

Tier 2 Initiative

Hawai'i Housing Finance and Development Corporation

Rental Housing: Encouraging New Construction

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The Tier 2 Initiative

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Department of Business, Economic Development & Tourism

State of Hawai'i



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Background and Need

Hawai'i has been experiencing a “brain drain” over the last few years. Many of the state’s brightest minds are opting to move away in search of affordable locations that can provide them with more comfortable lifestyles and better opportunities. This has resulted in a reduction of the labor pool and hindered economic growth in the State of Hawai'i (State).

The U.S. Census Bureau estimates that in 2022, approximately 67,257 residents left Hawai'i (DBEDT, 2022), with outmigration surpassing in-migration for the seventh straight year. The economic impact has been hard with about \$130 million in tax revenues lost.

The mission of the Hawai'i Housing Finance and Development Corporation (HHFDC), the State’s housing finance agency, is to increase and preserve the supply of workforce and affordable housing. Since its inception in 2006, HHFDC has facilitated the development of 14,268 affordable and workforce units statewide. Of those, 10,907 units have received low-interest loans from HHFDC’s Rental Housing Revolving Fund.

More than 4,800 affordable housing units have been funded by the agency since 2021, primarily through the Low-Income Housing Tax Credit (LIHTC) program that is reserved for projects that target those households earning between 30% of the Area Median Income (AMI) and 120% AMI. Existing housing finance programs offered by HHFDC often favor projects that target the lower end of that spectrum between 30% AMI and 60% AMI, not the “Tier 2” category consisting of those households earning between 60% AMI and 100% AMI. To help alleviate the brain drain problem, the 2022 Hawai'i State Legislature sought to encourage affordable housing developers to address the needs of these Tier 2 households.

The Legislature appropriated up to \$150 million from the State’s Rental Housing Revolving Fund (RHRF) for the development of mixed-income rental projects that target households earning at or above 60% AMI and at or below 100% AMI. With this legislative mandate and cash infusion, HHFDC’s Finance Division created the Tier 2 Initiative, or T2I. The program was launched in October 2022 and was fully awarded by November 2022.

Historical Success of Rental Housing Revolving Fund and Inception of Tier 2 Initiative

Historically, RHRF provides “Equity Gap” low-interest loans to qualified owners and developers that construct affordable housing units. Funds may be used for the development, construction, acquisition, preservation, and substantial rehabilitation of rental housing units. Funding for RHRF comes from various sources, including appropriations made by the Legislature, a share of the State’s conveyance tax that is assessed on all real estate transactions, and other income, such as private contributions, repayment of loans, and interest.

An average of six to seven projects are awarded annually through RHRF, with awards averaging \$25 million and 120 units. The average project utilizes \$165,000 of RHRF funding per unit with approximately \$68 million in total development costs.

Although statute allows RHRF to assist in the construction of projects that target residents earning up to 140% AMI, the statute also requires that priority be given to lower income households and consequently over 80% of the funds have historically been allocated to LIHTC affordable projects serving residents at or below 60% AMI. A significant number of the thousands of residents who have left Hawai'i are households above 60% AMI who are in need of housing. RHRF is the funding mechanism that can provide low-cost gap funding to make developing housing for this group feasible.





Through the years, the RHRF has funded over 95 affordable housing projects generating over 6,200 affordable units. The project-friendly financial terms have consistently proven invaluable in providing the missing gap financing to make projects feasible. The fund is a critical component of the financing stack that enables new construction for affordable housing. As the Legislature provides infusions to RHRF, the demand consistently exceeds capacity.

However, the need for affordable rental housing for residents who do not qualify for LIHTC projects (above 60% AMI) but are far from being able to afford market rents or purchase a home, has steadily grown during this same period. Census data reveals that Hawai'i comprises an average of 41.2% renter-occupied households versus a national average of 36.9% (*US Census, 2020*).

How the Tier 2 Initiative Works

By definition and by statute, priority for RHRF funds is given to projects utilizing LIHTC. HHFDC receives an average of 25 applications annually for RHRF loans. Due to the statutory requirements and, most importantly, the State's emphasis on creating housing for the lowest possible AMI categories, nearly all applications for RHRF are in conjunction with LIHTC and for new construction. As such, the RHRF program has been immensely successful in aiding projects geared at renters earning 60% AMI or less. But because the program prioritizes lower AMI projects, it has largely overlooked non-LIHTC eligible households earning between 60% AMI and 100% AMI. See Attachment 2.

In 2021, the Hawai'i State Legislature appropriated \$150 million for the Tier 2 Initiative. With the \$150 million in available funding and the mandate to help Tier 2 households, HHFDC staff moved quickly to establish an offshoot of the traditional RHRF Program.

The Tier 2 Initiative is groundbreaking in that it:

- Targets projects aimed at households earning between 60%-100% of AMI.
- Provides favorable interest rates and loan terms that cannot be found in the commercial market.
- Reduces the debt service stress to assist with project sustainability.
- Allows the RHRF program to move toward self-sustainability by revolving funds more quickly, reducing the annual need for legislative appropriations and tax revenue.
- Allows flexibility with senior financing to take advantage of the most favorable model at the time of development.
- Allows a project to take advantage of Recycled Private Activity bonds to provide low-cost senior financing to make mixed-income or workforce projects feasible.

The creation of the Tier 2 Initiative enabled the traditional RHRF program to expand its reach to an often-underserved target group of rental households. While traditionally, only a segment of the eligible AMI households (i.e. 60% AMI and below) received the majority of funding, the Tier II Initiative expanded the benefits of RHRF to a broader workforce group.

Following Hawai'i Governor Josh Green's signing of Act 236 in July 2022, a series of meetings with stakeholders was held to discuss the fund's availability and required uses for the newly allocated RHRF funding. Within the requirements of the legislation and based on feedback from stakeholder meetings, the RHRF Tier II Program was developed. See Attachment 4. The Notice of Funds Availability (NOFA) was posted on August 15, 2022, with applications due to HHFDC on September 16, 2022. See Attachment 5.



HHFDC's typical application lead time, from publication of the NOFA to the due date, is three months. However, for RHRF Tier II, the application period was reduced to one month. The urgency was created to 1) allow ample time for staff to review and recommend awards before the one-year legislative funds lapse date, and 2) to avoid this special funding running into the following calendar year, when the State of Hawai'i's private activity bond allocation would be received. Despite this abbreviated schedule, HHFDC still emphasized the priority of project readiness to proceed, as well as feasibility.

The new Tier 2 Initiative was developed within existing program parameters using existing resources. Aside from additional staff time, no added costs were incurred by HHFDC to implement and administer the program. In fact, an issue to be addressed by the program was to accelerate the revolving of RHRF funds to save State money, which is exactly what the Tier 2 Initiative did.

Results

Despite the dramatic reduction in lead-time for applications, the demand for Tier 2 funding was tremendous. HHFDC received eleven (11) applications for a total of 1,405 units. The total request for funds was \$331 million, more than twice the \$150 million available. The average total development cost was \$67.8 million, with an average of 129 units per project and \$575,592 per unit.

Since the RHRF typically provides gap financing, projects were free to explore alternative sources of senior financing for the projects. Applications varied in this regard with 501(c)3 bonds, HUD loans, and conventional financing all being proposed.

After assessment of all applications, four (4) projects were awarded Tier 2 funding totaling \$142.3 million in November 2022. See Attachment 3. While the development environment experienced an unprecedented rise in interest rates, construction costs, and labor shortages in the year that followed, two of these projects are on target to complete their financial closing and groundbreaking in 2024.

In addition to creating much-needed opportunities for Hawai'i's residents, the Tier 2 Initiative also addressed other concerns plaguing the State and the RHRF program. It identified an under-served segment of the affordable housing market for the State to provide solutions for and established a program that can be administered annually based on funds availability.

Based on the success of this initial round, we are confident that the program will be funded again. Developers have repeatedly asked HHFDC for funding status and lobbied the Legislature for support of the program. While the RHRF program is a tremendously unique solution to gap financing, the Tier 2 Initiative is a further innovation that will make a positive change in the availability of affordable housing for low- and moderate-income families earning between 60% and 100% AMI.



Attachments

Attachment 1: How the Tier 2 Initiative is Different

General RHRF Tier 2 Loan Terms (major variations from Tier 1 highlighted in yellow):

	Tier 1	Tier 2
Loan Term	Length of Affordability Period (55-65 years, approximately 90% repaid during term with balloon at maturity)	Length of Affordability Period (55 – 65 years, repayment in full forecasted average 35 – 40 years)
Interest Rate	Years 1 – 2 (Construction) 0.00 After Year 2 (Permanent) 0.25%	Years 1-3 (Construction): 0.00 After Year 3 (Permanent): 3.00%
Origination Fee	0.5% of Loan Amount	0.5% of Loan Amount
Term/Maturity	2 Years (Interim/Construction) <u>52-62 Years (Permanent)</u> 55-65 Years (Matches Affordability Commitment)	3 Years (Interim/Construction) <u>52-62 Years (Permanent)</u> 55-65 Years (Matches Affordability Commitment)
Repayment	Years 1-2: No Payments After Year 3: 50 - 75% of available cash flow after payment of expenses, senior debt service and other recognized expenses.	Years 1-3: No Payments After Year 3: 75% of available cash flow after payment of expenses, senior debt service and other recognized expenses.
Collateral	Junior Lien on Project Site	Junior Lien on Project Site
Additional Security	Recorded Declaration of Land Use Restrictive Covenants to encumber the fee-simple project land with the approved affordability commitment.	Recorded Declaration of Land Use Restrictive Covenants to encumber the fee-simple project land with the approved affordability commitment.

Attachment 2: Traditional Rental Housing Revolving Fund Program

While available RHRF funds were entirely awarded during HHFDC's annual funding rounds, the vast majority of awardees were 100% affordable unit projects with AMI set-asides at 60% and below. HHFDC's data shows the production in its financed units by AMI since 2007:

Percent of Area Median Income	Total Rental Units	Pct of Total	
30	1,019	5.1%	82.2%
40	379	1.9%	
50	3,692	18.4%	
55	44	0.2%	
60	11,346	56.6%	
70	0	0.0%	17.8%
80	1,000	5.0%	
90	0	0.0%	
100	1,506	7.5%	
110	5	0.0%	
120	352	1.8%	
130	0	0.0%	
140	717	3.6%	



Hale Kalele, all 80% AMI and below, used LIHTC and traditional RHRF

Attachment 3: Projects Completed with Tier 2 Initiative

The four projects awarded Rental Housing Revolving Fund assistance through the Tier 2 Initiative will produce 759 units, 755 of them targeting households earning between 60% to 100% AMI, which typically are not units that are able to access RHRF assistance.

Kahuina (Block C)

Island of O'ahu

- 124 Total Units
 - o 80 units at 80% AMI
 - o 43 units at 100% AMI
 - o 1 Manager Unit
- 61Year Affordability Commitment
- \$24 million RHRF Tier 2 loan
- Total Cost of Development: \$62 million



Koa Vista II

Island of O'ahu

- 97 Total Units
 - o 97 units at 80% AMI
- 61-Year Affordability Commitment
- \$25 million RHRF Tier 2 Loan
- Total Cost of Development: \$40 million



Attachment 3: Projects Completed with Tier 2 Initiative

Hualalai Court Apartments Island of Hawai'i

- 104 Total Units
 - o 21 units at 80% AMI
 - o 82 units at 100% AMI
 - o 1 Manager Unit
- 51-Year Affordability Commitment
- \$26 million RHRF Tier 2 Loan
- Total Cost of Development: \$55 million



Pohukaina Commons Phase I Island of O'ahu

- 434 Total Units
 - o 87 units at 80% AMI
 - o 345 units at 100% AMI
 - o 2 Manager Units
- 75-Year Affordability Commitment
- \$68 million RHRF Tier 2 Loan
- Total Cost of Development: \$222 million



Attachment 4: Hawai'i Administrative Rules (HAR) for Tier 2 Initiative

§15-311-25 Loans to for-profit entities. (a) Loans may be provided to for-profit entities for the purposes set forth in section 15-311-21 and shall be subject to any additional conditions set forth in this section. (b) The corporation shall set forth the terms and conditions of the loan on a case-by-case basis, including the interest rate, repayment requirements, appropriate security, and the like. (c) The corporation shall take all reasonable steps necessary to ensure that projects funded shall remain affordable for the economic life of the project or for as long as rental housing revolving fund moneys are invested in the project. 311-11 §15-311-25 (d) The corporation shall ensure that loans provided under this section are secured to safeguard against a change in the use or ownership of the project, or the project no longer fulfilling the intended purpose for which the loan was provided. Loans may be secured through any of the following means: (1) Use of a forgivable or subordinated mortgage; (2) Development of a project on government-owned land with conditions attached to the land; (3) Use of a regulatory agreement; or (4) Any of a combination of the above. (e) The corporation shall establish provisions for monitoring the following: (1) The progress of projects receiving loans and grants under this section; and (2) Compliance with the terms and conditions of the loan. The corporation shall have the right to rescind or recapture moneys loaned if the terms of the contract are not fulfilled. [Eff 4/23/10; am and comp /h,N 1 5 2022] (Auth: HRS §201H-202) (Imp: HRS §201H-202)

Attachment 5: The Notice of Funding Availability (NOFA) Announcement

State of Hawaii
HAWAII HOUSING FINANCE AND DEVELOPMENT CORPORATION

NOTICE OF FUNDING AVAILABILITY FOR:

Rental Housing Revolving Fund (RHRF) Tier 2 Moderate Income Funding Program
Funding for Mixed Income Projects

The Hawaii Housing Finance and Development Corporation (HHFDC) has up to \$150,000,000 in Rental Housing Revolving Funds (RHRF) available for eligible RHRF loans pursuant to Act 236 (SLH 2022) and Section 201H-202 of the Hawaii Revised Statutes. These funds are available only for mixed-income rental projects for individuals and families with incomes above sixty and at or below one hundred per cent of the median family income for the State of Hawaii.

Please note that the State of Hawaii's allocation of 9% LIHTC credits for 2022 has already been fully awarded. HHFDC's allocation of HMMF bonds, which are used in conjunction with 4% LIHTC credits, has also been fully awarded for 2022. Therefore, these programs are not available during this RHRF-only funding cycle.

All applications will be subject to funding availability and the minimum threshold/qualifying guidelines of the RHRF program. Funds may be used for development, pre-development, construction, acquisition, preservation, and substantial rehabilitation of rental housing units that meet the program's criteria for eligibility. Applications for Project Awards will be available on or about August 15, 2022, and may be viewed or downloaded from the HHFDC website at <https://dbedt.hawaii.gov/hhfdc/developers/consolidated-application-financing/>. **COMPLETED APPLICATIONS ARE DUE ON SEPTEMBER 16, 2022.**

For additional information about the program, an application packet, or if you have special needs/require auxiliary aids please contact Chelsea Newcom at (808) 587-0576.

State of Hawaii
HAWAII HOUSING FINANCE AND DEVELOPMENT CORPORATION
Rental Housing Revolving Fund
677 Queen Street, Suite 300
Honolulu, Hawaii 96813
(808) 587-0567

or

call toll free from the neighbor islands at
274-3141, ext. 70567 from Kauai
984-2400, ext. 70567 from Maui
974-4000, ext. 70567 from Hawaii
1-800-468-4644, ext. 70567 from Molokai or Lanai

The HHFDC does not discriminate against any person because of race, color, religion, sex, including gender identity or expression, sexual orientation, disability, familial status, ancestry, age, marital status, or HIV infection.

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