

City of Raleigh
Affordable Housing Summit 2024

Affordable Housing 201

August 17, 2024

Today's Conversation

**Refresher: What
is “Affordable
Housing”**

**What Does it
Take to Create
Affordable
Housing?**

**Financing
Affordable
Housing in
Urban Markets**

Key Takeaways



Refresher: What is “Affordable Housing”?

What is “Affordable Housing”?

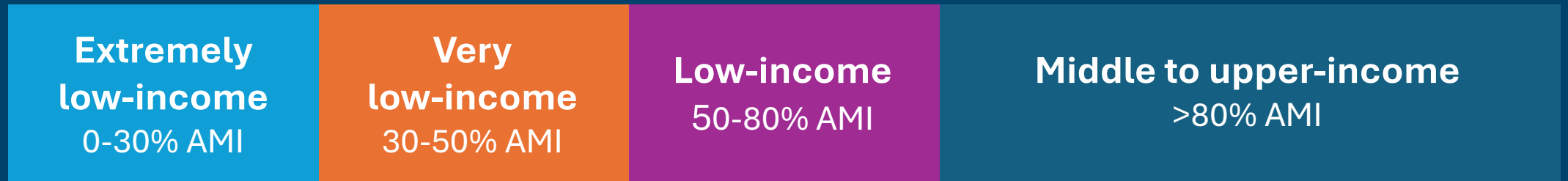


- ↳ Housing is considered “affordable” if it costs **no more than 30% of a household’s gross income.**
- ↳ When policymakers talk about affordable housing, it is specific to housing that is affordable to low-income households.
- ↳ Creating affordable housing often involves legal tools (such as deed restrictions) to ensure affordability over time and prevent competition with higher-income households.



What is “Affordable Housing”?

- ↳ “Low-income” is typically defined and benchmarked based on the Area Median Income (AMI) of a given community.
- ↳ If you lined up every household in Raleigh from lowest income to highest, the median income (100% AMI) would be the amount earned by the household in the middle of the pack.





What is “Affordable Housing”?

- ↳ Overall housing affordability depends on more than just subsidy programs and legally-binding affordable housing.
- ↳ Supply and demand for all housing plays a major role.
 - ↳ In market-rate housing, housing costs depends on demand (what renters or homebuyers are willing to pay).
 - ↳ Housing supply responds slowly to changes in demand.
 - ↳ Underproduction of housing (low supply) leads to high rents, whereas adequate production helps maintain lower rents.
- ↳ Most low-income households live in market-rate housing, so market rents matter.

What is “Affordable Housing”?



- ↳ In addition to rent levels, apartment vacancy rates are a good measure of rental housing market functioning.
- ↳ In regions that consistently underproduce housing, rents are high and vacancies are low.
- ↳ These regions also have **higher rates of homelessness**, because the root cause of homelessness is lack of housing affordability.

Every **\$100** increase in rent is associated with a **9% increase** in homelessness

(U.S. GAO)

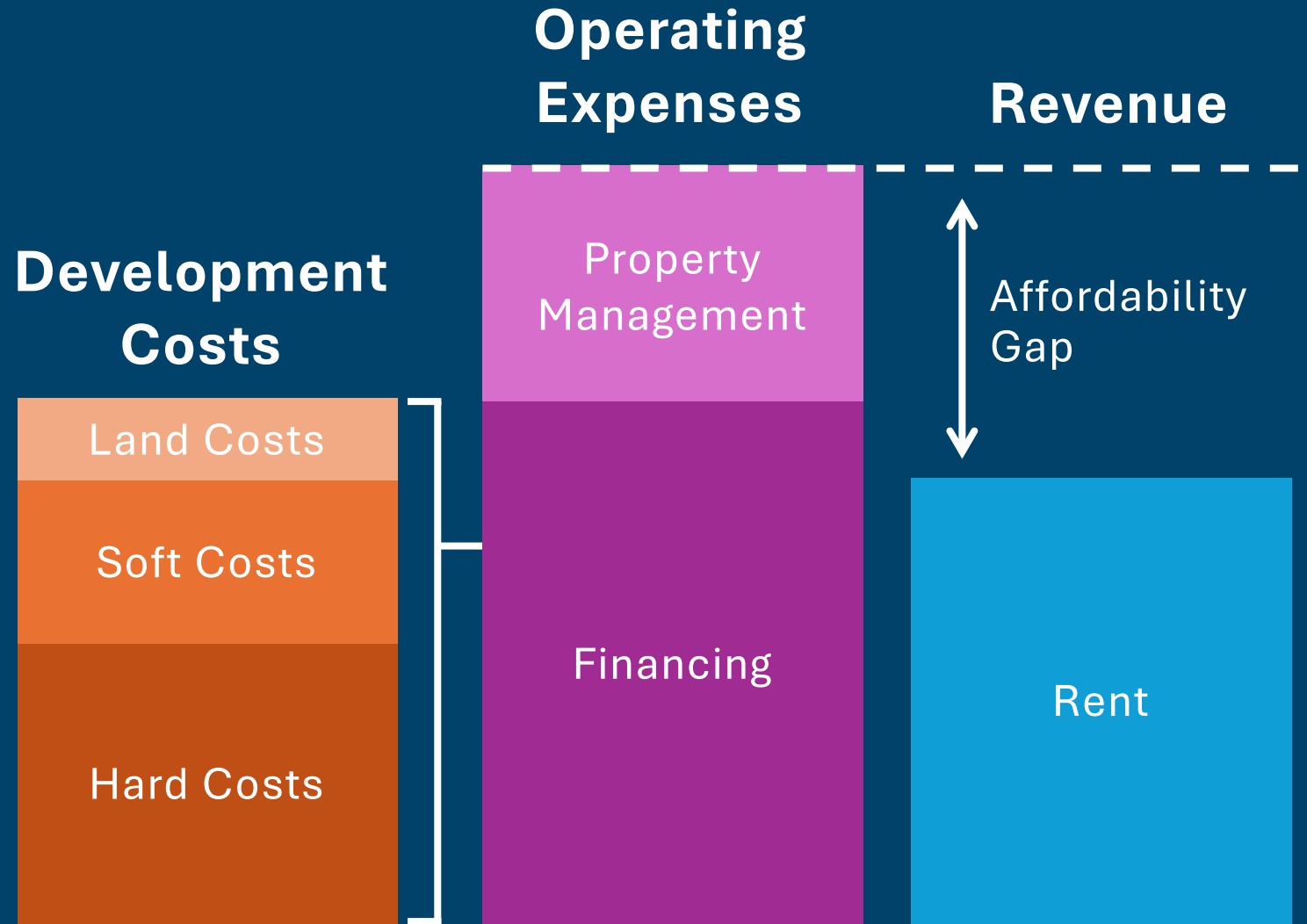


What Does it Take to Create Affordable Housing?



The Affordability Gap

The gap is the difference between **the cost to produce and operate** a rental property, and the **financing that can be supported** by rental income from that property.





The Affordability Gap

- ↳ Development costs vary by construction type and density.
- ↳ Affordable apartment units can cost \$250,000-300,000 to build, or more if parking decks and concrete podiums are involved.
- ↳ Rental revenue must cover building operations, loan payments, and investor returns.
- ↳ One unit serving a 60% AMI household can support ~\$125,000 in debt.
- ↳ This means that **the gap for an affordable unit starts at over \$100,000** and goes up from there depending on additional development costs.



Financing Affordable Housing

- ↳ The affordability gap is why affordable rental developments are financed differently than market-rate developments.
- ↳ If there is a gap between the value of the building as a source of income, and the cost of developing the building, the market-rate project simply won't be built.
- ↳ Affordable developments always have a gap.
- ↳ Filling the gap is the **role of government** and, sometimes, **philanthropy**.
- ↳ All three levels of government — **federal, state, and local** — may play a role in filling the financing gap.

Financing Affordable Housing

- ↳ For local governments, filling the gap on a project using **4% tax credits** has been the most **cost-effective** way to deliver affordable rental housing.
- ↳ The 4% credits make the gap smaller, with the remainder being filled with local funds.
- ↳ With a reliable source of local funding, affordable developers can partner with the City and (typically) County to pursue deals with a **high level of certainty** that the credits will be awarded.





Financing Affordable Housing in Urban Markets



Limitations of LIHTC

- ↳ LIHTC is incredibly important, but it has some significant limitations.
- ↳ First, the maximum amount of tax credits is based on most construction costs but **land does not count**.
- ↳ Each dollar spent on land adds to the gap.
- ↳ As a result, it's difficult to develop LIHTC housing in expensive urban areas such as Raleigh.
- ↳ Local governments must put in more gap financing per unit.

Making LIHTC Work in Raleigh

- ↳ In urban markets, it is often more cost effective to opt for more expensive construction types (like mid- to high-rise buildings on top of parking decks).
- ↳ Denser development saves spreads out the cost of land, which doesn't count toward tax credits.





Mixed-Income Development

↳ Combining LIHTC and market-rate properties in the same overall development can be an effective approach to expensive land.

↳ By contrast, including unrestricted units in LIHTC properties is unnecessary and usually problematic.

↳ For more information see these resources:

<https://www.novoco.com/periodicals/articles/the-many-meanings-of-mixed-income-and-how-they-affect-policymakers>

<https://www.novoco.com/podcast/march-26-2024-so-you-want-to-be-a-lihtc-developer-the-many-meanings-of-mixed-income>

↳ A different model of mixed-income housing will be discussed during the Innovations Panel!



Key Takeaways



Key Takeaways

- “Affordable housing” requires a low-income household to spend no more than 30% of their income on housing, and affordability is maintained over time.
- While legally-binding affordable housing is distinct from market-rate developments, market prices impact affordability.
- There is a financing gap to build affordable housing. The costs to build a unit is 2x (or more) than the amount of debt the rental income can support. Even free land and no profit are not enough to fill this gap.
- Leveraging the federal LIHTC with local money is a powerful tool to cost-effectively produce 100% affordable projects at scale.



Key Takeaways

- However, this requires relatively large sites at low cost, which are hard to find in urban markets like Raleigh.
- When land values get high enough, affordable developers must use more expensive construction types, as the increase in land costs outruns the savings in construction costs. This increases the amount of money per unit that local governments need to contribute to the project, even with tax credits.
- Providing affordable housing on high-value land can involve tools other than LIHTC. Stay tuned for the innovation panel to learn about one such tool!

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Questions?