Mixed-Income Housing and the HOME Program

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Foreword

Most housing professionals agree that concentrating assisted-housing for low- and very low-income Americans in dense, urban areas is not an effective use of scarce affordable housing resources. Over the past decade, professionals in the affordable housing industry have turned increasingly to mixed-income housing as an alternative to traditional assisted-housing initiatives. Mixed-income housing is an attractive option because, in addition to creating housing units for occupancy by low-income households, it also contributes to the diversity and stability of American communities.

There have been numerous successful mixed-income developments nationwide. State and local governments have developed incentive programs and initiatives to promote mixed-income housing. In the past decade, the U.S. Department of Housing and Urban Development (HUD) has provided support for public housing authorities to de-concentrate traditional public housing in favor of the development of mixed-income housing. In addition, HUD funding from the HOME Investment Partnerships Program can also be a valuable resource for states and local jurisdictions to finance mixed-income housing initiatives, or to develop, design and implement new mixed-income housing programs that address local housing needs. HOME funds are specifically designed to be flexible in order to meet local housing needs.

This publication, *Mixed-Income Housing and the HOME Program* provides guidance to HOME participating jurisdictions on how they can use HOME funds to support mixed-income housing development. It reviews the benefits of mixed-income housing, provides detailed information on the considerations that will “make or break” a mixed-income housing deal, and it highlights regulatory provisions of the HOME Program that must be addressed, many of which help facilitate the mixed-income housing programming. *Mixed-Income Housing and the HOME Program* draws heavily on real and hypothetical case studies to demonstrate the applicability of the publication’s lessons.

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Introduction

Mixed-Income Housing and the HOME Program provides guidance on how to develop financially viable and socially stable mixed-income housing with funds from the U.S. Department of Housing and Urban Development's (HUD's) HOME Investment Partnerships Program. Mixed-income housing is one of many options available to HOME participating jurisdictions (PJs) and their housing development partners. The challenges of developing financially viable mixed-income housing that is able to sustain its mixed-income character over time can be even greater than the challenges presented in a more typical affordable housing venture. This publication draws on a combination of real and hypothetical case studies to illustrate the principles of sound mixed-income housing development.

In 1990, the U.S. Congress created the HOME Program in order to expand the supply of decent and affordable housing for low-income Americans. The program was designed to be flexible so that it could be used to meet a wide variety of housing needs, in a wide variety of housing markets throughout the nation. As a block grant provided to state and local governments, HOME funds can be used for a number of eligible activities: to provide direct homebuyer assistance; to develop, through rehabilitation or new construction, new housing units for rental or for sale; to rehabilitate housing that is homeowner-occupied; and to provide direct tenant-based rental assistance.

Mixed-income housing gained national attention in 1993, with the authorization of the HOPE VI program. The HOPE VI Program is designed to support the development of mixed-income housing as a replacement for traditional public housing. Throughout the nation, many affordable housing advocates are turning to mixed-income development as the appropriate alternative to concentrations of assisted housing in low-income neighborhoods. Economically and socially mixed-income housing is believed to create a stable environment for low-income residents. Politically, mixed-income housing is more "acceptable" than low-income housing because it is not linked with the social problems often associated with poverty. Given the anticipated social, economic and political benefits, mixed-income housing is a popular policy objective, and a viable mechanism for creating affordable housing.

The flexibility of HOME funds makes them an ideal source of funding for mixed-income development. Unlike some funding sources, nearly all of the requirements of the HOME Program apply only to the units of housing that are financed with HOME funds. For developments that leverage private funds, HOME rules need not apply to the privately financed units. This means that virtually any rental or for-sale housing that includes a combination of HOME and private financing can be developed as mixed-income housing. PJs can, therefore, design mixed-income housing to meet their needs. The number of low-income units can vary widely in a mixed-income development based upon the PJ's goals, and how much funding the PJ invests in the development.

The purpose of this model is to introduce PJs and their housing partners to the concepts involved in developing mixed-income housing, while highlighting the HOME Program as an effective source of public financing for this type of housing. Chapter 1 describes the history, benefits, and recent manifestations of mixed-income housing policy at the local, state, and Federal levels. Chapter 2 describes developers' needs and perspective in the mixed-income housing development transaction. This chapter also reviews the factors for success in mixed-income housing developments. Chapter 3 outlines the HOME Program requirements related to the development of homeownership and rental mixed-income projects. Chapter 4 introduces additional sources of public financing that may be used to support the development of mixed-income housing, independently, or in combination with HOME funds. Case studies are presented throughout this publication to highlight the significant lessons of each chapter, and to demonstrate how these principles apply in real life.

About the Model Program Guides

This publication is one of a series of HOME model program guides published by the Office of Affordable Housing Programs of the U.S. Department of Housing and Urban Development. The model program guide series provides technical assistance and guidance on HOME Program implementation to participating jurisdictions. To get a free copy of this model program guide, see HUD's Office of Affordable Housing Programs online library at http://www.hud.gov/offices/cpd/affordablehousing/library/modelguides/index.cfm.

Chapter 1

An Overview of Mixed-Income Housing

Mixed-income housing has been the subject of housing policy discussion and action for several decades. Scientific measurement of the economic, social, and political benefits of mixed-income housing is difficult, and therefore still subject to debate. Nonetheless, many communities across the country, convinced of its merits, have promoted mixed-income housing development by requiring housing developers to include units for lower-income families within, and among, projects for wealthier client bases. State and Federal resources for housing development also support and provide incentives for the creation of mixed-income housing. This chapter provides an overview of the history and evolution of mixed-income housing development, and explores the reasons mixed-income housing has emerged as a promising housing opportunity. In addition, this chapter describes some of the practices employed at all levels of government to encourage its development.

What is Mixed-Income Housing?

A mixed-income housing development can be defined as a development that is comprised of housing units with differing levels of affordability, typically with some market-rate housing and some housing that is available to low-income occupants below market-rate. The "mix" of affordable and market-rate units that comprise mixed-income developments differ from community to community, and can depend, in part, on the local housing market and marketability of the units themselves. One of the challenges in developing mixed-income housing is determining a mix of incomes that can be sustained over time. In practice, there is no single formula, or standard definition, of mixed-income housing. Communities and developers around the county must evaluate local market conditions, and develop locally supported concepts and characteristics of the mixed-income development.

While it is unclear exactly when communities began making a conscious effort to promote mixed-income housing, evidence of *planned*, economically integrated communities dates back to the 1960s when Federal, state and local governments began assisting mixed-income housing developments.[1] These government efforts have continued, and today Federal, state and local governments employ a wide variety of methods to support the development of mixed-income housing. PJs and their housing partners can design approaches that take maximum advantage of many previously-established government incentive programs.

PJs can design mixed-income housing in a number of ways to meet a range of housing needs, such as:

- Develop a section of smaller, affordable units within a complex of larger market-rate units. This design supports buyers who might eventually "graduate" into the larger units in the same subdivision.
- Subsidize some number of low-income families with second mortgages in an otherwise market-rate development.
- Mandate a set-aside of a certain number (typically 20 to 60 percent) of units for low- and moderate-income households in market-rate developments.
- Develop units in accordance with inclusionary zoning requirements.

The Recent Evolution of Mixed-Income Housing at the Federal Level

In 1989, a National Commission on Severely Distressed Public Housing was named and charged with proposing a National Action Plan to eliminate distressed public housing by the year 2000. The Commission found that a major contributing factor to the failure of public housing was the concentration of poverty. It turned to mixed-income housing to remedy the intense social problems found in neighborhoods with concentrations of poor households living in assisted dwellings. The U.S. Congress and HUD first promoted mixed-income housing as a part of the solution to distressed housing conditions with the creation of the Urban Revitalization Demonstration (URD), later known as the HOPE VI program in 1993.

While the causes of poverty may be debated at length, it is generally accepted that households living in neighborhoods with concentrations of very low- and low-income residents face serious social and economic challenges, and these many low-income households are typically unable to achieve improved social or economic status.[2] There are numerous problems associated with the concentration of poverty, including high crime rates, increased health problems, malnutrition, high unemployment rates, and high numbers of children dropping out of school.

Researchers have noted that most troubled housing is located in areas in need of economic and social revitalization. Living in economically distressed areas, many very low-income families are isolated from working and middle class role models, and have limited access to jobs, good schools, and other opportunities that might help them secure economic and social stability. A widespread belief among scholars and housing professionals is that this isolation inhibits the participation of low-income persons in the social networks that are necessary to build strong, stable communities.

When there is a mix of persons with differing incomes in a neighborhood or development, the number of opportunities for interaction between low-income and middle- or upper-income residents is significantly increased. In theory, this interaction provides low-income residents with exposure to employment opportunities and social role models.

Based in part on such research and findings, the National Commission on Severely Distressed Public Housing determined that mixed-income housing is a positive tool to address economic and social isolation, de-concentrate poverty, and help transform public housing. The Commission's view was one that HUD and other policymakers adopted more widely in the early 1990s. In response, the HOPE VI program was funded and operated by Congressional appropriation from 1993 until 1999, when it was then authorized as Section 24 of the U.S. Housing Act of 1937.

To date, over $5 billion has been awarded to nearly 150 housing authorities nationally[3] in order to address severely distressed public housing through revitalization in three general areas: physical improvements, management improvements, and social and community services to address resident needs. HOPE VI Revitalization grants provide funding for the capital costs of major rehabilitation, new construction and other physical improvements, the demolition of severely distressed public housing, the acquisition of sites for off-site construction, and community and supportive service programs for residents. HOPE VI Demolition grants fund the demolition of severely distressed public housing, relocation, and supportive services for relocated residents.

In October 2000, HOPE VI was given national recognition as one of ten recipients of an "Innovations in American Government Award", one of the nation's most prestigious public service awards. HOPE VI was recognized for its Mixed-Finance Public Housing program, "an innovative approach that is transforming some of the nation's most severely distressed public housing from sources of urban blight to engines of neighborhood renewal."[4] The Mixed-Finance Public Housing program allows housing authorities to mix public, private, and nonprofit funds to develop and operate housing developments that may be made up of a variety of housing types: rental, homeownership, private, subsidized, and public housing. These communities are intended for residents with a wide range of incomes and are designed to fit into the surrounding community.

In addition to the HOPE VI Program, HUD has taken several other initiatives to promote mixed-income housing,[5] including changes in program rules for greater income diversity in other HUD-sponsored housing, and special standards for Federal Housing Administration (FHA) insurance that help to remove barriers to financing mixed-income housing. Through the promotion of mixed-income housing, Federal policymakers aim to:

- Change the physical shape of public and affordable housing;
- Establish positive incentives for resident self-sufficiency;
- Provide comprehensive services that empower residents; and
- Create partnerships with other agencies, local governments, nonprofit organizations, and private businesses to leverage support and resources.[6]

Benefits of Mixed-Income Housing

Although intentionally developed and HUD-financed mixed-income housing developments are relatively new and somewhat limited in scope, mixed-income housing can be evaluated through its early history. Historically, many pre-war city neighborhoods mixed housing types (such as single family homes, duplexes, tri-plexes, apartment buildings, or rooming houses) and income classes. As a result, there is considerable research, based on older housing patterns, of the benefits of mixed-income communities. Much of this research is focused on how mixed-income environments impact the education of children. In addition, there is ample research that provides evidence of the failure of concentrations of subsidized housing development in low-income neighborhoods.

Housing Policy Is School Policy: The Educational Benefits of Mixed-Income Housing

Since the publication of sociologist James Coleman's path-breaking *Equality of Educational Opportunity*,[7] educational researchers have consistently found that the socioeconomic status of a school's pupil population is the primary factor related to academic performance. Both academic performance and life opportunities of low-income pupils improve significantly when they are surrounded by middle class classmates. Several studies indicate that the standardized test scores of low-income students improve dramatically when they are moved from schools whose students are low-income to schools with economic integration.[8] Studies further confirm that the academic performance of middle-class students is not adversely affected by having modest proportions of low-income classmates.

Since the nation's schools are typically neighborhood-based, the lack of economic integration in the nation's schools is a direct reflection of the lack of economic integration in the nation's neighborhoods. This trend also results in a lesser degree of racial and ethnic diversity as well. In the nation's ten most *economically* segregated metropolitan areas, the average white suburban pupil attended an elementary school that was 87 percent white. As the nation's overall population of minorities is growing, this lack of diversity in schools leaves the nation's children ill-prepared for the diverse workforce they will join as adults. Mixed-income neighborhoods produce mixed-income neighborhood schools, and everybody wins.

Mixed-Income Housing Is Good Business: The Economic Benefits of Mixed-Income Housing

Effective mixed-income housing contributes to the long-term sustainability of affordable housing. In order to attract and retain occupants willing to pay market-rates for housing, the design and construction of all the housing units in the development (including the below market-rate units) tend to be of higher quality than traditionally developed affordable housing. In addition, the communities tend to be more stable than many of the communities that support exclusively low-income housing. These are direct benefits to low- and very low-income occupants.

Financially, it is more feasible to develop mixed-income housing in market-rate neighborhoods than it is to develop low-income housing there because the upper-income households can better support the higher property costs. In many housing markets, the rents paid by higher income households amply cover the cost of their units, and may be able to contribute to the subsidy of the units for lower-income households.[9]

There tends to be a higher market demand for housing that is accessible to economically viable areas. Mixed-income housing strengthens the "worker-job nexus" because the housing is located near jobs for lower-income residents. Most job creation, in fact, now occurs in America's suburbs, particularly in lower-skilled service and retail occupations, because the suburbs are where the bulk of the customers are located. Due to the lack of affordable housing in many suburban neighborhoods, local employers are faced with raising wage levels to offset their employees' costs of commuting long distances, or subsidizing special "reverse-commute" buses. Even so, employers experience costly high turnover rates when workers find jobs closer to home. For these reasons, many major businesses, such as the Silicon Valley Manufacturers Group and Chicago Metropolis 2020, have become active advocates for creating more economically diversified local housing markets.

As employers, local governments also gain from the development of mixed-income housing. Teachers, police officers, firefighters, and other local government employees often cannot afford to live in the very communities they serve, driving up local governments' recruitment, training, and salary costs. High-cost communities like Fairfax County, VA; Montgomery County, MD; Cambridge, MA; Key West, FL; Denver, CO; Irvine, CA; and Sacramento, CA have all adopted mandatory inclusionary zoning laws to support both high-quality economic development and their needs to house their own low- and moderate-income workforce.

Mixed-Income Housing Is a Safe Investment

Whatever other fears middle-class residents may harbor about low-income neighbors, the objection to mixed-income housing that is most often expressed is the fear that mixed-income housing will adversely affect their homes' market value. However, mixed-income developments usually contain only a limited percentage of subsidized housing. A comprehensive study of mixed-income housing neighborhoods in suburban Washington, DC showed no adverse effect whatsoever on the rate of increase in resale values of market-rate homes.[10] Moreover, in communities with substantive experience in mandating mixed-income developments, homebuilders have shown remarkable ingenuity in producing affordable housing that is architecturally compatible with neighboring market-rate homes, thereby preserving the character and marketability of the neighborhood.

Indeed, the greater challenge is often to maintain the long-term affordability of the subsidized homes and apartments of mixed-income developments. In strong housing markets, homeowners and landlords usually can reap a major windfall after the price control period expires. Therefore, PJs need to plan for the retention of affordable units in mixed-income developments upon expiration of affordability periods. Some tools for this purpose include: direct purchase (either at the outset or upon expiration of price controls), partial recapture of equity windfalls for affordable housing, revolving funds, or the use of housing equity trust funds.

Minimizing Political Opposition

NIMBYism ("Not In My Backyard") is perhaps America's most powerful "ism." Even in the most progressive communities, proposing specific, identifiable subsidized housing projects invariably draws strong, heated public opposition. Controversies before planning commissions and city councils never end.

While NIMBYism can be a problem in mixed-income housing development, it is less frequent, and more easily dispelled. Developers of mixed-income housing, like all developers, must take the time to understand the concerns and needs of any neighborhood in which they plan to build. Typically, however, they find that coalitions to support mixed-income housing development are easier to create than they are for traditional low-income housing developments.

There are tools available for local governments to minimize the project-by-project disputes that can arise when developing mixed-income housing, however. Some mixed-income housing strategies, such as mandatory inclusionary zoning laws, become self-executing. Public controversy may be intense while the change in policy is debated. However, once adopted, the implementation of inclusionary zoning disappears from public view and is handled bureaucratically at the level of sub-division plat review, and issuance of building permits. This results in uniform, equitably administered policies that denote better policy than project-by-project programs.

Current Practices in Mixed-Income Housing: Beyond HOPE VI

Today, all levels of government generally recognize the need for affordable housing opportunities, and many have turned to mixed-income housing as a positive option for creating these housing opportunities. Some state and local governments offer a variety of tools and incentives to encourage or require mixed-income housing development, such as:

- Favorable and inclusionary zoning policies and land use regulations that require a reservation of housing for low-income families. For example, in Montgomery County, Maryland up to 15 percent of any new housing development with fifty or more units must be made available to low- and moderate-income households.
- Financing incentives such as:
  - Density bonuses, which allow developers of mixed-income housing to build more units per acre than is normally permitted;[11]
  - Preference in proposal ranking for mixed-income housing developments, when making financial assistance available through competition; or
  - Providing public financial assistance only to projects that are designed as mixed-income housing.
- Tax incentives such as local tax abatements or tax increment financing for projects that are mixed-income developments. Most states have programs offering tax-exempt financing for projects reserving at least 20 percent of their units for low- and moderate-income households.

Case Study

Reaping the Benefits of Mixed-Income Housing: Park DuValle, Louisville, Kentucky

The Park DuValle development in Louisville, Kentucky is a newly developed mixed-income housing community whose success illustrates the social advantages and potential of using mixed-income housing to promote neighborhood revitalization in urban neighborhoods. From the beginning, the vision of Park DuValle was to create a mixed-income neighborhood of choice for middle class as well as low-income west end citizens, most of whom are African Americans. That vision drove nearly all project decisions, including design, amenities, services, and commercial considerations. So far, the vision has become a reality. In its sixth year of redevelopment, nearly 800 mixed-income rental units have been completed, and 450 single family, for-sale homes are nearly complete.

Background

Park DuValle is a HOPE VI project that combines HUD public housing assistance, Community Development Block Grant (CDBG), HOME, and Homeownership Zone funds; private equity generated through the sale of Low Income Housing Tax Credits; and conventional debt from national lenders. The overall Park DuValle site consists of about 130 acres in West Louisville. The sites were formerly occupied by the city's worst public housing and badly dilapidated privately-owned rental housing. The neighborhood is surrounded by lower priced single family homes, many in need of repairs. After the Housing Authority and the City formed a partnership to revitalize Park DuValle, it became clear that the project had to re-create an entire neighborhood, not just the housing stock, including streets, commercial activity, parks and recreation, and services for the new and returning residents.

The following article from a resident of Park DuValle, published in a local Louisville newspaper, tells firsthand some of the story of buying a home and living in a new mixed-income neighborhood. This testimonial provides, in personal terms, one resident's perspective on the benefits of mixed-income housing.

Business First of Louisville - December 10, 2001

http://louisville.bizjournals.com/louisville/stories/2001/12/10/editorial4.html

See the excitement for yourself at Park DuValle

Ralph Merkel

You simply have to see it to believe it. You may have seen and read news reports of governors and cabinet secretaries and mayors at events here, but my new neighborhood is really worth a visit.

You really need to travel to Park DuValle to see firsthand what's been done. I remember hearing about the HOPE VI award from the U.S. Department of Housing and Urban Development, oh, say, six years ago. They planned to tear down 50-year-old Cotter and Lang Homes and replace them with what they call "scattered-site" housing. Forget the fact that the American Institute of Architects has showered accolades on the revitalized Park DuValle. That's one of many acknowledgments by organizations and dignitaries who go home somewhere else afterward. I live here. I know.

What would possess me to build a home at 38th and Young? Seven years ago, it was one of the most dangerous corners in the city. Now all I hear are children playing touch football in their yards. No thugs here, no drugs here. This is a meticulously planned neighborhood that's running on all cylinders already, just three years after its rebirth.

I'm an urban pioneer of sorts, and that's part of the excitement of Park DuValle. It's only just beginning. There are roughly 600 apartments and 100 homes here now. Within 10 years, those numbers will increase dramatically. We'll have our own Town Center with grocery stores, bakeries—the kinds of places you walk to in the Highlands. But they will be in the West End. The newly renovated Southwick Community Center just re-opened. It's at the end of Russell Lee Drive, the curving, tree-lined boulevard that serves as the entrance to Park DuValle. It's right off Algonquin Parkway, a few blocks east of the Shawnee Expressway. The median is dotted with young trees that all promise to grow into the same kind of stately specimens that line our Olmsted-designed parkways. It's a wide street that encourages walking. There are sidewalks and old-fashioned streetlights everywhere. And dare I add that regular city bus service gets you downtown in 15 minutes? Everywhere you see evidence of the redevelopment taking shape. Homes are going up all across Park DuValle. People are building homes in the West End again.

It's taken numerous disparate groups to get this huge ball rolling. First, an avalanche of HUD money paid to demolish every brick of the old projects and to put in a new streetscape that encourages neighbors to linger on their front porches and chat. This is no drive-into-the-attached-garage suburb where you might see your neighbor once a month. We meet regularly to plan for the excitement of the future. We've already thrown ourselves a big party. In late September, we had a Jazz Brunch in a huge tent in one of the empty fields here. We enjoyed an old-fashioned cookout while Boogie Morton and his combo played. The kids had crafts. We had music and food. The fire department dropped by with its old pumper truck for the kids to explore. It was a great time. And everyone there sensed that this was the first of many such community bashes. So, we have shiny new homes and brand new yards. We have driveways we'll soon have to shovel. We carved out our own piece of the American dream from a master plan that we see developing before our eyes every day. We have parks a few blocks away. What's really cool is that dozens of people are working alongside us to continue to plan this new-millennium neighborhood. It's exciting, and beautiful, and a little bit overwhelming when you look at what's coming down the road: a Town Center built with numerous storefronts; a senior housing complex that is nearing completion; and hundreds more homes and apartments.

You might wonder why Realtors aren't touting this remarkable achievement right in our own backyard. Well, the whole community is so carefully planned that all new homes are constructed after the buyer enters into a contract with one of a handful of small builders. After a visit to Park DuValle's marketing center on Russell Lee Drive, you pick your lot, then your home. There are dozens of approved styles, all of which reflect the housing heritage of Louisville: Victorian, Craftsman, Colonial Revival. One story and two. If you have a substantial chunk of change you can build a signature home -- for tens of thousands less than if the same home were built in the East End. Take a look at the designer homes on Algonquin Parkway just past 34th Street. These one-of-a-kind houses were some of the first ones built here. You could drop them into Lake Forest and not notice the difference. They're stately and beautiful.

Instead of fleeing to the suburbs, we decided to invest in Louisville's future. I'm evidence that white flight has ended here. Building in Park DuValle was a no-brainer. The lots are so cheap it's almost ridiculous. When I closed, I made a separate transaction with the Housing Authority of Louisville—which temporarily owns all the land here—and bought my corner lot for $7,200. My friends from out of town are amazed at what's happened here. Judy, a land-use-planner from Indianapolis, marveled at my new neighborhood. Her husband, Jim, and I used to work together at WLKY-TV, and we both remember what used to be here. We once covered a drug-related murder just a few blocks from my front porch. That was in the mid-1980s, when this was a place just about nobody wanted to be after dark.

The despair of residents from the former Cotter and Lang Homes has been replaced by pride. There are public housing units a few blocks from my house now, but I defy you to tell me which ones they are. True integration of all incomes and races is the goal here. The idea is to create attractive places for people to flourish. No one here is stigmatized by his or her address. Doctors and lawyers and accountants live a few blocks away from people receiving public assistance. But you don't have to take my word for it. We're throwing another party, and you're invited. On Sunday, Dec. 9, we're holding the first Park DuValle Holiday Festival and Home Tour. It's free, and it's your chance to see what's going on. Come to Park DuValle from 2 to 5 p.m. that day to see why we're so excited about our new Kentucky homes. We have a great afternoon planned, with several surprise guests and a big party at dusk. You can tour some of the homes and apartments in my neighborhood. And at 5:15, we'll light our brand new Christmas tree, planted just outside the community center. When's the last time you heard of a holiday home tour in the West End? We're just bursting with pride as we want to welcome you into our new homes. Christmas is the season of hope. On Dec. 9, we hope you'll join us.

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End Notes

[1] Brophy, Paul C. and Rhonda N. Smith, "Mixed-Income Housing: Factors for Success." *Cityscape: A Journal of Policy Development and Research*, Volume 3, Number 2 (1997): 4.

[2] Wilson, William Julius. *The Truly Disadvantaged*. Chicago, IL: Chicago University Press. 1990.

[3] See HUD, "HOPE VI" available online at http://www.hud.gov/offices/pih/programs/ph/hope6/index.cfm for current investment levels and additional information about the HOPE VI program.

[4] See HUD, "HOPE VI" available online at http://www.hud.gov/offices/pih/programs/ph/hope6/about/.

[5] Khadduri, Jill and Marge Martin, "Mixed-Income Housing in the HUD Family Stock." *Cityscape: A Journal of Policy Development and Research*, Volume 3, Number 2 (1997): 33.

[6] See HUD, "HOPE VI" available online at http://www.hud.gov/offices/pih/programs/ph/hope6/about/.

[7] Coleman, James. *Equality of Educational Opportunity*. New Hampshire: Ayer Company Publishing. 1978.

[8] See Century Foundation, *Divided We Fail* (September 2002); and David Rusk. *Classmates Count*. Edgewood College: Center for Effective Democracy, July, 2002. The latter study of Madison-Dane County, Wisconsin shows that low-income pupils' standardized test scores improve dramatically as economic integration increases. This study demonstrated that moving from a school (and neighborhood) where 80 percent of a poor child's classmates are also poor to a school (and neighborhood) where 80 percent of that child's classmates are middle-class, on average, produces a 39 percentage point improvement in the low-income child's reading scores.

[9] Khadduri, Jill and Marge Martin, "Mixed-Income Housing in the HUD Family Stock," *Cityscape: A Journal of Policy Development and Research.* Volume 3, Number 2 (1997): 33.

[10] Innovative Housing Institute/Greater Washington Research Center. *The House Next Door*. Washington, DC. 1999.

[11] See the National Low-Income Housing Coalition website at http://www.nlihc.org/advocates/smartgrowth.htm.

Chapter 2

The Developer Mindset in a Mixed-Income Housing Deal

Whether for-profit, nonprofit, state-wide, or community-based, any developer considering mixed-income housing must evaluate the likelihood of a project's success from an important viewpoint—its financial feasibility. Without adequate consideration of key issues, even the best-intentioned mixed-income project could be set up to begin operating in a downward spiral toward eventual abandonment. Developers and HOME PJs need to realistically evaluate housing markets in their communities and assess the desires of consumers in order to determine whether a proposed mixed-income housing project can succeed over the long term. This chapter introduces the primary development issues that can have a significant impact on the long-term feasibility of a mixed-income housing project.

Thinking Like a Developer

Real estate developers must be concerned first and foremost with the short- and long-term financial feasibility of their projects. The short- and long-term feasibility of any development is determined by whether or not the project can attract buyers/renters and sustain a cash flow that sufficiently covers operating expenses. Several factors affect the ability of a market-rate housing development to achieve this objective, including location, marketability and design, cost, and management. These same issues are critical to the viability of mixed-income developments. All parties involved in a mixed-income project must understand these issues.

Developing a successful mixed-income development is typically easier in areas where there is already a strong demand for market-rate housing, because the market has been "tested" and is secure. PJs undertaking mixed-income housing for the first time are encouraged to start in areas with a strong demand for market-rate housing.

Location, Location, Location

The siting of mixed-income housing, as with any real estate, is one of the most important factors in determining the long-term success of a mixed-income housing development. Mixed-income housing is only successful when there is a demand for the market-rate units, as well as for the affordable units.

Sites selected for mixed-income housing development must be marketable. Several factors impact marketability, such as:

- Attractiveness of the site;
- Condition of the neighborhood;
- Reputation of the area;
- Visibility to passersby;
- Market rents in the area;

- Access to goods and services to meet the needs of projected resident population (good schools, quality shopping, etc.); and
- Proximity to targeted customers' current place of residence or work.

Unlike traditional low-income housing, site selection for mixed-income housing is driven primarily by marketability rather than revitalization goals. Siting a mixed-income development in an area in need of revitalization may attract low-income residents, but it is unlikely to attract higher-income residents who can afford to live in nicer neighborhoods. Developing a successful mixed-income development is typically easier in areas where there is already a strong demand for market-rate housing, because the market has been "tested" and is secure. PJs undertaking mixed-income housing for the first time are encouraged to start in areas with a strong demand for market-rate housing.

The cost of land and development is likely to be higher in market-rate areas than it is in revitalization areas. If a PJ wants to develop a riskier site where existing market demand might not be strong because property costs are prohibitive, or the mixed-income development is proposed as part of an area revitalization strategy, PJs are strongly encouraged to partner with experienced developers of market-rate housing. Among other things, developers with this experience will be able to provide advice on the use of amenities, on-site services, and quality materials in the housing product to help secure interest from market-rate buyers and renters.

Finally, as with site selection for any housing development, PJs should be conscious of the need to build community support for the development of mixed-income housing. In areas that currently have only market-rate housing, this is particularly important. The lack of experience of these residents with economic diversity in their neighborhood may result in a higher likelihood of neighborhood opposition to affordable housing, including mixed-income housing.

Marketability

> *The marketability of a mixed-income development is driven by one central question:* ***"Will people want to live here?"***

The marketability of a mixed-income development is driven by one central question: "Will people want to live here?" Foremost, the developer must understand potential customers, and consider their housing needs, desires, and financial capacity to purchase the product. Developers must evaluate and identify the customer's housing needs in terms of ideal unit size, amenities, unit layout, and locational preference. On-site services and amenities add a sense of luxury to a housing development, and tend to be desired by most potential occupants. The type of services and amenities should be tailored to the target population, and may include a pool; dry cleaning service; day care; extensive wiring for cable, phone, and internet; or security.

All developments should look appealing. Attractive materials should be used throughout the building, particularly in the reception and common areas. The grounds should be nicely landscaped. Tenants should have the ability to customize their unit to taste. In-unit amenities like icemakers, appliances, and curtain rods also add to a customer's comfort and a unit's attractiveness.

Creative unit design can enhance marketability. Good design can make small rooms appear larger, create more secure common spaces, make trash and recycling receptacles convenient yet inconspicuous, and improve parking locations. From a cost perspective, good design can maximize usable and rentable space and minimize unneeded, non-income generating space. Certain designs might provide an efficient layout that can lower the cost of operations. Not only can design save money, but it can also generate income or services. A "modern" design may peak interest and increase traffic for a small business in the building. An unused below-grade space might be converted into rentable storage.

Developers must do research about the housing in the area with which they will be in competition. People shop for the best housing they can find, at a price they can afford. Developers of mixed-income housing must create a housing unit whose “package” of location, design, amenities, and price will effectively compete for residents. If the quality of a unit, along with its amenities and services, is not comparable to that offered by the competition, the development’s marketability suffers.

Cost Issues

As with all housing development, developers and PJs must determine whether or not a mixed-income development is financially feasible. In order to understand whether the development can be financed adequately and whether the property will be financially feasible over time (for rental properties), PJs need to look at projected sources of financing, total development cost, projected income, and operating costs.

Development Cost

There are three main types of costs included in the development cost of mixed-income housing: the actual cost of rehabilitation or new construction, time-related costs, and opportunity cost:

- Rehabilitation and new construction costs should be estimated by someone experienced in cost estimating market-rate housing. All necessary design elements, amenities, and site improvements needed to make the market-rate development competitive **must** be included. These elements are not optional because if the units do not attract market-rate buyers or tenants, it will not be a successful project.
- Time-related costs include staff time, interest expense, inflation, and the possibility of new competition entering the market place prior to, or shortly after completion of, the development. Each of these factors should be considered for their impact on the development and its sustainability.
- Opportunity cost must be considered because a developer will weigh the benefits of pursuing the proposed project rather than another, in order to know which will be the best investment. PJs should take opportunity cost into consideration as well, as each proposed project needs to be considered against its opportunity cost, or the cost of funding another project instead of the proposed one.

Development costs are eligible HOME costs for the HOME-assisted units only. These costs can be determined as a pro-rated share of the total development cost, when all the units are comparable. However, when the market-rate and HOME-assisted units are not comparable, the costs related to the development of the units must be charged to the HOME Program on an actual cost basis, and cannot be based on a pro-rated share. This concept is discussed further in Chapter 3.

Projected sources of financing

Projected sources of financing have to be completely thought through before any HOME-assisted housing project is approved to prevent projects from stalling or failing. In a mixed-income housing situation, the combination of financing resources may become more complex as unique financing structures between public and private resources become necessary to adequately subsidize the development, sale, and/or operation of the units for lower-income households, while not overly enriching the project developer. Many different combinations of public and private funding can be made to work for an individual project, so PJs should be sure to examine the project closely to determine which would be most appropriate for the proposed development. Financing sources are discussed in Chapter 4.

Understanding project debt in this context is important. Housing developments can usually afford to carry some short- and long-term debt, but the maximum debt that projects can carry varies—especially as the percentages of low-income and market-rate units vary from project-to-project. PJs must assess what the sources are for long- and short-term debt, equity, and soft debt in individual projects. They should also consider whether predevelopment funds are available to get the project going, and determine early in the development process if credit enhancements, such as Federal Housing Administration (FHA) or Fannie Mae, will be necessary to help the project succeed.

Long-term financial feasibility

Long-term feasibility of any project, including mixed-income development, depends on steady cash flow sufficient to cover operating costs over time. Projecting costs and revenues over a minimum of fifteen years in a pro forma is a simple way to ascertain the potential financial feasibility of a project over this period of time. Generally, the costs of maintaining and operating a mixed-income development are comparable to those of a market-rate development, but additional resident services may be necessary to assist low-income families in their transition to a new environment. PJs and developers should plan for the associated costs.

A pro forma developed on a spreadsheet can be used to generate hypothetical scenarios in order to evaluate how changes in the ratio of assisted units to market-rate units impacts the financial viability of the project. There must be an adequate number of market-rate units to help keep the development sustainable over time. The level of subsidy, amenities, and design features must also be examined to ensure that unit costs are realistic and that the project income will adequately cover the expenses required to maintain the development.

Securing Sound Management

Whether a development is rental or homeownership, good management will be critical to its ability to maintain its attractiveness and marketability over time. Effective management is responsible for all aspects of managing the development, including security, resident relations, site maintenance, trash collection, and management of child play areas. Management is also responsible for tenant selection, intake standards, enforcement of lease provisions (including rent collection), and house rules, which are very important to the effective functioning of rental housing management. Management companies should also consider providing extra services such as in-unit upgrades, dog walking, package acceptance, cable TV and Internet service, and a business center.

There are many ways to manage rental property effectively. It can be done by in-house staff of the developer, or contracted to an entity with property management experience. On-site offices, when the size and scale of the development warrant it, provide a visible presence that many residents consider important. Managing and marketing can be separate functions, or the management company can undertake marketing activities. When making decisions about property management of a mixed-income rental development, developers should consider the proportion of occupants who have families, or who may not be employed. The management needs of these households may be more significant, and management planning should reflect those needs.

For more information on property management. . .

Good property management results in resident satisfaction and property maintenance, as well as marketability and long-term viability of the development. For detailed guidance on rental property management of affordable housing developed with HOME funds, see HUD's model program guide *Asset Management: Strategies for the Successful Operation of Affordable Rental Housing*. To get a free copy of this model program guide, see HUD's Office of Affordable Housing Programs online library at http://www.hud.gov/offices/cpd/affordablehousing/library/modelguides/index.cfm.

PJ Considerations

For a mixed-income project to be financially viable and retain its mixed-income nature over time, it must succeed in the marketplace and cannot be based on the fact that some units are subsidized. A developer of a mixed-income project has to remain focused throughout the development process on what the market demands, and then provide it in a manner equal to or better than the competition. PJs that are committed to sustaining mixed-income housing in their jurisdictions need to assess each project's marketability from the perspective of a private developer, and also evaluate how effectively the housing will meet the needs of the low-income population that it serves. The benefits of mixed-income housing to low-income occupants were explored in the previous chapter. There are some additional considerations a PJ should make when evaluating a potential project:

- Low-income households are likely to need easy access to public transportation and other services, such as health care, shopping, and public services.
- Decisions should be made with an eye for minimizing any stigma that might be created for the occupants of the low-income units. Low-income households may be stigmatized if:
  - All the low-income units are located in one part of the development.
  - The exterior design of the low-income units differs from the exterior design of the market-rate units. Low-income units can be designed differently than the market-rate units, but these variations should not be obvious to any passerby.
- Low-income *families* should be housed in developments with *families* occupying market-rate units, where possible. This will provide optimum opportunity for interaction between households, and will minimize the stigma that might ensue if the only children in the development are low-income. Where developments have children, recreational space should be provided.
- Depending on the housing market, financial feasibility of a project, and the proportion of low-income households that the development will support, direct HOME assistance might not be sufficient to facilitate mixed-income housing development. PJs should become versed on any other incentives and financing sources the state or local government offers, and work with colleagues throughout local government to develop incentives where they do not exist. Where warranted, PJs should consider recruiting interested developers to develop mixed-income housing. This may require special marketing or "packaging" of incentives.

Case Study

Location and Marketability Count: The Lessons of Montgomery County, MD

The Housing Opportunities Commission (HOC) of Montgomery County, Maryland has pursued mixed-income development for many years, and has learned from experience about the differences between developing low-income housing and mixed-income housing. The following case studies share the progression of HOC's learning, and underscore the importance of thinking like a developer when approaching mixed-income housing development.

Background

In 1974, Montgomery County, Maryland passed an inclusionary zoning law that required developers of fifty or more housing units to set aside at least 15 percent of the units for low- and moderate-income households. Specifically, it required two-thirds of the units set aside be offered to modest income households and one-third be offered to the HOC. HOC is the County's Public Housing Authority and administrator of Section 8.

McKendree

Shortly after this law passed, a developer proposed the new construction of the McKendree development. McKendree consisted of 86 back-to-back townhouse units. This development proposed to house low- and moderate-income households, and to satisfy the affordable housing set-aside in the new law. It was developed as part of a large Planned Urban Development called Montgomery Village (35,000 residents, as of 2000).

The developer offered HOC the opportunity to purchase 30 units. HOC requested that the units be dispersed throughout the "village," and that the dense back-to-back design that had been proposed be reconsidered. HOC's requests were denied at the Planning Board. Nonetheless, because of the significant need in the county for affordable housing, HOC purchased all 30 units it was offered. In addition, in order to fill one of its most urgent housing needs for family housing, HOC altered the unit design to increase the number of bedrooms in all 30 units from two or three, to four.

Shortly after the development was fully occupied, HOC started to receive complaints about unsupervised children, noise, poor maintenance, and even drugs and other criminal activity. In time, the development could not sustain itself as a desirable community, and as a result, failed to retain its mixed-income character. After only five years, many original homeowners sold their units at market value, as permitted by the law. Investors purchased many of the units, and, in turn, rented the units to Section 8 certificate holders. The few homeowners who remained at McKendree did so only because housing prices in Montgomery County had escalated beyond their financial capacity, and they could not afford to move.

Twenty-five years later, McKendree still has a relatively large number of rental properties and continues to be beset with many of the problems inherent in large, densely populated rental developments. Throughout this period, the County invested, and continues to invest, a considerable amount of its scarce community development resources in solving problems at this development.

Timberlawn Crescent

About 10 miles from McKendree, in an affluent part of Montgomery County, a smaller development called Timberlawn was underway. Planned as a condominium, townhouse and single-family development, Timberlawn was designed to appeal to the high end of the market. The neighborhood was almost fully developed with a large, attractive condominium community across the street where the HOC owned about 50 units. The development was located close to bus and subway transportation.

A parcel of the Timberlawn development became available at low cost to HOC when the developer went bankrupt and failed to build the required affordable housing units. Instead of for-sale housing, the HOC decided to build a rental development as a near replica of its neighboring condominium community across the street. There was nearly no other rental housing in the rest of Timberlawn.

The HOC called the new development Timberlawn Crescent. Today, Timberlawn Crescent provides fairly dense rental housing (107 units on about 5.5 acres) for a mixed-income population. Sixty percent of the 106 units are targeted to below-market renters, but additional income targeting is in place. There are six tiers of income served, ranging from a few units targeted to very low-income households up to market-rate.

The property was built to appeal to the higher-end tenant, and includes lush landscaping, a classy clubhouse available for private parties, and a first-rate day care. The market-rate and subsidized units are not differentiated in any way. Each apartment has a balcony, hardwood floors, ice-makers, washers, and dryers. Finally, and most importantly, the development is managed by a private, professional firm, under contract by HOC.

With Timberlawn Crescent, HOC's intention was to build and maintain a community that met or exceeded the established community norms, and it succeeded by all counts. Market rents at Timberlawn Crescent have more than doubled since it opened and are among the highest in the area, even though the community does not include the almost-obligatory swimming pool. The "affordable" units remain affordable to the targeted income groups. A drive through Timberlawn Crescent today is as pleasant—or perhaps more pleasant because of the lush growth of the carefully tended landscaping—as it was the first year it opened. Neighbors who originally opposed the development of Timberlawn Crescent now hold their community meetings in its attractive clubhouse. Instead of complaints, HOC receives compliments. A 1998 survey of neighbors and residents found 100 percent satisfaction with the property and its management. The marketability of this development has remained unchanged; it has remained at 100 percent occupancy since it first opened in 1989.

Keys to Success: Comparing McKendree and Timberlawn Crescent

Ultimately, the stick by which to measure the success of a mixed-income development is whether or not it continues to attract and retain market-rate occupants. By looking at the factors that contributed to McKendree's lack of success as a desirable, mixed-income community, and those that led to Timberlawn Crescent's ultimate success, the keys to successful mixed-income communities emerge:

Integrate the affordable housing units throughout the development. The affordable housing units at Timberlawn were well dispersed throughout the development, and generally indistinguishable from the market-rate units. In addition, there was a mix of families with children and those without in both the market-rate and the HOC units. On the other hand, the occupants of the low-income units at McKendree were segregated and stigmatized. The decision to develop only family units in a development that was otherwise nearly child-free compounded the stigmatization issue.

Design and construct the development to serve all the occupants. The development at Timberlawn Crescent was undertaken with a careful eye toward making the market-rate and affordable units indistinguishable. All tenants, regardless of their income level, were afforded the same level of amenities, and the development was designed to meet the tenants' needs for community and recreational space. On the other hand, the dense back-to-back unit design of McKendree allowed for only one exit to shared community space including play areas and parking. There were conflicts between the bicycles of young children playing on the streets and motorists. As the property and residents aged, parking lots became basketball courts for teenagers, and the outdoor public space became chaotic, and at times menacing to residents.

Locate near transportation and services. McKendree, developed in the early years of Montgomery Village, was somewhat isolated from amenities such as transportation and shopping. The occupants of the affordable units had limited accessibility to activities away from the development, and as a result, adults and children ended up "hanging out." Timberlawn Crescent, on the other hand, was near transportation and these problems did not occur.

Secure good, professional on-site management. A property must be well maintained and managed to attract market-rate residents. At Timberlawn Crescent, HOC secured an on-site private management firm with good results. The firm addressed and responded to resident concerns immediately. At McKendree, however, the number of HOC units seemed too small to justify on-site management. Therefore, when problems arose, it was more difficult to address them. HOC subsequently tried on-site management, but as time passed, and more and more units became rental units with absentee landlords, it was too late to turn around the downward cycle of the property that had begun.

Plan for a sustainable mix of occupants. A successful balance between the number of subsidized homes and market-rate homes can be delicate. However, developments can include a range of incomes, so that market-rate residents, while aware of the presence of subsidized housing, are not overwhelmed by it and do not feel that they are in the minority.

The six-tiered income targeting approach at Timberlawn ensures the development will serve low-income households, but does so in a way that limits any concentration of extremely low-income families. At McKendree, there was no effort at "social integration" of the low- and moderate- income households, and little thought about determining a mix of incomes that would be sustainable over time. The demographic differences between these households were significant. Moderate-income households were homeowners; low-income households were tenants. The homebuyers were primarily white, childless couples who were both employed. Most HOC tenants were racial minorities, with large families, and many were unemployed or underemployed. In fact, although HOC owned only one-third of the units, over half the McKendree residents were in HOC units; in addition, nearly ***all*** the children in development were public housing residents. These differences made the segregation of the low-income units more pronounced, and more problematic.

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Hypothetical Case Study

Site Selection for Direct Acquisition of Eight Units in a Condominium: Hometown, California

This hypothetical case study demonstrates a relatively easy method for increasing mixed-income housing development—through the direct acquisition of units available in the private market. The analysis undertaken by the agency described below is one that can be easily generalized to existing housing markets.

Background

The Housing Authority of Hometown, California created a nonprofit subsidiary, HAH Community Development Corporation (HAH CDC), to develop mixed-income housing. For its first project, HAH CDC applied for and has been awarded HOME funds from the City for the purchase of eight units in a condominium development of 80 units called Pipe Creek. Construction at Pipe Creek is expected to begin shortly.

Site Selection Criteria

HAH CDC targets the Pipe Creek condominiums for a number of reasons. It wants to create affordable units in a development that is able to sustain long-term occupancy by low-income households in a mixed-income environment. It knows the development needs to be able to remain attractive to market-rate buyers, as well as meet the service needs of its clientele. The HAH CDC establishes several criteria on which to evaluate the development's ability to meet this overall goal. Pipe Creek meets most of the key criteria:

- The property is located in a stable, middle class community, in an area of new residential growth that consists of "garden" condominiums and townhouse subdivisions. The newly developed housing is targeted primarily to middle-income families, most of whom own cars.
- The property is not in a census tract where there already is a high percentage of low-income housing.
- Pipe Creek is a development in architectural and economic harmony with neighboring developments. It is likely it will be able to sustain interest among market-rate buyers.
- The apartments are small but include basic amenities—washers, dryers, and balconies or patios.
- The property is close to services, shopping, and employment centers. There is currently minimal public transportation, and this will be a hardship to some residents. However, the local government budget includes neighborhood bus services within one year. A community service center, including a public swimming pool, is also planned by the city and is adjacent to the development. The projected bus route will serve these facilities.
- The property is in a school district with a small percentage of low-income students.
- Pipe Creek is particularly attractive because its residents will be moving into a new development. In an already established community of homeowners, an influx of tenants might be viewed as interlopers. In addition, as a newly developed condominium community, Pipe Creek is likely to be occupied primarily by owners. The difference in tenure type can be a source of tension in mixed-income developments; a low ratio of renters to owners is preferred. Older condominium developments are at greater risk of becoming rental properties, as owners move out and either sell or retain their units as rental investments. HAH CDC believes the development selected will retain its

stability with a greater percentage of owner-occupied units. It does not want its own rentals to "tip the balance" and change the basic tenure type of the property.

HAH Unit Location

Since HAH CDC seeks economic diversity, it purchases one unit in each of the eight buildings, so its units are geographically dispersed throughout the development. This will help to avoid stigmatizing the low-income residents. HAH CDC also purchases as many first level units as possible. With its experience operating affordable multifamily housing, it recognizes the need to mitigate potential complaints about noise levels. While impossible to eliminate noise in a multifamily unit, it can be reduced. For those units not on the first level, HAH CDC upgrades the carpet padding to provide extra sound insulation.

HAH CDC is committed to providing units to its low-income clients that are identical to the market-rate units. However, it selects some optional changes. It does not purchase upgrades that, if not properly maintained, are likely to break down, such as ice-makers. It chooses manufactured cabinet doors, rather than wood, because they are easier to maintain. In every other way the affordable units are identical to the market-rate units and include a dishwasher and stacked washers and dryers. All HAH CDC-owned units in the development have the same mechanics, appliances, and other features which will simplify property management.

Management

It is a great advantage to purchase all eight units in one condominium development, so HAH can work with one owner/manager, rather than several. In this instance, HAH plans to use its own staff to market and rent its units, and to provide general property management support. There is a small office in the development to be operated as a part-time satellite management office, contracted by the condominium association. HAH staff will coordinate with the condominium association and its property management firm for major repairs and minor repairs common to all the units.

Social Services

HAH CDC has negotiated an arrangement with the local Department of Social Services to provide case management services for its residents, as needed. HAH CDC management staff will conduct semi-annual preventive maintenance visits. These staff members are trained to be alert to maintenance issues that indicate the need for social service intervention.

Financing

HAH CDC is financing the purchase of the units with HOME funds from the city and a private first mortgage. It has contracts to purchase four two-bedroom and four three-bedroom units, which will be affordable to families earning approximately $22,000 (40 percent of the area median income of $55,000). HAH has a letter of commitment for a first mortgage from a local lender at 7 percent interest. The city loan of $440,000 will be non-amortizing, and carry a 3 percent simple interest rate. Payments are subject to available cash flow. At the end of twenty years, the principal of the HOME loan becomes due to the city. At that point it is expected that the city and HAH CDC will renegotiate the deal rather than have a complete pay-off of the loan.

Purchasing all eight units from the same party provides HAH CDC an opportunity to negotiate the purchase price. The developer agrees to a slight reduction in price because the eight units will require no marketing by the developer. In addition, this streamlines financing for the CDC. The process would be more burdensome had HAH CDC, of necessity, purchased from different developers at different sites. Exhibit 2-1 provides a project summary.

Coordination with the Condominium Association

HAH looks carefully at condominium monthly fees to be sure they are affordable to the residents. Utilities are individually metered at Pipe Creek, which HAH CDC prefers. HAH CDC plans to monitor the condominium fees because it has found that the early analysis of fees presented by developers is often overly optimistic. The HAH CDC is concerned about rising costs of maintenance and the adequacy of replacement reserves.

HAH CDC staff plans to participate at association meetings, and to encourage its residents to do the same. However, it does not plan to vote unless there are vital financial or maintenance issues involved. The condominium association is aware of HAH CDC's presence in the community and will be provided the name of a staff contact should problems arise in this relationship.

Marketing

Marketing affordable units in Pipe Creek will not be difficult. There is a shortage of affordable housing to serve the targeted income range. These households do not rank high on the public housing or Section 8 waiting lists and they have few, if any, affordable housing options. The majority of households in this income range are paying in excess of 50 percent of their incomes for rent. Eligible households on the HAH waiting list will be notified, with preference given to those working near the site.

Exhibit 2-1
Project Summary: Pipe Creek Condominiums

Location	Hometown, CA
Project type	Garden Condos
Number of Buildings	NA
Number of Units	8
Two BDR	4
Three BDR	4
Year Built	New
Price per unit, including closing costs	$75,000 average
Area Median Income	$55,000
High Home Rent 2 BDR	$804
Low Home Rent 2 BDR	$619
High Home Rent 3 BDR	$894
Low Home Rent 3 BDR	$688
2 BDR rent @ 40% of median	$495
3 BDR rent @ 40% of median	$550
Operating Costs	$3,000/year
Tenant Utilities	$1,200/ year
First Mortgage	$160,000
Interest Rate	7.0%
Term	30 years
HOME Funds	$440,000

Interest rate	3%
Term	20 year balloon

Chapter 3

Using HOME to Support Mixed-Income Housing

The HOME Program is a public funding source for housing development that provides ample flexibility for HOME participating jurisdictions. The program regulations are flexible to provide many opportunities for determining a mix of units, development costs, forms of assistance, and levels of assistance that can appropriately support individual projects. This chapter describes the HOME Program regulations, and offers illustrations of how projects effectively use HOME funding in compliance with these requirements.

Using HOME for Mixed-Income Housing Development

HOME is an ideal source of direct assistance for mixed-income housing development because of its flexibility, in terms of the types of housing activities it can support, and in terms of how financing can be structured. HOME funds can be used to support mixed-income housing through:

- Acquisition of existing rental or homeownership property;
- New construction or rehabilitation of rental or for-sale housing; or
- Direct homebuyer assistance programs.

HOME requirements generally apply only to the HOME-assisted units in a development. The most fundamental HOME requirement is that units assisted with HOME funds be occupied by low- or very low-income households at initial occupancy, and for some period thereafter (known as the "affordability period"). In developments located in neighborhoods with significant demand for market-rate housing, securing affordability will help ensure the mixed-income character of the development over time.

HUD's Office of Affordable Housing Programs maintains accurate and up-to-date information about the HOME Program at http://www.hud.gov/offices/cpd/affordablehousing/programs/home/index.cfm

Determining HOME-Assisted Units

Unlike other Federal programs, HOME distinguishes between the units in a project that have been assisted with HOME funds and those that have not, hence the term "HOME-assisted" unit. This distinction between HOME-assisted and other units enables PJs to spend HOME funds on mixed-income projects while still targeting HOME dollars only to income-eligible households.

When using HOME in a mixed-income project, the number of HOME-assisted units in the given project must be specified at the time of project commitment. The minimum number of HOME-assisted units may be based on either:

- The actual development costs of the HOME-assisted units; or

- Where all units in a development are comparable, a pro-rated share of total HOME funds relative to total development cost. For example, if $100,000 of HOME funds is invested in a development whose total development cost is $1,000,000, then the proportion of HOME funds to total development cost is ten percent. A minimum of ten percent of the units must be designated HOME-assisted.

PJs can always designate a higher number of units as HOME-assisted than that minimally required by HUD.

PJs can determine the number of HOME assisted units by "filling the gap" and designating the minimum number of units in the development. Alternately, PJs can determine the number of affordable units it wants the development to bear, and then use the HOME funds to pay the costs of those units only.[1] Once a designation of HOME-assisted units is made, PJs can also impose additional income targeting of those units, as discussed below.

Eligible Costs

HOME funds can be used to pay for hard costs, soft costs, and refinancing costs for all HOME-assisted units. In addition, HOME funds can be used for relocation costs for occupants of all units, not just those receiving HOME funds. Exhibit 3-1 outlines the eligible costs under the HOME Program. PJs need to plan for the allocation and tracking of costs across units in a mixed-income project, as described in the previous section, because in a mixed-income development, HOME funds cannot be used to finance any units that will be occupied by "over-income" tenants or buyers.

HOME requires PJs to adopt rehabilitation or construction standards. Typically, these describe with specificity, the types of materials and level of amenities that are eligible in an assisted unit. Some of the amenities or luxury items, such as a pool, that are needed to make a mixed-income development marketable may not be eligible costs in accordance with the HOME Program or the local rehabilitation or construction standard. Rather than omit these items, PJs should consider subsidizing these amenities with a different source than HOME funds, such as private debt, or the market-rate units.

Exhibit 3-1

HOME-Eligible Costs

Hard Costs	Soft Costs
Acquisition of land (for a specific project) and existing structures; Site preparation or improvement, including demolition; Securing of buildings; and Construction materials and labor.	Financing fees; Credit reports; Title binders and insurance; Surety fees; Recordation fees and transaction taxes; Legal and accounting fees, including cost certification; Appraisals; Architectural/engineering fees, including specifications and job progress inspections; Environmental reviews; Builders' or developers' fees; Affirmative marketing, initial leasing, and marketing costs; Staff and overhead costs incurred by the PJ that are directly related to a specific project; and Operating deficit reserves during rent-up, up to 18 months.
Relocation Costs Payment for replacement housing, moving costs, and out-of-pocket expenses; Advisory services; and Staff and overhead related to relocation assistance and services.	Loan Guarantee Accounts Deposit amount must be based on reasonable estimate of the default rate on the guaranteed loans, but may not exceed 20 percent of the total outstanding principal amount guaranteed; and A loan in default can be repaid in full.

Levels of Assistance

The HOME Program establishes minimum and maximum levels of assistance for the overall project and the HOME-assisted units. The minimum level of HOME assistance in a rental housing project is an average of $1,000 per HOME-assisted unit (calculated as $1,000 multiplied by the total number of HOME-assisted units). For example, if there are six HOME-assisted units in a project, then the minimum level of HOME assistance for the project is $6,000. The minimum HOME investment for homeownership units is $1,000 per unit.

Maximum HOME assistance per unit varies by PJ and is generally generous. Each year, HUD determines the maximum per-unit HOME subsidies based on each PJ's Section 221(d)(3) Program limits for the metropolitan area. The limits are issued by the multifamily division of the local HUD field office and are made available online at
http://www.hud.gov/offices/cpd/affordablehousing/programs/home/limits/index.cfm.

When considering support of a mixed-income development, these generous per-unit subsidy limits permit PJs to invest significant levels of assistance in a project in order to "buy" affordability over the long term.

Other Federal Requirements

Developments that are financed with HOME funds are subject to other HUD and Federal laws and regulations beyond the HOME Program rules. These requirements are crosscutting, meaning they apply to most Federally funded programs. Crosscutting requirements cover a wide range of activities that are regulated by the Federal government, including:

- Environmental requirements, such as environmental reviews, flood insurance, and site and neighborhood standards;
- Procurement and other uniform administrative requirements;
- Non-discrimination and equal access rules, such as fair housing, affirmative marketing, and handicapped accessibility;
- Employment and contracting rules, such as equal opportunity employment, Section 3 economic opportunity, minority- and women-business enterprise development, and debarred contractors;
- Prevailing wage requirements;
- Relocation;
- Conflict of interest rules; and
- Lead-based paint.

Unlike the HOME Program rules, the Federal crosscutting requirements typically apply to all the units in the development that have an investment of Federal funds, not only the HOME-assisted units.

Fair housing requirements have a particular importance for developers of mixed-income housing. The fair housing laws generally protect persons from discrimination based on race, color, national origin, religion, sex, familial status, disability, and age. The law has established that actions of housing professionals must not have the effect of being discriminatory toward members of any of these protected classes. This means, if households that will occupy HOME-assisted units tend to be members of one or more of these protected classes, but occupants of the market-rate units are not, differential treatment between the two groups might be construed as unlawful. This would preclude the use of different leases, policies, or implementation of rules within the development for occupants of market-rate and affordable units. For instance, if the lease calls for eviction of a tenant who uses illegal substances in the unit, management must apply this clause equally and consistently among tenants of market-rate units and tenants of assisted units. This would not apply to differences in services and amenities that are made available to residents in all units who are able to pay for them.

In addition, developers must distribute assisted and non-assisted units in an equitable fashion in accordance with fair housing requirements. For more information about other Federal requirements that must be considered when using HOME funds, see Appendices 1 and 2.

HOME Requirements for Rental Housing

Rental housing developed with HOME funds carries several requirements designed to ensure that HOME units are occupied by low- and very low-income tenants for some period of time. The following discussion will review the most significant HOME Program requirements for rental housing, with particular emphasis on the rules that have specific implications for mixed-income housing. More detailed information about these requirements can be found at HUD's Office of Affordable Housing Programs' website at http://www.hud.gov/offices/cpd/affordablehousing/programs/home/index.cfm.

Eligible Properties

HOME-assisted rental projects can be one or more buildings on a site, or multiple sites, that are under common ownership, management, and financing.

Income Targeting

All beneficiaries of the HOME Program must be low- or very low-income. A low-income household, for the purposes of the HOME Program, is defined as one whose gross annual income does not exceed eighty percent of the area median income. A very low-income household is one whose gross annual income does not exceed sixty percent of the area median income. Rental housing in the HOME Program is highly targeted to very low-income households, through the "Program Funds Rule," and the "Project Rule."

- The Program Funds Rule applies to all HOME funds used for all rental activity, including rental housing development and tenant-based rental assistance (TBRA) each fiscal year. Initially, ninety percent of the total households assisted through the PJ's rental or TBRA programs must be very low-income. The balance of the assisted units must be occupied by low-income households.
- The Project Rule lasts throughout the affordability period, discussed below. For every project with five or more HOME-assisted units, at least twenty percent of the assisted units must be occupied by families who have annual incomes that are at or below fifty percent of the area median income, occupying units with rents at or below the Low HOME rent, discussed below. This rule does not apply to projects with fewer than five assisted units.

PJs must determine that every beneficiary is income-eligible prior to occupancy. This verification must be based on a review of appropriate source documentation, such as wage statements, interest statements and unemployment compensation documents. The PJ can delegate this function to the project owner or manager. However, the PJ is responsible for monitoring the project owner to

For more information on determining income. . .

HUD's *Technical Guide for Determining Income and Allowances Under the HOME Program-Second Edition* is a good resource for information about income determination. To get a free copy of this model program guide, see HUD's Office of Affordable Housing Programs online library at http://www.hud.gov/offices/cpd/affordablehousing/library/modelguides/index.cfm.

Additionally, an income calculator tool is available online to help PJs determine whether or not tenants are eligible to receive HOME assistance based on their income. The income calculator can be found on HUD's Office of Affordable Housing Programs' training website at http://www.hud.gov/offices/cpd/affordable housing/training/homefront/ calculator/ calculator.cfm.

ensure that income verifications are performed consistently and accurately.

Owners must re-certify tenants' income throughout the affordability period to ensure that their incomes fall within the occupancy requirements. If incomes exceed the income allowable, then adjustments in the tenant's rent must be made and newly vacated units must be made available to income-eligible tenants. Income re-certifications can be in the form of written statements from the family or government program administrators if the family has been income-qualified for other public assistance. However, every sixth year during the affordability period, owners must collect and examine source documentation.

In the program design of a mixed-income housing development, PJs may want to target the HOME-assisted units more specifically to different income brackets within the HOME requirements. Since area median income is based on the metropolitan area, in some markets this might be necessary to accomplish certain income targeting goals. For instance, in some jurisdictions and in certain housing markets, low-income households are quite able to afford market-rate housing. PJs in these areas might choose to establish more stringent income targeting requirements to ensure that a particular development serves some households who are extremely low-income. Alternately, if a PJ is developing mixed-income housing in an area where it has concerns about being able to continue to attract market-rate tenants, it may choose to target its low-income occupancy to households at 60 percent of median income. The PJ may also wish to target some units for households at the poverty level with others reserved for households with higher incomes.

Rent Restrictions

Every HOME-assisted rental unit is subject to maximum rent limits that are designed to make rents affordable to low-income households. Because of the Project Rule, described above, there are both High and Low HOME rents in the HOME Program. The rent limits represent the maximum amount that tenants can pay for rent and utilities combined.

High HOME Rents

High HOME rents are established at the lesser of:

- Section 8 Fair Market Rents (FMRs) for existing housing, ***or***
- Thirty percent of the adjusted income of a family whose annual income equals sixty-five percent of the area median income.

Low HOME Rents

At least twenty percent of the HOME-assisted units in a project of five or more units must carry "Low HOME rents." These are established at the lesser of:

- No greater than thirty percent of the tenant's monthly adjusted income, ***or***
- Thirty percent of the annual income of a family whose income equals fifty percent of area median income.

Note, if the unit receives a Federal or state project-based rental subsidy and the very low-income household pays no more than 30 percent of its adjusted income for rent, then the maximum rent may be established at no greater than the rent allowable under the rental subsidy program.

As a result of the HOME rent affordability requirements, a developer of mixed-income housing will have to evaluate the potential for the mix of units to generate sufficient income to cover costs and expected returns on investment. At the same time, state and local program administrators must evaluate the level of HOME and other public subsidy necessary to achieve the income mix they desire in a project. For deeper targeting, additional subsidies may be necessary and appropriate.

“Fixed” and “Floating” Units

For mixed-income housing rental developments where properties will have both assisted and non-assisted units, the PJ and developer must designate whether the HOME-assisted units are “fixed” or “floating” HOME units.

“Fixed” units are specific units that are designated HOME-assisted. This designation remains with that specific unit throughout the period of affordability. When a PJ uses a fixed designation, units in the development do not need to be alike in terms of amenities, but there should be an appropriate mix of unit sizes (in terms of bedroom size of units), comparable to that of the development’s non-assisted units. Further, distribution of the assisted units throughout the entire development is required.

Designating fixed units provides mixed-income developers the flexibility to create units that have more amenities for the upper-income population without having to provide the same for the assisted units. These amenities may be necessary to attract the market-rate population. Conversely, this benefit might be outweighed by the risk of stigmatization of the fixed units.

“Floating” units are designated as HOME-assisted initially, but the specific units that carry the “assisted” designation may change over time, provided that the owners maintain the total number of HOME-assisted units constant. This means that the specific units may be occupied at various points in time by occupants of any income. When the HOME designation “floats,” the units must all be comparable in terms of size, features, and number of bedrooms. Costs for floating units need not be tracked unit-by-unit.

Housing with floating HOME unit designations may be slightly more difficult to manage than fixed units because project managers will need to keep track of unit occupancy by income in order to determine that the development remains in compliance. Nonetheless, the floating unit designation eliminates the possibility for certain units to be stigmatized and provides a more equal atmosphere among tenants.

Forms of Assistance

HOME funds can be used to support a mixed-income housing development in a number of different forms, and the PJ determines the form of assistance that is appropriate for the project. For instance, the PJ decides the loan terms and type of loan, such as interest bearing, or non-interest-bearing, or deferred payment. Although not typical for rental programs, HOME funds may also be made in the form of a grant. Some common types of financing for rental housing with HOME funds include:

- **Construction loans.** Construction loans provide short-term financing to cover the cost of construction or rehabilitation. Upon project completion, a permanent source(s) of funds pays off (or “takes out”) the construction loan.
- **Bridge loans.** Bridge loans are a source of short-term financing that is typically used in multi-stage projects, or when construction is complete, but not yet ready for permanent financing.
- **Predevelopment loans.** Predevelopment loans pay for project planning and pre-construction costs of a project. Under the HOME Program, typically predevelopment loans may only be made to actual projects, provided that construction starts within twelve months of when the loan is executed. The only exception to this is for community housing development organizations (CHDOs). PJs can lend predevelopment funds for any project to CHDOs, in order to provide working capital for the CHDO to do a project feasibility assessment. In these instances, the loans are repaid with permanent financing if the project goes forward. These loans may be forgiven if the project is not developed.

- **Permanent mortgage loans.** Permanent loans are long-term project financing used to pay off predevelopment, bridge and construction financing. Permanent loans are typically repaid over an extended period of time with the rental income of a project.
- **Credit enhancement.** Credit enhancement is typically provided in the form of mortgage insurance, used to enhance the credit-worthiness of a project in order to attract lenders who would otherwise not participate.
- **Refinancing, in certain circumstances.** HOME funds can be used to refinance existing debt when a property will be rehabilitated and the refinancing is necessary to permit or continue affordability. Certain restrictions apply. Refinancing cannot be the primary purpose of the HOME investment. Additional guidance on using HOME for refinancing is found at 24 CFR 92.205(b).

Subsidy Layering

Before committing funds to a rental housing project that combines the use of any other local, state or Federal assistance, the PJ must evaluate the project in accordance with guidelines that it has adopted to ensure that the PJ does not invest any more HOME funds than are necessary to provide affordable housing. These guidelines are referred to as Subsidy Layering Guidelines. Guidance on developing subsidy layering guidelines can be found in CPD Notice 98-01, *Layering Guidance for HOME Participating Jurisdictions When Combining HOME Funds With Other Government Subsidies*, available online at http://www.hud.gov/offices/cpd/affordablehousing/lawsandregs/notices/cpd9801.pdf.

Periods of Affordability

HOME-assisted rental units carry rent and occupancy restrictions for varying lengths of time, depending upon the average amount of HOME funds invested per unit, as described in Exhibit 3-2. These restrictions must be enforced during the period of affordability through a deed restriction or covenant on the property.

Exhibit 3-2
Periods of Affordability for Rental Housing

Activity	Average per unit HOME $	Minimum Affordability Period
Rehabilitation or Acquisition of Existing Housing	<$15,000/unit $15,000-$40,000/unit >$40,000	5 years 10 years 15 years
Refinance of Rehabilitation Project	Any $ amount	15 years
New Construction or Acquisition of New Housing	Any $ amount	20 years

HOME affordability requirements are *minimum* requirements. PJs may establish longer affordability terms.

Property Standards

Rental housing constructed or rehabilitated with HOME funds must meet state and local property codes and ordinances throughout the affordability period. Exhibit 3-3 summarizes the minimum property standards for each HOME activity area. If no state and local codes apply to the area in which a property is located, the project must meet the applicable national property standards.

Exhibit 3-3
Minimum Property Standards

Activity	Minimum Property Standard to be Met
Tenant-based rental assistance	Section 8 Housing Quality Standards (HQS).
Acquisition of existing housing (no rehabilitation or construction)	Applicable state or local housing quality standards and code requirements. If no local standards/codes apply, Section 8 HQS.
Rehabilitation of housing	Local written rehabilitation standards; AND State and local code requirements. If no local codes apply, one of the following national model codes: ❑ Uniform Building Code (ICBO),* ❑ National Building Code (BOCA),* ❑ Standard Building Code (SBCCI),* OR ❑ Council of American Building Officials one- or two-family code* (CABO), or ❑ FHA Minimum Property Standards** at 24 CFR 200.925 (for multifamily) or 200.926 (for one- and two-unit dwellings); AND Handicapped accessibility requirements, where applicable.
New construction of housing	State and local code requirements. If no state and local codes apply, one of the following national model codes: ❑ Uniform Building Code (ICBO),* ❑ National Building Code (BOCA),* ❑ Standard Building Code (SBCCI),* OR ❑ Council of American Building Officials one- or two-family code* (CABO), or ❑ FHA Minimum Property Standards** at 24 CFR 200.925 (for multifamily) or 200.926 (for one- and two-unit dwellings); AND Model Energy Code; AND Handicapped accessibility requirements, where applicable. New construction of <u>rental</u> housing must meet site and neighborhood standards at 24 CFR 893.6(b).

* Since the promulgation of the HOME Program regulation, these code-issuing agencies have merged to form the International Code Council (ICC). The model codes used by the HOME Program are no longer being updated; in their stead, the ICC has adopted the International Building Code. HUD will consider whether changes to the HOME regulations incorporating the International Building Code are appropriate.

Up-to-date information about the HOME Program is available on its website at http://www.hud.gov/offices/cpd/affordablehousing/. Information about the International Building Code is available at http://www.iccsafe.org.
**PJs using MPS may rely on inspections performed by a qualified person.

Monitoring and Inspections

PJs are required to monitor all assisted developments for compliance with income occupancy, rent restrictions, and property standards throughout the period of affordability. Monitoring must include periodic on-site inspections of HOME-assisted units in the project. The frequency of inspections depends on the total number of units in the project, as follows:

Number of Units	Frequency of Inspections
One to Four units	Every 3 years
Five to Twenty-Five units	Every 2 years
Twenty-six or more units	Every year

HOME Requirements for Homeownership Housing

This section outlines the HOME requirements applicable to homeownership housing, with particular attention to requirements that are especially important to mixed-income housing development. There are several ways that HOME can be used for homeownership housing. It can be used for the development of new housing, the purchase of existing housing, the purchase and rehabilitation of existing housing, lease purchase, or direct homebuyer assistance. Typically, direct homebuyer assistance is provided in the form of either downpayment or closing cost assistance, or soft second mortgages to bridge the gap between what the buyer can borrow from a private lender and the cost of the housing unit. Regardless of which type of homeownership activity is undertaken, the homeownership rules apply, unless noted otherwise.

Eligible Properties

For developers of mixed-income, for-sale housing, there are many HOME-eligible property types, provided that the property serves as the purchaser's principal residence. Property types may include:

- Single family property,
- Two- to four- unit property,
- Condominium unit,
- Cooperative unit, or unit in a mutual housing project, or
- Manufactured home.

Determining an Assisted Unit in For-Sale Housing

When HOME funds are used to develop or acquire multifamily structures, including for-sale housing, HOME will finance only the actual costs associated with the assisted units. The cost allocation rules described in the rental section (above) apply. In determining which units are HOME-assisted for-sale housing units, the following guidelines apply:

- In single family housing, any unit that receives HOME funds is considered assisted.

- In two- to four-unit properties, where HOME funds are used to assist the homebuyer in acquiring one unit, and that unit will be the principal residence of the purchaser, the long-term affordability requirements will apply to any unit of the structure that the PJ designates "HOME-assisted."
  - For the owner's unit, the resale and recapture rules will apply to the unit, as discussed later in this section.
  - For the rental units, the HOME rental rules apply to those units designated "assisted."

Forms of Assistance

Typically, HOME is provided to support homeownership endeavors in the form of grants, deferred-payment loans, or below-market-rate loans for down payment and closing cost assistance, gap financing, or development subsidy. HOME can also be provided as a loan guarantee.

Income Targeting

All HOME funds must be used to assist families whose gross annual incomes are at or below eighty percent of the area median income. The purchasing household must be low-income at the time a contract is signed to purchase existing housing or construct new housing. In the case of a lease-purchase project, the household must be low-income at the time the lease-purchase agreement is signed. In the case of a two- to four-unit project, where any of the rental units are designated HOME-assisted, the HOME income targeting rules for rental housing, as described earlier in this chapter, apply to occupants of the rental units.

Maximum Property Values

The **value** of any homebuyer property assisted with HOME funds may not exceed ninety-five percent of the median purchase price for that type of housing for the area.

Prior to investing HOME funds in a rehabilitation project, a PJ must secure an after-rehabilitation value estimate of the property to ensure compliance with this requirement. If the property to be acquired by a homebuyer does not require rehabilitation, the sales price of the property may not exceed ninety-five percent of the area median purchase price for that type of housing.

For more information on determining the median purchase price. . .

To determine the area median purchase price, PJs can either:

- Use data published by HUD and made available through local field offices or online at: http://www.hud.gov/offices/cpd/affordablehousing/programs/home/limits/maxprice.cfm, or,
- Determine the area median purchase price through a market analysis in accordance with the HOME Rule at 24 CFR 92.254(a)(iii).

Property Standards

HOME-assisted homebuyer properties must meet all state or local property codes and standards at the time of occupancy, except when the project involves acquisition and rehabilitation by the homebuyer. If no state or local codes apply to the area in which a property is located, the project must meet applicable national property standards. The minimum property standards for HOME-assisted homebuyer properties are listed in Exhibit 3-3 in the rental housing section of this chapter.

Affordability Requirements

Occupancy requirements on properties acquired with the assistance of HOME funds are imposed over the length of the affordability period. For homeownership, affordability requirements are enforced through resale or recapture provisions that are developed specifically for this purpose. The period of affordability is based on the amount of direct HOME assistance, as follows:

HOME Investment per Unit	Minimum Affordability Period
Less than $15,000	5 years
$15,000 - $40,000	10 years
More than $40,000	15 years

Resale and Recapture Provisions

If a HOME-assisted homebuyer transfers the property during the required period of affordability or the low-income owner no longer occupies the unit as a primary residence, HOME regulations require either (1) the recapture of HOME proceeds, or (2) the resale of the property to another low-income buyer. The PJ is permitted to determine which option to use, although the decision must be documented in the PJ's Consolidated Plan submission. The PJ may retain the right to make this decision, or permit the homebuyer to determine which option will be used at the time the assistance is provided, or at resale. Allowing the homebuyer to decide introduces an element of uncertainty and complexity, and could have a more detrimental impact to the success of mixed-income housing because of the importance of managing market values and marketability over time.

Recapture of HOME Proceeds

The basic premise of the recapture provision is that if a particular unit does not remain affordable throughout the period of affordability, then the HOME funds that were initially invested in the project are "recaptured" and re-invested in another HOME-eligible activity to assist another low-income household. Under the recapture provision, the owner may sell his or her property to any willing buyer at any price the market will bear. The sale of the property triggers repayment of some, or all, of the direct HOME subsidy that the buyer received when he/she originally purchased the home. (If the proceeds of sale are not sufficient to repay the HOME subsidy, a lesser amount is repaid.) Once the HOME funds are repaid, the property is no longer subject to any HOME program requirements. The recaptured funds must be used by the PJ for another HOME-eligible activity.

Resale Restrictions

The basic premise of resale restrictions is that a specific HOME-assisted unit remains affordable to low-income households over the entire affordability period. Under the resale provisions, an owner is obligated to resell the original HOME-assisted property to another income-eligible homebuyer. The new purchaser must occupy the property as the family's principal residence, and the sales price must be affordable to the new purchaser. Additionally, the original homebuyer must receive a "fair return" on his or her investment. Under HOME, each PJ defines both "fair return" and "affordable" in its Consolidated Plan. Land trusts and cooperatives are mechanisms by which long-term affordability can be maintained.

The resale option is the only option that preserves the affordability of the unit, and

For more information on resale and recapture provisions. . .

For more information on resale and recapture provisions, see HUD's model program guide *Using HOME Funds for Homebuyers Programs: Structuring Recapture and Resale Provisions*. To get a free copy of this model program guide, see HUD's Office of Affordable Housing Programs' online library at http://www.hud.gov/offices/cpd/affordablehousing/library/modelguides/index.cfm.

is therefore the best tool to preserve the mixed-income nature of a development, particularly in neighborhoods where market-rates are rising and the return on investment might be significant for the seller.

Hypothetical Case Study

Using HOME Funds in Mixed-Income Housing: Tall Trees Apartments

This hypothetical case study illustrates how the use of HOME funds in a mixed-income housing development impacts the financing and management of a project where the PJ chooses to designate the HOME funds as "floating."

Background

The Evergreen Park Community Development Corporation (EPCDC) has purchased the Tall Trees property described in Exhibit 3-4. It plans to convert it to a mixed-income, market-driven development. EPCDC is a county-recognized CHDO. It currently owns 60 rental units, mostly single family homes and condominiums, throughout the Evergreen Park area, which is a close-in older suburb of a major Midwestern city. It has a good reputation in the community for providing decent affordable housing, particularly for families in transition from homelessness.

Exhibit 3-4
Project Summary: Tall Trees Apartments

Project type	3 story garden apartment
Number of buildings	16
Number of units	128
1 Bedroom units	32 @ 650 square feet
2 Bedroom units	96 @ 850 square feet
Year built	1980
Condition	Below average
Current Occupancy	88%
Rent per square foot	$0.85
Gross rental potential	$87,040/month

The garden apartment complex sits on eight acres of land in Evergreen Park. The immediate surroundings are commercial, including a gas station, liquor store, McDonalds restaurant and a 3-story condominium. Behind the commercial development is a stable single family neighborhood of houses priced in the mid $100,000's. The nearest multifamily rental property is about six blocks away. It is of similar style and age, although in substantially better condition. Both properties were developed by the same company and then sold to different owners.

Overall, the property is in sound condition, but it has suffered from a lack of maintenance, and a failure to keep up with the market in terms of interior and exterior amenities. The individual units need re-painting and have outdated kitchens and baths. The brick exterior is in good condition, but the flat roof is failing in several locations on each building. The common areas, including parking, community room, pool, and landscaped areas, have all been neglected.

EPCDC Acquisition Plan

Tall Trees is in an excellent location for some of the transitional housing families EPCDC serves. EPCDC recognizes that it can also serve a large number of lower income elderly persons and families who can no longer afford to live in Evergreen Park. The Board of Directors of EPCDC believes the project is a good match with its mission.

The group discusses the possible acquisition with the county housing staff and with mixed-income housing experts. One of the main questions discussed is the income mix the property should target. After considering all the advice, EPCDC decides that approximately 30 percent of the development should serve low-income families—specifically, 12 transitional housing families and 28 low-income families. EPCDC believes this ratio will not tip the property to all low-income, and it can be supported financially. This mix will assure them of a significant public benefit, without unduly risking the project's market-rate appearance and reputation. It is EPCDC's hope that once the property stabilizes, and as cash flow and additional subsidy allow, the proportion of low-income occupants might be increased.

The Market Study

EPCDC commissions a market study of Tall Trees and all the rental properties in the market area. It concludes that this property, in good to excellent condition, should be able to draw $1.00 to $1.10 per square foot. Occupancy in the market area is currently around 96 percent. The study also finds no known plans to introduce additional rental units into this market area due to the scarcity of vacant land and the low vacancy rate in surrounding commercial properties. However, in order to achieve these rents and compete with the best of the older product in the market, the property will need significant rehabilitation and an improved image.

The Acquisition Negotiation

EPCDC hires a development consultant to research and estimate operating and development costs, to recommend a purchase price to the group, and to negotiate the sales agreement. The consultant estimates that the property is worth $3,870,000. This is based on the property's current net income and a "cap rate" that reflects the poor condition of the property.

The development consultant then prepares a pro forma to determine if the property could be purchased at that price and be financially feasible. The pro forma, illustrated as Version 1: 15-Year Cash Flow Analysis in Exhibit 3-5, assumes an acquisition price of $3,900,000 plus the cost of rehabilitation. It also takes into account EPCDC's targeted income mix and the costs of rehabilitation and professional management costs. EPCDC secures twelve project-based vouchers for its transitional housing units. The analysis indicates that the property should be able to support over $5 million in conventional debt, leaving a "gap" of over $1.3 million. The consultant explores the possibility of securing a second mortgage to finance the gap, but is unable to find a feasible loan. The project does not have sufficient cash flow to work. EPCDC decides to pursue any and all other options to make the deal work: higher rents, lower interest rates, reduction in operating costs, grants, and "soft loans."

Sources of Subsidy

Interest Rate

The Federal Home Loan Bank's Affordable Housing Program (AHP) provides write down funds to member banks that agree to lend them for approved affordable housing projects. EPCDC is able to obtain a commitment sufficient to lower the interest rate on the first mortgage loan by 2 percent, thus giving them an effective interest rate of 5.25 percent on a thirty-year mortgage. This, in turn, allows them to borrow additional funds in the first mortgage.

Operating Costs

The county agrees to forego taxes for a period of five years, as long as the EPCDC agrees to continue to rent to a mixed-income population during that period. This reduces the operating costs by $64,000 per year.

Deferred Developer Fee

EPCDC determines that its cash flow is stable enough that it can afford to defer a portion of its developer fee on the project. It determines that it can defer $178,247 in developer fee.

Grants and Soft Loans

After putting all of the above sources of subsidy together, the project still needs $853,000 in grants or soft loans to make the project work. EPCDC asks the county for HOME funds to fill the final gap. These funds represent about 60 percent of the total development costs of the 28 units to be occupied by the low-income residents. The loan would be paid back without interest starting in the first year out of half of the available cash flow. EPCDC projects it will be able to repay the entire loan by the 13th year. The city requires EPCDC to designate 28 units as “floating” HOME-assisted units.

The Final Analysis

Once HOME funds are included in the deal, EPCDC needs to verify that its project is in compliance with HOME requirements for the 28 assisted units. It evaluates:

- Are projected rents within the HOME rent restrictions?
- Do development cost estimates reflect the use of prevailing wages?
- Are maximum and minimum per-unit subsidies within the HOME limits?

In this project, at least six units (20 percent of 28 units) must be rented at or below Low HOME Rents. The remaining 22 assisted units can be rented at or below High HOME Rents. To determine the final rents, EPCDC evaluates the income of in-place tenants and determines that a sufficient number of in-place tenants are income-eligible for the assisted units, including both those rented at the High HOME rents, and those rented at the Low HOME rents.

Exhibit 3-6, Version 2: 15-Year Cash Flow Analysis, presents the revised financial pro forma that results from adjusting for the HOME funds.

Purchase and Operation

Once EPCDC purchases the property, it identifies a contractor with experience in the county’s rehabilitation standard. The rehabilitation work is about $12,000 per unit and includes electronic security at each building entry, kitchen counters, new bath fixtures, a complete paint job, carpeting, and a new roof. EPCDC will rehabilitate the vacant units first, and temporarily relocate existing tenants in these units while their units are rehabilitated. When the work is complete, tenants will be moved back to their original unit.

On the exterior, the clubhouse is expanded to include a larger party room and an additional marketing office, the pool is resurfaced and new pool furniture added. Because the clubhouse, pool, and pool furniture are not eligible costs, these amenities are paid for in full by the private mortgage. The development costs of the units themselves, and the other common areas, are pro-rated and the HOME

Program is charged its proportional share. The actual per unit costs of the HOME-assisted units are substantially less than the HOME maximum per unit subsidy.

EPCDC also hires a market-oriented management company with experience in turning around declining properties. The firm recommends to EPCDC the type of improvements that would pay off in better rents, better occupancy, and a better reputation. They also suggest a name change to mark the transition.

In its first meeting with the management company, EPCDC and the PJ explain the HOME rental requirements, as they relate to managing the rental property. The management company is also given the county's program literature. The most critical requirements are:

- The rules related to tenant income, including income verification upon initial occupancy, and annual income re-certifications;
- The rules related to charging High- and Low-HOME rents, and increasing tenant rents when/if there is an increase in a tenant's income;
- Recordkeeping and the city's reporting requirements, in order to verify compliance with the rent and income requirements;
- Prohibited lease provisions;
- The PJ's required non-discriminatory tenant selection procedures; and
- The PJ's affirmative marketing requirements.

Once on the job, the management company communicates to the existing residents that improvements are coming. They notify residents that there will be new leases to sign at renewal, and that all lease provisions will be enforced. Management immediately sets about changing the image of the property by improving exterior maintenance, responding quickly to residents' repair requests, and enforcing leases aggressively for things like noise, junk cars, and late or non-payment. A few of the more rowdy residents decide to leave, while others breathe a sigh of relief.

Once a significant number of units are rehabilitated and the major exterior work is well under way, the property changes its name to Pleasant Park. Along with the name change come new marketing materials, a new entry feature, and additional services. Marketing literature does not note that the property is a mixed-income development. Many residents do not know, and do not care.

Exhibit 3-5

Exhibit 3-5

Pro Forma, Version 1

15 year Cash Flow Analysis

	YEAR	1	2	3	4	5	6	7	8
Gross Rental Income		$ 1,161,120	$ 1,195,954	$ 1,231,832	$ 1,268,787	$ 1,306,851	$ 1,346,056	$ 1,386,438	$ 1,428,031
Other Income		$ 15,000	$ 15,450	$ 15,914	$ 16,391	$ 16,883	$ 17,389	$ 17,911	$ 18,448
Effective Gross Income		$ 1,176,120	$ 1,211,404	$ 1,247,746	$ 1,285,178	$ 1,323,733	$ 1,363,445	$ 1,404,349	$ 1,446,479
Vacancy Loss	5.00%	$ (58,806)	$ (60,570)	$ (62,387)	$ (64,259)	$ (66,187)	$ (68,172)	$ (70,217)	$ (72,324)
Total Actual Income		$ 1,117,314	$ 1,150,833	$ 1,185,358	$ 1,220,919	$ 1,257,547	$ 1,295,273	$ 1,334,131	$ 1,374,155
Operating Expenses		$ 473,600	487,808	502,442	517,516	533,041	549,032	565,503	582,468
Taxes		$ 64,000	65,920	67,898	69,935	72,033	74,194	76,419	78,712
Reserve for Replacement		$ 38,400	$ 39,552	$ 40,739	$ 41,961	$ 43,220	$ 44,516	$ 45,852	$ 47,227
TOTAL EXPENSES		$ 576,000	$ 593,280	$ 611,078	$ 629,411	$ 648,293	$ 667,742	$ 687,774	$ 708,407
NET OPERATING INCOME		$ 541,314	$ 557,553	$ 574,280	$ 591,508	$ 609,254	$ 627,531	$ 646,357	$ 665,748
Debt Service		$ 438,595	$ 438,595	$ 438,595	$ 438,595	$ 438,595	$ 438,595	$ 438,595	$ 438,595
Debt Service on Second Mortgage		$ 156,563	$ 156,563	$ 156,563	$ 156,563	$ 156,563	$ 156,563	$ 156,563	$ 156,563
Total Debt Service		$ 595,158	$ 595,158	$ 595,158	$ 595,158	$ 595,158	$ 595,158	$ 595,158	$ 595,158
CASHFLOW		$ (53,844)	$ (37,605)	$ (20,878)	$ (3,650)	$ 14,096	$ 32,373	$ 51,199	$ 70,590

Exhibit 3-5 (continued)

Exhibit 3-5 (continued)

Pro Forma, Version 1

	9	10	11	12	13	14	15
Gross Rental Income	$ 1,470,872	$ 1,514,998	$ 1,560,448	$ 1,607,262	$ 1,655,479	$ 1,705,144	$ 1,756,298
Other Income	$ 19,002	$ 19,572	$ 20,159	$ 20,764	$ 21,386	$ 22,028	$ 22,689
Effective Gross Income	$ 1,489,874	$ 1,534,570	$ 1,580,607	$ 1,628,025	$ 1,676,866	$ 1,727,172	$ 1,778,987
Vacancy Loss	$ (74,494)	$ (76,728)	$ (79,030)	$ (81,401)	$ (83,843)	$ (86,359)	$ (88,949)
Total Actual Income	$ 1,415,380	$ 1,457,841	$ 1,501,577	$ 1,546,624	$ 1,593,023	$ 1,640,813	$ 1,690,038
Operating Expenses	599,942	617,941	636,479	655,573	675,240	695,498	716,362
Taxes	81,073	83,505	86,011	88,591	91,249	93,986	96,806
Reserve for Replacement	$ 48,644	$ 50,103	$ 51,606	$ 53,155	$ 54,749	$ 56,392	$ 58,083
TOTAL EXPENSES	$ 729,660	$ 751,549	$ 774,096	$ 797,319	$ 821,238	$ 845,875	$ 871,252
NET OPERATING INCOME	$ 685,720	$ 706,292	$ 727,481	$ 749,305	$ 771,784	$ 794,938	$ 818,786
Debt Service	$ 438,595	$ 438,595	$ 438,595	$ 438,595	$ 438,595	$ 438,595	$ 438,595
Debt Service on Second Mortgage	$ 156,563	$ 156,563	$ 156,563	$ 156,563	$ 156,563	$ 156,563	$ 156,563
Total Debt Service	$ 595,158	$ 595,158	$ 595,158	$ 595,158	$ 595,158	$ 595,158	$ 595,158
CASHFLOW	$ 90,562	$ 111,134	$ 132,323	$ 154,147	$ 176,626	$ 199,780	$ 223,628

Exhibit 3-5 (continued)

INCOME			EXPENSES			
O/M Expenses per unit per year	$ 3,700		$ 473,600	Debt Assumptions		
Property Taxes	$ 500		$ 64,000	Rate		0.0775
Replacement Reserves	$ 300		$ 38,400	Term	30 years	
				DSCR		1.20
TOTAL EXPENSES PER YEAR			$ 576,000			
Income Inflation Factor		3%				
Expense Inflation Factor		3%				

GROSS INCOME:				MONTHLY	ANNUAL
	UNITS	TYPE		RENTAL	RENTAL
Transitional Hsg	12	2BR		$780	$112,320
	32	1BR CONV		$605	$232,320
	84	2BR-CONV		$810	$816,480
	128				
	TOTAL GROSS INCOME				$1,161,120
	Net Operating Income				$526,314
	Debt Coverage Required by Lender				1.20
	Amt Available for Debt Service				$438,595
	Debt Project Can Support				$5,101,128
	Total Project Costs				$6,453,000
	The Gap				$1,351,872
	Annual Debt Service on Second Mortgage (10% @ 20y)				$156,563

Exhibit 3-5 (continued)

Sources and Uses

Uses

Acquisition	$3,900,000
Rehabilitation	$1,280,000
Legal	$25,000
Construction loan interest	$100,000
Reserves	$200,000
Dev Fee	$400,000
Architectural and Engineering	$120,000
Landscaping	$128,000
Financing Costs	$300,000
Total development cost	$6,453,000

Sources

First Mortgage	$5,101,128
Second Mortgage	$1,351,872
Total Sources	$6,453,000

Exhibit 3-6

Exhibit 3-6

Pro Forma, Version 2

15 year Cash Flow Analysis

		1	2	3	4	5	6	7	8
	YEAR	1	2	3	4	5	6	7	8
Gross Rental Income		$ 993,630	$ 1,023,439	$ 1,054,142	$ 1,085,766	$ 1,118,339	$ 1,151,889	$ 1,186,446	$ 1,222,040
Other Income		$ 15,000	$ 15,450	$ 15,914	$ 16,391	$ 16,883	$ 17,389	$ 17,911	$ 18,448
Effective Gross Income		$ 1,008,630	$ 1,038,889	$ 1,070,056	$ 1,102,157	$ 1,135,222	$ 1,169,279	$ 1,204,357	$ 1,240,488
Vacancy Loss	5.00%	$ (50,432)	$ (51,944)	$ (53,503)	$ (55,108)	$ (56,761)	$ (58,464)	$ (60,218)	$ (62,024)
Total Actual Income		$ 958,199	$ 986,944	$ 1,016,553	$ 1,047,049	$ 1,078,461	$ 1,110,815	$ 1,144,139	$ 1,178,463
Operating Expenses		$ 473,600	487,808	502,442	517,516	533,041	549,032	565,503	582,468
Taxes		$ -	-	-	-	-	64,000	65,920	67,898
Reserve for replacement		$ 38,400	$ 39,552	$ 40,739	$ 41,961	$ 43,220	$ 44,516	$ 45,852	$ 47,227
TOTAL EXPENSES		$ 512,000	$ 527,360	$ 543,181	$ 559,476	$ 576,261	$ 657,548	$ 677,275	$ 697,593
NET OPERATING INCOME		$ 446,199	$ 459,584	$ 473,372	$ 487,573	$ 502,200	$ 453,266	$ 466,864	$ 480,870
Debt Service		$ 359,332	$ 359,332	$ 359,332	$ 359,332	$ 359,332	$ 359,332	$ 359,332	$ 359,332
CASHFLOW		$ 86,866	$ 100,252	$ 114,040	$ 128,241	$ 142,868	$ 93,934	$ 107,532	$ 121,538
Repayment of HOME loan		$ 43,433	$ 50,126	$ 57,020	$ 64,121	$ 71,434	$ 46,967	$ 53,766	$ 60,769
HOME Loan Balance		$ 809,567	$ 759,441	$ 702,421	$ 638,300	$ 566,866	$ 519,899	$ 466,133	$ 405,364

Exhibit 3-6 (continued)

	9	10	11	12	13	14	15
Gross Rental Income	$ 1,258,701	$ 1,296,462	$ 1,335,356	$ 1,375,416	$ 1,416,679	$ 1,459,179	$ 1,502,955
Other Income	$ 19,002	$ 19,572	$ 20,159	$ 20,764	$ 21,386	$ 22,028	$ 22,689
Effective Gross Income	$ 1,277,702	$ 1,316,033	$ 1,355,514	$ 1,396,180	$ 1,438,065	$ 1,481,207	$ 1,525,643
Vacancy Loss	$ (63,885)	$ (65,802)	$ (67,776)	$ (69,809)	$ (71,903)	$ (74,060)	$ (76,282)
Total Actual Income	$ 1,213,817	$ 1,250,232	$ 1,287,739	$ 1,326,371	$ 1,366,162	$ 1,407,147	$ 1,449,361
Operating Expenses	599,942	617,941	636,479	655,573	675,240	695,498	716,362
Taxes	69,935	72,033	74,194	76,419	78,712	81,073	83,505
Reserve for replacement	$ 48,644	$ 50,103	$ 51,606	$ 53,155	$ 54,749	$ 56,392	$ 58,083
TOTAL EXPENSES	$ 718,521	$ 740,076	$ 762,279	$ 785,147	$ 808,702	$ 832,963	$ 857,951
NET OPERATING INCOME	$ 495,296	$ 510,155	$ 525,460	$ 541,224	$ 557,460	$ 574,184	$ 591,410
Debt Service	$ 359,332	$ 359,332	$ 359,332	$ 359,332	$ 359,332	$ 359,332	$ 359,332
CASHFLOW	$ 135,964	$ 150,823	$ 166,128	$ 181,892	$ 198,128	$ 214,852	$ 232,078
Repayment of HOME loan	$ 67,982	$ 75,412	$ 83,064	$ 90,946	$ 99,064	$ 107,426	$ 116,039
HOME Loan Balance	$ 337,381	$ 261,970	$ 178,906	$ 87,960	$ (11,104)		

Exhibit 3-6 (continued)

INCOME			EXPENSES		Debt Assumptions	
	O/M Expenses per unit per year	$ 3,700	$ 473,600		Rate (after 2.5% write-down)	0.0525
	Taxes (forgiven for 5 years)	$ 500	$ 64,000		Term	30 years
	Replacement Reserves	$ 300	$ 38,400		DSCR	1.20
	TOTAL EXPENSES PER YEAR		$ 576,000			
	Income Inflation Factor	3%				
	Expense Inflation Factor	3%				

GROSS INCOME:				MONTHLY	ANNUAL
	UNITS		TYPE	RENTAL	RENTAL
Transitional Housing	12		2BR	$780	$112,320
Low HOME Rents	3		1BR	$460	$16,560
Low HOME Rents	3		2BR	$630	$22,680
High HOME Rents	5		1BR	$550	$33,000
High HOME Rents	17		2BR	$750	$12,750
	24		1BR CONV	$605	$174,240
	64		2BR-CONV	$810	$622,080
TOTAL.	128				$993,630
TOTAL GROSS INCOME		$993,630			
TOTAL GROSS INCOME		$993,630			
Net Operating Income		$431,199			
Debt Coverage Required by Lender		1.20			
Amt Available for Debt Service		$359,332			
Debt Project Can Support		$5,421,753			
Total Project Costs		$6,453,000			
The Gap		$1,031,247			

Exhibit 3-6 (continued)

Sources and Uses

<u>Uses</u>

Acquisition	$3,900,000
Rehabilitation	$1,280,000
Legal	$25,000
Construction Loan Interest	$100,000
Reserves	$200,000
Developer's Fee	$400,000
Architectural and Engineering	$120,000
Landscaping	$128,000
Financing Costs	$300,000
Total Development Costs	$6,453,000

<u>Sources</u>

First Mortgage	$5,421,753
HOME Deferred Loan	$853,000
Deferred Developer Fee	$178,247
Total Sources	$6,453,000

Case Study

Using HOME for Direct Homeownership to Support Mixed-Income Housing Development: Power CDC, Wichita, Kansas

Using HOME funds to provide direct homebuyer assistance is a relatively simple way to make homes affordable to low- and very low-income families. In Wichita, Kansas, Power Community Development Corporation (Power CDC) provides second mortgages to buyers in a neighborhood targeted for revitalization, as a way of making newly developed housing affordable. Initially, the CDC has attracted buyers at 80 percent of the area median income, a group that is well above the neighborhood median income. As the neighborhood begins to stabilize, the CDC is able to undertake additional income targeting in order to create a more consciously mixed-income community.

Background

James Arbertha, the executive director of Power CDC in Wichita, had a simple idea. He would build very nice new homes in Northeast Wichita and sell them to anyone who would buy them. Northeast Wichita had had decades of decline and few, if any, new homes had been built in the last 30 years. The neighborhood was dotted with vacant lots, and property values were very low. Although the median purchase price for the area is $147,000, in this neighborhood existing homes could be purchased for as little as $30,000.

Arbertha's idea was to acquire city-owned vacant lots with enough land to build at least two new homes in any one location. By concentrating the homes together, he felt there would be a greater visual impact on the neighborhood and he hoped it would inspire others to fix up their properties. After just two years of building, Power CDC is finishing its 20th home and every home so far has been sold before it was completed. Albertha's driving force has been to revitalize this old neighborhood by bringing people who once lived there back to new homes, with the hope that they will add new energy and commitment to the neighborhood.

Exhibit 3-7 provides a project summary.

Use of HOME Funds

The City of Wichita supports this endeavor by donating the land for the homes and waiving permit and tap fees for the CDC's properties. The City has established a HOME-funded second mortgage program that lends up to $25,000 per home, lowering the purchase price to approximately $50,000 for qualified buyers. Each buyer can be eligible for a loan in the amount needed to fill the gap between the the maximum first mortgage the buyer can qualify for and the purchase price of the house. The buyers have a range of incomes and all are working families. Since the City's maximum HOME second mortgage is $25,000, and the approximate sales price is $75,000 per home, no one is able to purchase these homes without the ability to secure a $50,000 first mortgage. Therefore, even buyers who are eligible for the HOME subsidy have substantially higher incomes than many of their neighbors. These buyers are able to provide relative stability to a poor community. Most buyers qualify for the subsidy, although some homes are sold to families that do not need assistance. Often these are people who grew up in the neighborhood, moved away, and now that there is decent housing, want to return.

The homes themselves are attractive, appealing, and well-constructed. They have two or three finished bedrooms, two baths, a basement that can be finished for expansion, and a two-car garage. The finished space is between 864 and 1,020 square feet, but feels much larger due to the design.

The development cost of each house is $61,000. With a $75,000 sales price, this revitalization effort does not require additional development subsidy. The CDC earns a 10 percent fee on the sales price. The difference between the fee and the cost to build is used to provide additional homebuyer subsidy, as needed.

Exhibit 3-7
Project Summary: Power CDC

Location	Wichita, Kansas
Address	Northeast Wichita
Project type	Single family detached
Number of Buildings	20
Number of Units	20
One BDR	0
Two BDR	8
Three BDR	12
Four BDR	0
Year Built	2000, 2001, 2002
Condition	Excellent
Price per unit, including closing costs	$75,000 average
Area Median Income	$54,000
Maximum HOME Income at 80% of Median	$43,200 (family of four)
Maximum House Price @ 95% of median for that type of house	$140,000

Contact
James Arbertha, Executive Director
Power CDC
1802 N. Hydraulic Street
Wichita, Kansas 67214
Email: Kpowercdc@aol.com

End Note

[1] For more information, see CPD Notice 98-02, *Allocating Costs and Identifying HOME-Assisted Units in Multi-Unit Projects*, available online at HUD's Office of Affordable Housing Programs' website at http://www.hud.gov/offices/cpd/affordablehousing/lawsandregs/notices/cpd9802.pdf.

Chapter 4:

Financing Mixed-Income Housing—HOME Funds and Beyond

Many housing finance mechanisms are available to support the development of mixed-income housing, including private debt, private equity, HOME funds, and other public funding sources. Frequently, it is necessary to combine funding from multiple public and private sources. When multiple sources are involved in a project, developers and HOME PJs must make extra efforts to understand the requirements associated with each funding source in order to ensure compliance and long-term success. This chapter describes other funding sources that are frequently used to support the development of mixed-income housing. The chapter highlights key issues to consider when combining HOME with these other funding sources.

Low-Income Housing Tax Credits

The most common subsidy used to serve moderate-income families is the Low-Income Housing Tax Credit (LIHTC). These credits were first available in 1987 and have since financed the development of hundreds of thousands of affordable units. Given its popularity, PJs should explore the use of LIHTCs to develop mixed-income housing.

LIHTCs generate equity capital for the construction and rehabilitation of affordable rental housing by providing owners of affordable housing a dollar-for-dollar credit against annual tax liability for up to 10 years. Although the LIHTC is administered by the Internal Revenue Service, states implement the program. Each state designates an agency or agencies (typically the state housing finance agency) to allocate the state's annual LIHTC allotment to for-profit and nonprofit developers in competitive rounds. Issuing agencies must create a qualified allocation plan (QAP) which details their own application process for awarding LIHTCs. After agencies award the credits, the developers sell or syndicate the credits to limited partners who have, or expect to have, Federal tax liability. This partnership between the developer and the investor becomes the owner of the property.

The owner must operate the property as a moderate-income facility for at least 15 years. Most states require developers to sign "extended use commitments" which lengthen the affordability period to as long as forty years. LIHTCs can help to secure substantial funding for projects—even with those serving low-income residents in as few as twenty percent of the units.

LIHTCs come in two forms, "nine percent" or "four percent" credits, depending on the other sources involved, the form of assistance, and how the funds will be invested. The nine percent rate is for new construction or rehabilitation developments not subsidized by the Federal government. The four percent rate applies to acquisition of eligible existing buildings and to Federally subsidized new construction or rehabilitation. These credit rates can be used for different parts of one project. For instance, in the acquisition and rehabilitation of a structure, the costs related to acquiring the building qualify for the four percent rate while the unsubsidized rehabilitation hard and soft costs qualify for the nine percent rate. This percent is multiplied by the eligible costs, or basis, of the project to arrive at a total amount of tax credits available for sale or syndication to investors. In some cases the basis of a project can be increased by 30 percent if it is located in a "qualified census tract" (QCC) or a "difficult development area" (DDA).

To qualify for the credit, a project must meet certain initial affordability requirements and must maintain that affordability during the life of the project. Each building in the project can meet the initial affordability requirements in one of the following ways:

- A minimum of 20 percent of the units must be affordable to households whose incomes are at or below 50 percent of area median income, or
- A minimum of 40 percent of the units must be affordable to households at whose incomes are at or below 60 percent of area median income.

Generally one can raise about one-half or more of the project costs for a 100 percent tax credit

project through the sale of the credits. The maximum LIHTC subsidy is not typically sufficient to support project feasibility, particularly in rural areas with low incomes and low rents and in urban areas with high development costs. Therefore, the remainder of the project funds must come in the form of loans from private lenders, or public sources such as HOME or CDBG, or some combination of public and private funds. In addition, rents in LIHTC-funded projects are not always affordable to very low-income households without additional subsidies. Using HOME funds to serve as the source of this additional subsidy allows for deeper income targeting.

The IRS Code requires that all units eligible for the tax credit remain available for rental to those earning no more than 60 percent of the area median income during the compliance period. Some developers, however, provide for a mix of incomes within a project while continuing to maintain the project's eligibility for the LIHTC. They reserve a portion of units for households at the top of the tax credit income limits (for households whose income is at 60 percent of area median income), and then reserve another "tier" for households whose income is at 40 percent of area median income, and finally reserve some units for those whose incomes are below 30 percent of area median income. This can be an effective strategy for mixed-income housing development.

In other housing markets, it is possible to effectively mix higher-income market units with the moderate income tax credit group. Some units might still be set aside for voucher holders to further expand the mix.

When combining HOME and LIHTC, the rules of both programs must be met. In particular, there are differences in the low-income occupancy and rent affordability requirements. In addition, LIHTC and HOME have slightly different rent and occupancy requirements for addressing tenants whose incomes increase above the required income limit. However, in these instances, the HOME Program permits housing providers to follow LIHTC requirements when the two funding sources are combined in units. This allows HOME units to comply with LIHTC requirements on an ongoing basis throughout the applicable affordability period.

The IRS Code does not usually allow a developer to claim the nine percent credit for projects that are subsidized with Federal funds. HOME funds, however, may still qualify for the nine percent credit if the PJ loans the HOME funds to the development at an interest rate at or above the Federal government's "Applicable Federal Rate," or AFR. The project may also qualify for the nine percent credit if the PJ loans the HOME funds at a rate below the AFR if it restricts 40 percent of the residential rental units to tenants with incomes at or below 50 percent of the area median income. However, such projects are not then eligible for a 130 percent increase in basis for projects in qualified census tracts or difficult development areas. If the HOME loan does not qualify under these conditions, then the project is eligible for only the four percent credit.

Although HOME funds can be granted, it is generally preferable to provide HOME funds to an LIHTC project in the form of a loan, rather than a grant. This is because when granted, HOME funds cannot be counted in the eligible basis for the project, and therefore do not contribute to the credits for which the LIHTC project is

> Some LIHTC projects qualify only for a four percent credit regardless of the way HOME funds are invested in the project. For example, a project with other Federal or tax-exempt mortgage revenue bond funds included in the basis is eligible only for a four percent credit under any circumstance; so HOME funds can be lent at any below market interest rate terms without consequence to the credit.

eligible. In some cases, however, a small HOME grant may be preferable to a below market interest rate loan, particularly if the project is eligible for the 130 percent QCT/DDA basis boost. Some experts have estimated that it could be more cost effective to provide a HOME investment of up to 20 percent of basis as a grant rather than a loan in such circumstances.

Because LIHTC projects are so complicated and competitive, they should be undertaken by, or in partnership with, an experienced LIHTC developer. When combined with HOME funds, these projects are even more complex because of the need to negotiate two sets of program rules. Nonetheless, the regulatory issues are manageable, and the use of LIHTCs with HOME funds for mixed-income housing development is an attractive option of for PJs.

For more information on using HOME with LIHTCs. . .

HUD has published a model program guide called *Using HOME with Low-Income Housing Tax Credits* to provide technical guidance to PJs who are combining these two sources of funds. To get a free copy of this model program guide, see HUD's Office of Affordable Housing Programs' online library at http://www.hud.gov/offices/cpd/affordablehousing/library/modelguides/index.cfm.

Community Development Block Grant Program

The Community Development Block Grant (CDBG) has three primary national objectives. Projects supported with CDBG funds must support at least one of these objectives, as follows:

- Benefit to low- and moderate-income persons;
- Aid in the prevention or elimination of slums or blight; or
- Meet a need having a particular urgency ("urgent need").

Together, these objectives promote the development of viable urban communities by providing decent housing, a suitable living environment, and expanded economic opportunities principally for low- and moderate-income persons.

Like the HOME Program, CDBG is flexible in terms of the types of eligible housing activities and forms of assistance that it will support. CDBG funding is not restricted to housing; it can be used for a range of activities such as real property improvement (including acquisition and rehabilitation), economic development, public facilities and improvements, homeownership assistance, relocation, and public services.

There are some differences between CDBG and HOME, as they relate to mixed-income housing development, that are noteworthy:

- Unlike HOME funds, CDBG funds may not be used for new construction of housing, unless it is performed by a community-based development organization (CBDO). However, CDBG funds can be used to acquire the land, finance pre-development activities, and provide infrastructure for new construction developments.
- For rental housing rehabilitation, in most cases, the investment of any amount of CDBG funds automatically requires that fifty-one percent of units be occupied by low- or moderate-income households whose incomes are at or below 80 percent of area median income. Depending on the market and the PJ's desired mix of incomes, this may or may not present a problem for a mixed-income development. In *newly constructed* housing of a multifamily, non-elderly rental housing project, however, the proportion of units in the project that must be occupied by households whose incomes are at or below 80 percent of area median income may be set equal to the proportion of the

total cost of the project to be borne by CDBG funds, provided that at least 20 percent of the newly constructed units must be occupied by income-qualified households at affordable rents.

- Alone, the CDBG program does not regulate rents, as does the HOME Program. The grantee is given the discretion to define rents, provided they meet an acceptable standard of "affordable." When grantees combine CDBG with HOME, HOME rent limits apply.
- CDBG does not require any specific long-term affordability period. This also means that there are no ongoing property inspection requirements, or income and rent recertification requirements. For purposes of mixed-income housing, however, a long-term affordability period can be an advantage, particularly in developments that are highly attractive and marketable, as it preserves a certain percentage of units for low-income occupants over time. When grantees combine CDBG with HOME, HOME periods of affordability apply.
- In homeownership housing, CDBG is similar to HOME in that it allows the definition of "single family" properties to include two- to four-unit structures. CDBG funds may be used to rehabilitate the owner- and renter-occupied units in such structures. In such cases, at least one unit in a duplex must be occupied by a low- or moderate-income (LMI) resident at the time of assistance, or 51 percent of the units must be LMI in a three- or four-unit property. In situations where low- or moderate-income renters occupy a property when it is initially obtained, the property must still meet the "affordable rent" requirements defined by the grantee. However, when a grantee combines CDBG with HOME, the HOME rules governing rents for two- to four-unit properties apply.
- In homeownership housing, there are no resale or recapture requirements in the CDBG program, whether money is used for rehabilitation or used by a CBDO to develop new housing. When a grantee combines CDBG with HOME, the resale and recapture requirements of the HOME Program apply.

Section 108 Program

The Section 108 Program is a loan guarantee program that permits entitlement communities to borrow up to five times their annual CDBG grant toward CDBG-eligible activities. Entitlement communities pledge future CDBG funds, as well as additional collateral, as security for the loan. If the state is willing to provide the pledge of future CDBG funds, non-entitlement communities may also participate in the Section 108 Program. HUD acts as the guarantor of a Section 108 loan, promising investors that the loan will be repaid.

The Section 108 Program enables jurisdictions to borrow large sums of money to undertake large scale, capital-intensive projects, and provides a mechanism to extend the impact of their CDBG Program. While spreading the costs over time, Section 108 provides the ability to access long-term funds at a fixed rate. Interest rates and repayment schedules vary on a case-by-case basis, but the maximum loan term is 20 years. Generally, most CDBG-eligible activities are Section108-eligible as well.

Entitlement communities may pledge future CDBG funds as repayment for the loan, but it is prudent to use Section 108 loans for projects that are likely to generate sufficient funds for repayment so that CDBG funds can still be used for other worthy community development projects. However, if a project does not generate sufficient income for repayment, HUD will take funds for repayment from future years' CDBG allocations. Conservative underwriting of Section 108 projects is therefore advised.

Because the Section 108 Program stems from the CDBG Program, the rules for combining Section 108 and HOME are similar to those for combining CDBG and HOME. The key difference between CDBG and Section 108 is that Section 108 is a loan program that requires repayment. Therefore, when comparing HOME and Section 108, PJs must be aware of the implications that loan repayment requirements have on the financing structure and collateral requirements of all funding sources. The flexibility to offer HOME and/or CDBG funds as a grant, deferred-payment loan, or subordinate loan to support the mixed-income project is not as feasible with a Section 108 loan as it is with CDBG funds.

Historic Tax Credits

When PJs or developers are working on the rehabilitation of historic buildings for mixed-income housing, they may be eligible for historic tax credits. Both Federal and state governments may have funds available for these non-competitive tax credits.

The Federal government offers a twenty percent historic tax credit. These tax credits are limited to properties that are either on, or eligible for, the National Register of Historic Places. The National Park Service keeps records of these properties that include individual buildings as well as entire districts or neighborhoods. Rehabilitation standards of properties on the national register are strictly defined, and will often add to the cost of rehabilitation. The value of historic tax credits is determined by the markets, which can include private institutional investors.

> If a developer combines the Historic Tax Credit and the Low-Income Housing Tax Credit, the Internal Revenue Service requires a developer to deduct the entire amount of the Historic Tax Credit from a project's basis before calculating the basis for the LIHTC.

State historic tax credits vary, and in some instances are more generous and have more liberal rules for their use than the Federal credits. Credits are typically available to both developers and homeowners and can be used towards mixed-income housing in historically eligible properties. The credits can be the critical difference in making a revitalization project in an historic neighborhood or an older downtown feasible. For example, many of the loft conversions taking place across the country have used these credits to provide upscale downtown housing. Combined with HOME funds, some of these units now also serve low-income families as well. Applicants should pursue the historic tax credits with an experienced development team, strong project ideas, and financial mechanisms in place.

State and Local Homeownership and Rental Initiatives

State and local governments often provide funding that can be used to develop mixed-income housing. Some examples include Florida's State Apartment Incentive Loan Program (SAIL), Montgomery County, Maryland's Housing Initiative Fund, Indiana's tax abatement fund for homebuyers, and housing trust funds.

The SAIL Program, administered by the Florida Housing Finance Corporation, provides mortgage loans at low interest rates to developers who build or substantially rehabilitate rental developments that are affordable to very low-income individuals and families, often in a mixed-income setting. Loans are generally secured by second mortgages on the property. The SAIL loan bridges the gap between the development's primary financing (plus equity and any additional sources of financing) and total development cost. Generally, loan amounts are provided up to 25 percent of qualified total development costs and are issued for a maximum of 15 years, unless housing credit syndication requirements or Federal National Mortgage Association (Fannie Mae) requirements dictate a longer term. Interest rates are set at three percent for developments with family and elderly set-asides, and one percent for those with farm worker set-asides. The SAIL loan requires repayment of interest only. Annual interest payments are based upon actual cash flow. Principal and interest are due at maturity.

The Montgomery County Housing Initiative Fund provides funds for the acquisition, construction, or rehabilitation of affordable multifamily housing projects, including mixed-income housing. The Housing Initiative Fund is used for County-sponsored projects and joint projects with the county's public housing administrator, the Housing Opportunities Commission (HOC). It is designed to provide “gap financing” to HOC, as well as for-profit developers, and nonprofit organizations to create or preserve affordable housing. Since 1989, more than $34 million has been provided to 39 projects.

The Indiana Tax Abatement Program allows units of local government (cities and counties) in the state to choose to abate taxes for six years on an ascending basis to encourage the development of affordable and mixed-income housing. Mixed-income developments in participating areas would, therefore, pay no taxes the first year, with stepped increases to eventually paying full taxes in the sixth year. Participation in the program is based on a voluntary action at the local government level, but when activated it also results in the abatement of state and other local property taxes on the same ascending bases.

There are many state and local affordable housing trust funds throughout the country, each with its own set of funding objectives and requirements. Most affordable housing trust funds are funded by a dedicated local revenue source, such as a percentage of the hotel bed tax or a fee charged at real estate closings. Housing trust fund dollars are often very flexible funding sources that can be used to support mixed-income housing developments, often in the form of closing cost assistance, low-interest loans, gap financing, and other financing mechanisms.

Tax Exempt Bonds

State and local governments, through state and local housing finance agencies (HFAs), raise money to fund housing projects by issuing bonds. Investors purchase two types of housing bonds: mortgage revenue bonds (MRBs), used to finance single family housing; and multifamily housing bonds (MHBs), used to finance rental housing. The investors, in turn, receive a series of interest payments plus the repayment of their initial investment when the bond matures.

HFAs use the capital raised from the sale of the bonds to make loans to housing projects. In turn, the debt service payments made by the projects are used by the issuing agency to repay the bondholders. Agencies are typically able to lend bond proceeds to projects at below market interest rates, in part because investors do not owe taxes on the interest they receive on these bonds. Multifamily housing bonds are ideal for mixed-income rental developments, because typically only a portion of rental development must be reserved for low-income occupancy (minimum of 20 percent). Typically, the use of MHBs is only cost effective with large projects because the financing costs are very high. Those who take advantage of the bonds should keep in mind that there are use and resale restrictions in some programs. Multifamily housing bond requirements vary from HFA to HFA, so PJs and developers must evaluate bond requirements side-by-side with HOME requirements. The more stringent rules of each program will apply in order to keep the development in compliance with both programs.

MHBs are especially useful in mixed-income development. The lower interest rate is a benefit shared by all units in the development, not just the low-income units. In addition, developers receive an automatic allocation of the four percent Low-Income Housing Tax Credits, which can be sold to help finance the project. When HOME funds are combined with such a project they can be granted or lent at below market-rates without reducing the amount of eligible basis for the tax credits. The state credit agency will automatically provide credits for any MHB-funded project that complies with the tax credit income and occupancy rules discussed previously.

Private Debt

Typically, private debt provides the majority of project financing for mixed-income housing. Mortgage brokers (for both single family and multifamily loans), institutional lenders like insurance companies and pension funds, local banks, and major regional and national banks are all sources for private debt. Private debt is a key component of project financing since it is relatively easy to obtain with lenders who make developer loans.

Although any kind of debt presents higher risks and requires repayment, these risks can be minimized through mortgage insurance and credit enhancement, which are available through the Affordable Housing Program of the Federal Home Loan Banks (FHL banks). Typically, the interest rate varies according to the risk level of the deal: the higher the risk, the higher the interest rate.

The Affordable Housing Program can also be a source of funds in mixed-income deals. Some of the FHL banks are particularly interested in mixed-income housing. PJs and developers can compete for affordable housing funds from each of the twelve regional FHL banks. The average subsidy is usually \$5 - \$10,000 per unit.

Private Equity

Private equity is money brought to a project from individual investors or partners, or the sale of tax benefits of the project. There are also a number of nonprofit foundations and socially conscious investment groups that take a specific interest in affordable housing projects, which can boost the equity brought into a mixed-income housing development. Because it is a non-Federal source of project funding, private equity carries no Federal or affordability requirements.

Some developers shy away from private equity because investors often have an expectation of a greater return on investment than private debt. For PJs, however, equity investment on the part of the developer is important because it is a sign of developer commitment—the developer should have a stake in the project in order to keep his or her interests aligned with those of the project's other funders. Including private equity may be more expensive to the project because of the greater expected return on investment, but it is an important financing source.

Hypothetical Case Study

Combining HOME and Tax Credits to Support Mixed-Income Housing: The Townhomes at Port Home

The mixed-income project in this hypothetical case study illustrates how to structure a deal that is financed with both HOME funds and LIHTCs, and includes a mix of market-rate, moderate-income, and low-income units.

Background

Port Home is a 500-unit subdivision being built over seven years on the northern edge of a moderately sized city, in an area thought of as middle to upper-middle class. The developer is a local, for-profit developer of primarily market-rate housing. Sixty percent of the homes in the Townhomes at Port Home will be single family detached for-sale housing. About 150 units will be townhouses for sale. The project under discussion here, summarized in Exhibit 4-1, is the sole rental component of Port Home, a 48-unit townhouse development.

Exhibit 4-1
Project Summary: The Townhomes at Port Home

Location	Port Home, Michigan
Project type	Rental townhouses
Number of Buildings	6
Number of Units	48
Two BDR	40
Three BDR	8
Year Built	2003
Condition	New
Cost per unit	$100,000 average
Area Median Income	$60,000
Operating Costs	$3,300/year
Tenant Utilities	$1,200/ year
Interest Rate on conventional loan	7.5%
Term	30 years
Interest rate on HOME Loan	AFR (around 4.5%)
Term	10 year balloon

The developer plans to provide housing for households with a mix of incomes due to the lack of available housing for modest wage workers in the Port Home area. The developer targets the following income mix: 28 units (60 percent of the development) are reserved for households paying market-rate rents, 14 units (29 percent) are reserved for moderate-income households, and 6 units (11 percent) are reserved for Section 8 project-based voucher households, who are likely to be extremely low-income.

To meet the tax credit requirement that 40 percent of the units be affordable to persons at or below 60 percent of area median income, the developer determines that at least 20 of the 48 units must be rented at or below LIHTC rents. This means the units for moderate-income households and the Section 8 units will all need to be rented at rents that meet the LIHTC requirements.

Financing

The developer generates Exhibit 4-2, Version 1: 15-Year Cash Flow Analysis, to illustrate the financial feasibility of the development with a combination of private loan funds and LIHTC syndication proceeds (equity). Only the low-income units are eligible for the tax credit and therefore the amount of equity raised is reduced. In addition, the lender requires a 1:1.15 debt service coverage ratio on the first mortgage. The project as structured cannot generate sufficient cash to repay a second loan to cover the balance of the construction costs. The developer, knowing that affordable housing is one of the City's top priorities, decides to ask for financial assistance from the Community Development Department.

The developer generates Exhibit 4-3, Version 2: 15-Year Cash Flow Analysis, to illustrate how $650,000 in HOME funds can make the project feasible. He requests that the City provide these funds as a loan at the Applicable Federal Rate (AFR) for 10 years. The developer proposes to pay the City interest only each year (subject to available cash flow) with any remaining balance and accrued interest to be refinanced at the end of 10 years. He accepts the HOME funding at the AFR because he wants to be able to claim the 9 percent credit on the HOME dollars.

[INSERT EXCEL SPREADSHEETS NAMED PORT HOME HERE.]

The units set aside for households with incomes over the LIHTC program limits are not eligible to receive tax credits. In addition, with HOME funding now included in the financing package, the developer must restrict the rents on 20 percent of the units to meet the Low HOME Rents. This has an impact on the cash flow of the project. In order to guarantee the project's feasibility, he will have to forgo part of his developer fee.

The City requires the principal of the loan to be repaid at the end of 10 years in a lump sum. Nonetheless, the HOME rent restrictions carry through to the end of the tax credit compliance period.

Before making the HOME investment, the City verifies that project rents and the number of units are in conformance with the program's requirements. City staff determines that:

- With $650,000 in the deal, there will have to be at least 7 HOME units (HOME investment/Total Development Cost = HOME units/Total Number of Units). The developer proposes to designate all 20 of the LIHTC units in the project as HOME-assisted.
- The maximum allowable High HOME Rents are the lesser of the Fair Market Rent or up to 30 percent of the annual income of a household at 65 percent of area median income. The developer agrees to charge rents affordable to households below this maximum threshold.
- The developer is in compliance with the requirement that at least 20 percent of the HOME-assisted units have Low HOME Rents that are no greater than the lesser of the 30 percent of the income of a household at 50 percent of area median income. The City finds that the rent structure of at least four units put the project in compliance with this requirement.

The City staff verifies compliance with rent requirements by charting the applicable rents, by funding source, as shown in Exhibit 4-4.

Exhibit 4-4
Maximum Rents Allowable, by Funding Source

	LIHTC	High HOME Rent	Low HOME Rent	Section 8 Rent	Market Rents
2 BR	800*	777*	575*	690*	890
3 BR	920*	975*	650*	780*	1100

* A $100 utility allowance has already been deducted from these rents.

Although the High HOME rents and the LIHTC rents are permitted to be higher, the developer determines that, given the area's housing market, rents must be lower than the maximum allowed to attract moderate- and low-income tenants. The Section 8 rents are also below the maximum rent permitted under LIHTC.

The City agrees to subordinate its loan and make it subject to available cash flow. This satisfies both the tax credit investor and the lender, and the project is able to close quickly.

Monitoring Long-Term Affordability

In addition to underwriting the project for financial feasibility and assessing the project's compliance with HOME and other Federal requirements, the city has an ongoing responsibility to monitor the project's compliance with HOME requirements. Since the state's Housing Finance Agency issued the tax credits, it also has an ongoing inspection and certification responsibility. The state also administers a HOME Program, and its program monitors are familiar with the HOME requirements. The City and the state agency enter into an agreement that specifies that the state will monitor property conditions and occupancy, in accordance with the LIHTC and HOME requirements. Since the local PJ remains accountable to HUD to ensure compliance with the HOME program rules, it requests several conditions in the agreement: the PJ will receive copies of all monitoring correspondence from the state, the PJ will retain the right to review the state's records related to the development, and the PJ reserves the right to conduct its own monitoring visits if necessary. The state and local PJ agree that if a compliance problem occurs, the city can take action on its own, or in concert with the state. The PJ is confident that these provisions will be sufficient to keep it informed about problems at the development, and enable it to monitor compliance as needed.

Exhibit 4.2
The Townhomes at PortHome

The Townhomes at PortHome, version 1

15 year Cash Flow Analysis

	YEAR	1	2	3	4	5	6	7
Gross Rental Income		$ 479,040	$ 491,016	$ 503,291	$ 515,874	$ 528,771	$ 541,990	$ 555,540
Other Income		$ 2,000	$ 2,050	$ 2,101	$ 2,154	$ 2,208	$ 2,263	$ 2,319
Effective Gross Income		$ 481,040	$ 493,066	$ 505,393	$ 518,027	$ 530,978	$ 544,253	$ 557,859
Vacancy Loss	6.00%	$ (28,862)	$ (29,584)	$ (30,324)	$ (31,082)	$ (31,859)	$ (32,655)	$ (33,472)
Total Actual Income		$ 452,178	$ 463,482	$ 475,069	$ 486,946	$ 499,119	$ 511,597	$ 524,387
Operating Expenses		$ 144,000	148,320	152,770	157,353	162,073	166,935	171,944
Reserve for replacement		$ 24,000	$ 24,000	$ 24,000	$ 24,000	$ 24,000	$ 24,000	$ 24,000
TOTAL EXPENSES		$ 168,000	$ 172,320	$ 176,770	$ 181,353	$ 186,073	$ 190,935	$ 195,944
NET OPERATING INCOME		$ 284,178	$ 291,162	$ 298,299	$ 305,593	$ 313,046	$ 320,662	$ 328,444
Debt Service on First Mortgage		$ 247,111	$ 247,111	$ 247,111	$ 247,111	$ 247,111	$ 247,111	$ 247,111
Debt Service on Second Mrtg		$ 79,134	$ 79,134	$ 79,134	$ 79,134	$ 79,134	$ 79,134	$ 79,134
Total Debt Service		$ 326,245	$ 326,245	$ 326,245	$ 326,245	$ 326,245	$ 326,245	$ 326,245
CASHFLOW		$ (42,067)	$ (35,083)	$ (27,946)	$ (20,652)	$ (13,199)	$ (5,583)	$ 2,199

Exhibit 4.2 (continued)

	8	9	10	11	12	13	14	15
Gross Rental Income	$ 569,428	$ 583,664	$ 598,255	$ 613,212	$ 628,542	$ 644,256	$ 660,362	$ 676,871
Other Income	$ 2,377	$ 2,437	$ 2,498	$ 2,560	$ 2,624	$ 2,690	$ 2,757	$ 2,826
Effective Gross Income	$ 571,805	$ 586,101	$ 600,753	$ 615,772	$ 631,166	$ 646,945	$ 663,119	$ 679,697
Vacancy Loss	$ (34,308)	$ (35,166)	$ (36,045)	$ (36,946)	$ (37,870)	$ (38,817)	$ (39,787)	$ (40,782)
Total Actual Income	$ 537,497	$ 550,934	$ 564,708	$ 578,826	$ 593,296	$ 608,129	$ 623,332	$ 638,915
Operating Expenses	177,102	182,415	187,887	193,524	199,330	205,310	211,469	217,813
Reserve for replacement	$ 24,000	$ 24,000	$ 24,000	$ 24,000	$ 24,000	$ 24,000	$ 24,000	$ 24,000
TOTAL EXPENSES	$ 201,102	$ 206,415	$ 211,887	$ 217,524	$ 223,330	$ 229,310	$ 235,469	$ 241,813
NET OPERATING INCOME	$ 336,395	$ 344,520	$ 352,821	$ 361,302	$ 369,967	$ 378,819	$ 387,863	$ 397,102
Debt Service on First Mortgage	$ 247,111	$ 247,111	$ 247,111	$ 247,111	$ 247,111	$ 247,111	$ 247,111	$ 247,111
Debt Service on Second Mrtg	$ 79,134	$ 79,134	$ 79,134	$ 79,134	$ 79,134	$ 79,134	$ 79,134	$ 79,134
Total Debt Service	$ 326,245	$ 326,245	$ 326,245	$ 326,245	$ 326,245	$ 326,245	$ 326,245	$ 326,245
CASHFLOW	$ 10,150	$ 18,275	$ 26,575	$ 35,057	$ 43,721	$ 52,574	$ 61,618	$ 70,857

Exhibit 4.2 (continued)

GROSS INCOME

				MONTHLY	ANNUAL
UNITS	TYPE	RENTAL	RENTAL		
	16	Voucher 2BR	$690	$132,480	
4	Voucher 3BR	$780	$37,440		
	24		2BR Market	$890	$256,320
4	3 BR Market	$1,100	$52,800		
48	Gross Rental Income		$479,040		
	Other income			$2,000	
	TOTAL GROSS INCOME		$481,040		
	Net Operating Income		$284,178		
	Debt Coverage Required by lender			1.15	
	Amt Available for Debt Service			$247,111	
	Debt Project Will Support			$2,944,742	
	Tax Credit Equity Raised			$1,146,960	
	Total Project Costs			$4,775,000	
	Balance to be Financed			$683,298	
	Debt Service on 2nd Mortgage (10%, 20yr)	$79,134			

Exhibit 4.2 (continued)

INFLATION	
Income Inflation Factor	2.5%
Expense Inflation Factor	3%

SOURCES AND USES

Sources		Uses	
Debt Project Will Support	$2,944,742	Land Acquistion	$350,000
Tax Credit Equity	$1,146,960	Construction	$4,000,000
Second Mortgage	$683,298	Syndication Costs	$25,000
Total Financing	$4,775,000	Fees	$400,000
		Total Costs	$4,775,000

TAX CREDIT EQUITY

Costs	Eligible for 9% Credit	Eligible for No Credit
Land Acquisition		$350,000
Construction Hard Costs	$4,000,000	
Total Soft Costs	$425,000	
Total Eligible Basis	$4,425,000	$350,000
Applicable fraction	40%	
Qualified Basis	$1,770,000	
Applicable credit %	9.00%	
Annual Credit Available	$159,300	
Ten Year Tax Credit Benefit	$1,593,000	
Equity Invested ($0.72 to $1.00)	$1,146,960	

Exhibit 4.3
The Townhomes at PortHome (Version 2)

The Townhomes at PortHome, version 2

15 year Cash Flow Analysis

	YEAR	1	2	3	4	5	6	7
Gross Rental Income		$ 473,340	$ 485,174	$ 497,303	$ 509,735	$ 522,479	$ 535,541	$ 548,929
Other Income		$ 2,000	$ 2,050	$ 2,101	$ 2,154	$ 2,208	$ 2,263	$ 2,319
Effective Gross Income		$ 475,340	$ 487,224	$ 499,404	$ 511,889	$ 524,686	$ 537,804	$ 551,249
Vacancy Loss	6.00%	$ (28,520)	$ (29,233)	$ (29,964)	$ (30,713)	$ (31,481)	$ (32,268)	$ (33,075)
Total Actual Income		$ 446,820	$ 457,990	$ 469,440	$ 481,176	$ 493,205	$ 505,535	$ 518,174
Operating Expenses		$ 144,000	148,320	152,770	157,353	162,073	166,935	171,944
Reserve for replacement		$ 24,000	$ 24,000	$ 24,000	$ 24,000	$ 24,000	$ 24,000	$ 24,000
TOTAL EXPENSES		$ 168,000	$ 172,320	$ 176,770	$ 181,353	$ 186,073	$ 190,935	$ 195,944
NET OPERATING INCOME		$ 278,820	$ 285,670	$ 292,670	$ 299,823	$ 307,132	$ 314,600	$ 322,230
Debt Service		$ 237,000	$ 237,000	$ 237,000	$ 237,000	$ 237,000	$ 237,000	$ 237,000
CASHFLOW		$ 41,820	$ 48,670	$ 55,670	$ 62,823	$ 70,132	$ 77,600	$ 85,230
Home Loan Payment		$ 29,250	$ 29,250	$ 29,250	$ 29,250	$ 29,250	$ 29,250	$ 29,250
Cash Flow after HOME Payment		$ 12,570	$ 19,420	$ 26,420	$ 33,573	$ 40,882	$ 48,350	$ 55,980
(goes first to pay deferred developer fee)								

Exhibit 4.3 (continued)

	8	9	10	11	12	13	14	15
Gross Rental Income	$ 562,653	$ 576,719	$ 591,137	$ 605,915	$ 621,063	$ 636,590	$ 652,504	$ 668,817
Other Income	$ 2,377	$ 2,437	$ 2,498	$ 2,560	$ 2,624	$ 2,690	$ 2,757	$ 2,826
Effective Gross Income	$ 565,030	$ 579,156	$ 593,635	$ 608,475	$ 623,687	$ 639,279	$ 655,261	$ 671,643
Vacancy Loss	$ (33,902)	$ (34,749)	$ (35,618)	$ (36,509)	$ (37,421)	$ (38,357)	$ (39,316)	$ (40,299)
Total Actual Income	$ 531,128	$ 544,406	$ 558,016	$ 571,967	$ 586,266	$ 600,923	$ 615,946	$ 631,344
Operating Expenses	177,102	182,415	187,887	193,524	199,330	205,310	211,469	217,813
Reserve for replacement	$ 24,000	$ 24,000	$ 24,000	$ 24,000	$ 24,000	$ 24,000	$ 24,000	$ 24,000
TOTAL EXPENSES	$ 201,102	$ 206,415	$ 211,887	$ 217,524	$ 223,330	$ 229,310	$ 235,469	$ 241,813
NET OPERATING INCOME	$ 330,026	$ 337,991	$ 346,129	$ 354,443	$ 362,936	$ 371,613	$ 380,477	$ 389,531
Debt Service	$ 237,000	$ 237,000	$ 237,000	$ 237,000	$ 237,000	$ 237,000	$ 237,000	$ 237,000
CASHFLOW	$ 93,026	$ 100,991	$ 109,129	$ 117,443	$ 125,936	$ 134,613	$ 143,477	$ 152,531
Home Loan Payment	$ 29,250	$ 29,250	$ 29,250	(Note: new second mortgage will replace HOME loan beginning in year 11)				
Cash Flow after HOME Payment	$ 63,776	$ 71,741	$ 79,879					
(goes first to pay deferred developer fee)								

Exhibit 4.3 (continued)

GROSS INCOME

UNITS	TYPE	MONTHLY RENTAL	ANNUAL RENTAL
3	2 BR @ 50%	$575	$20,700
1	3 BR @ 50%	$650	$7,800
13	Voucher 2BR	$690	$107,640
3	Voucher 3BR	$780	$28,080
24	2BR Market	$890	$256,320
4	3 BR Market	$1,100	$52,800
48	Gross Rental Income		$473,340
	Other income		$2,000
	TOTAL GROSS INCOME		$475,340
	Net Operating Income		$278,820
	Debt Coverage Required by lender		1.15
	Amt Available for Debt Service		$242,452
	Debt Project Will Support		$2,889,220
	Tax Credit Equity Raised		$1,146,960
	Total Project Costs		$4,775,000
	Balance to be Financed		$738,820

Exhibit 4.3 (continued)

INFLATION	
Income Inflation Factor	2.5%
Expense Inflation Factor	3%

SOURCES AND USES

Sources		Uses	
Debt Project Will Support	$2,889,220	Land Acquisition	$350,000
Tax Credit Equity	$1,146,960	Construction	$4,000,000
Deferred Developers Fee	$88,820	Syndication costs	$25,000
HOME Second Mortgage	$650,000	Fees	$400,000
Total Financing	$4,775,000	Total Costs	$4,775,000

TAX CREDIT EQUITY

Costs	Eligible for 9% Credit	Eligible for No Credit
Land Acquisition		$350,000
Construction Hard Costs	$4,000,000	
Total Soft Costs	$425,000	
Total Eligible Basis	$4,425,000	$350,000
Applicable fraction	40%	
Qualified Basis	$1,770,000	
Applicable credit %	9.00%	
Annual Credit Available	$159,300	
Ten Year Tax Credit Benefit	$1,593,000	
Equity Invested ($0.72 to $1.00)	$1,146,960	

Chapter 5:

Integrating the Lessons of the Model

Chapter 5 summarizes the lessons of this publication. It reviews the benefits of mixed-income housing, explores the factors leading to success of mixed-income developments, highlights HOME regulations that have implications for mixed-income housing, and discusses several available sources of funds for mixed-income development. The chapter ends with a case study of The Glen, a mixed-income development in Montgomery County, Maryland. This case illustrates how one community combined several funding sources with related requirements and numerous policy objectives to develop a thriving mixed-income community that has been able to sustain its marketability for many years.

Creating Mixed-Income Housing

Although mixed-income developments vary in demographics from community to community based upon local housing objectives and housing market conditions, most experts agree that there are many social and economic benefits to mixed-income housing development. Certainly, when compared to traditional, often economically impacted, low-income housing developments, mixed-income housing provides a more socially and economically stable environment for lower income residents. Public entities have many tools available to promote mixed-income development, including the HOME Program.

Housing developers have found that sustaining a mix of households in numerous income brackets over time can be difficult without careful planning and sound underwriting. When mixed-income housing is developed in severely distressed and unappealing housing markets, or when it does not have proactive, good management to market and maintain properties, it is at great risk of failing to attract market-rate buyers or tenants and “turning” low-income. Conversely, housing that is well-designed, marketed and in attractive locations can “tip” easily to market-rate occupancy without appropriate mechanisms in place to secure a certain percentage of affordable units. Ultimately, the mix of incomes that a community or property can sustain is dependent on the marketability of the community.

To be effective developers of mixed-income housing, HOME PJs must think like developers of market-rate housing **and** assess projects from the perspective of their low-income clientele. Preserving the utmost market-ability of the development requires sound judgment throughout all project decision-making, including:

- Location;
- Amenities;
- Proximity to services such as transportation, shopping, employment opportunities;
- Development design, landscaping and attractiveness; and
- Proper maintenance.

Finally, the development must be competitive with nearby housing opportunities.

Things that might be considered “extras” for affordable housing may be mandatory for mixed-income housing, especially in terms of in-unit amenities (such as washers, dryers, garbage disposals, and other appliances), and attractive landscaping and décor in common areas. Sometimes these “luxury items” are not eligible costs under the HOME Program or the local rehabilitation or construction standard. Rather than omit these items, PJs are encouraged to make every effort to secure an alternate funding source to pay these costs.

Securing Sound Management

Good management is critical to maintain the attractiveness and marketability of any development over time. Management must be capable of tending to all facets of the development—security, resident relations, trash collection, tenant selection, and lease enforcement. In mixed-income developments that might have a higher proportion of families or unemployed residents, management needs are greater and should be accounted for.

Meeting HOME Requirements

The HOME Program is an ideal source of funding for mixed-income development. It can be used for a range of activities, including acquisition, rehabilitation, new construction, or direct homebuyer assistance. PJs can invest HOME funds in as few as one unit, or in as many units as it desires. It can provide assistance up to a generous maximum per unit subsidy established by the Program. HOME requirements apply only to the units that are assisted. Further, PJs can decide to designate the assisted units as "floating" during the period of affordability. This means that, provided units are comparable (in terms of unit size and amenities), a certain number of units must be retained for low-income occupancy during the period of affordability, but the actual units may vary. This designation avoids any stigma that might result from a "fixed" assisted unit designation.

HOME PJs must comply with all HOME Program rules. The most fundamental HOME Program requirement is that all units that are assisted with HOME funds must be occupied by low- or very low-income households. HOME rents and sales prices are capped to ensure affordability. HOME-funded housing must remain affordable throughout a "period of affordability" that is established according to the amount of HOME funds that are invested per unit. In homeowner housing, PJs can choose whether to ensure affordability by restricting resale of a specific unit of housing to subsequent low-income buyers, or to recapture the HOME subsidy for subsequent use in another HOME-eligible activity.

Combining Sources of Funds

The development of mixed-income housing often requires the use of more than one source of public and/or private funds. When PJs must combine sources, they must design programs carefully to ensure compliance with the rules of each funding source.

In addition to HOME funds, the most common sources of funds used in mixed-income housing developments are low-income housing tax credits (LIHTCs), Community Development Block Grant (CDBG) funds, Section 108 loan guarantees, tax exempt bonds, private debt, and private equity.

Tax credits are a vehicle to generate equity capital to developments that meet certain public policy goals. LIHTCs are reserved for the construction and rehabilitation of affordable rental housing. LIHTC units must remain affordable for at least fifteen years, with 20 percent of the units affordable to households with incomes at or below 50 percent of area median income, or 40 percent of the households with incomes at or below 60 percent of area median income. For certain historic buildings, state or Federal historic tax credits may be available for developers who are able to comply with strict rehabilitation standards to retain the historic nature of the property.

Using CDBG funds for mixed-income housing development can be done with careful planning. Only certain eligible nonprofit organizations can carry out new construction activities. In rental rehabilitation, typically 51 percent of the units must be occupied by persons at or below 80 percent of the area median income. However, rents in rental housing are defined by the grantee and do not carry long-term affordability requirements.

Section 108 loan guarantees are typically useful for large projects that will generate sufficient cash flow to repay debt service. Project eligibility and program requirements generally follow the CDBG guidelines. Since future CDBG allocations are used as collateral for Section 108 loans, and are therefore at risk, these loans may be underwritten more conservatively.

State and local governments offer a variety of affordable housing programs whose funds can be used in mixed-income development. Some of these programs are specifically targeted to mixed-income development. Through housing finance agencies, many state and local governments raise money to fund housing developments by issuing bonds. Projects make debt service payments to repay bondholders. Tax exempt financing is useful in mixed-income developments because the low interest rate benefits all the units in the building, not just the affordable units.

Many mixed-income developments use two important private sources of funds—private debt and private equity. A well-planned, marketable and effectively underwritten development should be able to carry some private debt, although it may need additional public subsidy to finance the gap between the amount of debt it can carry and projected costs. Credit enhancement can help minimize risk to lenders. PJs should also look for investor or owner equity in projects because it represents developer commitment. Private equity also carries no requirements and can be used to finance costs that might be ineligible with public sources.

Putting the Elements Together for Success

PJs and their developer partners who are interested in developing mixed-income housing developments must become adept at securing and combining many sources of funds, negotiating a myriad of rules that may not always appear compatible, and making strategic decisions that reinforce the primary goal of marketability. The pay-off provides low-income residents exposure to social and economic opportunities that might otherwise be unavailable to them, and affordable housing located in stable, attractive environments.

Case Study

The Glen, Montgomery County, Maryland

Financing mixed-income housing can sometimes be even harder than financing a traditional low-income development. Since the sources for low-income housing, such as HOME, cannot be spent on upper-income apartments or houses, a mixed-income development almost always needs multiple sources of financing. This can represent a special challenge when developing a new or rehabilitated mixed-income community. The units that rent or sell at market value must completely carry themselves financially, and, as demonstrated in this example, must often carry part of the cost of the low-income units as well. In the end, packaging a product that attracts market-rate tenants will be critical to the success of the mixed-income housing development.

Background

This case study examines the development of an infill new rental development in a working class suburb of Washington, D.C. The site for the 90-unit apartment project, now called "The Glen," was made up of several parcels of land that formerly contained old and modest single family homes. It has narrow road frontage and is extremely deep. On either side of the site sit multifamily garden apartments built more than 40 years prior to development of The Glen. One is a large development of over 600 units, while the other is a modest-sized, 70-unit development. Both are in decent condition, but neither has been modernized extensively since built in the 1960's.

The Location

Prior to development, the site of The Glen was not attractive. Yet, the location was ideal. The surrounding neighborhood has a wide range of services, including some older shopping centers, a community gym, public library, and near-by public transportation. Washington's public transit system passes the site with subway stations about a mile in either direction. About a half-mile away is Brookside Gardens, one of the state's best horticultural gardens. Behind the property is Wheaton Regional Park, the county's million-dollar playground for children.

When The Glen was being developed (1995), the area was in transition. An increasing number of African-Americans and recent immigrants from Latin America and Southeast Asia were moving in. Turnover was relatively high. As a neighborhood in transition, County officials were concerned that the neighborhood was at-risk. It noted that there was a growing perception that drugs were becoming a problem, and the crime rate had increased.

The Developer

The developer and owner of The Glen is the Housing Opportunities Commission (HOC), a local public housing agency with a mission to create and sustain mixed-income housing. The location seemed ideal to HOC because of the many near-by community amenities. By the time HOC started thinking about developing a site in this neighborhood, it had enough experience to be confident it could provide a site plan, design, and management program that could create neighborhood stability.

Land Costs

A local developer assembled the parcels of land for the project and sold them to HOC at the market price at the time, about $20,000 per unit, for a total land cost of $1.8 million. In addition to the direct land costs, the developer purchased 45 transferable development rights (TDRs) from nearby farmers in order to achieve the desired density. Local TDR guidelines allow farmers to sell development potential of their agricultural land to other developers. The TDR certificates are used to increase density in places the county has identified as eligible for increased density because of the availability of an array of public services. The program preserves farmland while fostering “smart growth.” The TDRs cost the developer an additional $500,000.

The Design

The developer planned to house families on the site and decided the best unit design would be a townhouse rather than garden apartments. The townhouse design would set the development apart from neighboring developments, providing an attractive alternative that could command higher rents. Due to the tight dimensions of the site, in order to achieve the required density, the townhouses had to be built in a piggyback arrangement, with one two-story home built above another two-story home. Most units were two bedroom units with a den, although some three bedroom units and flats were built on the ends of rows to accommodate larger families and residents with mobility impairments.

Once the basic design was determined, the project had to go through the county’s public hearing and approval process. The development faced somewhat muted NIMBY opposition, as the closest adjacent residents were renters. But owners of the adjacent rental properties made their opposition known, as did environmentalists concerned about protecting the streambed and some impressive oak trees on the property. After some adjustments to the plans, the project was approved and ready to be financed and built.

The Income Mix

As illustrated in Exhibit 5-1, the income mix for the community was targeted such that approximately 60 percent of the units (55 units) would be rented at market-rate and nearly 40 percent (35 units) would be rented at below-market rents, in several different tiers. The lowest income tier had rents set to be affordable to households at 35 percent of the area median income, the middle tier was affordable to households at 50 percent of the area median, and a few units were made affordable to households at 65 percent of area median income. The remaining units were rented at market rents, which at the time were predicted to be $800 for a two bedroom unit, a relatively modest rent by Montgomery County standards for new townhouses.

Exhibit 5-1
Income Targeting at The Glen

Income Tier	Percent of Median	Number of Units
Market Rent	80+%	55
Below Market 1	65% (HOME)	5
Below Market 2	50% (HOME)	10
Below Market 3	35% (STATE)	20

Amenities and Design

It was important to the developers to make sure the project would not be perceived as a low-income development. As a result, all the affordable units are built to the same standards as the market units and are scattered throughout the development. All units have an excellent amenity package such as washers and dryers, ceiling fans, dishwashers, self- cleaning ovens, and refrigerators with icemakers. The units are large (1040 square feet for the two bedroom) but only 16 feet wide. Each has a spacious balcony as well as a small front yard. The top floor units have vaulted ceilings and every unit has two full baths on the bedroom level with a half bath on the living room level. The dens have hardwood floors and French doors. The windows are triple glazed for energy efficiency and to block noise from the busy main thoroughfare the development faces. Extensive soundproofing was also designed into the buildings.

Landscaping is particularly lush. The community is surrounded by a metal picket fence to give the appearance of exclusivity, and visitors are greeted at a beautiful community building that also contains the management offices. Mailboxes are clustered in the community building in order to promote neighborliness, and management is able to greet residents on a regular basis.

Financing

Financing for this project required a lot of cooperation and coordination. Sources are listed in Exhibit 5-2. The main source of financing came in the form of tax-exempt bonds that were issued by HOC, which is also the housing finance agency for the county. The bonds were not insured, so the investors had to rely on the soundness of the project's economics for repayment. The State of Maryland, which has a very low-income housing finance program, lent the project $1.3 million, the County provided $800,000 in Federal HOME funds, and HOC put in $840,000 of its own funds.

Exhibit 5-2
Sources of Funds for The Glen

Essential Function Tax-exempt Revenue Bonds	$8,800,000
State of Maryland Partnership Rental Housing Program	$1,300,000
Montgomery County Maryland HOME Funds	$800,000
HOC Housing Investment Funds	$840,000
Total Funds	$11,740,000

Making the Funding Work Together

The tax-exempt bonds required that at least 20 percent of the units serve families with incomes at 80 percent of area median income and below, and that the project be owned by a public entity. These restrictions were not a problem given the targeted income groups, and the intended ownership (HOC) of the development.

The HOME Program required that most of the units financed with HOME dollars serve families whose incomes were at or below 60 percent of area median income, with some of the units serving households with incomes at or below 50 percent of median income. (See the Project Rule described in Chapter 3 of this publication.) This was also consistent with the developer's goals. Seventeen units were designated as HOME-assisted, and those units were designated as "floating" units.[1]

The state program was designed to serve households whose incomes were at or below 50 percent of the state median income, which is considerably lower than the metropolitan area median income determined by HUD. Therefore, The Glen was required to serve households whose incomes were at 35 percent of the area median income, as determined by HUD. The state contributed up to $65,000 per unit for these units and required that the rents remain affordable for this very low-income group for at least 40 years.

The actual development cost of the HOME-assisted units was $1.96 million ($130,000 per unit), yet the county contributed only $800,000 (approximately $47,000 per unit). The remaining costs, including luxury items that are ineligible under the HOME Program, were funded by the bond funds.

Likewise, the state funding subsidized 20 units at a rate of $65,000 a unit, still less than the $130,000 per unit development cost. The remaining $55,000 per unit also came from bond proceeds, and the HOC contribution.

It was clear that the market units had to cover their share of the debt service and subsidize the affordable units, in part. Full occupancy and regular market rent increases were important for financial success.

The Outcome

The development was completed a little late and a little under budget. The private management firm worked tirelessly to prepare the marketing strategy, the advertisements, the model apartments, and all the other details of the community prior to opening. When it came time to start leasing, the initial response was excellent from the market-rate renters. Almost immediately the asking rents were raised nearly $100. However, this interest did not last. There was soon resistance to the higher rents. Management needed to make some compromises in order to assist the marketing. It strove to make strategic changes that would attract new tenants, without lowering the quoted rents. For instance, since the unit did not have a dining room, it converted the den into a dining room with a pass through from the kitchen. This helped attract applicants with existing dining room furniture. Management also offered bonuses, such as one month's free rent to facilitate lease-up.

For the affordable units, a renting family had to have enough income to pay the rent but not too much income to no longer qualify. For each targeted income bracket, this window of eligibility was narrow but the demand for affordable housing in the area was significant, and there were ample families who met the criteria. There were no problems leasing the affordable units. Families loved the separate spaces such as a den that could be used as a playroom, the children's bathroom, and the master bath.

It was important to the success of the development that the market-rate and low-income units be occupied in roughly the same proportion, so that the development never felt like it was a "low-income development." As a result, it was sometimes necessary to postpone renting to a qualified low-income family for a short period until sufficient market units were leased.

Over 90 percent of the units leased on-schedule. The last 10 percent took more time than expected and caused some worry among staff. After initial lease-up, the upward movement on rents was slow and it was a hard job to keep full occupancy because the market rental rate was about 10-15 percent higher than alternative apartments in the area. Within two years, however, the occupancy stabilized and rent increases became more regular. The project was on its way to becoming comfortable financially and providing an excellent home to 90 families in a growing area.

Owners of nearby apartments felt the competition from The Glen and began renovations to stay competitive. Shopping centers were also renovated and other in-fill residential developments were planned. There is no doubt the proximity to public transportation made the entire community more attractive to market-rate tenants, but the introduction of The Glen, with its attractive, high quality, and well-designed units signaled a positive direction for the community.

By 2002 the neighborhood had changed dramatically for the better. This once “at-risk” neighborhood has lost its reputation for drugs, crime, and marginality. It is now a destination for a diverse group of mostly working families.

End Note

[1] At the time The Glen was developed, HUD had not yet issued guidance that directly addressed the ability to have HOME-assisted units float throughout the project over time. Nonetheless, HOC and the County agreed on the importance of the floating unit designation to the development, so an arrangement was worked out that placed a HOME second mortgage against all the units in the property. The county discussed this approach with HUD, and received its approval to move forward. Today the concept of floating units is well established under the HOME Program.

There was an even more difficult problem with floating the state-assisted units. That program required a first mortgage on each state-supported unit, and there could be no other debt in a superior lien position. This was worked out in a complicated legal structure that created a condominium that would be recorded in the event of a default on the state units. In the event of a default, the state would then have title to 20 previously identified condominium units. The bondholders had to agree to drop their mortgage on those units in such a case. Ultimately, this strategy was adopted.

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Appendix 1

Other Federal Requirements for Homebuyer Programs

Other Federal Requirements	Apply to Homebuyer Programs?	Special Issues/ Considerations	Regulatory Citations and References
Non-Discrimination and Equal Access Rules			
Fair Housing and Equal Opportunity	Yes.	PJs must affirmatively further Fair Housing. Particular attention should be paid to signs of discrimination in sale of properties.	• 92.202 and 92.250 • Title VI of Civil Rights Act of 1964 (42 U.S.C. 2000d et. seq.) • Fair Housing Act (42 U.S.C. 3601-3620) • Executive Order 11063 (amended by Executive Order 12259) • Age Discrimination Act of 1975, as amended (42 U.S.C. 6101) • 24 CFR 5.105(a)
Affirmative Marketing	Yes, for all projects of five or more HOME-assisted units.	PJ must adopt affirmative marketing requirements and procedures.	• 92.351
Handicapped Accessibility	Yes.	New projects must be designed and constructed in accordance with applicable standards. Rehabilitated properties may require modifications.	• Section 504 of the Rehabilitation Act of 1973 (implemented at 24 CFR Part 8) • For multifamily buildings only, 24 CFR 100.205 (implements the Fair Housing Act)
Employment and Contracting Rules			
Equal Opportunity Employment	Yes.	Contracts and subcontracts for more than $10,000 must include language prohibiting discrimination.	• Executive Order 11246 (implemented at 41 CFR Part 60)
Section 3 Economic Opportunity	Yes, if amount of assistance exceeds $200,000 <u>OR</u> contract or subcontract exceeds $100,000.	Include Section 3 clause in contracts and subcontracts.	• Section 3 of the Housing and Urban Development Act of 1968 (implemented at 24 CFR Part 135)
Minority/Women Employment	Yes.	PJ must develop procedures and include in all contracts and subcontracts.	• Executive Orders 11625, 12432 and 12138 • 24 CFR 85.36(e)
Davis Bacon	Yes, if construction contract includes 12 or more units that are HOME-assisted.	If applicable, requirements apply to the whole project, not just the HOME-assisted units. Include language in contracts and subcontracts. Requirements do not apply to volunteers or sweat equity.	• 92.354 • Davis-Bacon Act (40 U.S.C. 276a - 276a-5) • 24 CFR Part 70 (volunteers) • Copeland Anti-Kickback Act (40 U.S.C. 276c)
Conflict of Interest	Yes.	PJs should ensure compliance in-house and when using subrecipients.	• 92.356 • 24 CFR 85.36 • 24 CFR 84.42
Debarred	Yes.	PJs should check HUD list of	• 24 CFR Part 5

Other Federal Requirements	Apply to Homebuyer Programs?	Special Issues/ Considerations	Regulatory Citations and References
Contractors		debarred contractors.	
Environmental Requirements			
Environmental Reviews	Yes.	Categorically excluded **not** subject to 58.5. Buildings to be constructed in the future require a compliance review.	• 92.352 • 24 CFR Part 58 b(5) • National Environmental Policy Act (NEPA) of 1969
Flood Insurance	Yes.	Must obtain flood insurance if located in a FEMA designated 100-year flood plain. Community must be participating in FEMA's flood insurance program.	• Section 202 of the Flood Disaster Protection Act of 1973 (42 U.S.C. 4106)
Site and Neighborhood Standards	No.		• 24 CFR 893.6(b)
Lead-Based Paint	Yes for pre-1978 units.	Notices to purchasers and tenants. Visual assessment must be performed. Paint stabilization must be completed (if applicable). Safe work practices and clearance. Provisions included in all contracts and subcontracts.	• 92.355 • Lead Based Paint Poisoning Prevention Act of 1971 (42 U.S.C. 4821 et. seq.) • 24 CFR Part 35 • 982.401(j) (except paragraph 982.401(j)(1)(i))
Relocation	Yes.	Required notifications to tenants. Required language in offers and contracts for acquisition of property.	• 92.353 • Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 (URA) (42 U.S.C. 4201-4655) • 49 CFR Part 24 • 24 CFR Part 42 (subpart B) • Section 104(d) "Barney Frank Amendments"

Appendix 2

Other Federal Requirements for Rental Programs

Other Federal Requirements	Applies to Rental Housing Programs?	Special Issues/ Considerations	Regulatory Citations and References
Non-Discrimination and Equal Access Rules			
Fair Housing and Equal Opportunity	Yes.	PJs must affirmatively further fair housing. Pay particular attention to signs of discrimination in leasing practices.	• 92.202 and 92.250 • Title VI of Civil Rights Act of 1964 (42 U.S.C. 2000d et. seq.) • Fair Housing Act (42 U.S.C. 3601-3620) • Executive Order 11063 (amended by Executive Order 12259) • Age Discrimination Act of 1975, as amended (42 U.S.C. 6101) • 24 CFR 5.105(a)
Affirmative Marketing	Yes; for projects containing five or more HOME-assisted units.	PJ must adopt specific procedures and requirements.	• 92.351
Handicapped Accessibility	Yes.		• Section 504 of the Rehabilitation Act of 1973 (implemented at 24 CFR Part 8) • For multi-family buildings only, 24 CFR 100.205 (implements the Fair Housing Act)
Employment and Contracting Rules			
Equal Opportunity Employment	Yes.	Contracts and subcontracts over $10,000 should include language prohibiting discrimination.	• Executive Order 11246 (implemented at 41 CFR Part 60)
Section 3 Economic Opportunity	Yes, if amount of assistance exceeds $200,000 OR contract or subcontract exceeds $100,000.	Include Section 3 clause in contracts and subcontracts.	• Section 3 of the Housing and Urban Development Act of 1968 (implemented at 24 CFR Part 135)
Minority/Women Employment	Yes.	PJ must prescribe procedures and include in contracts and subcontracts.	• Executive Orders 11625, 12432 and 12138 • 24 CFR 85.36(e)
Davis-Bacon	Yes, if construction contract includes 12 or more HOME-assisted units.	Include language in all contracts and subcontracts. Requirements apply to whole project not just the HOME-assisted units.	• 92.354 • Davis-Bacon Act (40 U.S.C. 276a - 276a-5) • 24 CFR Part 70 (volunteers) • Copeland Anti-Kickback Act (40 U.S.C. 276c)
Conflict of Interest	Yes.	PJs should ensure compliance both in-house and when using subrecipients.	• 92.356 • 24 CFR 85.36 • 24 CFR 84.42

Other Federal Requirements	Applies to Rental Housing Programs?	Special Issues/ Considerations	Regulatory Citations and References
Debarred Contractors	Yes.	PJs should check HUD list of debarred contractors.	• 24 CFR Part 5
Environmental Requirements			
Environmental Reviews	Yes.	Level of review depends upon the activity. For rehabilitation and new construction (5 or fewer units); categorically excluded **subject** to 58.5. New Construction (more than 5 units) subject to environmental assessment.	• 92.352 • 24 CFR Part 58 • National Environmental Policy Act (NEPA) of 1969
Flood Insurance	Yes.	Must obtain flood insurance if located in a FEMA designated 100-year flood plain. Community must be participating in FEMA's flood insurance program.	• Section 202 of the Flood Disaster Protection Act of 1973 (42 U.S.C. 4106)
Site and Neighborhood Standards	Yes; for new rental construction only.		• 24 CFR 893.6(b)
Lead-Based Paint	Yes for pre-1978 units. Applies to HOME and non-HOME-assisted units. Requirements differ depending on whether rehabilitation work is performed.	Rehabilitation Notices to owners. Paint testing of surfaces to be disturbed. Risk assessment, if applicable, based on level of rehabilitation assistance. Appropriate level-hazard reduction activity (based on level of rehabilitation assistance). Safe work practices and clearance. Provisions included in all contracts and subcontracts.	• 92.355 • Lead Based Paint Poisoning Prevention Act of 1971 (42 U.S.C. 4821 et. seq.) • 24 CFR Part 35 • 982.401(j) (except paragraph 982.401(j)(1)(i))

Other Federal Requirements	Applies to Rental Housing Programs?	Special Issues/ Considerations	Regulatory Citations and References
Lead-Based Paint (Continued)		**Activities not involving rehabilitation** **Notices to purchasers and tenants.** **Visual assessment must be performed.** **Paint stabilization must be completed (if applicable).** **Safe work practices and clearance.** **Provisions included in all contracts and subcontracts.**	
Relocation	Yes.	Displacement must be minimized; existing tenants must be provided a reasonable opportunity to lease a dwelling unit in the building upon completion of the project. Reimbursement for temporary relocation, including moving costs and increase in monthly rent/utilities, must be provided, as well as advisory services.	• 92.353 • Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 (URA) (42 U.S.C. 4201-4655) • 49 CFR Part 24 • 24 CFR Part 42 (subpart B) • Section 104(d) “Barney Frank Amendments”