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NEW MARKETS TAX CREDITS



Heritage Housing Partners is using New Markets Tax Credits at Fair Oaks Court, a 44-unit homeownership project in Pasadena, Calif., which includes the rehabilitation of nine historic houses and the construction of 35 condominiums.

Pioneering Deal Uses NMTCs for Housing-Only Project

BY MOIRA CHRISTOPHER

PASADENA, CALIF.

In the expensive Southern California housing market, crafting a financing structure that yields homeownership costs affordable to low-income buyers is enormously challenging. Combine a target of serving low- and moderate-income families with a goal of preserving and moving existing houses that are contributors to a local historic district, and you get a project with an average development cost of \$477,425.

Through diligence and creativity, Heritage Housing Partners (HHP) found the key to this quandary through the use of New Markets Tax Credits (NMTCs) at Fair Oaks Court, a 44-unit homeownership project here, which includes the rehabilitation of nine historic houses and the construction of 35 condominiums. HHP needed a large cash infusion to bring the sales prices down to low- and moderate-income levels, and “we had tapped out every source of financing—city, county, state,” said Charles Loveman, executive director of HHP. “We couldn’t make the numbers work. What’s the saying, ‘Necessity is the mother of invention?’”

HHP’s need led to the first use of New Markets Tax Credits for a housing project in the country, according to Doug Bystry, president and CEO of Clearinghouse Community Development Financial Institution. Other deals have involved mixed-use projects. Although the city, county, and state had made large funding awards—\$6.18 million for 37 low- and moderate-income units—more was needed.

Designed to stimulate investment in low-income communities, NMTCs provide a credit against federal income taxes in the amount of 39 percent of a qualified equity investment—meaning it has to be invested in eligible community development uses. The credit is claimed over a seven-year credit allowance period, and the funds have to remain invested in qualified uses for the entire seven years. Community development entities (CDEs), like the Clearinghouse Community Development Financial Institution, apply to the Community Development Financial Institutions Fund, a branch of the U.S. Treasury Department, for an allocation of the NMTCs. CDEs, in turn, issue credits to their investors.

Complying with the NMTC requirement to keep the equity invested during a seven-year compliance period was the most complex issue for HHP. Loveman and Bystry came up with a

winning solution: Use the NMTC equity for Fair Oaks Court, and upon sales of the units, carry a portion of the repaid equity onto another project and then to another, so that three projects benefit from the NMTCs over the seven-year period. Loveman had been working with the neighboring city of Glendale on another homeownership project, so the Glendale project was chosen to be the second project.

"I'd always been interested in New Markets Tax Credits because for-sale housing was an eligible use," said Loveman. "It didn't require too much originality—it was just a matter of figuring out how best to leverage the public money so that we maximized the NMTCs."

"Doug Bystry was very helpful in working with us in considering a number of scenarios before we decided we could meet the program requirements by going from Fair Oaks Court to another project in Glendale, and then to another project in Glendale, to keep the funds deployed over seven years," said Loveman. "While we had originally been working on the funding for Fair Oaks Court in Pasadena, the city of Glendale is a big hero because of how quickly it came to the table and committed its funds and arranged financing to make this deal possible," said Loveman.

Glendale had to approve the sale of the two project sites to HHP, approve a disposition and development agreement, make a loan commitment to the projects, and enter into an intercreditor agreement with the city of Pasadena—all almost two years before groundbreaking would occur in Glendale.

Loveman and Bystry agreed that the deal was complex, but as Bystry noted: "The benefit we achieved in the level of affordability we could get using NMTCs is unprecedented. It's a project we're extremely proud of. Given the high cost of housing in Southern California, this is the most affordable project we've ever done."

Among Fair Oaks Court's 44 units are 37 that will be sold to low- and moderate-income households (defined as households with incomes from 80 to 120 percent of area median income). There are four market-rate units, which are all detached, rehabbed historic houses, and three houses categorized as "workforce" housing, for households with incomes from 120 percent to 180 percent of area median income.

Soft funding helped

The NMTCs brought a total of \$6,266,000 into the project, only \$930,000 of which has to be repaid. To meet the required seven-year investment period, only \$2.9 million of the

NMTC equity will remain in the Fair Oaks project, and the remaining \$2.4 million will move on to the Glendale projects. Low-income buyers will receive \$78,378 from NMTC-generated equity, which does not require repayment; plus \$159,250 from the city at approximately 1 percent or 2 percent interest, with payments deferred for five years, after which a small payment is required; plus \$60,000 from the county of Los Angeles for the two-, three-, and four-bedroom units at a rate of 1 percent, deferred until sale or refinance; plus \$30,000 from the state's Begin Program for the 31 new construction units. (Loveman noted that the rehabbed units cost less, so they don't need this additional subsidy, which has a rate of 0 percent, deferred until sale or refinance.) The total amount of soft money per unit: \$327,628.

Moderate-income buyers will receive the same \$78,378 from NMTCs, plus \$100,000 from the city, plus \$37,500 from county, plus \$30,000 from the state's Begin Program, for a total of \$245,878 in soft money.

A cross subsidy generated by the market-rate units, which will sell for an average of \$675,000, also helps lower prices for the low- and moderate-income and workforce buyers. Net sales prices will average \$100,000 for the low-income units, \$225,000 for the moderate-income units, and \$450,000 for the workforce housing units. Downpayments are expected to be between 3 percent and 5 percent of the sale prices.

The city's \$4.17 million loan converts from construction to low- and moderate-income homebuyer assistance. Other funding includes an \$8 million construction loan from Washington Mutual at prime.

The Glendale projects will include a total of 55 units on the two sites, of which 37 are low- and moderate-income and 18 are market rate. The NMTCs will bring \$65,000 per unit to the Glendale projects, less than in Pasadena because there will be no costs for moving existing houses.

"This is the largest ownership project we have done," said City Manager Jim Starbird. "That's remarkable, considering that it is very hard to do affordable housing in the Glendale, Pasadena, and Burbank areas, first because the land is so expensive, and second because construction costs are so high."

Relocation of the existing houses and demolition of the unsalvageable houses at Fair Oaks Court began last July, and construction of the new units began in October. Construction will be complete in December 2007.

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