

Construction Capital to Flow into Low-Income Apartments

by Donald S. Bradley

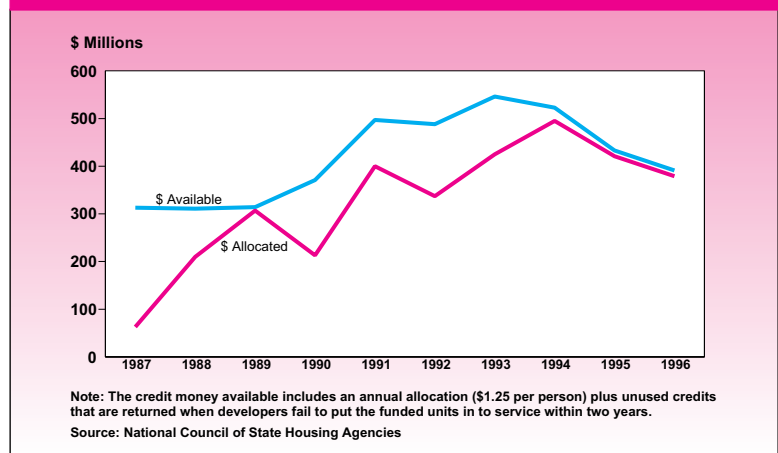
THE STRONG TIDE OF multifamily-housing-sector activity clearly is lifting the boats of those households that rent by choice. For families for whom renting is an economic necessity, though, this wave of prosperity threatens to wash past them in the years ahead, leaving them no better off than before.

Yet, the most rapidly growing demand for rental housing lies with lower-income families, those earning 50 percent of area-median income or less, who are competing for a dwindling supply of housing that consumes no more than one-third of their income in rent (See "Rental Market Enters Era of Change, *SMM*, November 1996). The number of unsubsidized apartments affordable to such tenants has declined by 3 million, or 38 percent, between 1974 and 1993, at the same time that market rents have risen, according to a 1996 report by the Department of Housing and Urban Development (HUD).

Availability largely is failing to keep up with need because apartments affordable to very-

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EXHIBIT 1: Low-Income Housing Tax-Credit Allocations



The money allocated by the states for housing-credit supported apartments often fails to match the money available for this purpose, reducing the potential inventory of low-income units. The shortfall is exacerbated further when developers fail to deliver housing-credit-approved projects because they cannot put together the necessary financing. (Data documenting the actual number of credit-supported units that join the housing stock are not available.) Freddie Mac has entered into a forward loan commitment program to address this problem.

low-income families generally do not generate enough rental income or appreciation to cover the costs of developing and maintaining these properties. The Low-Income-Housing Tax Credit offers about the only life raft left to these renters. It does so by generating equity financing that can fill the gap between the development costs for a project and market-rate financing.

A state housing finance agency allocates the federal tax credit to specific projects which, when

completed, will rent to low-income tenants at restricted rents for an average of 42 years, a 1997 study for the National Council of State Housing Agencies found. The developers of these proposed projects then sell the credits to private investors, who consequently become limited partners in the project. The credits are used by investors as dollar-for-dollar writeoffs against tax liabilities. With the investors' cash as an equity stake, developers do not need to

borrow as much money to finance the projects.

Since its creation by Congress in 1986, the housing credit has supported almost 900,000 apartments for extended low-income use. At least one fundamental issue, however, prevents the housing credit from producing even more affordable units. The states, particularly in the earlier years of the program, encountered difficulties allocating all of the money that Congress made available for housing credits each year, reducing the potential inventory of low-income units (*Exhibit 1*).

Compounding the problem, allocations are made for the addition of approximately 90,000 units each year, but only about 50,000 to 60,000 units actually are completed and rented. The remainder drop out, often because the developer is unable to find or afford the short-term construction financing and long-term permanent financing needed to build a proposed project, the HUD report found. In recent years, the state housing finance agencies have become more effective in closing the gap between unit allocations and unit completions by requiring construction financing before awarding credit allotments.

To help alleviate this capital shortage, Freddie Mac in July became one of the few funding sources in the country to offer forward loan commitments for financing newly constructed

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12 to 24 months. The construction advances are secured by a promissory note or letter of credit supplied by or on behalf of the construction lender. When the project is built and meets property-income and occupancy thresholds, the construction loan converts to a standard, long-term mortgage, which Freddie Mac then will purchase from the permanent lender. **SMM**

housing-credit properties. At the beginning of the transaction, a developer participating in the Freddie Mac pilot project locks in the same fixed rate of interest for the construction and permanent loans, based on the terms of the forward commitment between Freddie Mac and the permanent lender. Freddie Mac then funds advances to the construction lender for a short-term construction loan of