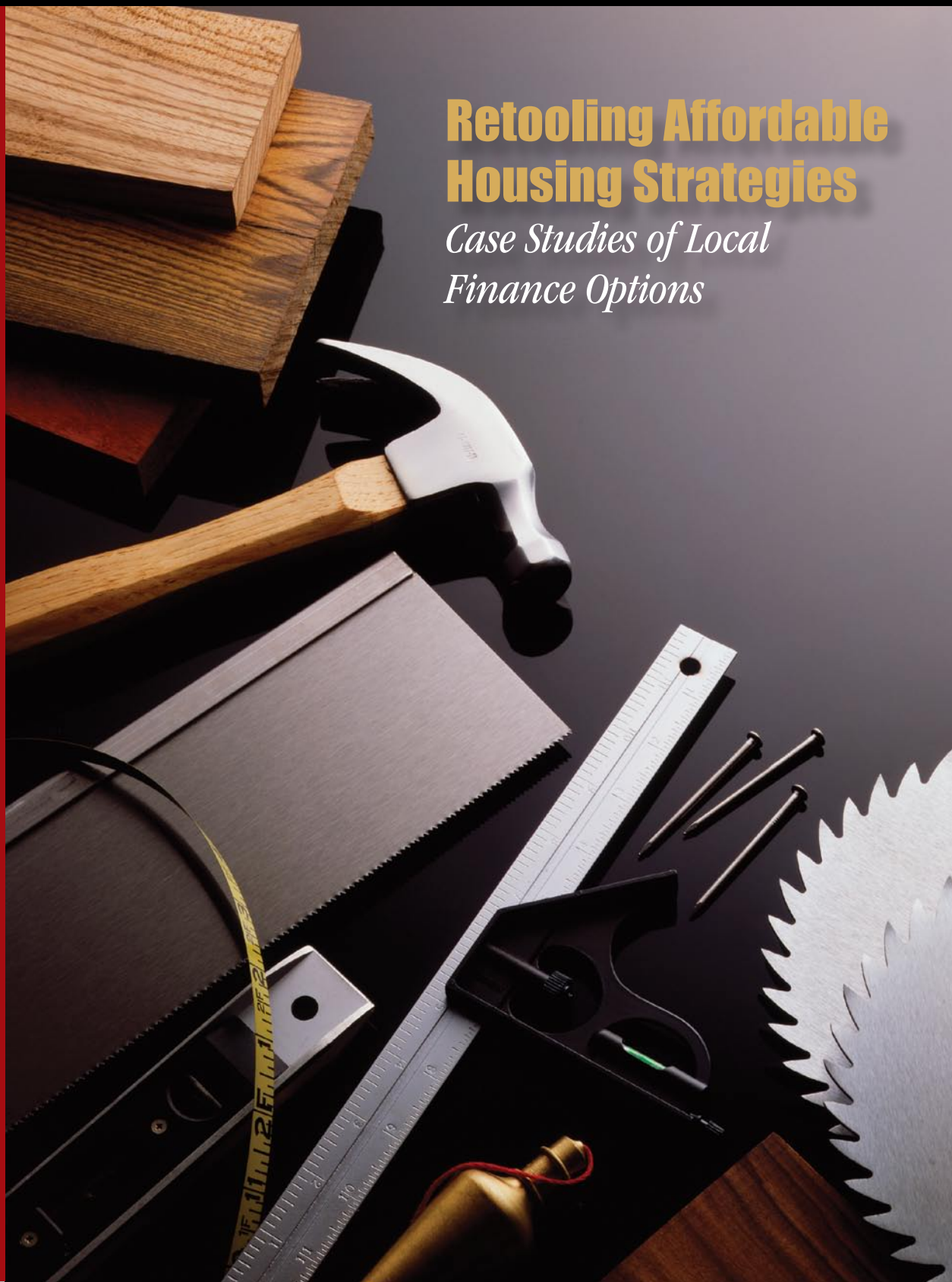
Banking and Community
Perspectives

ISSUE 1 2007

FEDERAL RESERVE BANK OF DALLAS

In this issue:

We have changed our look but not our in-depth content. Banking and Community Perspectives *will continue to provide thorough analysis of current and critical issues facing low- and moderate-income people and communities. We hope you like the new design.*



Retooling Affordable Housing Strategies

Case Studies of Local Finance Options

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Across the nation, more and more Americans are facing a housing cost burden—that is, paying more than 30 percent of their gross income on housing. For many working families, home prices and rental rates are increasing faster than their incomes. In the Eleventh Federal Reserve District, this is a growing challenge. The supply of decent, affordable housing lags far behind the rate of demand.

This serious cost burden and the need for quality, affordable housing is not limited to low-income households. Firefighters, nurses, police officers, teachers, health care workers and other middle-income earners are increasingly finding it difficult to live in the communities where they work. Recognizing this problem, policymakers and housing providers are reaching into an ever-expanding tool kit of public finance options. Their creative approach toward affordable housing production has generated many successes. This issue of Banking and Community Perspectives *explores these finance tools and demonstrates how local municipalities are leveraging public funds to provide safe, decent, quality housing that is affordable for all income earners.*

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Retooling Affordable Housing Strategies

Case Studies of Local Finance Options

Affordable housing is housing that costs the owner or tenant no more than 30 percent of gross income, according to the Department of Housing and Urban Development (HUD). Rent or mortgage payments that exceed this percentage are considered a cost burden to the household because other basic expenses like health care, education and transportation are compromised.

In Texas, the number of families facing a cost burden is growing three times faster than the availability of decent, affordable housing, according to the Texas Low Income Housing Information Service. Rising housing costs have created a housing shortage not only for lower-income groups, but also for middle-income professions such as teachers, nurses, firefighters, police officers and others who can't afford to live in the communities they serve. Maintaining employment does not guarantee that a family can find decent affordable housing.

The problem is compounded by the federal government's diminishing role in housing and community development programs. Local entities rely on federal assistance programs to buy down the cost of housing for low- and moderate-income residents. According to the Center on Budget and Policy Priorities (CBPP), because of budget deficits, the current administration and Congress have reduced funding for a number of domestic programs, including most low-income housing programs. Community development block grants, the Home Investment Partnerships Program and public housing have been hit the hardest; their funding declined by 20 percent, 16 percent and 11 percent, respectively, from 2004 to 2006. In 2007, the administration proposed further cutbacks of $1.3 billion. These decreases in large federal block assistance programs have affected nearly every low-income housing grant program important to state and local plans to increase affordable housing. And as federal funding declines, construction costs continue to rise.

Photo: Elizabeth Sobel

Lyons Gardens, a 53-unit senior complex in Austin, is a model for similar development.

Some local communities, however, are discovering that affordable housing and community development programs can flourish even with reduced federal backing. This issue of *Banking and Community Perspectives* presents case studies that show resourceful ways local entities are promoting affordable housing and expanding community development opportunities. Even though many of these programs are not new, they are undersubscribed or have fresh potential to impact more residents.

Table 1

Texas Housing Affordability Index

MLS area	Median house price	Interest rate	Required income	HUD median family income	Housing affordability index
Austin	$174,300	6.63%	$42,879	$69,600	1.62
Brownsville	$ 88,600	6.87%	$22,339	$33,000	1.48
Dallas	$156,100	6.51%	$37,927	$65,500	1.73
El Paso	$132,100	6.63%	$32,497	$39,500	1.22
Fort Worth	$116,800	6.51%	$28,379	$63,400	2.23
Houston	$148,200	6.61%	$36,383	$60,900	1.67
Lubbock	$102,400	6.63%	$25,191	$48,500	1.93
McAllen	$114,400	6.87%	$28,844	$30,800	1.07
San Antonio	$141,700	6.87%	$35,727	$53,100	1.49
Texas	$142,400	6.63%	$35,031	$54,300	1.55
U.S.	$219,300	6.55%	$53,504	$59,600	1.11

NOTES: The Multiple Listing Service (MLS) area represents the local reporting Realtors association's geographical coverage area. The housing affordability index is the ratio of median family income to the income required to qualify for an 80 percent, fixed-rate mortgage to purchase the median-priced home. Data are for fourth quarter 2006.

SOURCE: Real Estate Center at Texas A&M University.

General Obligation Bonds in Austin

In Austin, the shortage of affordable housing has been aggravated by falling incomes and rising housing costs. In 2006, incomes dropped 4 percent while housing costs increased 10 percent. This mismatch between income and home prices gives Austin one of the highest cost burdens in Texas.

The Texas A&M Real Estate Center's housing affordability index shows the degree of affordability by city (*Table 1*).[1] Dividing HUD median family income by the required income for homeownership, affordability in

The advantage of general obligation bonds is that they permit the city to borrow funds at one of the lowest possible interest rates.

Private activity bonds helped finance Hillcrest Manor Senior Community in Lubbock.

Photo: Bridget A. Moreno

Austin (1.62) is better than the state average (1.55) but worse than Dallas (1.73), Fort Worth (2.23) and Houston (1.67). Furthermore, Austin's housing authority currently reports that it has about 4,000 families on the public housing waiting list and 6,000 on the Housing Choice Voucher (Section 8) list. Neighborhood Housing and Community Development (NHCD) Director Paul Hilgers says the affordable housing crunch is getting worse as the number of new citizens and jobs coming to Austin outpaces the number of available affordable housing units. Austin realized it had a problem, Hilgers says, and its citizens have taken action.

In November 2006, Austin voters approved a $55 million affordable housing bond program by 62 percent. As a result, the city will issue general obligation bonds allocated over seven years to fund the financing, acquisition, development or rehabilitation of safe, clean and affordable housing.

The advantage of general obligation bonds is that they permit the city to borrow funds at one of the lowest possible interest rates. They are a form of long-term borrowing in which the city issues municipal securities and pledges its full faith and credit to their repayment. Bonds are repaid through annual debt service. Property taxes for this one initiative will rise about $6 a year for the owner of a $174,000 home—the median-priced home in the city. Nonprofit, for-profit and preservation groups can apply for funding through a request-for-proposal to finance developments that meet the program's objective.

"Because we know these funds are available and not subject to budget cuts, they greatly increase our ability as a community to plan, leverage and be creative on how these dollars will be used over time," says Margaret Shaw, deputy director of the city's NHCD department.

Austin's bond program is only the second in the state, after Houston, to use general obligation bonds specifically for affordable housing. Program administrators hope the bonds will attract $300 million in additional funds and create over 12,000 jobs. NHCD has established the program's accountability guidelines, which were subject to public comment. The notice of funding availability will be released this summer.

Heather Way and Karen Paup of Housing Works Action, an advocacy coalition based in Austin, credit the following tactics for the bond campaign's success:[2]

- Having a consistent and compassionate message that resonated with voters. Campaign literature described the estimated unmet and growing need at $1.3 billion.
- Identifying voter perceptions with pre-election surveys to gauge the interest of affordable housing programs.
- Creating alliances with other advocacy groups. In Austin, environmental advocates proved most influential.
- Working closely with the city's bond election advisory committee early in the process, which enabled the advocates to have their initiative placed on the ballot.

Advocates and community leaders point to existing local models like Lyons Gardens, an award-winning, 53-unit senior complex in East Austin that is experiencing a nearly two-year waiting list. Hilgers says that with this additional source of bond financing, more communities like Lyons Gardens can help alleviate an unmet need.

Private Activity Bonds

State and local jurisdictions can raise revenue through the sale of tax-exempt private activity bonds (PABs), which can be used to finance affordable multifamily developments or provide funds for low- and moderate-income homebuyer mortgage assistance. PAB funds can also be used for public programs, such as airports, sewers, industrial parks and student loans. States are allotted a debt limit for such bond issuances. The 2006 limit was $85 per state resident, a $5 increase over 2005. According to the Texas Bond Review Board, this raised Texas' 2007 cap to just under $2 billion, an increase of almost $170 million from 2006. Half of the allocation goes to local and state multifamily and single-family mortgage programs and half to other public needs.[3]

Public activity bonds have the capability to assist many residents but have been underused because of program complexities and changing market conditions. PABs are broken

down into two types, mortgage revenue bonds and multifamily bonds, depending on what is being financed. Both types allow state and local governments to access private financing to support affordable housing. By lowering the interest rate on mortgage loans, mortgage revenue bonds make homeownership affordable for families that can't meet payments on a conventional loan. Multifamily bonds give low-income families access to quality housing the market might not otherwise provide.

Private Activity Bonds in Lubbock

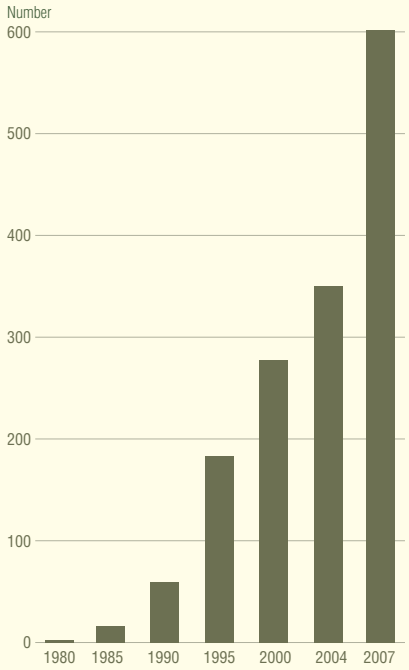
Lubbock Housing Finance Corp. (LHFC) administers PAB housing programs in Lubbock. The corporation has not issued single-family bonds in recent years because there was a significant gap between the interest paid on the outstanding bonds and the interest that would have been earned by investing the bonds' proceeds. Negative arbitrage has been the largest barrier over the years, according to LHFC Executive Director Shari Flynn.

With improving economic circumstances and higher interest rates, bond issuance is now more attractive and competitive. In 2007, the LHFC plans to partner with South Plains Housing Finance Corp. to issue a combined $37 million in single-family mortgage revenue bonds that will service Lubbock and 14 counties outside the city. Single-family bonds will be used to finance below-market-interest-rate mortgage loans through a network of local lenders. Families and individuals who are purchasing their first home or who have not owned a home in the past three years will be eligible.

In 2006, the LHFC also issued a $10 million multifamily bond for a complex in north Lubbock called Hillcrest Manor Senior Community. The 220-unit housing facility, still under construction, is subsidized by an additional $624,800 in 4 percent tax credits from the Texas Department of Housing and Community Affairs (TDHCA). The 4 percent housing tax credit typically accompanies such bonds and is used to further subsidize the project and help provide below-market rents for income-eligible residents.

Flynn stresses that PAB programs are more likely to succeed if they have professional staff or consultants who understand how to structure a bond deal, know the real estate market, and learn from the successes and mistakes of other local issuers. Texas has 82 housing finance corporations throughout the state. Not all are active, but according to Flynn, if conditions are favorable, more of these organizations could impact a great number of low- and moderate-income residents, even in rural areas, where HUD income limits are lower, making bond financing more difficult.

Figure 1
Growth of Housing Trust Funds in U.S.



SOURCE: Housing Trust Fund Project, Center for Community Change.

State Housing Trust Fund

Over the past six years, Texas' state housing trust fund has dispersed roughly $7 million a year. The state Legislature mandates that at least $3 million of the fund be used for the Texas Bootstrap Loan Program, a colonia self-help construction program, limiting funds for the remainder of the state. Relative to the size of other state housing trust funds, Texas' is quite small. Illinois, Arizona and Ohio have dedicated funding sources that create revenues of well over $25 million a year. Florida, a peer state with a population similar to Texas', has a housing trust fund with revenues in excess of $300 million.

Housing Texas, an Austin-based advocacy coalition, is developing a comprehensive strategy for expansion of the state housing trust fund. Its tactics include building alliances among community leaders, community development corporations, financial institutions, developers, environmentalists, rural interests and service providers that will lobby the Legislature. The coalition's legislative agenda recommends a document recording fee or real estate transfer tax to raise revenue for a dedicated fund. This would allow more long-range planning, rather than advocating for the fund every two years as is done today.

One proposal that has garnered coalition support is creating local housing trust funds with state matching contributions, but ultimately the structure and mission would be decided by the Legislature. Supporters are seeking a dedicated source of funding that would collect $25 million to $50 million a year and support the construction of 25,000 homes to shelter 75,000 Texans. As of this writing, a House–Senate conference committee voted to approve an increase to the state housing trust fund by an additional $10 million for the biennium.

Housing Trust Funds

Housing trust funds—public revenues set aside by cities, counties or states for affordable housing development—have exploded across the country; since 1990, over 500 new ones have emerged (*Figure 1*). Texas has not kept pace with the rest of the nation. It has only three: one in Austin, one in San Antonio and a statewide one created by the Legislature and housed at TDHCA in Austin (*see box*). The city of Fort Worth is close to finalizing plans for a housing trust fund this year.

A housing trust fund receives revenue from such sources as taxes, fees, loan repay-

ments and interest from an endowment fund or corpus (a fund's principal). The funds are more flexible than federal grant dollars and can be layered with other funding. Local injection of dollars can mitigate risk and allow for deeper subsidies for residents. Most housing trust funds are administered by the agency or city department responsible for federal housing programs.

Creating a housing trust fund is not a simple or quick political process. It is often fraught with difficult funding choices. Dedicating money to an affordable-housing fund limits overall budget flexibility, which is not always popular with elected officials. Often, housing trust funds are created in response to public demand that the government address critical housing needs.

Photo: Roy C. Lopez

Construction is under way in the 232-lot Sierra Vista development in Fort Worth's Rolling Hills Neighborhood Empowerment Zone.

San Antonio Housing Trust

Unlike the Austin and statewide housing trust funds that are currently supported through appropriated general revenue dollars, the San Antonio Housing Trust relies on the dedicated interest generated from an affordable housing corpus. Created in 1988 by the city of San Antonio with an initial investment of $10 million from the sale of its cable franchise, the fund is governed by an 11-member board of trustees appointed by the City Council.

The trust fund is unique in that it is a nonprofit subsidiary, a community housing development organization, a housing finance corporation and the city's housing trust fund administrator. This makes the organization flexible in its approach to funding development requests. The trust is independent of any city department, but the board can only make funding recommendations to the City Council, based on a review of development proposals.

Interest earned from the $10 million corpus and loan servicing capitalize the funding rounds that are held about every one and a half years. Since its inception, the trust has awarded almost $13 million to nonprofit housing organizations, historic preservation groups and private developers. These funds have leveraged over $190 million in private and public funds, a nearly 15 to 1 ratio. John Kenny, executive director, says the San Antonio Housing Trust has created 3,600 units of affordable housing since its inception.

Infill Incentives

Municipal leaders have long touted infill development as an alternative to conventional development patterns that cause urban sprawl. Infill can be defined as the recycling of vacant or underused tracts within cities and suburbs. Every city, town and suburb has properties that need rehabilitation or development. Local governments use infill incentives to promote development in places where infrastructure and services are present.

According to PolicyLink, a national nonprofit research organization, local governments offer infill incentives for a number of reasons:

- Reusing vacant or blighted properties, which can revitalize underperforming neighborhoods;
- Increasing jobs, spurring commerce and creating safer neighborhoods, which can generate a tax base, particularly for school districts;
- Taking advantage of economies of scale by building denser developments;
- Reducing auto congestion and pollution when infill is close to transit routes or is in walking distance of services and entertainment. Many cities and older communities in the Eleventh Federal Reserve District have seen core neighborhoods improve under this type of incentive.

Cities such as Fort Worth and Richardson have developed strategies to sustain infill growth and investment.

Neighborhood Empowerment Zone in Fort Worth

In the late 1990s, Fort Worth's inner city was in danger of decaying while new development encircled it like a lasso, city officials recall. In response, the City Council designated specific districts as priorities for spurring commercial and residential development. In 1999, the Texas Legislature authorized municipalities to establish zones to revitalize distressed neighborhoods through waived fees and municipal tax abatements.

The Fort Worth City Council was the first to take advantage of this legislative tool by establishing a neighborhood empowerment zone program in 2001 to promote private investment in housing and businesses.[4] To be designated such a zone, the area must have a plan to promote the creation or rehabilitation of affordable housing and increase economic development activity.

Fort Worth currently has 16 inner-city neighborhood empowerment zones. To qualify for the program, the property owner must spend at least 30 percent of the appraisal district value of the home, excluding land, on the rehabilitation. For example, if a home is appraised at $50,000, the documented rehabilitation costs must exceed $15,000.

To be eligible for the incentives, property owners or developers must fill out an applica-

tion, be current on all property taxes and have no liens previously filed against them. Liens that can be released include weed, demolition, board-up and paving liens, which can reach into the thousands of dollars. Fees that can be waived include building, demolition and water impact fees. Properties may also qualify for five-year, 100 percent tax abatements on the city's portion of the property tax liability.

Critics say the city may be creating too many incentives, forgoing fees and taxes it would ordinarily capture within these zones for day-to-day city services. Jerome Walker, Fort Worth housing director, responds that much of the development would not occur without these incentive awards and they are an investment that will pay dividends over the long term. According to city officials, the neighborhood empowerment zone program has waived nearly $22 million in potential taxes and fees, the majority in municipal tax abatements. Program investments within the zone have totaled over $400 million.

Home Improvement Incentive Program in Richardson

As a strategy to attract business and in response to neighborhood advocacy for a policy that would revitalize deteriorating housing stock, the city of Richardson recently initiated the Home Improvement Incentive Program.[5] The neighborhood services department of this inner-ring suburb of Dallas manages the program, which offers a one-time tenfold rebate on the increase in city taxes based on a home's postimprovement appraised value. For example, if a homeowner makes improvements and sees a $300 increase in the city portion of his property tax bill, the homeowner would receive a one-time $3,000 rebate check from the city.

To qualify, an improvement project must have begun after Feb. 12, 2007, cost at least $20,000 and be completed within 24 months of project approval. Property owners are required to sign a contract with the city, provide officials with a project cost estimate, consent to periodic inspections and authenticate construction costs. The county appraisal district determines the home's certified value.

Although the tax rebate program is open to any owner of a single-family home, the hope is that the program will benefit the older sections of Richardson and curtail a trend toward declining property values as residents move to newer suburbs or into Dallas. Don Magner, who oversees the incentive program, says Richardson was compelled to implement the plan because it promotes a dual objective of both infill and economic development.

"The City Council believes that infill residential redevelopment will attract and encourage business relocation and expansion, since business will look to the immediate and available housing stock to meet the needs of the workforce," he explains.

Tax Increment Financing

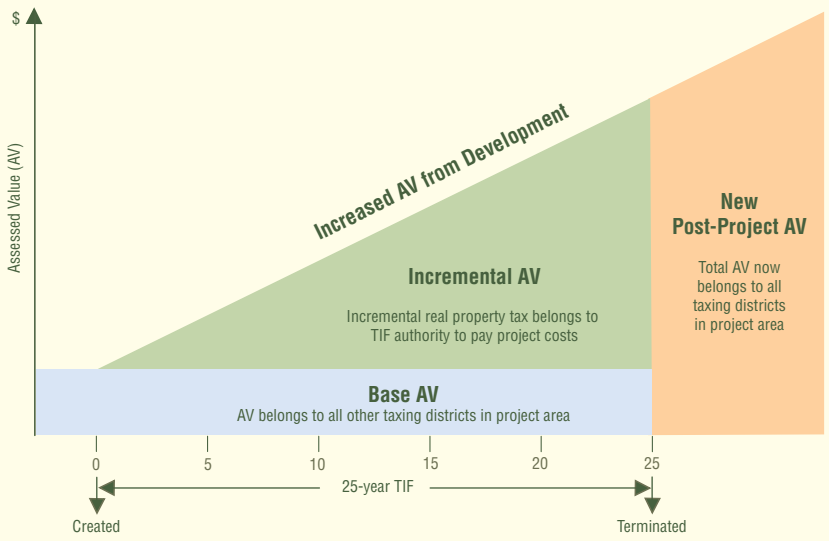
Tax increment financing (TIF) is a tool local governments can use to publicly invest in building and infrastructure improvements within a defined area. These improvements are usually associated with community revitalization but have not always been implemented in such a manner, even though that was an original intent of the Texas TIF legislation.

Another intention of the TIF is to promote the viability of existing businesses and attract development to an area. The public improvements, which make the area more attractive to investors, push up property values and therefore generate more taxes. These incremental taxes are removed from the general tax rolls and used to fund public improvements within the TIF district (*Figure 2*).

In the standard TIF model, municipal bonds are used to raise the capital needed to finance site improvements like public works projects, affordable housing, demolition and environmental remediation.

In the standard TIF model, municipal bonds are used to raise the capital needed to finance site improvements like public works projects, affordable housing, demolition and environmental remediation. If the city decides to issue bonds for initial financing, the incremental tax revenue is used to repay the bonds. When the bonds are retired, the TIF-generated tax base reverts to the general tax rolls. Other TIF zones opt for a pay-as-you-go model, financing the improvements as the revenues are raised.

Figure 2
TIF Assessed Value Over Project Life



SOURCE: Craig L. Johnson and Robinson and Cole Law Firm, "Tax Increment Financing," National Association of Realtors, November 2000.

TIF opponents have expressed concern that this financing tool will lead to gentrification, the use of eminent domain and rapid transformation of a community's historic character. Many fear that overuse of TIFs will lead to higher property tax bills because a declining portion of the tax base is available to local government agencies to pay for everyday services like code compliance, fire protection and police enforcement.

Midland Tax Increment Financing

When Midland's downtown area experienced an economic downturn in the 1990s, the city lost its standing as the region's undisputed energy center. The exodus of major oil companies and declining office staffs reduced demand for downtown office space. The ensuing low rental rates made it difficult for owners to invest in capital upgrades. As a result, the downtown tax base dropped from $180 million in 1991 to $122 million in 2001.

City leaders felt intervention was necessary to save the long-term viability of downtown. The area needed retail, cultural and, most important, residential development to bring vitality to its economy. In March 2001, the City Council established a TIF zone to finance affordable housing infrastructure in the zone.

Six years later, the TIF district is starting to bear fruit. The total assessed value in 2005 exceeded the base-year value (2001) by $9.2 million, which resulted in a tax increment of over $121,000 for the year ending Dec. 31, 2005.[6] According to estimates, the TIF district's 2006 revenue will be nearly $230,000, which includes the revenue of the four participating taxing entities.

With its generated increment, the city is currently partnering with the Midland Community Development Corp. to finance qualified public improvements to Old Pueblo Park, a 25-unit single-family housing development on the downtown periphery. The development has added nearly $2 million in assessed value to the tax rolls, and more affordable-housing investment is scheduled in the coming year. The homes are priced from the mid-$70s, with demand soaring. Although most observers point to the energy industry's resurgence in the Permian Basin as the main reason for the downtown rebound, the TIF has contributed to the recovery and economic diversification.

Future Framework

The gap between income and housing costs, coupled with declining federal grant assistance for affordable housing, has forced local entities to assume an increased role in addressing the housing needs of their residents. The approaches described here are part of a varied and expansive tool kit available to local officials. By committing to innovative finance options, policymakers can address the sobering affordable housing realities that many cities are facing. Communities throughout the Eleventh Federal Reserve District are adapting to changing economic and political environments and finding success as the affordable housing paradigm shifts.

NOTES

[1] Real Estate Center at Texas A&M University: Texas Housing Affordability Index, http://recenter.tamu.edu/data/dataaffd.html.

[2] Housing Works Action, www.housingworksaction.org.

[3] For more information on private activity bonds, see the Texas Bond Review Board website, www.brb.state.tx.us/pab/pab.html.

[4] For more information, see the city of Fort Worth's website, www.fortworthgov.org/housing/info.

[5] For more information on Richardson's Home Improvement Incentive Program, see www.cor.net/NeighborhoodServices/HomepageImprovement.html.

[6] "Reinvestment Zone No. 1: Downtown Midland TIRZ Annual Report 2005," City of Midland, April 2006.