CHPC
NEW YORK CITY

PUMP UP THE VOLUME

Recommendations to Improve the Allocation of Private Activity Bonds to Better Support Housing in New York State

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FOREWORD

Over 49,000 units of affordable housing have been created in New York City using **tax-exempt private activity bonds (PABs)** in the past nine years, and this resource will continue to be an important component for Mayor De Blasio's Housing Plan to be a success.

However, while information on other City, State and Federal housing resources is readily available, there is limited publicly available information on the allocation, demand and use of PABs in New York State.

Between 2005 and 2013, the City and the State housing agencies issued a total of $11.5bn in PABs but the total PAB volume cap in the State during that same period was $15.4bn.

Was the nearly $4bn balance issued for eligible non-housing activities or did some of the balance remain unspent? How is the decision to allocate this important resource made? What are the priorities? What is the pipeline and how do projects get selected?

Our research shows that multifamily housing makes for the best use of PABs, in part because it leverages Low Income Housing Tax Credits and in part because housing is often the only feasible use of PABs due to onerous requirements that limit their usefulness for economic development. But, despite the reality that little non-housing activity is generated through the use of PABs, State legislation prioritizes allocating bond volume to economic development agencies rather than to housing agencies, whose annual allocations are not fully decided until late in the year.

As a result, New York City's Housing Development Corporation (HDC) and New York State Housing Finance Agency (HFA) are limited in their ability to appropriately plan their pipelines and to more accurately manage the demand for PABs. The current allocation process also potentially creates an illusion of scarcity within the development community, when in fact in any given year there may be more available bond allocation than is assumed.

The lack of certainty over the bond allocations available to HDC and HFA can translate into uncertainty discerning how the two agencies make their funding decisions. HDC and HFA have an informal agreement that determine the types of housing projects that each agency will finance in New York City, but these guidelines were created for administrative ease rather than to address housing policy priorities.

Improving policy coordination for HDC and HFA's uses of PABs and making available information about each agency's priorities and pipeline would better ensure that the right mix of affordable and market-rate projects are developed to meet the City's housing needs. It would also create a clear pipeline of projects that can ensure no PAB volume is left unused in the State.

This research study, **Pump Up The Volume**, has led us to the following recommendations to improve the PAB allocation process, make it more transparent and advance New York City's housing needs:

- *Reform State legislation to make housing the priority in the bond allocation process in order to guarantee that housing agencies have sufficient allocations to effectively manage their project pipelines.*

- *If legislation cannot be enacted, the Division of the Budget can*

accomplish this objective in large part by increasing allocations to housing agencies from the Statewide Bond Reserve at the beginning of the year.

- *The State Division of the Budget should report annually which agencies have received bond allocations, how they have been used and whether any volume cap has been carried forward or expired.*

- *HDC and HFA should develop a coordinated strategy for using PABs to target identified priority housing needs.*

- *This strategy should prioritize affordable housing developments where tax credits represent the greatest share of total development costs, while continuing to fund 80/20s and other projects to ensure that no bond volume is left to expire.*

- *These priorities should be clearly publicized, along with the pipeline of development projects, in order to increase developers' understanding of the process and to manage expectations that they will receive PAB financing.*

INTRODUCTION

INTRODUCTION

New York City has been well respected for its use of tax-exempt private activity bonds (PABs) to develop affordable housing[1]. The City's Housing Development Corporation (HDC) maintains an Aa2 bond rating[2] and is one of the largest issuers of private activity bonds in the country. Indeed, as other sources of housing subsidies have declined, the City's reliance on PABs has steadily grown.

Mayor De Blasio has set an ambitious goal to create or preserve 200,000 units of affordable housing over the next decade. In order to meet this target the City will need to maximize critical federal housing resources, among which are PABs.

This study considers how PABs have been used in New York City over the past nine years and suggests ways to improve the allocation of volume cap to finance affordable housing.

The goal of this report is to propose ways to enhance the use of PABs and thereby assist policymakers in maximizing their effectiveness in meeting New York City's affordable housing and concomitant economic development goals.

The research has relied on the analysis of bond issuances and other public documents, as well as interviews with public sector and private sector industry participants. The New York City Housing Development Corporation (HDC) shared its database of bond issuances for this study and we obtained data on issuances by the New York State Housing Finance Agency (HFA) from its publicly available disclosure

1 Except where otherwise specified, the term "bond" and the acronym "PAB" throughout this report refer specifically to tax-exempt private activity bonds that are subject to the federally mandated state ceiling (see next section).

2 Aa2 Moody's and AA S&P ratings. Source: HDC.

documents known as Official Statements. We interviewed officials from both HDC and HFA to understand their priorities and operations and provided them with the opportunity to give feedback on our initial data analysis. Interviews with developers and tax-exempt bond underwriters yielded further insight into the interplay between tax-exempt bond financing and other subsidies and incentives, in particular federal Low-Income Housing Tax Credits (LIHTC)[3] and the City's 421-a property tax abatements.

And finally, we hosted a series of meetings with participants of the study and CHPC board members involved in the study to further debate and discuss its findings and recommendations.

The 2005-2013 study period cuts across economic cycles, including the years leading up to the housing bust in 2008, the subsequent recession and the current recovery[4]. Our recommendations are consistent with today's economic conditions, characterized by the availability of financing at record-low interest rates. Therefore, the approach to allocating PABs should be flexible in order to adapt to changes in the financing environment.

3 LIHTC is referred to simply as "tax credits" throughout this report.

4 The study period also spans four gubernatorial administrations, including a party change in 2007. There was no change in the mayoral administration during this period.

UNDERSTANDING PRIVATE ACTIVITY BONDS

UNDERSTANDING PRIVATE ACTIVITY BONDS

The federal government subsidizes states and municipalities by allowing them to issue tax-exempt bonds. Investors buying these bonds are not required to pay federal income taxes on the interest they earn, so they are willing to accept lower returns. This allows states and municipalities to obtain financing at lower interest rates than if investors were taxed on the interest (see Table 1). In the words of the Congressional Budget Office, "the revenue forgone by the federal government effectively pays part of the borrowing costs of state and local governments"[5].

Table I. Taxable And Tax-Exempt Bond Interest Rates in 2013.

Corporate bonds (Moody's Aaa)	High-grade municipal bonds (Standard & Poors)	Yield spread
4.24%	3.96%	28bp

Source: 2014 Economic Report of the President, Table B-17.

Federal regulations also allow states and local governments to issue tax-exempt bonds on behalf of private entities serving a "qualified" purpose. Airports, student loans, manufacturing plants, mortgage programs for single-family homeownership and multifamily rental projects, among others, are considered qualified purposes that can benefit from tax-exempt private activity bond financing[6]. These bonds

5 Congressional Budget Office, Reducing the Deficit: Spending and Revenue Options, March 2011. For a detailed discussion on the amount of revenue forgone by the federal government, see Joint Committee on Taxation, The Federal Revenue Effects of Tax-Exempt and Direct-Pay Tax Credit Bond Provisions, July 16, 2012.

6 Congress has recently made proposals to reduce the tax benefits of PABs and to eliminate PABs altogether as part of a wider tax reform. Although none of these proposals have passed, there is the risk that future attempts at tax reform could affect PABs.

are secured by the revenue stream of the projects they finance, such as rental income in the case of a multifamily rental project.

For some of these qualified purposes, including for multifamily rental projects, the federal government places a cap on the volume –the total dollar amount– of tax-exempt bonds that can be issued in each state. This "volume cap" or bond ceiling[7] is set every year in proportion to each state's population (with a minimum amount for small population states). In 2014, the volume cap is $100 per resident, resulting in over $1.9bn of allowable annual bond issuance for New York State[8].

This bond ceiling is allocated among the state and local agencies that issue the bonds. If any portion of the ceiling remains unissued by the end of the year, that portion expires and becomes unavailable for issuance. However, unused bond volume can be carried over for up to three years as long as a valid purpose and an issuing agency have been specified, but it expires if after three years the bonds have not been issued. In New York State there is insufficient publicly available data to determine how much bond volume is carried forward from one year to the next or whether any portion of the State's volume cap or available carryforward expire.

7 The terms "volume cap" and "bond ceiling" are used interchangeably throughout this report.

8 Internal Revenue Bulletin 2013-47. Revenue Procedure 2013-35. November 18, 2013; and Internal Revenue Bulletin 2014-9. 2014 Calendar Year Resident Population Figures. February 24, 2014.

HOUSING VS. ECONOMIC DEVELOPMENT

HOUSING VS. ECONOMIC DEVELOPMENT

Policymakers deciding how to allocate PABs to state and local agencies must strike a balance between the needs for housing, economic development and other qualified purposes. Some localities will prioritize projects that create jobs and strengthen the tax base while others, including New York City, may find that addressing the lack of affordable housing is a more pressing need. This can lead policymakers to perceive housing and economic development objectives as tradeoffs that cannot be simultaneously accomplished. This view, however, undervalues the economic impact of housing development.

Housing Is Economic Development

It is a mistake to assume that housing development cannot be one of many tools in a city's economic development toolbox. Where the demand for housing is high, housing development creates short-term construction jobs, sustains long-term jobs in maintenance and property management, enables new household formation, builds the local tax base and ensures a sustained customer base for local businesses. These are all desirable outcomes by any measure of economic development.

The magnitude of these impacts will vary depending on factors such as building size and resident incomes, but in tight housing markets like New York City even medium-sized developments with low-income residents will have a positive effect on the economy. The National Association of Home Builders estimates that a typical new 100-unit LIHTC building creates 122 jobs on average during construction, a number on par with the jobs created in a new market-rate building of the same size[9]. This figure includes jobs created directly and indirectly

9 National Association of Home Builders, The Local Economic Impact of Typical Housing Tax Credit Developments, March 2010.

through construction activity, as well as jobs induced from the spending of construction-related income and taxes. The construction phase of this typical development also generates $827,000 on average to local jurisdictions from business taxes and sales taxes on construction materials, among other sources[10].

Where new construction improves blighted space, property values in the surrounding areas also tend to increase and generate additional property tax revenue for the municipality. One study found that under Mayor Koch's Ten Year Plan a City investment of $2.4bn in new construction and gut rehabilitation of 66,000 units yielded $2.8bn in additional property tax revenue over the following 20 years just from properties located within 2,000ft[11].

There is little doubt that housing development, including affordable housing, can have long-lasting beneficial economic effects. In places with high housing costs, the choice between housing and economic development is a false one.

Strings Attached

Undoubtedly there are many instances where a non-housing economic development project should be awarded a PAB allocation. But the reality is that PABs are not a particularly useful financing tool for non-housing economic development initiatives. Federal regulations impose many conditions to using PABs for economic development which generally render such projects impractical — particularly in high cost areas. For example, industrial development bonds are restricted to narrow definitions of farming or manufacturing activities and generally cannot exceed a face value of $1m (under certain conditions they can be increased to a maximum of $10m), which is why they are referred to

10 This includes impact fees, which New York City does not have. However, the high construction costs in the City are likely to generate sufficient sales tax revenue to compensate for the absence of impact fees.

11 Schwartz, Ellen et al. July 28, 2006. "The External Effects of Place-Based Subsidized Housing". Regional Science and Urban Economics 36(2006):679-707.

be as small issue bonds. This helps to explain why, in 2013, small issue bonds accounted for less than 4% of PAB issuances nationwide and less than 1% in New York State[12].

Financing housing development with PABs also comes with strings attached, the most relevant of which is the requirement to provide affordable units: either 20% of the units must be set aside for households earning up to 50% of AMI ($42,950 for a family of four in New York City) or 40% of the units must be set aside for households earning up to 60% of AMI ($51,540). Issuing housing PABs and meeting these income restrictions additionally makes the affordable units eligible for 4% tax credits (which are not a charge against the State's annual cap for the highly competitive 9% tax credits)[13]. The result is that the use of PABs for housing development leverages additional federal housing subsidies at no cost to state and local governments. No other use of PABs brings in additional federal subsidies.

Housing also receives the same interest rate savings from the tax-exempt nature of the bonds as non-housing purposes. As long as interest rates on conventional financing remain at record lows these savings will be minimal and the tax credits leveraged through housing will be more beneficial[14]. However, the interest rate savings of PABs will be crucial for housing if interest rates increase as expected.

12 Council of Development Finance Agencies, CDFA Annual Volume Cap Report. An analysis of 2013 Private Activity Bond & Volume Cap Trends, July 2014.

13 4% tax credits are available for any units that are set aside for households earning 60% of AMI or less, so units set aside under PAB financing requirements generally qualify for tax credits (recycled PABs, discussed later in this paper, do not qualify for 4% tax credits).

14 In 2012, interest rates on corporate bonds rated Aaa (Moody's) were the lowest since 1956 at 3.67%. In 2013, interest rate spreads between corporate and high-grade municipal bonds were the lowest since 1958 at 28bp. Source: 2014 Economic Report of the President, Table B-17.

PRIVATE ACTIVITY BONDS IN NEW YORK STATE

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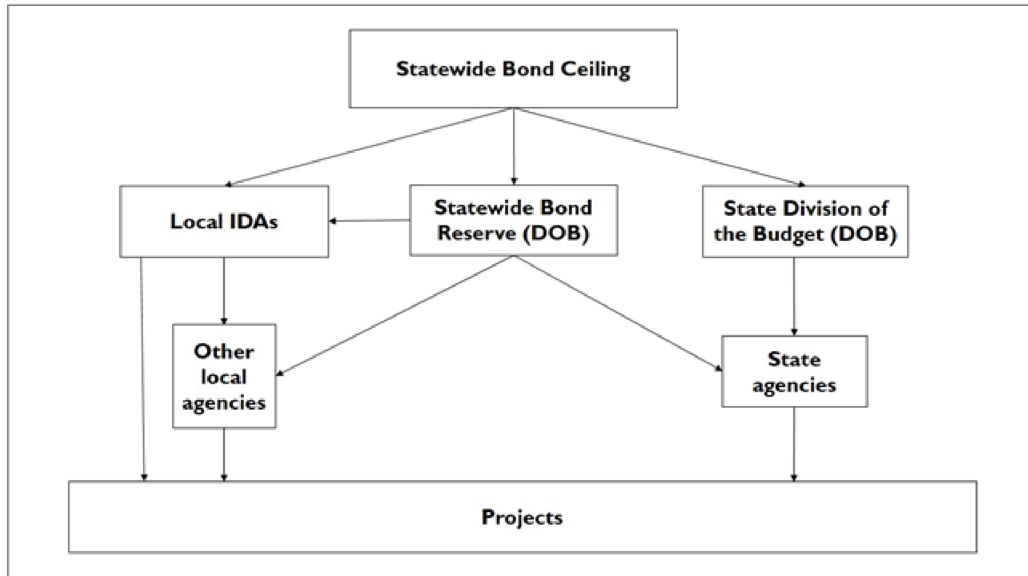
The Bond Allocation Process In New York State

Federal law provides that half of a state's bond ceiling will be allocated to the state and half to local agencies, in proportion to their share of the state population. It also gives states the authority to allocate their bond ceiling differently if they so choose, something which New York has chosen to do under legislation entitled the Private Activity Bond Allocation Act (PABA). Since the initial adoption of PABA it has contained a sunset provision requiring annual or bi-annual legislative action to reauthorize it, a process which unnecessarily casts uncertainty regarding how bond allocations will take place in the future.

Pursuant to PABA, one-third of the statewide bond ceiling is allocated to Industrial Development Agencies (IDAs) in proportion to their share of the State's population. Another one-third remains with the State Division of the Budget (DOB) for distribution to State agencies. The final one-third is held in a Statewide Bond Reserve and managed by DOB. Any bond allocations that the local IDAs have not used by October 15 are added to the Reserve, from which DOB makes additional allocations to state and local issuers as needed. PABA also allows agencies to make multi-year allocations for housing development projects, allowing them to commit allocations in future years for projects begun in the current year[15].

15 This multi-year provision of PABA is only available for housing development projects. Future allocations come out of the bond ceiling of the future year they are made for.

New York State Bond Allocation Flowchart



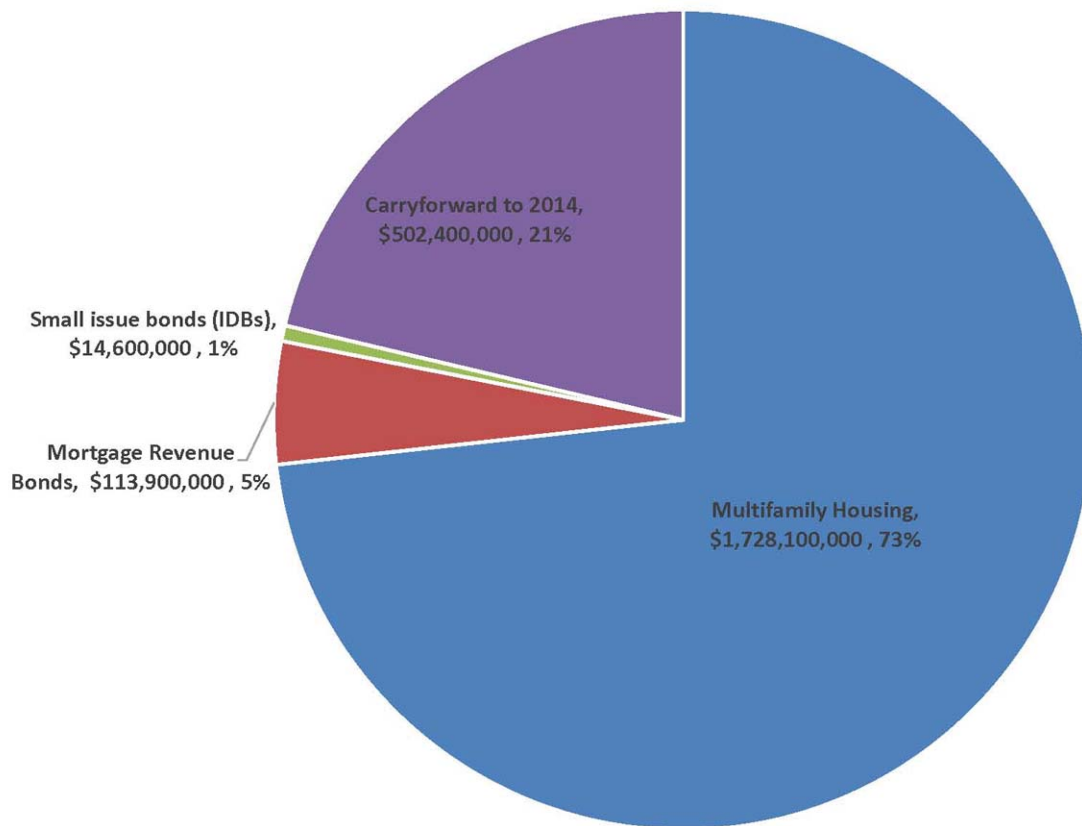
In New York State, there is no publicly accessible information tracking how bond allocations are used by the various issuing agencies. We do not know how much DOB initially allocates to each state issuing agency, nor how much is recaptured into the Reserve from IDAs that do not make full use of their allocations. We also do not know how distributions are made from the Reserve, nor whether any portion of the state ceiling is carried forward or expires because it is not used or committed before December 31. The best source of information on how bond allocations are used in New York is an annual survey by the Council of Development Finance Agencies (CDFA), but this relies on self-reported data by DOB which rarely includes detailed information.

In spite of the paucity of the data, we know that several state and local agencies have made use of PABs in recent years, including HFA, HDC and the Hudson Yards Infrastructure Corporation. Housing has been, by far, the largest use of PABs in the state. According to CDFA's report for 2013, one of the few years for which data is available, over $1.7bn

of the state's $2.3bn PAB capacity was issued for multifamily housing projects (see Chart 1)[16].

Chart 1

PAB Uses in New York State.



Source: Council of Development Finance Agencies, CDFA Annual Volume Cap Report. An analysis of 2013 Private Activity Bond & Volume Cap Trends, July 2014

For most of the past ten years, HFA and HDC have alternated as the largest single issuers of multifamily housing tax-exempt bonds in the

16 This represents 73% of the State's bond issuing capacity for the year (new allocation plus available carryforward from previous years), and 93% of total PAB volume issued.

country (Table 2).

Table 2. Top Five Issuers Of Multifamily Housing PABs, 2005-2011 (in millions of dollars).

Agency	2005	2006	2007	2008	2009	2010	2011
NYS HFA	1,044.8	569.4	**968.9**	705.9	**1,138.3**	768.9	**1,035.8**
NYS HDC	**1,314.4**	**1,113.8**	534.6	**911.2**	956.9	**798**	688.5
MASS HFA	130.5	181.2	166.9	62.2	158.6	480.1	198.2
CAL CDA	242.3	285.2	294	145.4	119.9	209.7	101.4
CAL HFA	217.6	76.9	56.8	149.7	61.0	170.8	130.6

Source: Council of Development Finance Agencies, CDFA 2011 National Volume Cap Report.

A Process That Creates Scarcity And Uncertain Timing

HFA receives its bond allocation from the State. HDC receives allocations from the City's Economic Development Corporation (EDC) as well as from the Statewide Bond Reserve[17]. In recent years EDC has ceded the bulk of its allocation – approximately $260m annually– to HDC for use on multifamily rental projects. HDC has also received annual bond allocations from the Statewide Bond Reserve which have ranged widely year to year, from approximately $330m to nearly $490m[18].

The transfer of bond allocation to HDC occurs in phases. At the beginning of the year the agency receives an initial allocation from EDC of approximately $180m and, sometimes, an early allocation from

17 Technically, HDC receives bond allocations from the New York City IDA, but this agency is set up within EDC.

18 Approximate figures obtained from interviews and estimates using HDC's database of bond issuances.

the Statewide Bond Reserve. Around October 15 (the deadline by which all uncommitted bond allocation throughout the state is added to the Statewide Bond Reserve), HDC negotiates additional allocations based on its scheduled pipeline of development projects and the availability of excess bond volume. These typically include the balance of EDC's unused allocation, as well as additional allocations from the Statewide Bond Reserve.

Inherent to this process is a degree of uncertainty over the exact bond allocation that will be available to HDC, creating difficulties for the agency in planning its pipeline of development projects. Although the agency has good working relationships with DOB and EDC and is usually able to negotiate additional bond allocations after the October 15 deadline, HDC cannot know with certainty whether this will be sufficient to finance its entire development pipeline until late in the year. This in turn creates a rush to close projects in the narrow time frame between October 15 and December 31. Any uncommitted bond allocation could compromise HDC's capacity to obtain additional allocations in future years. It should be noted that developers interviewed for this study indicated that HDC manages its pipeline effectively and does not convey uncertainty regarding the availability of financing. HDC, however, emphasized that having a predetermined allocation of PABs would greatly facilitate internal management and improve planning.

This process might seem justified if the demand for bond allocation were so great that it risked exceeding the state bond ceiling, but this simply does not appear to be the case. A review of IRS data collected from filings required for bond issuances reveals that between 2005 and 2011 the state bond ceiling was only exceeded twice. On at least one of those occasions, available carryforward was used but was not exhausted. According to the CDFA reports, in 2012 $1.2bn worth of bond volume was carried forward from 2009-2011, and in 2014 $502m

was carried forward from 2011-2013[19]. Although the inability to find financeable projects in the wake of the 2007-2009 recession may partially explain such large carryforwards, the sheer volume of unused bond issuing capacity also reveals shortcomings in the allocation process: some agencies may receive larger allocations than they can realistically issue, preventing others with greater issuing capacity from receiving the allocations they need in time to finance all their projects. HDC is greatly affected by this. Its issuing capacity is greater than its initial allocation yet it is made to wait until after October 15 to know whether its final allocation will be sufficient to finance the projects in its pipeline.

"Rules Of Engagement"

Although HFA issues housing bonds statewide, in New York City HFA and HDC overlap in their jurisdiction. To manage this the two agencies have an unofficial understanding regarding which types of development projects each will finance in the City - the so-called "rules of engagement" (see Table 3). These rules are fluid, having evolved as changing administrations redefined priorities and the relationships with one another.

Under the current arrangement, HFA uses PABs to refinance preservation projects in the State's Mitchell-Lama portfolio and to finance new construction and preservation projects in partnership with other State agencies (such as the Office of Mental Health). These development types include a majority of income-restricted units. In addition HFA finances new construction of 80/20 developments, which consume a majority of the agency's bond allocation and have 80% of the units at market rate and 20% restricted to households earning up to 50% of AMI (many HFA 80/20s in practice reserve a portion of these units for households earning up to 40% of AMI).

19 Council of Development Finance Agencies, CDFA 2011 National Volume Cap Report, July 2012; and CDFA Annual Volume Cap Report. An Analysis of 2013 Private Activity Bond & Volume Cap Trends, July 2014. No data is available on unused bond volume carried forward into 2013.

HDC primarily uses PABs to finance preservation and new construction projects where the majority of the units are income-restricted and which do not involve State agencies. Through a variety of programs, such as LAMP or New HOP, it defines the precise mix of income levels and makes available supplemental subsidies to ensure the projects are viable[20]. These subsidies include funds from the agency's corporate reserves as well as from the City's Department of Housing Preservation and Development (HPD), which has worked closely with HDC to develop these programs[21]. Additionally, in 2010 HDC financed the preservation of thousands of NYCHA units across 21 City- and State-sponsored developments that do not usually receive federal funding. This program, referred to as NYCHA Federalization, was made possible by provisions of the American Recovery and Reinvestment Act of 2009.

Table 3. Projects Financed Under The "Rules Of Engagement"

Agency	Characteristics	Majority of Units Are...	Project type
HFA	State Mitchell-Lama portfolio	Income-restricted	Preservation
	Partnerships with State agencies	Income-restricted	Preservation or new construction
	80/20	Market-rate	New construction
HDC	All other affordable projects	Income-restricted	Preservation or new construction

20 For detailed information on LAMP, New HOP and other programs see the term sheets available on HDC's website: www.nychdc.com.

21 The Commissioner of HPD is also the Chair of HDC.

These "rules of engagement" guide developers to the appropriate agency to obtain financing for their projects. Depending on the type of project, developers queue up to HDC or HFA with their requests for financing, establishing a pipeline that each agency manages according to the bond allocation it has available and its consideration of the project's merits. Since 2012, the two agencies have also coordinated the transfer of "recycled" bond allocation from HDC to HFA for use on 80/20 projects that do not seek tax credit equity. This joint recycling program was made possible by the 2008 Housing and Economic Recovery Act and has allowed the two agencies to finance more units of housing without requiring additional bond allocations[22].

However, the criteria for selecting which projects will receive financing is unclear and many interviewees expressed the opinion that having a better understanding of the agencies' priorities would help developers shape their proposals and become more competitive. Former HDC officials pointed out that term sheets describing the agency's requirements for each program are readily available.

Other interviewees indicated a belief that important affordable housing projects were unnecessarily delayed because the "rules of engagement" prevented developers from fully taking advantage of bond availability. In instances when HDC had fully committed its allocation, but HFA still had availability, the "rules of engagement" precluded the developers of affordable housing from "crossing the street" and applying for financing with HFA.

22 Recycled bonds do not count against the State's volume cap because, for federal tax purposes, they are treated as refunding bonds for a previous bond issue. As a result, HFA and HDC can use recycled PABs to increase the number of projects financed without requiring additional bond allocations. Unlike conventional PABs, recycled bonds do not leverage 4% tax credits. This makes recycled bonds preferable for projects that do not seek tax credit equity or as supplemental financing for projects where 50% of the cost is financed with conventional PABs (the threshold required to qualify for 4% tax credits).

Because there is no public reporting on the statewide allocations from DOB nor any public information about what applications are in the queue for HDC and HFA review, it is not possible to know with certainty how well the “rules of engagement” work and whether important affordable housing priorities are overlooked.

Looking Elsewhere: The Bond Allocation Process In California And Texas

California and Texas have the largest bond ceilings in the country, followed by New York. The California Debt Limit Allocation Committee (CDLAC) and the Texas Bond Review Board (BRB), respectively, govern the allocations of PABs in those states.

In both states it is established by law that housing shall be a priority for bond allocations and it is easy to obtain information regarding the portion of the state ceiling that has been allocated to this as well as other uses. In California, applications for bond allocations by state and local agencies are awarded competitively through a scoring system, while in Texas projects are prioritized based on affordability criteria that is spelled out in the law.

The bond allocation processes in California and Texas are highly transparent. CDLAC’s regulations, scoring criteria, meeting minutes, application materials and lists of tentative and final bond allocation decisions are easily accessible online. Similarly, the BRB publishes weekly statements of available bond volume statewide and a list of approved bond issues. While New York need not replicate any particular model, these states show that it is possible to state priorities more clearly and more transparently.

WHAT PRIVATE ACTIVITY BONDS HAVE BUILT IN NEW YORK CITY

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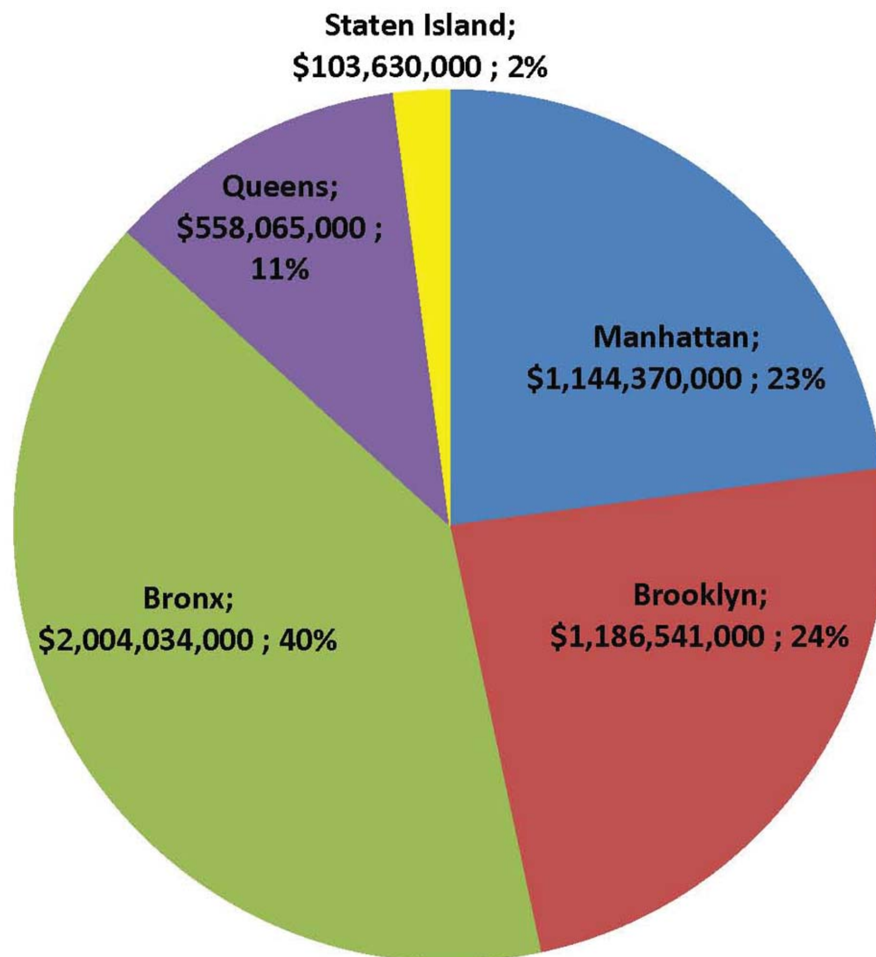
Between 2005 and 2013, HDC and HFA collectively issued over $11.5bn in new and recycled PABs to finance the preservation and new construction of 49,747 income-restricted units in New York City. Due to the one-time nature of the NYCHA Federalization program, the figures presented in this section do not include $449m issued by HDC under the program in 2010 to preserve 14,465 units of public housing.

HDC issued PABs totaling just under $5bn during our study period, including approximately $460m in recycled PABs, which financed the preservation and new construction of 37,394 income-restricted housing units and 2,088 market-rate units (see Charts 2 and 3). The income-restricted units are distributed across the five boroughs, with the breakdown of dollars per borough matching closely the number of units developed.

Chart 2

Dollar Amount of HDC Bonds Issued, 2005-2013

TOTAL: $4,996,640,000

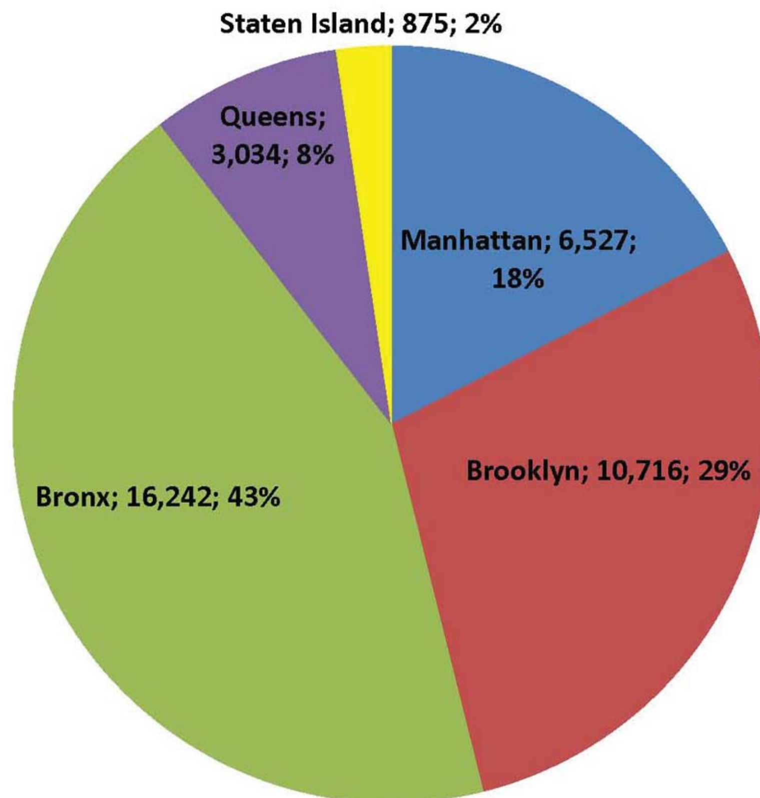


Source: HDC

Chart 3

Location of Income-restricted Units Financed by HDC, 2005-2013

TOTAL: 37,394



Source: HDC

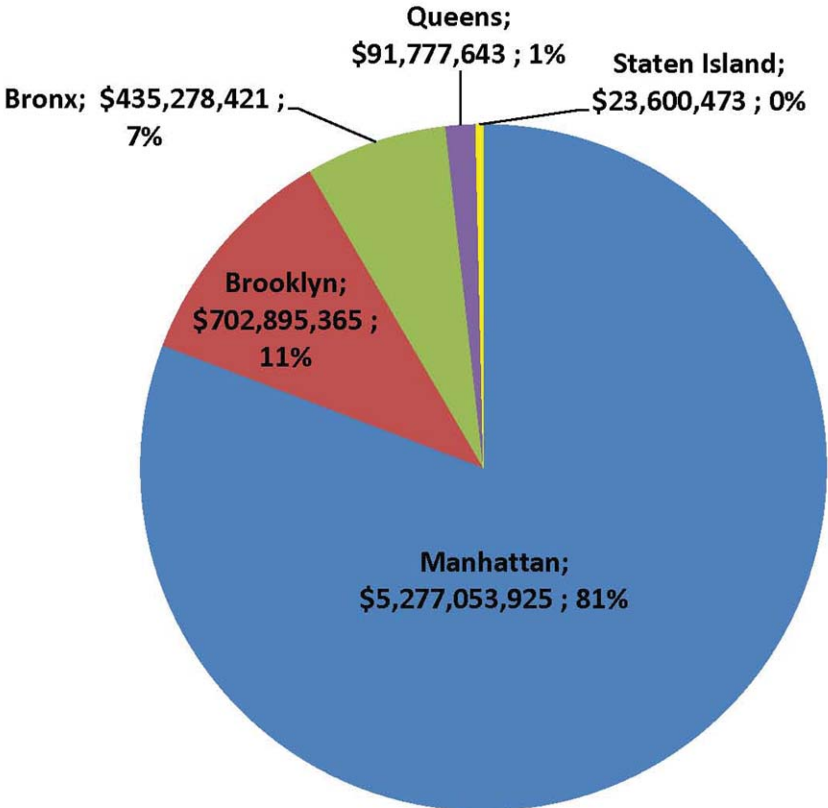
HFA issued $6.5bn in PABs over the study period, which financed the preservation and new construction of 12,353 income-restricted units and 10,538 market-rate units in New York City (see Charts 4

and 5)[23]. Although the income-restricted units are spread across the five boroughs, the share of PABs issued for projects in Manhattan is significantly larger than the share of units produced in the borough: 81% of its bond volume was issued for projects in Manhattan but this financed only 34% the agency's income-restricted units.

Chart 4

Dollar Amount of HFA Bonds Issued, 2005-2013

TOTAL: $6,530,605,827



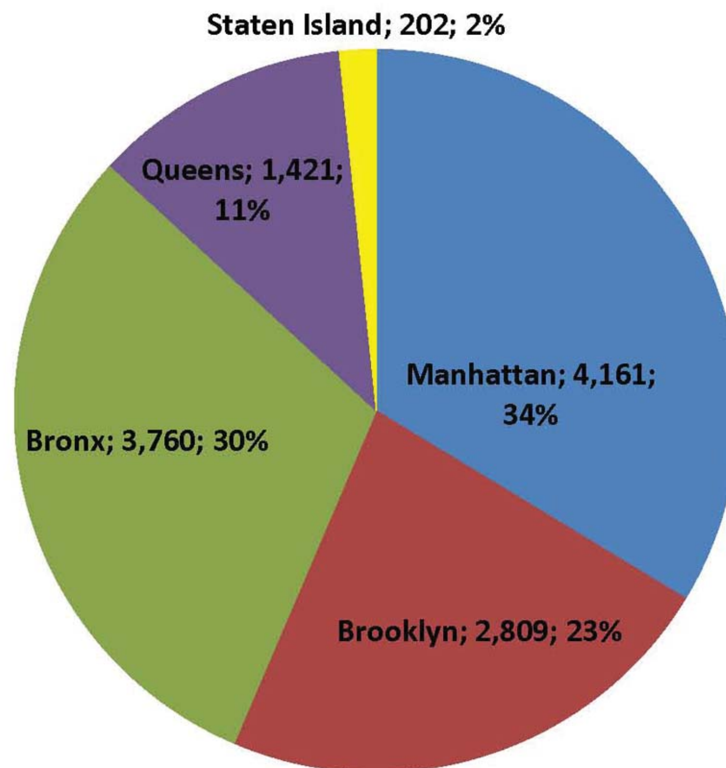
Source: HFA Official Statements

23 This figure includes new and recycled bonds (HFA's Official Statements do not distinguish the two) and represents only projects financed with PABs in New York City. HFA has financed additional units using other resources. HFA also issued an additional $1bn in PABs during our study period to finance the preservation and new construction of 12,157 income-restricted units and 501 market-rate units outside of New York City.

Chart 5

Location of Income-restricted Units Financed by HFA, 2005-2013

TOTAL: 12,353

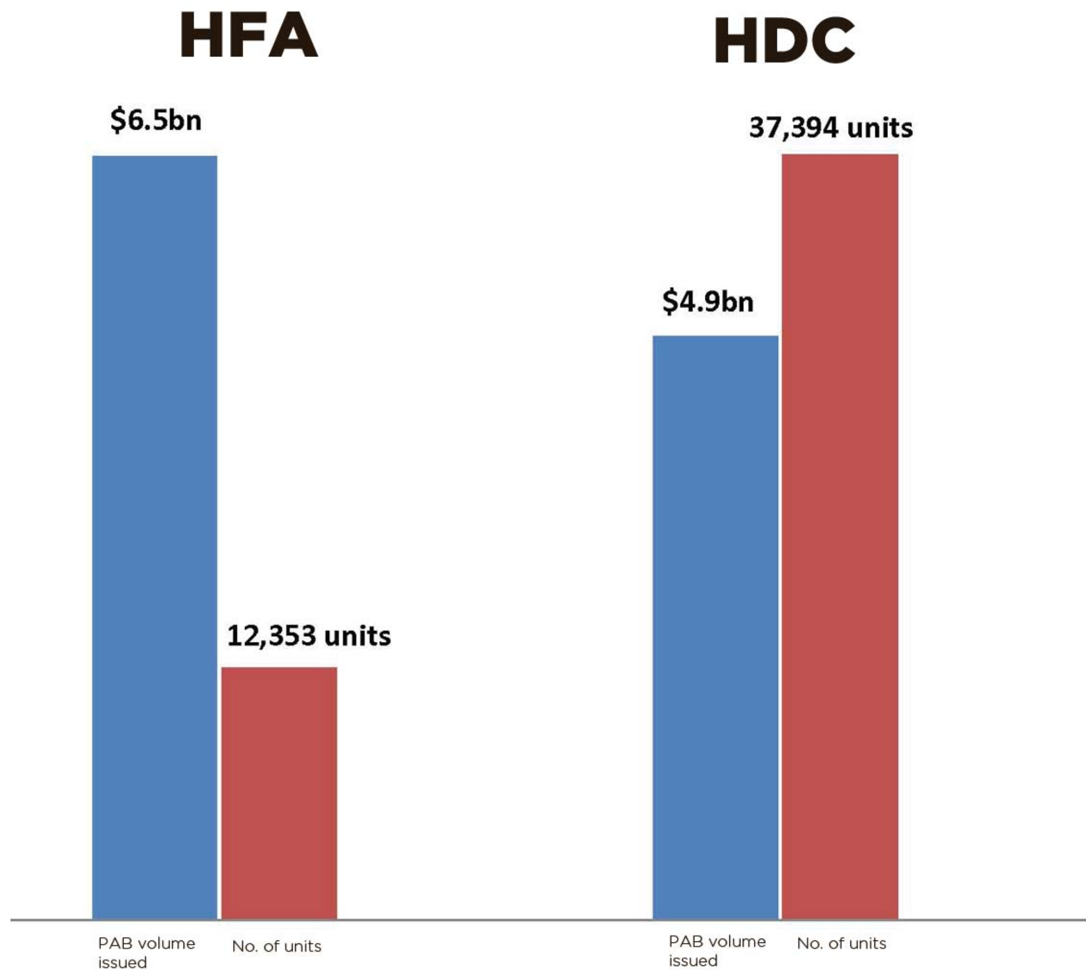


Source: HFA Official Statements

Comparing the two agencies, HFA used 31% more bond allocation than HDC for its projects in New York City but this financed 67% fewer income-restricted units (see Chart 6).

Chart 6

Total PAB Volume Issued and Income-restricted Units Financed in New York City, 2005-2013



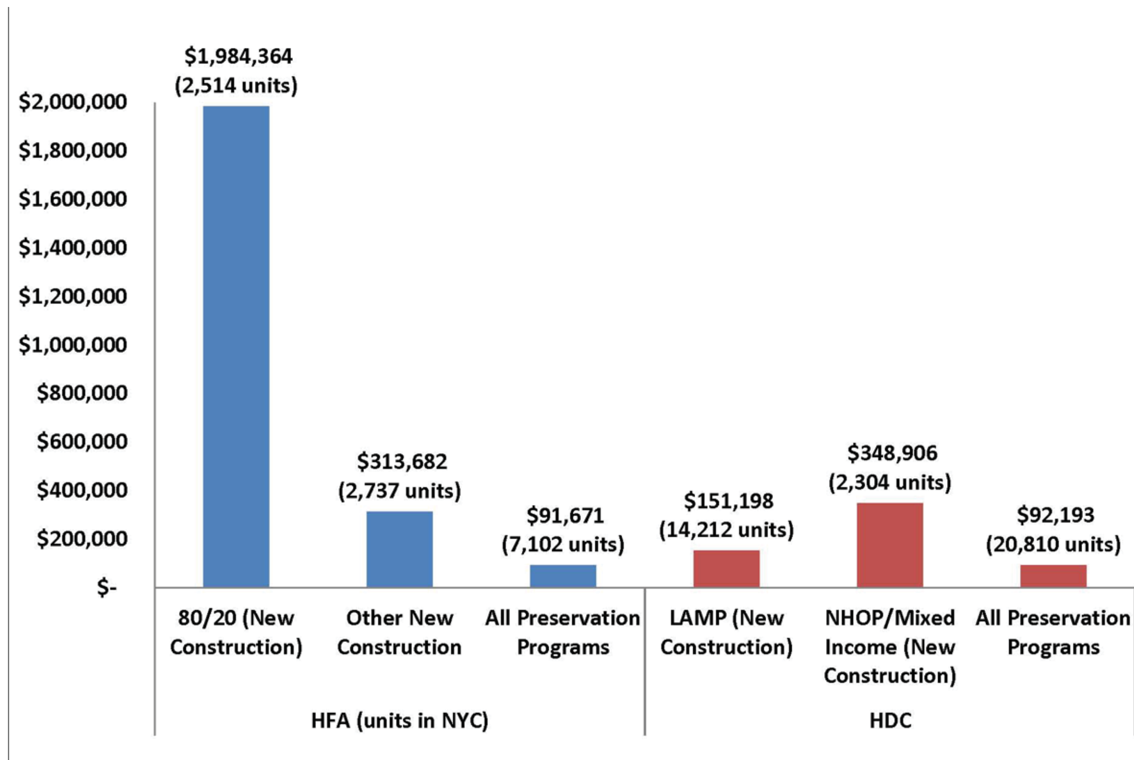
Source: HFA Official Statements and HDC

This imbalance is explained by the fact that HFA has dedicated most of its bond allocation to financing 80/20 developments, which required an average of $1.9m in PABs per income-restricted unit, compared to

$348,906 for the next highest new construction program (see Chart 7).

Chart 7

PAB per income-restricted unit for select programs, 2005-2013



Source: HFA Official Statements and HDC

The previous chart also shows that preservation programs require a much lower use of PABs per income-restricted unit than new construction programs, approximately $92,000 for both HFA and HDC. Both agencies also financed a greater number of preservation units than new construction units throughout the period of our study, despite issuing more bond volume for the new units.

A CLOSE LOOK AT 80/20 DEVELOPMENTS

A CLOSE LOOK AT 80/20 DEVELOPMENTS

The use of PABs per income-restricted unit in 80/20 developments is significantly greater in comparison to other programs. Looking at the "raw" numbers, it would be easy to jump to the conclusion that HFA uses its bond allocation less efficiently than HDC. The full picture, in fact, is far more balanced and nuanced.

There Are Limited Subsidies For Affordable Housing

The more units in a development that are set aside for incomes up to 60% of AMI, the more tax credit subsidy that can be leveraged. A building where all the units are reserved at this income level will leverage the greatest share of its total development costs in tax credits, which at current tax credit investment rates in New York City can represent between 30% and 35% of total development costs[24]. Additionally, these projects typically have lower land acquisition and construction costs than 80/20s, making the PAB cost per unit lower than in projects that are ineligible for tax credits.

In spite of this, affordable projects usually require supplemental subsidies from HDC, HPD, HFA or another governmental source, which there is a limited capacity to provide[25]. Prioritizing development that is eligible for tax credits may be the "smart" choice, but there should be an alternative course of action for PABs when the required supplemental subsidies are beyond the financial wherewithal of the subsidizing agencies. As long as there is a strong demand for market rate housing, a pipeline of 80/20s can ensure New York is able to commit its entire bond volume cap within the federally required time

24 Source: Interviews

25 HDC, for example, supplemented financing for projects receiving PABs with over $206m in taxable bonds and $716m in corporate reserves over the course of our study period. Many projects also received additional subsidies from other sources, such as the City's Department of Housing Preservation and Development.

period, preventing the loss of bond allocation and of the associated residential development and economic stimulus.

The income-restricted units in 80/20s can also obtain tax credits, although developers may not always seek the tax credits in order to retain more equity in the project. 80/20s also do not require supplemental subsidies from HDC or HFA because they can cross-subsidize the units that are below market with the rents from the market rate units. Because 80/20 projects are usually located in neighborhoods with high rents, these units often provide one of the few sources of newly built low-income housing. 80/20s are also usually large in size, which can produce a stronger economic impact than smaller income-restricted developments, including more jobs during construction and a stronger customer base and tax base due to the influx of new residents with relatively high purchasing power.

Bond allocation is a “use it or lose it” proposition. As long as bond issuances are made first to low-income projects for which supplemental subsidies are available, using the balance of the allocation to finance 80/20s is appropriate—one could even argue necessary—as long as there exists demand for such projects. The higher use of PABs per income-restricted unit in 80/20s is not negative as long as it does not detract resources from income-restricted housing.

Reaching Lower-Income Households

87% of the 49,747 income-restricted units financed by both agencies during our study period were set aside for households earning a maximum of 60% of AMI[26]. Units reserved for households above this threshold are not eligible for tax credits, so supplemental subsidies are required in order to keep rents below market rates. In units that are eligible for tax credits, lowering household incomes below 60%

26 Not including units set aside for lower-income maximums (such as 40% or 50% of AMI).

of AMI decreases the rent rolls, thereby also increasing the need for supplemental subsidies to make up the difference. As a result, developers of affordable housing often find themselves targeting projects to a "sweet spot" just under 60% of AMI, where rents can be maximized while still qualifying for tax credits[27].

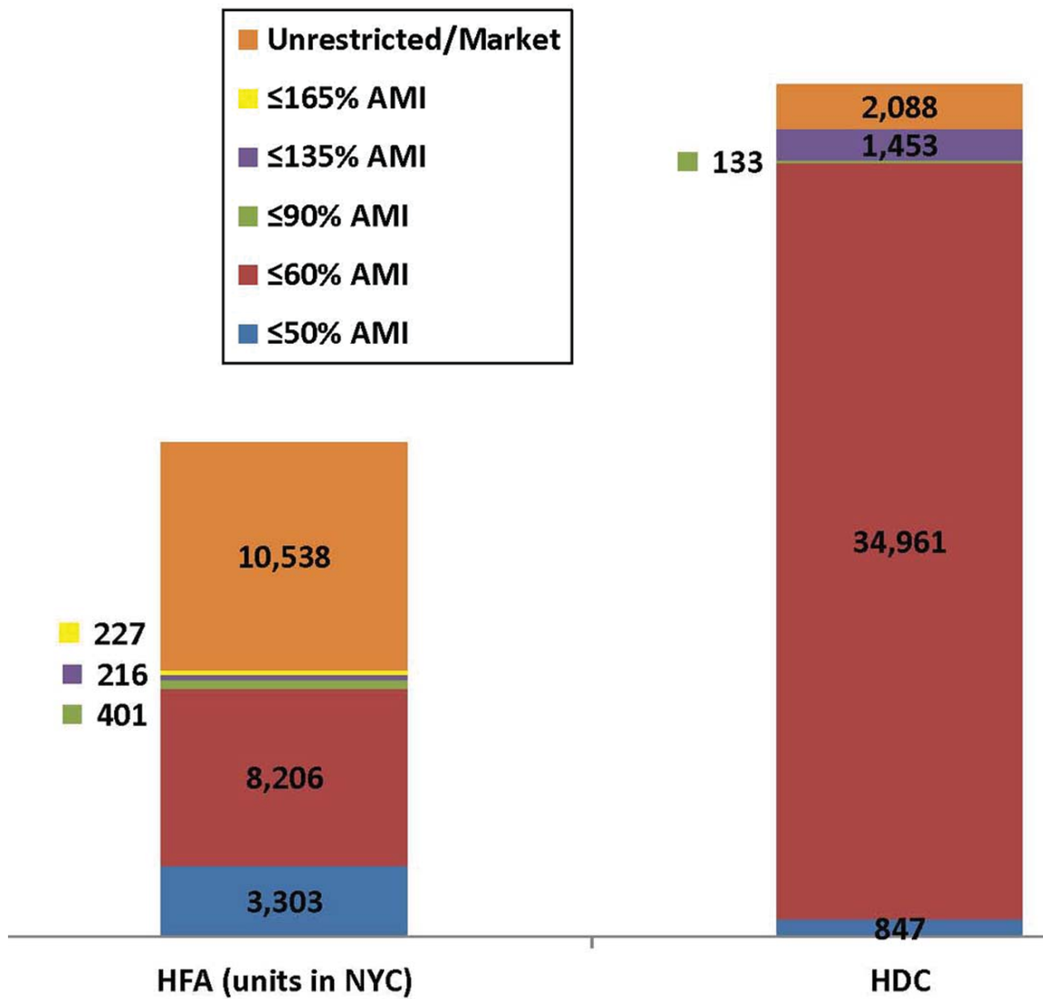
Federal law requires that projects receiving PAB financing set aside either 20% of the units for households earning up to 50% of AMI or 40% of the units for households earning up to 60% of AMI. While affordable projects usually target units at 60% of AMI, the ability of 80/20s to cross-subsidize the low-income units using the rents from the market-rate units enables them to reach lower-income households without requiring supplemental subsidies. This explains why nearly 27% of HFA's income-restricted units were set aside for households earning up to 50% of AMI[28] whereas HDC, which financed far fewer projects containing market-rate units, only set aside 2% of its income-restricted units at this income level. Chart 8 shows the number of units financed by each agency at selected income levels.

27 This is often in the 57%-60% of AMI range. Source: Interviews.

28 Including units set aside for lower-income maximums (such as 40% of AMI).

Chart 8

Affordability Levels of Units Financed in New York City 2005-2013



Source: HFA Official Statements and HDC

The 421-A Factor

Our interviews revealed that the 421-a property tax abatement program, rather than the availability of PAB financing, is the primary driver behind the development of 80/20s. Today's availability of conventional financing at record-low interest rates makes PAB financing less significant to a project's bottom line than the savings from the 421-a tax abatement. However, since the affordability requirements tied to bond financing are only slightly more restrictive than those already mandated under 421-a, developers of 80/20s generally take advantage of PAB financing anyway –especially if they are seeking tax credit equity from the affordable units[29].

The result is that today bond financing is used for 80/20 developments that would be developed without PABs under the 421-a tax abatement program. When interest rates on conventional financing rise PABs could become a greater driver of development and demand for bond financing for 80/20s could increase. There should be clear priorities in place to determine the appropriate amounts of PAB financing that should go to 80/20s and to projects with more affordable units, no matter the economic environment.

Recent Changes In 80/20 Financing

After meeting with CHPC to review the preliminary findings of this study, HFA announced a significant policy change in the financing structure of 80/20 developments. Beginning in 2014, HFA will use PABs solely on the low-income component of 80/20 projects, with the remaining market-rate units being financed with conventional lending. In other words, HFA will only finance 20% of total development costs

29 The 421-a tax abatement program requires that 20% of the units are set aside for households earning up to 60% of AMI. As a result, complying with the more restrictive PAB financing requirements also satisfies the 421-a requirement so a project can benefit from both programs by providing the affordable units required for PAB financing.

using PABs.

This policy change should reduce the volume of PABs per income-restricted unit in 80/20s from an average of $1.9m to $396,872[30] and free up over $440m in PABs per year for additional projects[31]. Whether this increase in bond availability can be used to finance a greater number of fully affordable projects will depend on how it is allocated and on the capacity to provide the supplemental subsidies that these projects usually require.

HDC has built up corporate reserves through bond issuance fees, investments, securitization and interest rate spreads between borrowing and lending costs in order to make these subsidies available over the long term. These efforts are sufficient to provide the necessary supplemental subsidies for the projects currently financed with HDC's bond allocation, but any significant increase in PAB financing for affordable projects would require finding new sources of subsidy.

HFA and HDC could re-examine the "rules of engagement" so that more affordable projects are placed under the purview of HFA, but this would also require HFA to make available more subsidy. In addition, a rise in interest rates on conventional financing could cause HFA to have to increase the share of 80/20 development costs it finances using PABs, which would reduce the amount of bond allocation that the recent policy change freed up. It becomes apparent, however, that HFA and HDC's "rules of engagement" should be aimed at making the best use of their bond allocations and that they should evolve to respond to changing circumstances.

30 $1,984,363 was the average bond allocation per affordable unit in HFA's 80/20 developments prior to the policy change (see Chart 7). $396,872 is 20% of that amount.

31 Estimate based on 80% of the average annual volume of PABs issued by HFA for 80/20 developments over our study period.

KEY FINDINGS AND RECOMMENDATIONS

KEY FINDINGS AND RECOMMENDATIONS

Our analysis has led us to three key findings and recommendations to improve the use of PABs in New York State. These recommendations would reform the bond allocation process to facilitate financing of necessary housing projects in New York City while ensuring resources are available for viable economic development projects throughout the State.

1. The PAB allocation process does not prioritize housing

Federal regulations make it easier to use PABs for housing than for economic development projects. However, the bond allocation process in New York State does not reflect this reality and allocates one-third of the state's bond ceiling to local IDAs that are less likely to use their allocations than housing agencies. This makes the availability and the timing of bond allocations to HFA and HDC less certain. It also increases the probability of bond volume carryforwards or expirations and the corresponding loss of tax credit equity that would be leveraged if the allocations were used for housing.

Recommendations:

- Reform State legislation to make housing the priority in the bond allocation process in order to guarantee that housing agencies have sufficient allocations to effectively manage their project pipelines.

- If legislation cannot be enacted, the Division of the Budget can accomplish this objective in large part by increasing allocations to housing agencies from the Statewide Bond Reserve at the beginning of the year.

2. A lack of transparency makes it difficult to know how each agency uses PABs

There is no publicly accessible data on how much bond allocation each State and local issuing agency receives, for which purposes it is used and whether any portion of the state ceiling is carried forward or expires. Making this information transparent would help policymakers determine the appropriate amounts of volume cap that should be allocated to different agencies and for which purposes.

Recommendation:

- The State Division of the Budget should report annually which agencies have received bond allocations, how they have been used and whether any volume cap has been carried forward or expired.

3. The “Rules of Engagement” between HDC & HFA do not ensure a joint strategy to advance New York City’s housing needs.

The “rules of engagement” between HDC and HFA do not respond to a joint assessment of the housing needs of New York City. Instead, they assign different types of projects to each agency without clearly prioritizing volume cap allocations for the projects deemed most important, such as those that leverage the most resources for low-income housing. As a result, developers often do not know where they stand in each agency’s pipeline nor how they could improve their proposals to become more competitive.

Developments that are fully affordable at the tax credit level can leverage 30%-35% of total development costs through tax credits,

a higher percentage than can be leveraged in projects that contain market-rate units. PAB allocations should prioritize these low-income projects, but the limited availability of necessary supplemental subsidies means some bond volume remains available for projects containing market-rate units (HFA's recent change in the financing structure of 80/20s will free up further bond resources). These projects not only provide additional housing (including some low-income units), but often also have a strong economic development impact. After supplemental subsidies for low-income projects are exhausted, any remaining bond allocations should be used to meet the demand for other types of housing in order to prevent any bond volume expirations.

Recommendations:

- HDC and HFA should develop a coordinated strategy for using PABs to target identified priority housing needs.

- This strategy should prioritize affordable housing developments where tax credits represent the greatest share of total development costs, while continuing to fund 80/20s and other projects to ensure that no bond volume is left to expire.

- These priorities should be clearly publicized, along with the pipeline of development projects, in order to increase developers' understanding of the process and to manage expectations that they will receive PAB financing.

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QUESTIONS FOR FURTHER STUDY

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This report has proposed ways to enhance the use of PABs in New York City given today's market conditions and housing needs. Our recommendations are premised on the current economic environment and may need to change as markets fluctuate and housing needs evolve. In this section we pose three questions raised during our research which we did not attempt to answer, feeling that each could be worthy of its own study.

1. How will rising interest rates affect the demand for PABs?

Many practitioners in our interviews stressed that, in the current low interest rate environment, savings from PABs relative to conventional financing are minimal. Instead, the 421-a tax abatement program provides much more significant savings and constitutes the primary driver of 80/20 development in New York City. In cases where 421-a would have sufficed to move an 80/20 development forward, it is questionable whether also providing PAB financing is a good use of resources since the gains from doing so (reducing the incomes levels in the affordable units from 60% to 50% of AMI) are minimal.

It is widely expected that today's low interest rates will begin to rise in the not-so-distant future, which will increase the interest rate spread between tax-exempt bonds and conventional lending. This will increase the significance of PABs in the financing structure of residential developments and is likely to drive up the demand for PAB financing. As the availability of PABs makes or breaks more deals, it will become more pressing to have clear priorities for what types of projects HDC and HFA should prioritize.

2. Should HDC programs target lower income households?

In order to stretch its financial resources, HDC has typically limited its underwriting of affordable units to rents that target households just under 60% of AMI. This ensures the most efficient use of its corporate subsidies: units affordable to households with incomes above 60% of AMI would require supplemental subsidies to make up for the absence of tax credits, whereas units well under that level would require more subsidies in addition to tax credits and existing subsidies in order to compensate for lower rents. The result, however, is that households that are under or over the targeted incomes are largely shut out of the market for this type of housing.

HDC has other programs that target households with higher and lower incomes which were not the subject of this study. The administration has made low-income housing one of its priorities and should analyze whether, overall, these programs are sufficiently diverse to meet the needs of low-income households.

3. Should projects be eligible for PAB financing in areas where mandatory inclusionary zoning is adopted?

The administration has proposed mandating affordable housing in areas rezoned for greater density as part of an inclusionary zoning requirement. If the affordability requirements in this policy are equally or more restrictive than the requirements for PAB financing, HFA and HDC will have to evaluate whether to continue making PABs available for projects in these areas. PABs could become a necessary tool for meeting inclusionary zoning mandates if interest rates rise, but if they remain low it is possible that more affordable units could be created if PABs are issued for projects in non-inclusionary parts of the city.

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