Stretching the 9's

Virginia Housing Development Authority

Rental Housing: Encouraging New Production

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Award Submission

ENTRY NAME:

Stretching the 9's

ENTRY CATEGORY:

Rental Housing
Encouraging New Production

"By creating a unique tax credit point category in its QAP, VHDA incentivized linking the underutilized 4% bond credits with a 9% competitive application. This pioneered a new financing tool that makes larger deals work. Further, VHDA's multifamily finance team diligently addressed the challenges of financing an innovative new hybrid building, working closely with APAH and our investor to ensure the new program was both compliant and financially viable. This kind of tool is especially important in heavily populated areas with a great demand for affordable housing and limited sites. As a result, we accomplished our shared goal of creating new affordable housing here in Northern Virginia that otherwise may have been impossible to develop and finance."

Nina Janopaul, President and CEO
Arlington Partnership for Affordable Housing

Background

Traditionally, there have been two ways that affordable housing developers can receive housing tax credits to make their deals financially viable – one is through the use of 9% competitive tax credits, and the other is by using 4% tax-exempt bond credits.

However, in Northern Virginia and several other areas of the state, the need for affordable housing is increasing significantly, and the cost to produce this housing is much higher than in other parts of the state. As a result, it takes more credits to produce a tax credit unit in these areas than it does elsewhere in Virginia.

As a result, the Virginia Housing Development Authority created a program that is making more efficient use of 9% credits by blending them with 4% credits, thereby allowing developments as a whole to use fewer 9% credits than they otherwise would. The benefit of this program is that it "stretches" the pool of tax credits, thereby allowing more affordable housing to be built. In fact, it is estimated that one extra medium sized development (70 units) can be built **each year** as a result of this program.

Why/When it was Undertaken

VHDA's Qualified Allocation Plan (QAP) limits the amount of 9% credits that are allocated to any one developer each year. Additionally, due to underutilization of tax exempt bonds and 4% credits in recent years, there is an abundant supply of bond cap available, and by extension the availability of 4% tax credit equity that would otherwise remain unused. Because some developments in high population and high cost areas may exceed the developer's 9% credit limit – and due to the Authority's desire to rely less on the 9% credit per deal in hopes of more efficient allocation – VHDA proposed the innovative idea of providing an incentive for developments that combine both 9% and 4% credits into its QAP in 2015 so that developments could be built using a lower amount of 9% credits and without exceeding the 9% credit limit on developers.

"The 9% credits are a finite resource, and in order to maximize their use, we came up with the idea of pairing them with the non-competitive, or automatic, 4% credits," said Art Bowen, VHDA's Managing Director of Rental Housing. "The 4% tax-exempt bonds are very much underutilized currently, and this program allows us to take advantage of their available bond cap to take pressure off of the 9% credits and create more affordable housing."

The program works by allowing developers to "divide" a development into two separate deals – with two separate owners – on one parcel of land. One development is built with competitive 9% tax credits, and the other is built with the 4% tax-exempt bond credits, thereby "stretching" the competitive 9% credits to maximize their effectiveness and make the deal financially feasible.

As a result of this idea, VHDA has been successfully "stretching the 9's" to help offset affordable housing demand by blending these two pools of tax credits. VHDA implemented this tax credit QAP option in 2015 by instituting high point category incentives that gave people an increased probability of winning credits for their developments.

Why it is Meritorious and Meets NCSHA Award Judging Criteria

Innovative

VHDA was the first housing finance agency in the nation to put incentives in its QAP to encourage these types of developments. Additionally, we believe we have more of these 9%/4% developments being built or planned than any other state in the nation. In fact, five developments choosing this option in the first year it was available (2015) received credits, two deals were awarded credits in 2016, four deals were awarded credits in 2017, 14 deals in 2018, and nine deals have applied for the 2019 application round. There was even an additional development that opted for this program after already winning a 9% award. The project had run into cost problems, and VHDA offered them this path as a way to move forward with their project, which possibly would not have been built if they hadn't taken advantage of the tax credit combination deal.

Replicable

Every state HFA can easily replicate this program. By creating QAP point category incentives to encourage maximizing the use of 9% credits, the HFA's can create a powerful tool to offset the housing demand in higher cost areas of their states.

Responds to an important state housing need

VHDA's program creates the ability to fund more affordable units than if they were only allocated 9% tax credits. "In fact, the developments awarded credits through this program produced enough units to allow us to fund an additional development each year with the 9% credits that weren't used on the competitive side, because they were provided by the 4% tax-exempt bond credits," said J.D. Bondurant, VHDA's Tax Credit Director. "While this new option is popular in high cost Northern Virginia, it is also working in less expensive areas of the state as well by creating more affordable units when tax credit resources are scarce – in fact, we've had several applications from the Blacksburg, Richmond, and Tidewater areas," he added.

Demonstrates measurable benefits to HFA targeted customers

By utilizing this unique program, VHDA has been able to provide additional affordable housing than would otherwise be possible. As previously mentioned, by reducing the 9% credit on a per deal basis, VHDA has been able to fund one additional average-sized 9% tax credit development (approximately 70 units) each year than otherwise would have been possible. Also, these buildings may not have been built because without this program the developers may not have been able to get under the state's 15% tax credit cap to make the deals work.

Proven track record of success in the market place

This program is successfully accomplishing our goal of producing more units with a given amount of 9% tax credits. VHDA has already produced 707 units of affordable housing from the five developments using this program in 2015, 256 units from the two developments in 2016, 801 units for the four developments in 2017, and 2,368 units for the fourteen developments in 2018. For 2019, a total of 1,555 units could potentially be created from this year's applications. By adding all of these years together, a possible total of 5,687 units could be built.

Benefits that outweigh the costs

The approach of combining tax-exempt bonds and 4% credits with 9% tax credits creates more affordable housing units in Virginia that are available for a minimum of 30 years. This benefit outweighs any additional costs associated with the program.

We have learned as we have progressed through this process. In fact, we have made improvements over time to simplify and clarify the types of physical and financial structures that are acceptable. Any additional costs of using this approach will wane over time as developers becoming more familiar with the unique aspects of the program.

Demonstrates effective use of resources
By encouraging the use of underutilized tax-exempt bond authority, VHDA has maximized the use of 9% and 4% tax credits, and is the first HFA in the nation to include this financing option in its QAP. In fact, due to the limitations on the amount of 9% credits that a developer can receive each year (15% per developer), this program allows them to make deals financially feasible while staying beneath the state cap.

A good example of this program's effectiveness can be seen with the Arlington Partnership for Affordable Housing (APAH), which wanted to build the Columbia Hills development but exceeded their cap – with this one deal – due to the high costs in Northern Virginia. APAH became the first developer to receive credits as a result of the program's point category incentive, and as such was able to stay under the 15% cap on 9% credits ($2.9 million in credits instead of $3.8 million), thereby allowing the development to proceed and creating more affordable housing in a high-cost area (see Columbia Hills ad in Attachments). This initial project from 2015 has been successfully constructed and placed into service, providing 229 new affordable housing units in Arlington, VA.

Effectively employs partnerships
Since this program is relatively new, it has created an enhanced partnership between VHDA and developers to ensure that everyone understands the requirements. Also, tax credit syndicators and attorneys were brought in to be certain that they understood and supported the program. We are clearly seeing repeat borrowers participating in the program a second time, which indicates that they are making the choice because it is both effective and manageable. VHDA even had initial discussions with the IRS to be sure that these projects are acceptable from the legal and regulatory perspectives.

Achieves strategic objectives
By "stretching" the 9% credits, this program helps VHDA provide more affordable units in higher cost areas, such as Northern Virginia, that otherwise would not be possible. In fact, VHDA estimates that 5,687 new units will be built or begin construction as a result of this program by the end of 2019.

Conclusion
As other sources of subsidized funding have disappeared or been reduced, more developers and others in the affordable housing industry are seeking the 9% tax credit as their source of funding. This places significant demand on the LIHTC program. VHDA's new program takes what has recently been an underutilized resource – tax-exempt bonds and 4% credits – and pairs them with the 9% credit program to make it go further.

The program has been offered for three years now, and has been very successful. In fact, the Authority created 707 units of affordable housing from the five developments using this program in 2015, 256 units from the two developments in 2016, 801 units for the four developments in 2017, and 2,368 units for the fourteen developments in 2018. For 2019, a total of 1,555 units could potentially be created from this year's applications. These units would not have been possible using traditional affordable housing finance methods. Also, technical complexities that were initially encountered have largely been mitigated now, thereby bringing additional efficiencies to the program.

VHDA is the first HFA in the nation to offer this option through a structured program – it is included in our QAP and Tax Credit Manual, and we offer a strong point incentive for developers choosing this option to finance their developments.

In addition, the program is very easy to replicate, and VHDA staff members have spoken with several other states interested in implementing a similar program.

Attachments:

- Advertisement featuring APAH's Columbia Hills Apartments
- VHDA Tax Credit Manual point categories as part of the selection criteria

Attachment A

The Columbia Hills development in Arlington, VA is a great example of the 9%/4% program in action.

Stretching Tax Credit Dollars

Courtesy of KGD Architecture

Stretching the 9's

Each year, it's a competition as developers apply for a limited supply of tax credits. This year, developers earned extra points in their applications, with VHDA's Stretching the 9's incentive.

Get Points: Since 9 percent tax cedits are in short supply and 4 percent bond credits are plentiful, we're asking developers to help "stretch the 9's" by combining the two types of credits. In doing so, you could earn up to 40 points on your application for tax credits to help fund your properties.*

2016 Deadlines: Developers interested in points under this incentive must submit a 9 percent application for 2016, and must have an approved tax-exempt bond application submitted prior to Nov. 1, 2016. Bonds must be issued by April 3, 2017. Developments using the Stretching the 9's incentive must be closed by April 28, 2017.

Questions? Contact J.D. Bondurant, assistant director of LIHTC programs, at 804-343-5725 or email jd.bondurant@vhda.com.

Look Who's Already Stretching the 9's:

- Churchill North (Richmond)
- Columbia Hills (Arlington) *pictured*
- Crescent Apartments (Fairfax)
- Clairmont Apartments (Norfolk)
- Fieldstone (Montgomery)
- Lexington I (Portsmouth)

** Points earned depend on percentage of aggregate units funded by tax-exempt bonds.*

VHDA.

Attachment B

The 9%/4% hybrid deals are highly incentivized in Virginia's tax credit program.

Bonus Points			
#	Point Category	Points	Explanation
7.12.4	9% Developments with 4% Bond Funding	25,35, or 45	Developments funded with 9% Tax Credits that are also funded with 4% Tax Exempt Bonds: • 30% of Aggregate units funded by Tax-Exempt Bonds (25 Points) • 40% of Aggregate units funded by Tax-Exempt Bonds (35 Points) • 50% of Aggregate units funded by Tax-Exempt Bonds (45 Points) Both developments must be closed by April of the year following the allocation year. A one-time 4% bond closing extension to September of the year following the allocation year will be allowed with a $10,000 extension fee. Failure to close the tax-exempt bond development by this date will result in the loss of the 9% credits and penalty points for three years that are double the points received.
7.12.5	Rental Assistance Demonstration (RAD) program, or other PHA conversion to project-based rental assistance, and competing in the LHA Pool	0 or 10	Any development participating in the Rental Assistance Demonstration (RAD) program, or other PHA conversion to project-based rental assistance, competing in the Local Housing Authority pool. Applicants must show proof of a CHAP or HUD commitment.

7.13. Reservation Application- 4% Tax-Exempt Bonds

Developments financed with tax-exempt bonds are eligible to apply for tax credits on a rolling basis and do not need to compete for credits. These developments, because they are federally subsidized, only qualify for the 4% credit. If bond financing must be more than 50% of the development's aggregate basis plus land while the maximum allowable credits are calculated on 100% of the qualified basis of the low-income units. VHDA must determine that the development satisfies the threshold requirements of the QAP. Only the minimum amount of credits will be allocated to the development to make it financially feasible. In the case of rehabs, if the authority determines that the rehab can be done without credits the request for credits may be denied.