Policy Changes in the Qualified Allocation Plan for Higher Production of Units

Arizona Department of Housing

Special Achievement

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2019 NCSHA Awards Nomination - Special Achievement Category

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In 2017 the National Low Income Housing Coalition published a report in which Arizona was cited as having among the fourth lowest availability of affordable housing per low-income renter in the nation. In response to this report, the Arizona Department of Housing (Department) conducted an analysis of its Qualified Allocation Plan (QAP) to determine whether the policies and standards it contained were truly responsive to the housing need. Massive construction of market rate and luxury apartments was underway, rents were soaring and the construction of affordable housing was not occurring except through the Low Income Housing Tax Credit Program (LIHTC), which was relied upon more and more to house the homeless and disabled, rehabilitate public housing, solve tribal housing needs, and conduct historic preservation. At the end of the process, which included six public meetings with stakeholders, government entities, non-profits and tribal representative, many long-standing scoring preferences and underwriting standards were updated with provisions designed to ensure that limited tax credits were being used in the most cost effective way possible.

Making substantial changes to the QAP was challenging. Developers align project concepts with QAP provisions sometimes months or years in advance relying on year-to-year consistency in scoring to develop new project proposals. As it turned out, however, most in the development community understood the need for innovation in LIHTC policy that would "move the needle" in favor of higher production. In Arizona's case, the following point scoring criteria was determined to be non-responsive to the housing need: 1) provision of tenant services and community space; 2) proximity to light rail; 3) expensive energy standards, and 4) historic preservation. These were replace with cost effective new policies that achieved the following: 1) higher ratios of residential floor space; 2) lower costs per unit; 3) energy efficient housing at no additional cost; and 4) optimized availability of sites in proximity to services.

In 2011, in the midst of the recession, many low-income families in the State required the extra assistance of services such as childcare, after school programs, job training, financial literacy and case management. In order to be competitive developers were compelled to provide these services which were financed with project cash flow. By 2016 the job market had recovered but rents had soared and the shortage of affordable housing had increased. Services were draining projects of cash flow, reducing the ability to maximize the primary mortgage and increasing the amount of tax credits required per project. Further, these services required community and office space which supplanted residential square footage. In response, the Department ended point scoring for tenant services as well as the use of project cash flow to fund them. Certain permanent supportive housing was still allowed to use cash flow to fund services, however, the Department provided point incentives for projects that leveraged behavioral health or other outside funding sources to fill the need.

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To ensure the maximization of residential floor space the Department created a new point category for projects that achieve a 60% or better residential floor area efficiency. Project efficiency points reduced the feasibility of historic renovation of any building whose original design was not conducive to adaptation to high density residential. The Department supports historic preservation and recognizes the importance of preserving community assets that reflect our collective identity so long as the project itself achieves at least 60% or better residential floor area efficiency.

Prior to 2018, the QAP provided equal favor to both rehabilitation and new construction projects. Over the last year, however, there has been a resurgence in demand for 4%/bond financed rehabilitation proposals, in effect greatly increasing affordable housing rehabilitation activity. The Department recognized this change in the market as an opportunity to affect an increase in new construction activity. The department added points in the QAP for new construction effectively separating the funding sources by activity type with the 9% LIHTC used for new construction and the 4%/Bond transactions accomplishing the rehabilitation activity. The Department made gap financing available to 4%/bond projects to ensure its efficacy as a rehabilitation tool.

The Phoenix Light Rail was completed in 2005 and the Department began incentivizing half-mile proximity to it in 2008. As a result 42 projects got built in proximity to the Phoenix light rail by 2016. However, also by 2016, land prices in along the light rail had soared and it was questionable whether more points should be allowed for light rail coverage than to bus coverage, especially given that the geographic coverage of bus transit was vastly greater. In 2017, bus and light rail points were given equal measure. Lower land prices for sites outside of the light rail corridors deceased total development costs overall and increased site selection options enhancing the ability to locate projects in proximity to good schools, grocery stores and health facilities. Achieving "Service Enriched Locations" in this manner has been a point scoring priority for which Department for since 2011 and remained so in 2018.

The Department began incentivizing sustainability in 2006 when points were provided for water conservation. Sustainability goals increased steadily until 2017 when ADOH was incentivizing, through points, LEED for Homes Gold Certification (LEED v4), Energy Star and a full range of other measures including alternative energy, local materials, energy conservation, healthy homes and recycling. Between 2006 and 2017 local governments had vastly increased energy standards in local building codes with many using the International Energy Conservation Code as a minimum standard. This evolution in energy efficiency codes was yielding energy efficient units without the costly point incentives offered by the Department. The Department replaced energy points with an energy "threshold." All new construction are now required to achieve a weighted average HERS Index of 65, a standard largely on par with new local energy codes.

To complement the changes above, the Department made the following changes to underwriting criteria in the 2018 QAP: 1) increased the maximum tax credit allocation from $1.750 to $2 million to foster larger projects which yielded more units per project and better economies of scale for increased financial liability; 2) placed a cap on basis for Total Development Cost using a per bedroom maximum thereby allowing more projects to be funded; and 3) requiring that equity payouts resulting from related party acquisitions to be included in the capital stack of the new project as seller carry-back loans. This "win-win" scenario benefited the new project while still allowing the payment of equity over time through the cash flow generated by the new project.

While it may take a few years to determine the effect these changes will have, preliminary results from the 2018 round certainly support a positive outcome as follows: 1) 9% more units were awarded; 2) Total Development Cost per unit decreased 8.1%; and 3) Tax Credits per unit decreased 7.1%.

Summary of Changes

2018 Low-Income Housing Tax Credit Qualified Allocation Plan

1. The maximum tax credit reservation increased from $1.750 to $2 million to foster larger projects.

2. Added Building Efficiency scoring criteria.

3. Eliminated points for developers to offer "on-site tenant services".

4. A threshold for energy efficiency requirements was set, rather than incentivizing costly sustainable features (e.g. LEED Certified properties.

5. Prevent developers from taking equity from related party ownership transfers, requiring the equity to be provided as source in the development budget and paid back through seller carry back financing paid with cash flow.

Example of excessive use of space

Example of proper use of space