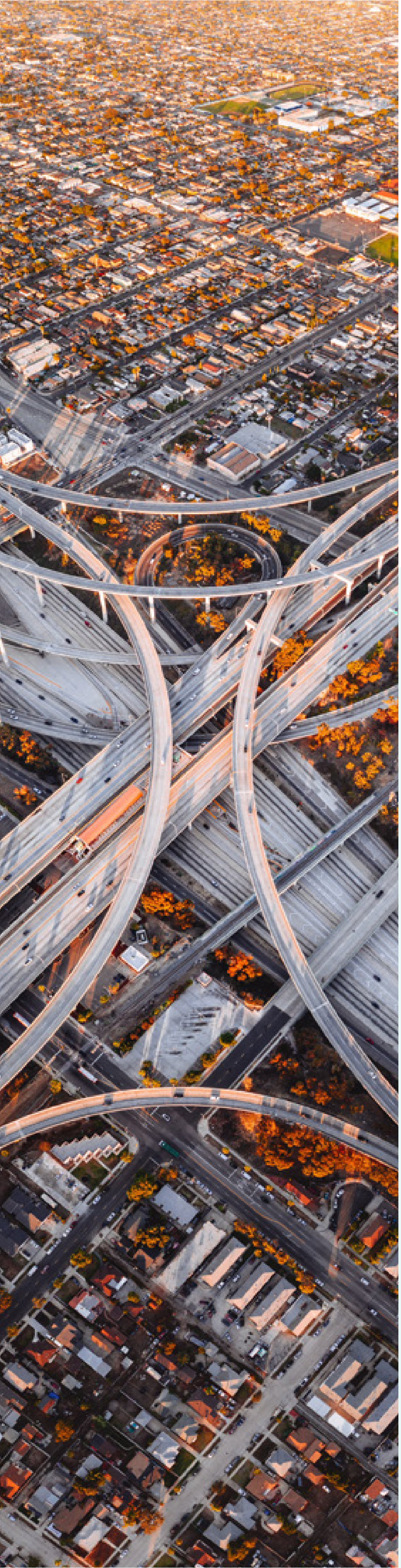

UP FOR GROWTH Policy Brief March 16, 2021

Exempting Housing Bonds From the Private Activity Bond Volume Cap to Spur Economic Recovery and Incentivize Accessible Growth

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Background

The United States is experiencing a housing shortage and affordability crisis. More than 47% of American households are cost burdened, which is classified as spending more than 30% of their income on rent (Joint Center, 2019). Renters at all income levels are impacted by cost burdening, but the affordability crisis most severely impacts households with lower incomes. 71% of extremely low-income renters spend more than half of their income on rent (NLIHC, 2020). The shortage of affordable housing compounds inequality, excludes families and individuals from high-opportunity areas, and limits access to safe housing options. Housing is a critical resource, and affordable rental projects are important for relieving cost burdens on low-income renters.

Affordable housing developments are critical for meeting housing goals and ensuring that low-income families and individuals have access to quality homes. However, development costs can make it economically infeasible for property owners to charge rents that low-income households can afford. The number of low-cost rental units declined by 3.1 million between 2012-2017, a drop from 33% to 25% of total units (Joint Center, 2020). Financing low-income affordable housing requires special mechanisms, including Private Activity Bonds (PABs). PABs help finance below-market rate units and, in conjunction with the Low-Income Housing Tax Credit (LIHTC), are essential for financing hundreds of thousands of affordable homes. PABs are tax-exempt, and therefore investors are willing to accept a lower rate of return than they would for taxable investments. This lowers the cost of borrowing, freeing up additional capital and allowing savings to be funneled back into the projects themselves, making low-income affordable projects financially feasible.

There are 27 qualified activities for PABs — including airports, water, sewage and high-speed rail projects — but housing-related activities accounted for 91.5% of PAB dollars in 2018 (Novogradac, 2019). The federal government places an annual state volume cap on 14 of the 27 qualified private activities, including on affordable multifamily housing development projects. The volume cap is determined on a per capita basis; for 2020, each state received $105 per capita (multiplied by the state's population), with a minimum amount of $321,775,000 for smaller states that are more sparsely populated. This volume cap applies to all eligible private activities, and states and localities have discretion with how the funds are distributed. If the state does not use all of its bond authority during the first year it was received, the state can carry forward that bond authority. Carryforward authority is available for an additional three years, at which point it expires.

Despite the critical and growing need for affordable housing and the efficacy of PABs on housing production, these artificial "ceilings" limit the number of affordable projects that can be built. They require states and localities to make tradeoffs in allocating bonds. As the housing affordability crisis grows, PABs are an even more critical resource in financing housing. Yet, they continue to face funding competition with other qualifying activities. Affordable housing is critical for a healthy economy and functioning society, and innovative adjustments to the bond volume cap can help increase the supply of housing and reduce the burden on renters and homeowners. Up for Growth has developed a policy proposal that would call for the exemption of housing activities from the private activity bond cap for a period of five years. The proposal calls for amending statute to allow for this exemption and to create additional criteria for jurisdictions to qualify. The modifications to the bond volume cap, specifically as they relates to housing production, will help make PABs more effective at boosting the affordable housing supply while simultaneously spurring economic recovery.

Up for Growth's bond volume cap exemption proposal would reform PAB use for qualifying affordable housing projects by exempting these projects from the bond volume cap for a five-year period. This exemption would likely help support the development of more affordable units — particularly in states that approach or exceed their bond volume cap each year.

Proposal Summary

The bond volume cap exemption proposal would amend Sec. 146 of the IRS tax code to exclude qualified residential rental projects from the private activity bond cap for a period of five years, ending on December 31, 2025. Qualified residential rental projects are those that provide 20% or more total units to renters earning 50% or less of area median income (AMI) or 40% or more total units to renters earning 60% or less AMI. The proposal would also require that qualifying projects meet one of three criteria:

I. The project must be located with ½ mile of fixed guideway transit;

II. The project must be located in a census tract with 5 jobs per acre; or

III. The project must be located in an opportunity area for children (as defined by the Secretary) with access to high-performing schools.

Policy Analysis

PABs help spur the creation of 40,000-50,000 housing units each year and have created nearly 1.2 million affordable units since their establishment (NCSHA, 2020). They are incredibly important tools for states and localities to leverage in order to incent the development of more affordable homes. In recent years, as more PAB dollars have gone toward affordable housing development, the nation's total utilization rate has increased from 37% to 65%, which has put several states in situations where demand for PABs is outpacing the supply (Norris, 2019). Eight states — New York, Massachusetts, New Jersey, Connecticut, Tennessee, Minnesota, Colorado, and Washington — face an oversubscription problem where their utilization rate exceeds their annual allocation, which means these states must forgo certain projects in order to stay under the volume cap (Norris, 2019). An additional seven states — California, Texas, Georgia, Florida, Nevada, Hawaii, New Mexico — and the District of Columbia are all facing looming volume cap crises as their allocation and issuance amounts move closer to their volume caps (Norris, 2019). In Washington state, there were $760 million in multifamily PAB requests but only $250 million in bond cap volume (Norris, 2019).

This scarcity environment means that many states must make difficult decisions about allocating PABs, limiting the number of affordable housing projects that can be built. Limitations on affordable rental housing construction come at a particularly bad time, as many Americans are unable to find affordable homes, particularly in high-opportunity areas. The proposal would lift bond volume caps on multifamily affordable housing projects, thereby allowing states to support all eligible projects, which would increase the number of affordable homes. Removing the volume cap on affordable multifamily rentals would also free up PABs for other eligible activities that will not have to compete with housing projects for very limited funds.

Exempting eligible affordable multifamily housing projects from the bond cap will help spur the creation of affordable homes in two other ways. It is important to note that Congress established a permanent minimum 4% LIHTC rate in 2020 as part of its end-of-year spending bill. This provision will increase financial feasibility for hundreds of affordable units, and estimates indicate that it will produce more than 130,000 affordable homes over the next 10 years (Lawrence, 2020). Projects that finance at least 50% of development costs with PABs and that meet affordability criteria automatically receive the 4% credit. This increased utilization of 4% LIHTC will put even more demand on PABs, as projects that get at least 50% of their financing from PABs are eligible for the 4% credit. Exempting these projects from the bond cap will help avoid the additional stress on the volume caps that comes from an increased

About Up for Growth

Up for Growth® is a national 501(c)(3) cross-sector member network committed to solving the housing shortage and affordability crisis through data-driven research and evidence-based policy.

Our mission is to forge policies and partnerships to achieve housing equity, eliminate systemic barriers, and create more homes.

Launching Policy Briefs

Up for Growth is excited to launch its series of policy briefs where we offer evidence-based and data-driven analysis of a variety of pro-housing policies. Each brief will focus on a specific local, regional, state, or federal policy and will inform policymakers, advocates, and practitioners as they advance meaningful solutions to housing underproduction. Up for Growth's member network will be surveyed to obtain critical insights and considerations to inform policies that further our organization's mission.

Members can email policy@upforgrowth.org to submit their ideas for policies to be evaluated in future briefs.

interest in 4% credits. Additionally, exempting affordable multifamily housing projects from the volume cap adds certainty to the development process because affordable housing developers know that they will not have to compete with other private activities for limited bond resources. This certainty will likely help increase project application and result in the creation of more units.

The volume cap was created in response to worries over reduced federal revenues and concerns that bond financing for private activities was competing for investors with traditional public projects. The concern was that state and local governments would then need to raise interest rates for the bonds issued for public projects in order to entice investors, leading to an inefficient allocation of capital (Maguire & Hughes, 2018). While there is a revenue loss associated with tax-exempt bonds, the activities themselves can be revenue-generating, and the benefits can offset the costs. The economic benefits of affordable housing extend beyond the units themselves. Access to jobs, education, transportation, healthcare, and other amenities is critically important to low- and moderate-income residents of affordable units, yet this access is limited by the already-constrained market. There is an established precedent for exempting certain activities from the bond cap, including airports, nonprofit hospitals, 501(c)(3) organizations, and others. Much of the forgone tax revenue from the bond exemption can easily be made up elsewhere, and the 5-year sunset provision will limit long-term tax revenue loss.

Additionally, as the country grapples with the consequences of COVID-19, the need for affordable, quality housing is even more apparent. This major public health crisis, coupled with economy and labor market shocks that contributed to mass unemployment, has also put millions of Americans at risk of losing their homes. Exempting affordable multifamily projects from the volume cap will help states address housing needs, while also adding jobs and other economic benefits associated with the construction of homes.

This proposal more specifically targets the volume cap exemption to areas that meet at least one of three criteria: projects near transit; projects in job-rich areas (as defined by at least five jobs per acre), or projects in an "opportunity area for children," a criterion left for the Secretary to define but one that must include access to high-performing schools. Up for Growth estimates that more than 35% of census tracts meet at least one of these criteria, which indicates that the bill would have a large footprint. Additionally, areas where housing need is greatest, namely areas connected to transit, jobs and amenities, as well as those with growing populations and economic centers, are likely to meet more than one of the criteria. This specific targeting will help ensure that PABs are going to the areas where there is the greatest need. Creating specific definitions or guidance around an "opportunity area for children" could make the proposal even more impactful. Affordable housing development is disproportionately concentrated in higher-poverty neighborhoods (Fischer, 2018). Enumerating specific opportunity-area criteria that use the best available, outcome-based evidence for the Secretary to consider would help ensure more equitable housing access. Research has shown that growing up in high-opportunity areas improves children's long-term earnings and increases long-run tax revenue. (Chetty, et al 2020). Positioning affordable housing, especially projects with 2+ bedrooms that can accommodate families, could help improve social and economic equity and create a higher return on investment for the government.

As the demand for homes continues to dramatically outpace supply, quality affordable homes continue to become more out of reach for millions of families and individuals. Financing low-income affordable units is a challenge for developers, and PABs are critical for ensuring the projects are feasible. As the housing crisis grows, more states are issuing PABs to support the development of affordable multifamily projects, thus pushing the limits of their volume cap. This proposal would help alleviate the pressure on states by temporarily exempting these activities from the PAB volume cap. This exemption will likely spur the creation of more homes, particularly in states with the greatest need.

Acknowledgement

We would like to thank David Williams, Up for Growth Board of Directors Member, for his thoughtful recommendations and review of this legislative brief.

Endnotes

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