CRA guidance explicitly recognizes loans to and investments in community development financial institutions (CDFI) as community development activities. In the case of a qualified investment, CRA consideration may be based, at the bank's option, on either the full amount of an investment or a pro rata share of community development loans made by the CDFI. The pro rata share is based on the bank's percent of equity in the CDFI. A bank may also choose to receive partial consideration for both the qualified investment test and its pro rata share of loans.

Banks that provide technical assistance for CDFIs—including developing loan application and underwriting standards, lending employees, or serving on boards and committees—are eligible for CRA consideration for these activities as a community development service. Other examples of community development services with CDFIs include developing secondary market vehicles or programs, assisting in marketing financial products, furnishing financial services training for staff, contributing accounting or bookkeeping services, and assisting in fund-raising. Referring an applicant to a CDFI or another community development lender may also receive CRA consideration if a bank has determined the applicant is ineligible for bank financing and it is bank policy to refer credit building loans to the CDFI.

Loans and investments supporting an organization that covers an area larger than the bank's assessment area(s) may also receive CRA consideration. The bank's assessment area(s) need not receive immediate or direct benefit, provided that the purpose, function, or mandate of the organization includes serving geographies or individuals within the bank's assessment area(s). Examiners may also consider activities in the broader statewide or regional area even if the activities do not serve the bank's assessment area(s) as long as the bank has been responsive to needs in its assessment area(s). In evaluating "responsiveness," examiners consider all activities that serve the bank's assessment area(s) as well as opportunities available to the bank in its assessment area(s).

Bankers should consult with their supervisory office if they have questions about specific projects, loans, investments, or services and the types of documentation needed to demonstrate the benefit to LMI individuals or other qualifying purposes of community development.

For more information, contact Vonda Eanes at vonda.eanes@occ.treas.gov.

Preservation of LIHTC Properties: Year 15 Considerations

David Black, Community Development Expert, OCC

The federal low-income housing tax credit (LIHTC) program promotes public-private partnerships[1] that create affordable rental housing. The program uses federal tax credits to attract private equity to qualified affordable housing projects. Since the program's inception in 1986, banks have been significant investors in LIHTCs.

The program has been successful in developing new affordable rental housing, with more than 2.7 million affordable housing units placed into service.[2] Rents must be affordable to households earning 60 percent or less of area median income.

Housing financed with LIHTCs has time limitations on the rental affordability restrictions. Initially, the program mandated rent restrictions for 15 years. But in 1989, just three years after the program's inception, Congress introduced several measures to improve the efficiency of LIHTCs. Among these, the program was made permanent in 1994, and awarding credit allocations became a competitive process. Another key change added 15 years to the existing 15-year compliance period (the additional 15 years is known as the "extended-use period"). As a result, properties placed in service after 1990 are generally required to remain affordable for at least 30 years.[3]

National Housing Trust

Skyview Park Apartments, a 188-unit affordable housing property in Scranton, Pa., underwent a renovation performed by the National Housing Trust and the Enterprise Preservation Corporation and financed with low-income housing tax credits, a 20-year Section 8 project-based contract, and other financing sources.

During the compliance period, limited partner (LP) investors generally receive 10 years of annual allocations of federal tax credits provided the properties are rented to income-qualified tenants at affordable rents and meet federal property quality guidelines. Failure to comply with program guidelines can result in recapture of previously claimed credits. The tax benefits of the credits and related losses are the investor's principal economic benefit from the investment. After the 15-year compliance period, the tax credits are exhausted and previously claimed tax credits may no longer be recaptured, although owners may still be sued for not following the terms outlined in the regulatory agreements. At this time or sooner, investors may choose to exit their interest in the properties, usually by selling or transferring the LP's interest to the general partner (GP) or by selling the property to a third party.

This transfer of ownership after year 15 creates two critical challenges to the property operating and remaining affordable through the extended-use period. First, the property owner must have the managerial and financial resources to effectively maintain and manage the property over the remaining years of rent

[1] The World Bank defines a public-private partnership as "a long-term contract between a private party and a government entity, for providing a public asset or service, in which the private party bears significant risk and management responsibility, and remuneration is linked to performance."

[2] U.S. Department of Housing and Urban Development, "Low-Income Housing Tax Credits."

[3] Certain exceptions are discussed in a later section. Some housing credit allocating agencies require longer commitments, and some property owners pledge affordability for longer periods.

restrictions. The viability of the property can be compromised by excessive debt, or if reserves or other financing are not in place to meet growing capital requirements as the property ages.

Second, the property owner can choose whether to preserve the property as affordable housing once the rent restrictions expire after year 30 or later, depending on the state's use restriction agreement requirements. Community needs and strategies are important components of the decision whether to maintain affordable housing. For example, rapidly gentrifying areas may have a critical need to preserve rent-restricted units. In other cases, affordability restrictions may run counter to community development strategies of income diversification.

The market for rental housing may also affect this preservation decision. Where there is little difference between market and restricted rents, there may be little need to maintain mandated rent restrictions. Where significant differences between market and restricted rents exist, however, there may be substantial community benefits in the units remaining rent restricted. This community benefit objective may conflict with the interests of the property owner, who may gain considerable financial benefits by converting the units to market rate.


National Housing Trust

Hazel Hill Apartments, in Fredericksburg, Va., faced foreclosure and tenant displacement before the National Housing Trust and the Enterprise Preservation Corporation acquired it, substantially renovated and preserved it, and constructed a new community building. The 147-unit property receives Section 8 project-based subsidies that will sustain its affordability for many years.

More than 1 million LIHTC-financed affordable units will reach the end of their year 15 compliance period by 2020.[4] Earlier research by the U.S. Department of Housing and Urban Development (HUD) on year 15 transfers indicated few problems in the process.[5] More recently, however, affordable housing advocates have raised concerns that, in some cases, profit-taking at transfer has threatened the long-term affordability of LIHTC properties and public support for the LIHTC program. Advocates were concerned about projects being stripped of operating reserves,[6] affordable housing developers being unable to compete with financially motivated investors when properties were placed for sale,[7] and property owners financially benefiting from rental assistance contracts that exceed allowable LIHTC rents,[8] a practice that could potentially erode public support for the LIHTC program.

Few Properties Convert Before Year 30

During the compliance period, the LP investor receives tax benefits from its investments when the properties are leased to income-

4 HUD, Office of Policy Development and Research, "What Happens to Low-Income Housing Tax Credit Properties at Year 15 and Beyond?," August 2012.

5 Ibid.

6 Halliday, Toby, "Squeezing the Housing Credit at Both Ends," Bipartisan Policy Center, March 11, 2014.

7 See "Preserving America's Affordable Rental Housing: The Role of the Nation's Banks" in this edition of *Community Developments Investments*.

8 According to the California Tax Credit Allocation Committee (CTCAC), the concern is that the property owner is receiving value not as a result of its own performance but as a result of the policy decisions made by a public agency. Rather than the value being taken out at sale, the CTCAC felt the value should remain with the project and be available to finance rehabilitation needs. See the CTCAC memo "Proposed Regulation Changes With Initial Statement of Reasons," July 16, 2015. Commentators to the proposed regulatory change noted that the so-called Section 8 "overhang," when the project-based rental assistance contract rents exceed LIHTC rents, is often used to finance supportive services for tenants. This proposed regulatory change was not finalized.

qualified tenants at affordable rents. The staff of state housing credit allocating agencies (HCAA) oversees compliance with LIHTC program requirements and reports noncompliance to the Internal Revenue Service (IRS). Failure to comply with program regulations may result in the recapture of some or all previously allocated credits.

A land use restriction agreement (LURA) is required on all LIHTC properties. A LURA is a binding agreement between the property owner and the HCAA to limit the use of the property to affordable housing through the extended-use period, and includes certain income qualifications and rent restrictions. The LURA may contain additional requirements, such as the provision of supportive services or units targeted to specific populations (e.g., the elderly or people with special needs). The LURA is binding on all successor owners of the property, except under the exceptions described below, and is enforceable under state law. In addition, many LIHTC properties have soft debt from public sources as part of their financing package that may also carry affordability restrictions and reporting requirements.

During the extended-use period, the economic benefits of LIHTC properties come from the properties themselves, rather than the LIHTCs. The HCAA carries out its compliance responsibilities by reviewing annual reports and conducting periodic site inspections. Compliance violations are no longer reported to the IRS. The properties may be sold at a price established by the buyer and seller, although, depending on state requirements, the sale may require HCA approval.

National Housing Trust

The National Housing Trust, the Enterprise Preservation Corporation, and the affordable housing developer Mi Casa helped the tenant association of Meridian Manor, a 34-unit property in Washington, D.C., acquire, rehabilitate, and preserve the apartment building for households earning no greater than 50 percent of area median income.

LIHTC regulations provide for two exceptions to the extended-use requirement. First, if LIHTC properties are acquired by a valid, arms-length foreclosure, the extended-use period terminates on the date of acquisition. Few LIHTC properties, however, enter into foreclosure.[9] Second, completing the qualified contract (QC) process allows property owners to discontinue the affordability restrictions.[10] The property owner starts the process with a request to the HCA to find a buyer to make a bona fide offer for a price determined by a statutory formula. If a buyer makes such an offer,[11] the extended-use requirements remain in effect. If the HCA is unable to find a buyer within one year of the request, the LURA can be terminated.

Under both exceptions, for a period of three years, the owner may not terminate existing tenancies without good cause or raise rents by more

[9] CohnReznick, "The Low-Income Housing Tax Credit at Year 30: A Focus on Recent Property Performance (2013-2014)," December 2015.

[10] Many property owners give up the ability to request a QC when submitting their application for LIHTC allocations.

[11] There is no requirement for the sale to actually happen. Treas. Reg. section 1.42-18(a)(1)(iii).

than what would be allowed under the program rules.

Types of Transfers

An investor can exit a LIHTC project in several ways.[12] The method of exit depends on several factors, including the agreement the investor has with its partners, applicable laws and regulations, tax and other financial issues, and relationship and reputation issues.

The most common exit involves the sale of a property or the transfer of a partnership interest.[13] When a property is sold, the partnership is dissolved and the LP, the GP, or both exit the transaction. The HCAA and other lenders holding debt on the property need to approve the sale, depending on the agreements in the partnership documents. In the transfer of a partnership interest, the underlying business remains intact. In many LIHTC transactions, the GP purchases the LP interest at the end of the compliance period. The nature of this transaction, including the parameters for establishing a purchase price, is typically delineated in the partnership agreement.

Qualified nonprofit organizations, government agencies, tenants, and certain tenant organizations may negotiate a right of first refusal (ROFR) to purchase the LIHTC property for all outstanding debt and any tax liabilities generated as a result of the transaction.

The LP investor may sell its interest in the project to the GP through a put option, usually for a nominal price (e.g., $1,000). The put option is negotiated up front and included in the partnership agreement.

Finally, the LP investor may donate all or a portion of its partnership interest to a nonprofit entity, usually the GP. The donor may take a charitable contribution tax deduction on the donation.

If the property needs extensive rehabilitation, the rehabilitation work may be financed through the property owner obtaining new LIHTCs. Resyndication of the property with a new allocation of LIHTCs requires rehabilitation costs of at least approximately $6,000 per unit.[14] Some HCAs require rehabilitation expenditures that significantly exceed this federal minimum. LP investors usually require higher rehabilitation thresholds.

The least common type of exit is conversion of the affordable property to market-rate rentals or condominiums. There are two paths to this type of conversion. A tenant or tenant organization may purchase a property through the ROFR process, and at some predetermined time the tenant will have the option to buy the unit. Alternatively, a property owner or investor that is unable to find a new buyer for its property with the extended-use restrictions may pursue the QC process previously described.

Balancing Financial and Community Benefits

According to industry experts, banks have accounted for approximately 85 percent of the equity raised using LIHTCs.[15] This equity has allowed the properties to be developed and leased at affordable rents.

While banks have been invaluable as investors, they have done much more to make the LIHTC program a success. Financial institutions have also been valuable partners in providing debt financing and facilitating the high levels of performance achieved by LIHTC-financed properties. This leadership has been critical.

In all exits, banks need to balance financial and community concerns. As investors, banks may view making legitimate claims on partnership assets as part of their fiduciary responsibility. As business partners, banks may want to consider the impact of various exit strategies on long-term business and community relationships. And as participants in public-private partnerships designed to meet public goals, banks may want to consider the impact of their exit on the preservation of the affordable housing asset.

For more information, contact David Black at david.black@occ.treas.gov.

12 For a more extensive description of different types of transfers, please see the *Novogradac LIHTC Year 15 Handbook,* Novogradac & Company, 2015.

13 HUD, Office of Policy Development and Research, "What Happens to Low-Income Housing Tax Credit Properties at Year 15 and Beyond?," August 2012.

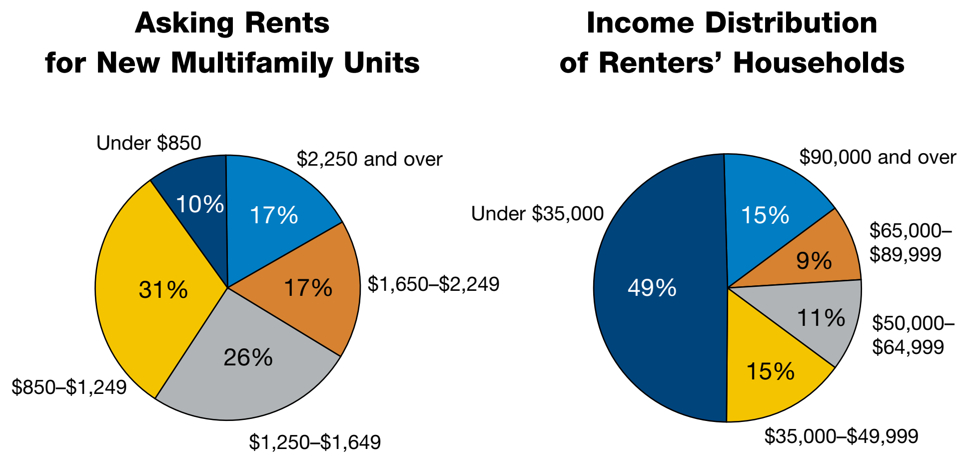
14 The threshold is inflation adjusted.

15 CohnReznick, *The Community Reinvestment Act and Its Effect on Housing Tax Credit Pricing*, May 2013.

Banks and the Recapitalization of Existing Affordable Housing

Todd Crow, Executive Vice President, Manager of Tax Credit Capital, PNC Real Estate

Timber Pines is a fictional 90-unit low-income housing tax credit (LIHTC) property in Louisville, Ky. It was built in 1996 and serves low- and moderate-income families earning between 50 percent and 60 percent of the HUD-published area median income, which in the Louisville area means an annual income of between $33,500 and $40,200 for a family of four. Families meeting these requirements are able to rent a two-bedroom, two-bathroom apartment for $675 per month, estimated to be as much as 30 percent below market rents for a comparable unit.



Source: Joint Center for Housing Studies of Harvard University

Note: Percentages do not add up to 100 because of rounding.

Approximately 64 percent of all rental households earn under $50,000 per year, and affordable rents for these households are less than $1,250 per month. Only 41 percent of new multifamily units have rents less than $1,250 per month.

The property has performed very well but is now 20 years old and showing signs of stress. In the next few years, the property will need new roofs. Kitchen and bathroom appliances have been replaced as needed, but annual operating costs are increasing. While the property is covering debt service and producing modest cash flow, it is not sufficient to fund any meaningful renovation. As a LIHTC property, the property is covered by a land use restriction agreement (LURA), which requires rents to remain restricted for 10 more years (for a total of 30 years of restricted rents).[1] As a result of these restrictions, the owner is unable to increase rents to generate an economic return from making the investment necessary to rehabilitate the property. Timber Pines is clean and safe, but aging and becoming more expensive to operate.

The partnership that owns Timber Pines in this fictional example is a typical LIHTC limited partnership with a local real estate developer acting as the general partner and a syndicated fund as the investor. The 15-year term of the compliance period is over. On behalf of the investors, the syndicator would like to liquidate its investment and has requested that the general partner either repurchase its interest or sell the property. The general partner of this partnership is a subsidiary of a small real estate company whose principal is trying to retire. As such, the property is listed for sale. Since Timber Pines is a nice property with a strong track record, there is third-party interest in acquiring the property.

During the listing period, there are several offers for the property. Three of these offers are from real estate investors that intend to benefit from the property's cash flow over the remaining 10 years at restricted rents. Ultimately these investors intend to renovate the property and increase the rents by 30 percent to 40 percent in 2027. Importantly, starting in 2027, this renovation will displace the existing low- and moderate-income tenants with more affluent tenants who can afford the

[1] It should be noted that some jurisdictions require rent restrictions beyond 30 years.

Bolton Housing: The Preservation Cycle

Bolton North is a senior affordable apartment building located in Baltimore, Md. The property consists of 208 one-bedroom, one-bathroom units in a 16-story high-rise building on 1.266 acres. All of the residential units are supported by a long-term project-based HAP contract that expires in 2031. The project was acquired in September 2014 for just over $23.3 million by a preservation fund owned by a joint venture among the NHP Foundation, Urban Atlantic, and PNC Bank. Of the purchase price, $7.7 million was funded with equity from the fund while $15.6 million was funded with a balance-sheet loan from PNC Bank.

At the time the project was acquired by the preservation fund, the asset strategy called for redevelopment utilizing 4 percent tax credits, a moderate rehabilitation of the property (estimated at $15,800 per unit), and an extension of the restricted rent period to 2045. Working with the city of Baltimore and the state of Maryland, the fund is working to address the necessary entitlements, arrange for a payment in lieu of taxes, and secure an allocation of tax-exempt bonds and 4 percent tax credits. Under the current plan, investment objectives of the fund will be satisfied.

Currently the property is scheduled to be acquired from the preservation fund in March 2017 and recapitalized on terms that allowed for an attractive return to the investment fund, a per unit rehabilitation budget that exceeded original projections ($27,300 versus $15,800), and a contractual extension of the long-term affordabilty of the project for an additional 30 years. Two additional projects in this fund, also in Maryland, are expected to close as tax credit transactions in 2017. According to Richard Burns, President and CEO of the NHP Foundation, “Preservation of the nation’s supply of affordable rental housing is critical and a central part of the NHP Foundation’s mission. The collaboration and partnership with PNC has been essential in preserving the affordability of the Bolton project and others like it.”


NHP Foundation

Bolton North Apartments, a senior-housing community in Baltimore, Md., was preserved as affordable housing through the year 2045 by a joint venture among the NHP Foundation, Urban Atlantic, and PNC Bank.

higher rents. These buyers believe they can get a modest return on their investment over the holding period, but their interest in the property is driven primarily by the prospect of selling or refinancing the property after the rents are increased at the end of the restricted rent period.

The remaining three offers are from smaller developers who plan to redevelop the property and keep it affordable by securing a new LIHTC allocation and immediately performing $40,000 of rehabilitation per unit. Given the uncertainty of a tax credit allocation, the buyers who seek to maintain the property’s rent affordability each propose to take an option for the property for 12 months and close only if they receive a tax credit allocation.

The top offer is from a market rate buyer from the first group who proposes to close as an all cash purchase in 45 days. This offer is selected by the seller, and the property is sold.

For stakeholders in the creation and preservation of affordable rental housing, what has just happened? What are the implications? What does “preservation” mean in this context?

First, please keep in mind that this scenario is fictional. At PNC Bank, however, we see versions of this scenario play out on a regular basis when selling from our approximately $9 billion syndicated LIHTC portfolio. While having sold interests in over 400 LIHTC projects on behalf of our investment funds over the past five years, we’ve seen only a small percentage of these projects developed with extended affordability.

Second, no one in this story has done anything wrong in this writer’s opinion. Each party has honored its contractual commitment and has pursued its own economic interests within clearly prescribed program boundaries. No good guys. No bad guys. No harm. No foul.

Third, it is important to have this example in mind when you think about “preservation.” What is preservation? Currently, the term seems to be used very loosely. For some, it can be shorthand for rehabilitating an existing property. For others, it seems to mean simply the acquisition of an existing affordable housing project, often with no specific intent. For purposes of this discussion, preservation means something different: the acquisition of an existing affordable project for the specific intended purpose of contractually extending the affordability period by utilizing a LIHTC allocation, a Section 8 housing assistance payment (HAP) contract, or other forms of subsidy necessary to address the physical needs of the project.

So then, why is the outcome described in this fictional example so unsatisfying? Primarily because this scenario will likely lead to the eventual displacement of families and seniors who rely on this type of housing. And because we know that the cost per unit of preserving the quality and affordability of this housing is far less than the cost of replacing it. But what should be most troubling is the knowledge that the same private and public sector forces that created this housing could be doing more to preserve it.

PNC Bank has taken an innovative approach to preservation. PNC and its affiliates offer a variety of balance sheet and agency finance products to assist clients in acquiring and preserving affordable housing. But beyond lending, PNC Bank has been an active investor and has expanded one of the industry’s largest LIHTC syndication platforms to include sponsorship of syndicated preservation funds. PNC Bank has invested equity in multiple preservation funds sponsored by third parties and has recently syndicated an investment fund that raised $100 million in equity that has been levered at 60 percent to acquire $250 million in at-risk affordable housing projects nationally. The fund is designed to deliver a very attractive risk-adjusted return while pursuing extended affordability via a LIHTC recapitalization (see an actual example in “Bolton Housing: The Preservation Cycle”on page 18).

Whether lending or investing, banks can, and do, play an important role in preservation of affordable rental housing. Working with our top developer clients as well as stakeholders in state and federal government, banks have an opportunity to do more, much more.

The views expressed by Mr. Crow are his own, and this article was prepared for general informational purposes only. The information and views in this publication do not constitute legal, tax, financial, or accounting advice or recommendations to engage in any transaction. For more information, visit the PNC web page or contact Todd Crow at todd.crow@pnc.com.

Minnesota Partnership Helps Preserve Rural Housing

Robyn Bipes, Vice President of Loan Fund and Mortgage Lending, Twin Cities Habitat for Humanity

Some housing crises grab national headlines: sub-prime lending, the collapse of the housing market, or the urgent need to create more stable housing for our military veterans. Unfortunately for thousands of seniors and modest-income families, there is another housing crisis that has gone largely unnoticed: the looming loss of hundreds of thousands of the most affordable rental housing units in small towns and rural areas across the country.

Minnesota Preservation Plus Initiative

Prairie Rose Apartments, in Red Lake Falls, Minn., is a 16-unit Section 515 apartment property preserved with funding from USDA Rural Development, low-income housing tax credits, and a nonprofit organization.

What's at Stake

Many parts of rural America face disinvestment. For years, affordable housing in rural areas has lacked private reinvestment, and the condition of rental housing has continued to decline due to aging properties and unaddressed rehabilitation needs. Rural areas do not see as much new construction; rents often are lower so developers are attracted elsewhere for greater profits; and state and federal resources allocated to building or revitalizing rural areas are vastly insufficient. Yet, these affordable rental properties are home to some of America's lowest-income seniors and families.

Without investment in rural housing, the situation may get much worse. Over the next eight years, rural America could collectively lose an estimated 11,500 affordable, federally assisted U.S. Department of Agriculture (USDA) Rural Development rental properties, currently home to more than 300,000 seniors and lowest-income Americans. This threat hinges on the loss of affordable mortgage financing for rural multifamily rental buildings. When the USDA mortgage secured by a rural multifamily rental building is paid off, the tenants in the property no longer receive USDA rental assistance. The rental assistance payments keep rents affordable for tenants and provide stable rent payments for the property owners.

The story could have a happy ending, however. In rural places across the nation, banks are partnering with nonprofit and community lending organizations to find new ways to stabilize and preserve this much-needed and irreplaceable affordable housing before it is permanently lost.

Decades of Affordable Housing Finance

The U.S. Department of Housing and Urban Development (HUD) creates much of the country's affordable housing in urban centers and larger towns. The USDA, through its Rural Development division, has for decades provided financing for the creation and preservation of affordable housing in smaller towns, regional city centers, and rural areas with populations less than 20,000. The USDA's Rural Development Section 515[1] housing program provided low-interest mortgages, with effective rates as

1 Authorized under Section 515 of the Housing Act of 1949 (42 USC 1485).

low as 1 percent for 30 to 50 years, to small building owners, nonprofit groups, and mom-and-pop operators who developed and operated apartment buildings as small as eight units to house rural farm labor and other low- and moderate-wage households. The majority of this housing stock was built as modest walk-up apartments between 30 and 50 years ago.

These affordable properties have weathered decades of use, with insufficient funds for upkeep and rehabilitation. Many original owners who built this housing stock are aging too, often with no clear plan for who can take over the properties or care for their tenants.

The situation is reaching a crisis point as thousands of these affordable developments across the country are now nearing the end of their USDA-financed mortgages. While an end to a mortgage payment sounds good to most people, the striking reality is that when a USDA Section 515 mortgage is paid off, the owner is no longer under contract to provide affordable rents. When rent restrictions end, many owners elect to sell their properties or convert them into units that demand market-rate rents. According to USDA Rural Development, 11,500 properties will reach this maturity payoff point by 2024, creating a severe impact on hundreds of thousands of residents.

The USDA's Section 515 program also provides important rental assistance to many tenants of these properties. With this assistance, tenants can afford the rent by paying no more than 30 percent of their income on housing, helping ensure they have enough money for food, clothing, transportation, and health care. When a USDA mortgage matures or is prepaid, this rental assistance disappears. Consider this example: A renter with a household income of $1,000 a month has a rent payment of $500. Of this, the renter pays $300 and USDA rental assistance covers the rest. When a mortgage matures, the affordability restriction expires and the owner raises the rent to $600 a month at the same time that the tenant's rental assistance disappears. The renter must now pay $600, twice the previous amount. On average, households in a USDA-financed Section 515 property earn less than $15,000 a year, and many are on fixed incomes and unable to afford any significant rent increases.

Making the rural disadvantage worse is the fact that the USDA does not provide portable rental vouchers to tenants living in properties when USDA mortgages mature. Portable vouchers can protect tenants against rent increases when a property matures out of the program, by allowing them to use a voucher where they live or to find a similar property that will accept a voucher. Without vouchers, existing renters are often unable to pay the full rent to stay in their current housing. Finding other affordable housing can be difficult in rural communities where affordable housing has not been developed in years, or where the nearest affordable apartment is towns away.

How big is this problem? According to USDA Rural Development, rental assistance helps more than 215,000 of the 333,845 households that are renters in USDA-financed apartment buildings. The loss of USDA-financed housing will cause a doubling or, in some cases, tripling of rents, displaced seniors and low-wage earners, fewer suitable replacement apartments to house them, and further disinvestment in rural towns.

Banks Consider Public-Private Partnership

While national attention on this crisis lags, states like Minnesota, Oregon, and Ohio with large and aging portfolios of USDA-financed properties are proactively developing public-private partnerships among banks, public entities, and nonprofit organizations to effectively preserve these affordable units before too many are lost.

In Minnesota, a collaboration of Minnesota Housing (the state housing finance agency), the USDA Rural Development Minnesota office, and the Greater Minnesota Housing Fund (GMHF), a nonprofit lender, has resulted in a creative set of financing tools and incentives that have attracted private capital from banks and other investors. These resources are preserving Minnesota's most at-risk USDA-financed affordable rental properties before they convert to market-rate housing.

The Minnesota partners created a proactive statewide system to identify USDA-financed rural properties at highest risk of being lost. The funding partners then prioritize state resources and philanthropic dollars to provide incentives to owners to preserve or transfer their properties to preservation-minded for-profit groups and nonprofit organizations willing to buy and preserve these affordable units. These state incentives include an annual set-aside of $300,000 in low-income housing tax credits (LIHTC or housing tax credits) reserved for USDA Rural Development properties each year, and a prioritization of deferred loans from Minnesota Housing and other funders for properties that clearly demonstrate federal rental assistance is at-risk. Affordable housing developers in Minnesota have successfully used this set-aside to secure tax credit equity for their USDA developments, and raised private equity capital from banks and other investors in exchange for the tax benefits offered by the LIHTC program. The USDA has extended the term of its existing debt in some cases, allowed additional private mortgage debt as a new source of capital in others, and continued to provide rental assistance at properties that receive significant investments from the state and other funders.

The GMHF, with its 20-year history of creating and preserving rural housing, leads the private side of the partnership. The U.S. Department of the Treasury has designated the GMHF a community development financial institution (CDFI). As a CDFI, the GMHF blends its affordable housing mission with risk-managed lending. The GMHF acts as an intermediary for private capital, creating financing tools that fill niches in the housing market. The GMHF attracts capital from banks, private investors, and philanthropic organizations to fill financing gaps and invests in low-income communities. The GMHF made a multiyear commitment to raise $10 million in private capital to preserve the most at-risk USDA units. National banks and foundations based in Minnesota provide low-interest loans to the GMHF, which the GMHF uses to provide pre-development loans, property acquisition and construction loans, tax credit bridge loans, and longer-term amortizing mortgages to USDA properties across Minnesota.

The GMHF also leveraged private capital through its tax credit syndication subsidiary, which raises private capital for placement as equity in multifamily affordable developments. Through this subsidiary and public-private partnerships, the GMHF over the last seven years has financed the preservation of 25 USDA properties in rural communities underserved by other national tax credit syndicators or direct investors. By using this combination of state investments and private funds, existing owners of USDA properties and preservation buyers can keep the USDA affordability restrictions in place and preserve rental assistance before the mortgages are paid off or prepaid.

How Banks Are Helping

Minnesota banks have played an important role in preserving Minnesota's rural rental housing. Banks make direct lending investments in USDA-financed properties by providing acquisition and construction loans to current owners rehabilitating their properties, or to nonprofit or for-profit developers positioned to acquire these properties and preserve them before the mortgages mature or are paid off. In Minnesota, banks such as Wells Fargo and U.S. Bank as well as community banks such as Bremer Bank have made construction loans to USDA preservation transactions. Minnesota's preservation buyers generally have found that community banks are more likely to provide stand-alone construction lending on these relatively smaller properties (and corresponding smaller loans) than their larger counterparts that have a larger Community Reinvestment Act (CRA) footprint.

Banks also can preserve USDA properties by purchasing the LIHTCs on a project-by-project basis through tax credit syndicators or through direct equity investments,[2] which result in a dollar-for-dollar offset of the bank's tax liability. In addition to tax advantages, banks may receive CRA consideration for investing in housing tax credits that preserve affordable rental housing. In Minnesota and elsewhere, banks have made very little LIHTC investment in rural preservation, in part because of the smaller size of each transaction. Affordable-housing developers have responded to this challenge by aggregating multiple USDA Rural Development properties together for portfolio acquisition, using 4 percent tax credits and bank loans. The larger size of these transactions makes them more attractive to larger banks and investors.

Although banks have helped preserve USDA properties, many

[2] National banks may make investments that are primarily designed to promote the public welfare under the investment authority in 12 USC 24(Eleventh) and the implementing regulation, 12 CFR 24. This authority allows banks to make investments if those investments primarily benefit low- and moderate-income individuals or areas, or other areas targeted by a government entity for redevelopment, or if the investments would receive consideration under 12 CFR 25.23 (the CRA regulation) as a "qualified investment." Examples of public welfare investments include those supporting affordable rental housing, such as by making direct and indirect equity investments in projects that use LIHTCs, and CDFIs certified by the Treasury Department's CDFI Fund.

Minnesota Preservation Plus Initiative

Vesterheim Manor, in Preston, Minn., is a 16-unit Section 515 property that was preserved and updated though a collaborative financing effort involving Minnesota Housing and the Greater Minnesota Housing Fund to make the property safer for seniors and disabled tenants.

affordable-housing developers and CDFIs indicate that the banks' participation has been insufficient and not aligned with need. This lack of bank involvement may be due to the complexity of the transactions; the remoteness and small size of the properties, which leads to smaller loan sizes; and the multiyear process of preserving units with federal assistance.

The Minnesota partners have encouraged banks to invest directly in these smaller, rural deals by making direct investments in CDFIs or the nonprofit entities that are purchasing the at-risk properties.

The GMHF as a CDFI raised capital for its preservation lending from public sources and from strategic investments made by national banks including Wells Fargo Bank and U.S. Bank. These banks invested in the GMHF's revolving loan fund by providing equity equivalent loan investments totaling more than $4.5 million, which the GMHF leveraged and deployed to preserve multifamily properties in every region of the state. The banks' investments in the GMHF are efficient and effective: Equity equivalent investments provide flexible, low-cost capital to nonprofits like the GMHF, and loan losses are reserved and funded using philanthropic and private dollars, ensuring that all lending capital can be returned to the bank when due. In Minnesota, private capital from national banks safely flowed through the GMHF to rural properties, at a scale and efficiency that exceeded what an individual bank might reach if it made loans directly to USDA properties. The banks' funds were leveraged at the property level with federal and state resources, resulting in significant public-private leverage.

Banks with a local connection also invest in nonprofit developers to expand their preservation efforts. One example is the Southwest Minnesota Housing Partnership (SWMHP), a nonprofit developer that creates and preserves affordable housing statewide. The SWMHP has received loans to cover working capital, numerous letters of credit, and a low-interest equity equivalent loan of $1 million from First Farmers & Merchants Bank, in Pipestone, Minn.

Public-Private Model Can Be Replicated

As the Minnesota example proves, banks have opportunities to invest in rural housing preservation. Each state has opportunities for direct investments by banks, or investments in the entities that are working to preserve these properties. The preservation model is particularly successful when there is a public-private partnership between agencies and CDFIs, and between lenders and rental housing owners, since preserving these properties can take years.

The economic and social return for a bank's investment, however, can achieve multiple successes: (1) Capital is directed to the bank's assessment areas, and the bank may receive CRA consideration for its investment; (2) at-risk multifamily properties in rural markets are preserved; (3) loans to nonprofit groups and CDFIs help to grow those entities as businesses and strengthen the rural job landscape; and (4) the bank helps preserve the affordable rental properties for decades to come. Without these bank loans and investments, states may not be able to keep pace with the loss of these irreplaceable rural housing units.

For more information, contact Robyn Bipes at robyn.bipes@tchabitat.org.

Articles by non-OCC authors represent the authors' own views and not necessarily the views of the OCC.

Freddie Mac's Role in Preserving Multifamily Affordable Rental Housing

David Leopold, Vice President, Targeted Affordable Sales & Investment, Freddie Mac

I was recently in San Francisco, one of the toughest markets for renters, to mark the improvement—and preservation—of more than 1,400 rental homes for very low-income families and seniors. The event celebrated the rehabilitation of 14 properties across the city through the Rental Assistance Demonstration (RAD) program, which helps preserve affordable housing. The program's aim is to convert public housing to privately held affordable housing, infuse significant new capital for much needed repairs, and establish a more stable funding base going forward.

Freddie Mac

San Francisco affordable housing such as this one has been financed by Freddie Mac and preserved through the San Francisco Rental Assistance Demonstration program.

Supply Drops as Needs Grow

The United States faces a serious and growing rental housing crisis, as discussed in Ellen Lurie Hoffman's article in this edition of *Community Developments Investments*. While the supply of affordable housing is disappearing, demand continues to grow. For the lowest-income renters, there are only 65 affordable units for every 100 households.[1] And the current limited stock is at risk. A key source of public subsidy for this housing is the federal low-income housing tax credit (LIHTC), but the income and rental restrictions imposed by those subsidies will expire on nearly 60 percent of the 2.2 million units in 10 years.[2]

The available housing often is in dire need of improvement. Throughout the United States, public housing needs more than $26 billion in essential repairs, according to the National Housing Law Project. In San Francisco, the need is estimated at more than $270 million. Freddie Mac's San Francisco RAD partnership is helping make possible some of these much-needed repairs, while keeping these homes affordable now and for generations to come.

Building Partnerships in Cities and Rural Areas

With its lenders and borrowers, the Freddie Mac team helps provide income-restricted rental properties across the nation, from dense metropolitan areas like San Francisco to rural counties like Angelina County, Texas. Freddie Mac develops products to maximize the value of subsidies for borrowers and maintain as many affordable units as possible for the long term.

In San Francisco, the city took the lead in launching the RAD project.

1 Joint Center for Housing Studies of Harvard University, "America's Rental Housing: Expanding Options for Diverse and Growing Demand," 2015.

2 Ibid.

Local leaders recognized affordable housing to be a community asset that, once lost, is expensive and difficult to replace. Freddie Mac provided an aggressively priced tax-exempt loan (TEL), customized for each individual property and designed for long-term affordability. Freddie Mac also provided $83 million of permanent mortgage financing, and Bank of America Merrill Lynch provided about $770 million in construction financing and LIHTC equity, making the San Francisco RAD program one of the bank's largest community development efforts. All of the properties receiving these subsidies are restricted to tenants earning no more than 60 percent of area median income.

National Model

The first phase of San Francisco RAD stands out as a national model in several key ways:

- **Scale:** 14 properties, 1,400 units, and seven development partners.
- **Complexity:** The largest RAD conversion in the nation, with multiple layers of financing from the public and private sectors.
- **Commitment to residents:** Zero displacement, and strong engagement with local service providers to promote long-term success.
- **Efficiency:** The union of a variety of different groups, supported by the city leadership, each lending its specific expertise, to follow a single, streamlined process. This process drove down costs, achieved economies of scale, and helped Freddie Mac close its financings faster.

Financing Track Record

Freddie Mac financed more than $5 billion in affordable rental housing in 2015, up more than 115 percent from the previous year. In 2015, it committed more than $1 billion in TEL business and more than $1 billion in taxable mortgages specifically for preservation. Targeted affordable housing falls outside the $35 billion Federal Housing Finance Agency's cap on Freddie Mac's multifamily loan purchases, so it is an area in which the company can really grow.

Freddie Mac securitizes about 90 percent of the multifamily loans it purchases, transferring the vast majority of expected credit risk from taxpayers to private investors. It also pools and securitizes subsidized affordable housing loans, which helps drive down the cost of mortgage debt and provides liquidity to this critical market. The company will continue to develop financial strategies to drive more investment capital into affordable housing and preservation, benefiting investors, borrowers, and renters. In the year ahead, Freddie Mac expects even more growth in targeted affordable housing, with a continued focus on preservation, so that more low-income families find quality rental housing they can afford.

For more information, visit Freddie Mac's multifamily targeted affordable housing web page or contact David Leopold at david_leopold@freddiemac.com or Shaun Smith, Multifamily Senior Director, Targeted Affordable Production, Freddie Mac, at shaun_smith@freddiemac.com.

New Fannie Mae Product Helps in Efforts to Preserve Affordable Housing

Bob Simpson, Vice President, Affordable, Green, and Small Loan Business, Fannie Mae

As rents rise and wages stagnate for many American households, preserving the physical condition of properties and affordability for renters is essential. Current market dynamics can make it more profitable to convert properties to serve higher-income tenants, diminishing the existing affordable housing stock. An additional problem is that the new supply of affordable rental housing is not keeping pace with demand.

Fannie Mae has helped provide affordable rental housing to low-income individuals and families for nearly 30 years. The Multifamily Affordable Housing (MAH) business segment is defined as those properties with recorded rent and income restrictions and 20 percent of the units reserved for those earning 50 percent or less of the area median income (AMI); 40 percent reserved for those earning 60 percent or less of AMI; or a Section 8 Project Based Housing Assistance Payment (HAP) contract covering at least 20 percent of the units.

In partnership with its Delegated Underwriting and Servicing Lenders, Fannie Mae has delivered over $4 billion of MAH financing in 2016, building on the more than $3 billion in new production in 2015.

Innovation has been a key component of Fannie Mae's strategy to meet these challenges and to capture even more of the affordable housing business. Concentrating first on meeting the unique needs of properties with expiring federal low-income housing tax credits (LIHTCs) that will pursue a tenant-in-place rehabilitation through a new allocation of tax credits, Fannie Mae created a new mortgage-backed security (MBS), the MBS as Tax-Exempt Bond Collateral (M.TEB) execution. M.TEB has all the benefits of tax-exempt bonds along with a lower interest rate and significant savings over the life of the loan. Often the borrower uses this execution to take out a bridge loan while the borrower applies for tax credits.

Fannie Mae

Woodland Towers, in Collinsville, Ill., was preserved with low-income housing tax credits and tax-exempt bonds and has received new rental subsidies from a Section 8 housing assistance program contract.

For example, the Woodland Towers apartment complex in Collinsville, Ill., will use 4 percent LIHTCs along with tax-exempt bonds to significantly improve current property conditions, stabilize ongoing operations, and preserve the property's long-term affordability. In conjunction with the $7.4 million in new financing provided by Wells Fargo Multifamily Capital, a Fannie Mae Delegated Underwriting and Servicing Lender, the 104-unit project also will secure a new 20-year Section 8 HAP contract. With the M.TEB structure, Fannie Mae issues an MBS to serve as collateral for the bonds. Since Fannie Mae guarantees timely payments of principal and interest to the MBS trust, the bondholders enjoy a direct pass-through of the monthly payment, and the borrower captures interest rate savings over what could be achieved with traditional bond credit enhancement. The property will undergo interior and exterior renovations, improving the quality for residents while ensuring the long-term affordability for 30 years through the initial tax credit compliance period and the extended-use period.

Loans to smaller rental properties play a unique role in the rental housing market and are key to preserving units across the country. Fannie Mae recently expanded small loan underwriting, because small loans tend to be more affordable. The company's small loan program offers fixed- and variable-rate financing for loans of $3 million or less in most markets, and $5 million or less in eligible higher-cost markets, on smaller rental properties. The company has provided $15.7 billion of liquidity to this market since 2009.

Demographic and economic shifts require that the industry take a multifaceted approach to ensure that existing affordable properties remain available to the growing numbers that need them, while also doing what it can to support the production of new units. This support includes providing green financing solutions and options for both new construction and preservation of affordable rental stock, as well as enhancing the pricing for these types of transactions.

Fannie Mae

Winslow Cross Creek, in Sicklerville, N.J., is a newly constructed Energy Star-certified property financed by $1.9 million and $2.4 million in construction take-out loans from Fannie Mae.

Fannie Mae continues to maintain a significant market share in affordable rental housing finance by providing permanent take-out financing for acquisition, bridge, or construction loans. These tools and enhancements provide resources in preserving vital affordable rental housing stock. Together with its network of affordable and small loan lenders, Fannie Mae is committed to meeting the challenges of the affordable rental housing market in 2017 and beyond.

For more information, visit the Fannie Mae multifamily housing web page or contact Bob Simpson, Vice President, Affordable, Green, and Small Loan Business, at bob_f_simpson@fanniemae.com.

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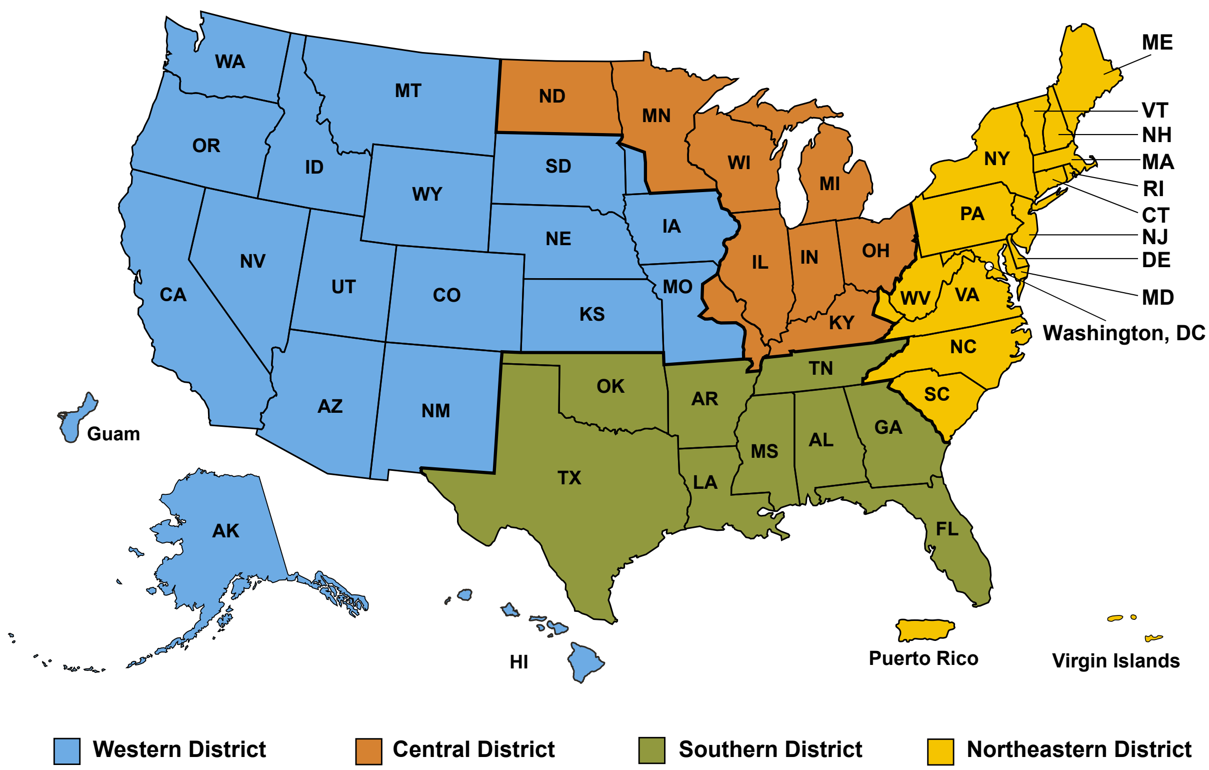
Preservation Database Helps Identify Subsidized Affordable Transactions

The advent of the National Housing Preservation Database permits researchers and market participants to conduct new types of analysis on subsidized affordable properties. For instance, by linking the National Housing Preservation Database to the Real Capital Analytics database of multifamily transactions, researchers and market participants are able to better identify sales of multifamily properties involving federal subsidies and assess market trends. In addition, apartment sales can be broken down into various subsidy types at the time of sale.

The following are examples of the market statistics that can be calculated by linking these two databases:

- Confirmed sales of existing subsidized affordable apartment properties totaled at least $9.2 billion in 2015 and more than $5.3 billion in 2016.
- At a minimum, sales of federally subsidized properties, including Section 8, totaled an estimated $2.4 billion in 2015 and another $2.4 billion in 2016.
- At a minimum, sales of properties subsidized with LIHTCs were estimated at $6.8 billion in 2015 and another $4.7 billion in 2016.

Community Affairs supports the OCC's mission to ensure a vibrant banking system by helping national banks and federal savings associations to be leaders in providing safe and sound community development financing and making financial services accessible to underserved communities and consumers, while treating their customers fairly.



E-mail and telephone information for the OCC's District Community Affairs Officers is available at www.occ.gov/cacontacts.

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