PRESERVING AFFORDABILITY OF NEW YORK CITY'S ASSISTED HOUSING STOCK

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I. Introduction

The New York City Department of Housing Preservation and Development estimates that there are approximately 250,000 units of privately owned government-subsidized rental housing throughout New York City that have been developed with three subsidy programs: Mitchell-Lama, the Department of Housing and Urban Development (HUD) Multi-family Rental, and the Low-Income Housing Tax Credit (LIHTC) program.[1] Representing approximately one-eighth of the total rental units in the City, these portfolios have acted as important community development tools, as well as a vital safety net to ensure affordable housing opportunities for low- and moderate-income New Yorkers.

However, the original contracts and restrictions that kept rents affordable are expiring, and a combination of real estate market forces in the City, increased operating expenses, and other forces have resulted in the erosion of New York City's stock of affordable housing at an alarming rate. Between 1990 and 2006, more than a quarter (27 percent) of the HUD-subsidized and Mitchell-Lama housing stock was lost.[2] The preservation and production efforts outlined in Mayor Bloomberg's New Housing Marketplace Plan for 2004 through 2013 calls for the construction or preservation of 165,000 units of affordable housing.[3] However, these ambitious efforts do no keep pace with the losses in the City's current stock of housing that was created and kept affordable through government initiatives and programs.

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[1] "Preserving Government Assisted Affordable Housing," New York City Department of Housing Preservation and Development, Feb. 2006, p. 1.

[2] Waters, Tom. "Closing the Door 2007: The Shape of Subsidized Housing Loss in New York City," Community Service Society Policy Brief, May 2007, p. 2 [hereafter "Closing the Door 2007"].

[3] "The New Housing Marketplace 2004-2013: Creating Housing for the Next Generation," New York City Department of Housing Preservation and Development, 2005, p. 2.

Government agencies and non-profits use various tools to maintain the affordability of the assisted stock, but the net loss of the units suggests that they may need to reposition existing strategies or pursue alternate strategies in the City's preservation efforts. In particular, the City has traditionally relied on its once large inventory of vacant land and In Rem property to underwrite some of the costs of building affordable housing. This asset made it relatively cheap to build new housing units. The depletion of this inventory through disposition to private and non-profit developers, however, results in fewer opportunities to subsidize the construction of new units with this strategy. This shift makes the preservation of the existing housing stock even more critical than the before.

Moreover, the City has not strongly targeted their preservation strategies or defined their preservation goals for particular properties or markets. Our discussions with City representatives reveal that the City's preservation practice does not affirmatively target expiring projects, but rather responds to owners who first approach them about preservation strategies.[4] This results in the City working with some properties that appear to have been over-subsidized in an effort to maintain their affordability and other properties that are lost to the affordable housing stock that had potential for preservation. Given limited resources and the need to provide housing to the more than 1 million residents expected to move to the City by 2030,[5] we believe that this is not a sustainable long-term strategy for the City.

Based on these current circumstances, this paper will evaluate the current assisted stock, the challenges in keeping the units affordable, and existing strategies to preserve affordability, in

[4] Confidential Interview with Senior HPD Official.

[5] "PLANYC 2030: A Greener, Greater New York," The City of New York, 2007.

order to make recommendations as to the most effective strategies to preserve the affordability of the units. The primary goal of this analysis is to identify threats to the viability, financial and otherwise, for preserving the affordability of units in the currently assisted housing stock, and to recommend strategies that will create an incentive structure for property owners to maintain the affordability of the units in their buildings. These strategies may or may not involve the original programs that subsidized the development of these properties, for reasons that will be discussed throughout the paper. Instead, preservation strategies are evaluated for their cost-effectiveness, potential to address the particular needs and conditions of each property, and contribution to meeting particular preservation goals – either ensuring affordability for existing tenants, or preserving the long-term affordability of a unit for the City's affordable housing stock.

In Section II, we will discuss the financial and regulatory structures of the three programs, as well as their characteristics – such as the ownership, location, quality, and financial condition of the housing stock; the income mix of the tenants; and the challenges to preserving affordability of units under each program. Section III will analyze the challenges to affordability within each of the programs, and will outline a typology of property opt-out risks and needs that can be used as a framework to understand the general issues that the preservation strategies must address. Section IV will discuss the existing strategies utilized to preserve affordability under each of the three programs, and their applicability to different property types in the typology established in Section III. Section V will present two case studies of properties whose restrictions expired and will analyze the use of existing strategies for preservation. This section will also discuss whether alternative strategies may have improved the outcomes for affordability in the properties. Section VI will present several alternative strategies for preservation, and their

applicability to various property types in the typology. Finally, Section VII will synthesize all of the findings of the paper to present recommendations for various strategies to address different opt-out risks and property needs within the typology framework.

II. Overview of Programs

The Mitchell-Lama, HUD Multi-family, and LIHTC developments represent three approaches to private ownership of government assisted affordable housing stock. Estimates of the number of units in the three portfolios vary, ranging from about 225,000 units[6] to approximately 250,000 units.[7,8]

While the details are different between the programs, together they have served as a set of strategies for government to partner with the private sector in the development of affordable housing options for City residents. Many of these programs were implemented at the height of activity during the 1970's and 1980's, when New York City's housing stock was severely deteriorated by widespread abandonment and disinvestment. The programs were designed to stimulate investment in neighborhoods throughout the City, stabilize the pace of abandonment and increase the supply of affordable housing units for the City's new and current residents. What is also common to these programs is that they all have time limited commitments for participation in the program with many of the units now reaching the time when they no longer need to remain within the affordability restrictions.

The residents of privately-owned, government subsidized housing are mixed in terms of income and race but are generally households that are unable to afford adequate housing in the unassisted or private rental market. More than one-third of the households currently living in

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[6] Authors' estimate based on LIHTC data from the HUD LIHTC database, and HUD Multi-Family Rental and Mitchell-Lama data from the Community Service Society.

[7] "Preserving Government Assisted Affordable Housing," *supra* note 1.

[8] Although estimates of the number of units in the three portfolios vary, the analysis in this paper will focus on the data from the HUD LIHTC database and from the Community Service Society, since that data contains the most detail and allows for a more robust analysis. To the greatest extent possible, costs and benefits will be discussed on an incremental basis in order to maximize the utility of the analysis based on different estimates of units in the portfolio.

Mitchell-Lama and HUD Multi-family housing stock have incomes below the federal poverty line and two-thirds have incomes below 200 percent of poverty.[9] By comparison, less than one-fifth of all New York City households have incomes below the federal poverty level.[10] The LIHTC was also designed to reach low and moderate income families, targeting those with incomes at or below 60 percent of the Area Median Income (AMI), which is $42,540 for a family of four in 2007.[11] HUD Multi-family properties are largely found in poor, non-white neighborhoods, while Mitchell-Lama's are more likely to be found in neighborhoods with more income and race mix.[12] The following table shows that residents of Mitchell-Lama and HUD Multi-family properties have lower median incomes, a higher percentage of poor households, and higher minority levels than the overall City population.

Table 1: Demographic Characteristics of Tenants in Mitchell-Lama and HUD Multi-family Rental Stock[13]

	Mitchell-Lama	HUD Multi-family[1]	All NYC Households
Median Income	$22,500	$11,664	$42,000
Poverty Rate	28.9%	54.0%	17.3%
Race			
White Head of Household	27.8%	17.9%	43.8%
Black Head of Household	39.5%	27.9%	22.8%
Hispanic Head of Household	26.4%	47.1%	23.3%
Asian Head of Household	5.3%	7.1%	9.5%

[1] Excludes HUD Multi-family properties that are also Mitchell-Lama properties.
Sources: 2000 Census and 2005 New York City Housing and Vacancy Survey.

[9] Waters. "Closing the Door 2007," *supra* note 2, p. 2.

[10] Waters, Tom & Victor Bach. "Closing the Door: Accelerating Losses of New York City Subsidized Housing" Community Service Society, 2006, p. 2 [hereafter "Closing the Door 2006].

[11] HUD. *Low Income Housing Tax Credit Rent and Income Limits for New York City, 2007*.

[12] Waters, Closing the Door 2006, *supra* note 9, p. 2.

[13] Table adapted from Waters, "Closing the Door 2006," *id.*

A. MITCHELL-LAMA PROGRAM

From the 1930's through the 1950's, government's primary intervention into the housing market was through the public housing model, in which independent authorities created by government built and managed housing for the lower income residents of the City. In recognition of the difficulties of the public housing model, New York State Senator MacNeil Mitchell and Assemblyman Alfred Lama introduced and passed the enabling legislation that would create the Mitchell-Lama housing program. While public housing was originally meant to house a mix of low and moderate income families, over time the middle income families left, leaving behind a concentration of high crime and poverty rates in public housing.[14] Given these trends, policy makers involved with the Mitchell-Lama program worked to create an affordable housing program model that could serve middle-income families facing rising housing costs.[15]

The Mitchell-Lama model is similar to the other programs we will discuss because it seeks to leverage partnerships between government and the private sector to build new affordable housing developments. Around the time that these programs were created there was a growing sentiment that while government should still intervene in the housing market, it had not demonstrated that the government could efficiently manage its housing stock. Policy makers therefore sought to create incentives that would encourage the private sector to build housing in neighborhoods and for communities where little investment or outright abandonment was occurring.

1. Incentives Structure

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[14] Plunz, Richard, *A History of Housing in New York City* (Columbia University Press 1990).

[15] *Id.*

Under the Mitchell-Lama program, the City and State provided capital assistance for construction, as well as ongoing operating subsidies. These included:

- *Free or low cost land for development:* The properties were located throughout the five boroughs with substantial holdings in Manhattan, the Bronx and Brooklyn. The City offered the land through disposition of land and property acquired through eminent domain also known as *in rem* housing.
- *Financing from the City or State of up to 90% and 95% of construction costs:* High financing levels reduced the necessary developer equity, reducing the risk for the developer. Lower up front cost also reduced the barriers to entry as a housing developer and made the program accessible to many smaller developers. The government mortgages also provided low interest rates, reducing operating costs in the form of lower annual debt service.
- *Tax abatements for the term that the building remained in the program*: Abatements of the taxes that the owner were required to pay reduced the operating cost for the owners who in turn could lower the costs for the residents while still earning a profit.

In exchange for these generous subsidies, the City and State placed a number of restrictions on the developers to ensure the provision of affordable housing units. The restrictions specified income limits targeted towards middle-income tenants. This meant that resident incomes in these developments were considerably higher than those for public housing residents and initially higher than some of the incomes in the surrounding neighborhood. Rent restrictions limited the maximum allowable rent levels to ensure affordability of the low- and moderate-income tenants.

The restrictions also locked the owners into maximum profit levels – initially set at 6% and later increased to 7.5%.

A total of 269 developments with over 105,000 apartments were built under the Mitchell-Lama program. An additional 44,000 units were created under programs that served as precursors to Mitchell-Lama and operate under similar regulations. In total 149,000 units were developed under these programs.[16] The Mitchell-Lama program created a combination of rental and co-operative housing units. Of the units that still operate under use restrictions from Mitchell-Lama and similar programs, 66,997 units are co-ops and 57,994 units are rentals.[17] The oversight for these units is split according the the government entity that holds the mortgage for the building. As of 2004, HPD's Division of Housing Supervision supervised 135 Mitchell-Lama developments with City mortgages, representing 55,300 units of affordable housing. The New York State Department of Housing and Community Renewal (DHCR) supervised 92 Mitchell-Lama developments with State mortgages within the City, representing 63,685 units of housing.[18] While still in the program, unit rents are set by the agency with oversight over the building.

2. Opt-Out Provisions

The loss of units created under Mitchell-Lama is a result of the opt-out provisions. When the Mitchell-Lama program was originally created, use restrictions were required for 35 years,

[16] "Affordable No More: New York City's Looming Crisis in Mitchell-Lama and Limited Dividend Housing," New York City Office of the Comptroller, Feb. 18, 2004, p.3 *available at* http://www.comptroller.nyc.gov/bureaus/opm/reports/Feb18-04_Mitchell-Lama_Report.pdf [hereafter "Comptroller's Report"].

[17] *Id.*

[18] *Id.*

but there were few early takers.[19] After only two years the State amended the laws and added provisions that would allow Mitchell-Lama developers to buy out of the program "after 20 years upon prepayment of the mortgage…When developments buy out, they are no longer subject to DHCR regulation, and apartments need not be kept affordable for moderate income families."[20]

B. HUD Multi-family Program

Housing development programs subsidized by HUD share many characteristics with the Mitchell-Lama program after which they were modeled. They feature publicly-subsidized private development and ownership, government use restrictions on rent levels and eligible incomes for tenancy, and limited return on equity. HUD Multi-family Rental properties also have expiring subsidies, which has contributed to losses in the stock of affordable housing in the portfolio.[21] In 2006, there were 47,247 of these units, down from 53,416 in 1990.[22]

1. Incentives Structure

Two primary types of HUD subsidies were used independently or in combination to subsidize projects. First, HUD used mortgage-based subsidies to stimulate private developers to create more than 50,000 units of low and moderate-income housing between 1965 and 1978.[23] The main programs, under Sections 221(d)(3) and 236 of the National Housing Act, created

[19] Brozan, Nadine. "Tenants Adjust to Life After Mitchell-Lama," *New York Times*, January 26, 2003.

[20] DHCR Mitchell Lama Program Information Page, http://www.dhcr.state.ny.us/ohm/progs/mitchlam/ohmprgmi.htm. Affordability restrictions through the rent stabilization law might still apply, as described further in Section IV.

[21] "Why the Mayor's Legislation Should Protect Both Mitchell-Lama Rentals and HUD-Subsidized Housing," CSS Policy Memorandum, Community Service Society, Dec. 15, 2003.

[22] Waters. "Closing the Door 2007," *supra* note 2 at p. 3. Note that these numbers do not include units for the elderly and disabled subsidized under Sections 202 and 811.

[23] DeFilippis, James. "Keeping the Doors Open: HUD-subsidized Housing in New York City," Policy Brief, Community Service Society, May 2003, p. 3.

federal loans at the below-market interest rate (BMIR) of three percent,[24] and provided a monthly interest reduction payment (IRP) directly to the lenders to reduce the effective interest rate to one percent.[25] Federal mortgage insurance and substantial tax incentives were also offered to reduce the risk of these loans and offset financial liabilities.

In exchange, the owners agreed to restrictions that required them to rent the units to low- and moderate-income households at affordable budget-based rents with limited dividends. To sweeten the pot, for-profit owners were permitted to prepay their subsidized mortgages after 20 years, even though the mortgages were typically written for a 40-year term.i[26] Once prepaid, owners are no longer bound to the use restrictions that were tied to the mortgages.

Between 1974 and 1984, HUD shifted its approach to affordable housing by providing project-based rental assistance subsidies under the Section 8. Under this program, the rent contributed by the tenant is determined as some percentage (currently 30 percent) of their income, and the subsidy pays the owner the difference up the fair market rent (FMR) estimated by HUD based on operating costs of the project.[27] The rents in these developments are based on tenant income and could provide for lower rents that were affordable to lower income tenants than those units with mortgage only subsidies, where rents were based solely on the finances of the building and its operating budget.[28] Many of these Section 8 subsidies were added to older mortgage subsidies in order to rescue failing projects from foreclosure and to reach very low-

[24] "Stemming the Tide: A Handbook on Preserving Subsidized Multifamily Housing," Local Initiatives Support Corporation, Sept. 2002, p. 1.

[25] *Id*.

[26] Waters. "Closing the Door 2006," *supra* note 9 at p. 3.

[27] Project-based Section 8 replaced its precursors, Rent Supplement, and Rental Assistance Payment (RAP) programs.

[28] "Stemming the Tide," *supra* note 26 at p. 4.

income families. HUD Multi-family property owners can, however, opt out of a project-based Section 8 subsidy at the expiration of the contract, which was usually 20 years.[29]

2. *Opt-Out Provisions*

Property owners can, and are converting these federally-subsidized units to market rate through four primary mechanisms: (1) paying off or pre-paying the subsidized mortgage, (2) terminating HUD mortgage insurance, (3) opting out of a Section 8 subsidy contract at its expiration, or (4) HUD foreclosing on a property and it is not sold to an alternative "preserving" owner that will maintain project-based subsidies.[30] Although "distress threats", evidenced by poor building conditions, are responsible for significant losses in this stock, this analysis focuses on expiring contracts and thus focuses on mechanism 1 and 2 above.[31]

C. COMMON GROUND: LOSS OF MITCHELL-LAMA AND HUD MULTI-FAMILY UNITS

The following two tables show that many property owners opted-out of the Mitchell-Lama and HUD Multi-family rental programs between 1990 and 2006, resulting in a loss of 27 percent of the affordable housing stock in the two portfolios.[32] The non-Mitchell-Lama HUD-subsidized stock declined by 12 percent between 1990 and 2006.[33]

[29] These long-term subsidy contracts were for 20 years if HUD-insured and 30-40 years if financed with state and local tax-exempt bonds. Stemming 4.

[30] Waters. Closing the Door 2007, *supra* note 2.

[31] *Id.*

[32] Waters. Closing the Door 2007, *supra* note 2 at p. 3.

[33] *Id.*

More than 26,000 units, totaling 40 percent of the original Mitchell-Lama stock, left the program in the first 16 years of contract expirations – between 1990 and 2006.[34] While the initial surge of Mitchell-Lama developments leaving the program seems to have reached a plateau,[35] the loss of units continues to have a significant impact and thousands of units will reach the expiration of their Mitchell-Lama contracts in the coming years. Between 2005 and 2015, more that 15,000 additional rental units will become eligible to leave to the program. If all these developers eligible to do so over the next 8 years leave the program, an additional 13,000 Mitchell-Lama rental units will be lost. The loss of assisted units has and will continue to severely reduced the impact of the Mayor Bloomberg's 10-year New Housing Marketplace Plan; although HPD has funded the creation of 12,229 affordable housing units since 2002, the City lost 12,943 units of Mitchell-Lama housing during that same period.[36]

When comparing the loss rate between Mitchell-Lama units and non-Mitchell-Lama HUD Multi-family units, it was found that Mitchell-Lama properties are much more vulnerable to opt-outs by their owners. In fact, Mitchell-Lama units are more than three times as likely to be owned by property owner who chooses to opt-out of the program, compared to HUD Multi-family units.[37] Moreover, units with federal subsidies were substantially less likely (in proportion to the existing stock) to be lost to the market than those without federal subsidy.[38]

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[34] *Id.*

[35] *Id.* at p. 2. Those buildings most determined to leave the program have already done so.

[36] "Thompson: Affordable Housing Crisis is Accelerating," Press Release, NYC Comptroller William Thompson, Jr., May 5, 2006 *available at* http://www.comptroller.nyc.gov/press/2006_releases/pr06-05-056.shtm.

[37] Waters. Closing the Door 2007, *supra* note 2 at p. 3.

[38] *Id.*

Table 2: Losses of Affordable Housing by Category[39]

	Units in 1990	Units in 2005	Units in 2006	Lost 1990-2006	Lost 2005-2006
Mitchell-Lama					
With Federal Subsidy	41,822	32,118	30,080	11,742 (28%)	2,038 (6%)
Without Federal Subsidy	23,823	10,965	9,312	14,511 (61%)	1,653 (15%)
Total Mitchell-Lama	65,645	43,083	39,392	26,253 (40%)	3,691 (9%)
Not Mitchell-Lama					
Project-based Section 8	52,578	47,000	46,665	5,913 (11%)	335 (1%)
Other Federal Subsidy	838	582	582	256 (31%)	0
Total Not Mitchell-Lama	53,416	47,582	47,247	6,169 (12%)	335 (1%)
TOTAL	119,061	90,665	86,639	32,422 (27%)	4,026 (4%)

Source: Data compiled by the Community Service Society from records of the U.S. Department of Housing and Urban Development, New York State Division of Housing and Community Renewal, New York City Department of Housing Preservation and Development, and Office of the Comptroller of City of New York.

The next table shows that the loss of units also varies greatly not only by the type of housing (Mitchell-Lama and HUD Multi-family), but by subsidy type. Here, we see that project-based Section 8 units are most likely to be preserved, with only an 11 percent loss rate, followed by units with other rent subsidies, with a 27 percent loss rate. Units with only a mortgage subsidy or tax abatement were substantially more likely to be lost to the stock, with a loss rate of 57 percent. In general these findings suggest that increasing levels of subsidies serve as a disincentive for buildings to exit from the programs.

[39] Table adapted from "Closing the Door 2007," *id.*

Table 3: Losses of Affordable Housing by Form of Subsidy[40]

	Units in 1990	Units in 2006	Lost
Rent subsidies			
Project-based Section 8	56,438	50,386	6,052 (11%)
Other rent subsidy	31,762	23,063	8,699 (27%)
Total rent subsidies	89,021	74,270	14,751 (17%)
Other subsidies			
Federal mortgage subsidy	7,038	3,878	3,160 (45%)
Tax abatements only	23,823	9,312	14,511 (61%)
Total other subsidies	30,861	13,190	17,671 (57%)
TOTAL	119,061	86,639	32,422 (27%)

Source: Data compiled by the Community Service Society from records of the U.S. Department of Housing and Urban Development, New York State Division of Housing and Community Renewal, New York City Department of Housing Preservation and Development, and Office of the Comptroller of City of New York.

D. LOW-INCOME HOUSING TAX CREDIT PROGRAM

The Low-Income Housing Tax Credit program (LIHTC) was created in 1986 under the Federal Tax Reform Act.[41] As a federal program, LIHTC allocates tax credits to states annually, and allows state housing finance authorities to administer the program and distribute the credits.[42] At the federal level, the program is administered wholly by the Internal Revenue Service, and functions as an off-budget tax credit program through the tax code. The federal government allocates approximately $1.90 per capita in tax credits to New York State annually, allowing support of nearly $350 million per year throughout the state.[43] LIHTC allocations in New York

[40] Table adapted from "Closing the Door 2007," *id.*

[41] "The New Housing Marketplace: Progress Report 2005," New York City Department of Housing Preservation and Development.

[42] "Introduction to Low-Income Housing Tax Credits," Enterprise Community Partners, Oct. 2006.

[43] Division of Housing and Community Renewal, "Low Income Housing Credit (LIHC).

are administered primarily by the New York State Division of Housing and Community Renewal (DHCR). HPD allocates tax credit funds to New York City in the amount of $10 to $12 million per year to an average of 40 projects.[44]

LIHTC projects have historically served two primary roles in creating affordable rental housing in New York City – rehabilitation of existing units, and construction of new units – with the majority of projects falling into the category of rehabilitation. Between 1987 and 2003, two-thirds of the affordable units created using the tax credits were in rehabilitated buildings, although the rehabilitated buildings tended to be about half the size of new construction projects.[45] There were more than 31,000 LIHTC-assisted affordable rental units created in New York City between 1987 and 2003.[46]

Table 4: Geographic Distribution of LIHTC-Assisted Units, 1987 to 2003

Borough	Number of Properties	Percent of Properties	Number of Units	Percent of Units
Bronx	195	22%	9,120	29%
Brooklyn	320	36%	7,400	24%
Manhattan	350	40%	13,700	44%
Queens	5	1%	420	1%
Staten Island	10	1%	470	2%

Source: Low-Income Housing Tax Credit Database. Downloaded from HUD website, September 20, 2007.

The majority of properties in the LIHTC portfolio – nearly 80 percent – have an income mix among tenants, with a portion of units rented at market rents, and a portion of affordable

[44] HPD Website. http://www.nyc.gov/html/hpd/html/developers/low_income.shtml. Accessed October 4, 2007.

[45] Ellen, Ingrid & Ioan Voicu. "The Impact of Low Income Housing Tax Credit Housing on Surrounding Neighborhoods: Evidence from New York City," Furman Center for Real Estate and Urban Policy at New York University, May 2007.

[46] Database of LIHTC Units. Downloaded from HUD website, Sept. 20, 2007.

units – for which the developer received LIHTC. However, even among mixed-income properties, an average of 72 percent of units within a property are affordable to low and moderate income families. LIHTC-assisted properties are generally in better condition compared to other assisted housing portfolios, given that they were built or rehabilitated only about 15 years ago and given the income mix in most of the properties. As a result, it is primarily market threat – not distress threat – that is of greatest concern relating to LIHTC-assisted properties.

1. Incentives Structure

LIHTC essentially serves as a private equity infusion to developments with an affordable rental housing component. A property can receive a 4% credit, or a 9% credit; tax credits will be allocated annually for ten years in an amount equal to the eligible development costs for the eligible affordable units times the credit percentage. A private investor will typically purchase the credits for a development through a tax credit syndicator, such as LISC or Enterprise Community Partners. As the LIHTC has become more established and risks have been mitigated, private investors will typically add to the equity of a project in an amount equal to approximately $0.94 per dollar of the present value of the ten-year stream of tax credits. The value of LIHTC has declined over the past year, from a high of about $0.97 per dollar.[47] The project receives equity and the private investor receives the amount of the tax credit as a stream of credits against the private investor's federal corporate income tax annually for ten years. The private investor(s) – referred to as the General Partner – retain a 99.99% interest in the property, while the non-profit or for-profit developer – the Limited Partner – retains ownership of 0.01% of the property.[48]

2. Opt-Out Provisions

Although there is a mandatory 15-year extended compliance period for credits allocated after 1989, tax credit investors have realized all of their financial gains by the end of the first 15-year period. At the end of the initial 15-year compliance period, the investor has the option to sell its interest in the property. The original allocating agency – DHCR or HPD – has one year to

[47] Kimura, Donna. "LIHTC Market Steadies," *Affordable Housing Finance*, Sept. 2007.

[48] Online presentation by Gregory Griffin & Marian O'Conor from Enterprise Community Investments, "Year 15: Nonprofit Transfer Strategies for Expiring LIHTC Properties," May 16, 2007.

identify a qualified purchaser who will maintain the affordability of the units. If the allocating agency does not identify a qualified preservation-oriented purchaser within one year, the General Partner can sell the property to any purchaser and LIHTC rent restrictions can be removed from the property.[49] As shown in Table 5, more than 25,000 affordable rental units in New York City that were financed with LIHTC will reach the end of the initial 15-year compliance period between 2007 and 2020.

Table 5: Geographic Distribution of LIHTC-Assisted Units, 1987 to 2003
By 15th Year

15th Year	Total	Bronx	Brooklyn	Manhattan	Queens	Staten Island
2002-2006	5,670	1,720	1,495	2,380	0	80
2007-2011	10.380	2,390	2,660	5,170	40	125
2012-2016	11,610	3,675	2,800	4,620	255	265
2017-2020	3,430	1,335	445	1,530	120	0
TOTAL	31,100	9,100	7,400	13,700	420	470

Source: Database of LIHTC Units. Downloaded from U.S. Department of Housing and Urban Development (HUD), Sept. 20, 2007.

At that time, private developers typically have little financial incentive to retain their stake in the properties, and may seek to sell them to the non-profit partners or to other developers. Although the Limited Partners in the properties have the first right of refusal to purchase the properties, financial limitations may prevent them from purchasing or operating the

[49] "Low-Income Housing Tax Credit," National Low-Income Housing Coalition, March 2007.

properties without further subsidy. Moreover, depreciation recapture taxes – or exit taxes – due at the time of sale increase the proceeds needed from the sale of the property and provide greater incentive for a developer to sell the property to an investor who will increase the rents to market rates. Thus, there is an on-going threat that the general partners will sell their ownership in LIHTC properties to other private investors who will not maintain the affordability of the units. The need to garner a purchase price high enough to cover the remaining debt on the property and the exit taxes often means that the general partners must sell to purchasers who intend to charge market rents.

Even if private investors do not sell the properties, there remains a risk that units will be taken to market rents when existing income-restricted tenants vacate. In many cases, the rental markets in the areas in which the LIHTC units were created have grown over the past 15 years to such an extent that there is a great financial incentive to increase rents to market rates. This financial incentive has been compounded by the lack of a regulatory mechanism to monitor compliance during the 15-year extended compliance period. HPD's Qualified Allocation Plan for LIHTC allows it to exercise limited regulatory authority in the extended compliance period for developers who apply for new tax credits.[50] Moreover, DHCR has had some success with property owners who are out of compliance with LIHTC requirements, but who want to participate in additional deals with the agency.[51]

Although LIHTC properties may reach the end of the original 15-year compliance period, some of the properties – especially those funded with 4% credits – were also financed with tax-

[50] "2007 Low Income Housing Tax Credit Qualified Allocation Plan," New York City Department of Housing Preservation and Development, April 2007.

[51] Presentation by Deborah VanAmerongen, Commissioner of NYS Department of Housing and Community Renewal, Oct. 31, 2007.

exempt bond financing, which means that the bond-granting agency may have imposed additional use restrictions on the properties at the time of development. Approximately 100 of the properties in the LIHTC database had additional tax-exempt bond financing.[52] These properties have less immediate risk of increasing rents to market.

LIHTC properties are subject to long-term rent stabilization, which limits annual rent increases, even after the original investors sell their interest.[53] Although this provision can provide a good deal of protection for tenants in neighborhoods who have not seen as rapid rent appreciation, tenants in the highest risk neighborhoods – such as those in much of Manhattan – will not receive as much protection through rent stabilization.

3. Other Considerations for Maintaining Affordability

[52] Database of LIHTC Units. Downloaded from U.S. Department of Housing and Urban Development (HUD), September 20, 2007.

[53] New York City Department of Housing Preservation and Development. *Preserving Government-Assisted Affordable Housing*, February 2006.

During their holding period for the property, LIHTC investors can take advantage of an additional financial benefit – they can deduct operating losses and depreciation of the property from their income each year. A property with large operating losses can result in a negative capital account at the time of sale of the property – that is, the investor may have taken more deductions from the property than its invested capital. At the time of sale, the investor will have to pay the resulting in an "exit tax," or recapture of depreciation, at the time of the sale.[54,55] As a result, investors will demand a higher sales price for the property from any purchaser, including a non-profit General Partner, creating a financial barrier to a non-profit organization or other preservation-oriented entity to purchase the property and preserve affordability.

[54] Online presentation by Gregory Griffin and Marian O'Conor from Enterprise Community Investments, "Year 15: Nonprofit Transfer Strategies for Expiring LIHTC Properties," May 16, 2007.

[55] Enterprise Community Investments, "Year 15 Definitions."

III. Synthesis of Risks and Typology of Properties

A. Expiring Use/ Opt-Out Provisions

A common feature of all of the programs described above is the expiring use provisions that were written into the agreements with developers using government subsidized programs to build affordable housing. The provisions allow a developer to take a building out of the program after a prescribed period of time if the owner meets certain conditions – typically involving repayment of the government subsidized loans and cessation of government subsidies. This option is attractive to building owners, allowing them more discretion in raising rents and attracting higher income tenants.

Many of the properties that were developed with government subsidies were built in once undesirable neighborhoods of the City. Part of the financing plan was to give low cost or free land to the developers. The land transferred through these programs often became available because the previous owners were not able to or could not earn a profit from the operation of the building. Developers taking such land were taking a risk in investing in areas that had been abandoned by other owners and the expiring use clause was meant to give them reassurance that their risks would not result in government oversight into perpetuity. A limit on the time of the commitment to the program was perceived by policy makers as necessary for insure the developers would comply with the government restrictions at least for a period of time.

In our discussions with policymakers we also learned that there was a degree of lack of foresight about the strength of New York City's rental market that led to the introduction of the opt out provisions and the desire to get the programs up and running in what was then a very depressed market. As mentioned before, many of the buildings developed under these programs were in troubled parts of the City. Even the most optimistic policymakers did not expect the growth in the real estate market to outweigh the value of the package of incentives including low interest loans and tax exemptions and abatements that continued participation in the program offered.[56] In evaluating the risk of whether a building will remain or leave affordability restrictions, it is important to note that not all incentive packages given to the developers were equal. Some programs received only tax credits while others received a combination of land, low interest loans and other benefits that may be lost when the building leaves the program. As was discussed previously, the higher the level of subsidy in place in a building. the lower risk that the owner will seek to escape affordability provisions. Understanding this dynamic will allow policy makers to make more strategic interventions based on the cost of opting out of the program for the owner. The higher the level of subsidy, generally the higher costs the owner would incur in the form of lost subsidies and other incentives.

B. METHODOLOGY

[56] Interview with Rubin Wolfe at HPD, Sept. 17, 2007.

This section synthesizes the most common risks to affordability that were identified for programs in the previous section and presents a typology for understanding properties in the assisted stock. First we will review the six risk factors that influence an owner's opt-out decisions. Then we will identify a matrix for understanding the nature of the threat faced by the building. This will provide us with a framework to identify the challenges to preserving the affordability for a particular property. Third we will analyze the obstacles to affordability and strategies for preserving affordability relative to two distinct types of preservation goals. Through this framework and analysis we believe that New York City can tailor an effective and efficient preservation plan by addressing the different dynamics at work in the in a particular property.

C. Risk Factors

In order to provide recommendations about how to create strategies for preserving the affordability of units developed under these programs we must first create a framework for better understanding the factors that affect whether there is a strong risk that the owner will want to free the property of affordability restrictions. Our review of these programs suggests that all three programs share at least six characteristics that influence the threat of continued affordability of properties and that should be taken into account when pursuing strategies and recommendations for preserving the affordability of particular properties.

1) Strength of the local real estate market

2) Physical Rehabilitation needs of the property

3) Operating expenses of the project

4) Involvement or presence of an entity with a stake in preserving the affordability

5) The relative burden of administrative requirements for operating in the program and

6) Other use restrictions that might maintain affordability or put in place other restrictions

1. Strength of Local Real Estate Market

The rental markets in all New York City neighborhoods have increased appreciably since many of the properties in the three assisted portfolios were developed. There is a gap between the market rents in the surrounding neighborhood and the maximum allowable rents the owner can charge while still operating under the program restrictions. This gap would also apply when there is a large profit to be made through the sale of the development to another entity. The gap represents a financing gap that any preservation effort needs to take into account. Thus, whether the preservation strategy chosen is to preserve affordability with the existing owner, or to subsidize the purchase of the property by a preservation-oriented entity, policy makers must take into account the market conditions operating in the area surrounding each development.

While the rental markets throughout the City have improved since the 1970's and 80's the pace of this improvement has not been even throughout the City. For example, the following four communities in Manhattan have the highest median rents citywide and represent the greatest market risk for LIHTC properties, with median unsubsidized rents ranging from $1,400 to $1600 per month:

- Financial District/Greenwich Village (Manhattan Community Districts 1 & 2)
- Upper East Side (Manhattan Community District 8)
- Stuyvesant Town/Turtle Bay (Manhattan Community District 6)
- Clinton/Chelsea/Midtown (Manhattan Community Districts 4 & 5)

By contrast, properties in neighborhoods whose median rents have not grown as rapidly may be more amenable to maintaining affordability in their properties through incentive

programs that are cost-effective for the City. These six community districts, with median rents that are currently at or below the maximum allowable LIHTC rents, include:

- Morrisania/Belmont (Bronx Community District s 3 & 6)
- Rockaway/Broad Channel (Queens Community District 14)
- South Shore (Staten Island Community District 3)
- Highbridge/South Concourse (Bronx Community District 4)
- University Heights/Fordham (Bronx Community District 5)
- Mott Haven/Hunts Point (Bronx Community District s 1 & 2)[57]

For all LIHTC properties in the five boroughs that will expire between 2007 and 2020, the financing gap for 15 years of affordable rents is estimated at more than $577 million.[58] This gap varies from an average of $2,400 per unit in additional subsidy in the Bronx to more than $43,000 per unit in Manhattan.

HUD and Mitchell-Lama units are exposed to similar market threats. As shown in the table below, more subsidized housing is lost in high-market areas. This is particularly so for units without rent subsidies and units that have non-Section 8 rent subsidies, which are primarily Mitchell-Lama. For this stock, the loss in high-market areas – those areas for which the average monthly rent was $1,350 or more between 2001 and 2004 – was two to nine times as great as in low-market areas. High-market areas are found entirely in Manhattan below 96th Street. Low market areas – in which average rents were below $1000 from 2001 to 2004, and including northern Manhattan, all of the Bronx, and central Brooklyn – were much less susceptible to market forces. HUD Section 8 housing does not seem to be threatened as much by market forces

[57] Been, Vicki, et. al., "State of New York's City's Housing and Neighborhoods: 2006," Furman Center for Real Estate and Urban Policy, 2007.

[58] This estimate assumes that market rents and LIHTC maximum allowable rents grow at the same rate through 2035. The actual financing gap is likely to be somewhat higher, given that maximum LIHTC rents are based on Area Median Income (AMI), and market rents have grown at a faster pace than income in recent years.

because federal preservation tools such as Mark-Up-to-Market, discussed more below, are able to adapt to changing market forces than are non-Section 8 Mitchell-Lamas.[59]

Table 6: Rates of Loss of Subsidized Housing[60]

	Low-Market Areas	Middle-Market Areas	High-Market Areas
No Rent Subsidy			
2001 to 2006	5.0%	5.8%	9.7%
Rent subsidy, not Section 8 (primarily Mitchell-Lama)			
2001 to 2006	1.4%	8.8%	13.3%
Section 8			
2001 to 2006	1.5%	1.0%	0.1%

Source: Data compiled by the Community Service Society from records of the U.S. Department of Housing and Urban Development, New York State Division of Housing and Community Renewal, New York City Department of Housing Preservation and Development, and Office of the Comptroller of City of New York.

The stronger the surrounding rental markets the higher to incentive to leave the affordability restrictions. Understanding the surrounding rental market is key to appropriately identifying where scarce City resources should be targeted. Policy makers must understand that it will be considerably more costly to preserve a development in a high rental market versus a development in a weaker market.

2. *Physical Rehabilitation Needs of the Development; and*

3. *High Operating Expenses*

[59] Waters. Closing the Door 2007, *supra* note 2 at p. 11. While we are aware that housing markets have changed since the 2001 to 2004 period, we must confine ourselves to this analysis for consistency of data purposes.

[60] Table adapted from "Closing the Door 2007," *id.* at p. 10.

A second type of financing gap occurs when the operating income for the building is less than what is needed to cover the increasing cost of running the building. These buildings face a "distress threat". Many owners of government-assisted properties have experienced higher operating costs than expected.[61] Over time the lack of sufficient operating income meant that owners would forgo making long-term improvements on the building and in the worst cases would allow daily maintenance issues like broken elevators and heating systems to go without repair.

A primary factor has been rapidly rising energy prices in recent years. Utility allowances for many affordable housing programs have not kept up with prices. For example, the average Utility Allowance for LIHTC units in 2007 was $75 per month for electric and gas,[62] compared to an average monthly energy bill in New York State of $174.[63] These high operating expenses have contributed to deferred maintenance throughout the life of the properties. Moreover, rising energy costs may continue to strain properties, even if the affordability of their units is preserved.

In some instances these issues were further compounded because the lack of basic maintenance for the building has caused rent strikes on the part of the tenants that further weakened the owner's ability and willingness to make repairs to the property. The lack of capital needed to make repairs on the development, combined with the resulting tenuous relationships with building residents, provides a strong incentive for the owner to opt out of the program. The property owner may seek to either charge the higher rents needed to repair and reposition the

[61] "Preserving Government-Assisted Affordable Housing," New York City Department of Housing Preservation and Development, Feb. 2006.

[62] HUD. *Low Income Housing Tax Credit Rent and Income Limits for New York City, 2007.*

[63] Energy Information Administration, *2001 Residential Energy Consumption Survey*. Data inflated to 2006 using energy price data from 2001 and 2006.

property, or simply to have the opportunity to sell the development and step away from the project entirely.

Rehabilitation needs must be considered when assessing the opt-out risk of a property. For example, they are a large determinant in whether property owners with HUD Section 8 contracts opt out of the program, especially because owners of substandard projects want to get avoid HUD supervision and the resulting punitive measures. In nationwide trends, those projects whose inspection scores are categorized as "severe" had 28 percent opt-out rate between 2001 to 2005.[64] The next inspection score level, "substandard" had a 19 percent opt-out rate. Compared to the 6 to 4 percent opt-out rates for "satisfactory" and "superior" projects, the substandard opt-out rates are substantial and indicative of one of the main factors that leads to loss in the affordable housing stock.[65] For this reason, one of the main factors for consideration in the preservation struggle is how much the project might need in rehabilitation costs.

4. *Owner Dedication to Provision of Affordable Housing*

While financial concerns play a large role in determining whether buildings will remain or opt out of various affordability schemes, the mission of the organization that owns and manages the development also factors into the decision making process. Many of the programs mentioned in our paper leveraged private sector development in order to build affordable housing units. Some of these private developers, however, follow a "double bottom line" evaluation and are guided by missions that include a commitment to community development and affordable

[64] "Project-based Rental Assistance: HUD Should Update its Policies and Procedures to Keep Pace with the Changing Housing Market," General Accounting Office, Report to Congressional Committees, April 2007, p. 21 [hereafter "GAO Report"].

[65] *Id.*

housing.[66] Additionally, as non-profit organizations have grown in size and capacity, they are increasingly able to compete and operate on par with for-profit developers, and have developed and successfully operated substantial portfolios.

Non-profit organizations and other preservation-oriented entities, such as Community Development Trust (CDT), have a greater mission-driven motive to maintain the affordability of their properties beyond the original compliance period. For example, a recent nationwide study conducted by the General Accounting Office found that for-profit owners were four times more likely than non-profit owners to opt-out of their project-based Section 8 contracts at termination.[67] Moreover, fundraising capacity may help non-profit sponsors supplement operating income of their properties. About one-quarter of LIHTC properties for which the sponsor type was reported had non-profit sponsors, which may reduce their opt-out risk.[68] The preservation of an expiring contract building is influenced by whether the ownership is profit or mission driven. While in all cases the operations of the building need to be made financially viable, mission driven organizations demonstrate an increased willingness to find creative solutions for ensuring the long term affordability of the development.

5. Programmatic Administrative Burdens

While many of the losses to the affordable housing stock can be attributed to the market, there remains an X-factor for why owners are choosing to opt out of contract renewals even

[66] Interview with Joseph Reilly, CEO of Community Development Trust, Nov. 16, 2007.

[67] GAO Report, *supra* note 65 at p. 18.

[68] Analysis of LIHTC database. Downloaded from HUD website.

when market incentives are not that high. Perceptions and experience with administrative inefficiency and bureaucracy do influence decisions on whether to preserve the shrinking stock.

HUD is notorious for imposing administrative hurdles to preservation deals. Of the expiring Section 8 contracts crisis, Denise Muha of the National Leased Housing Association says that "HUD fatigue is the biggest risk to these properties" because the owners "cannot deal with HUD bureaucracy."[69] David Buchwalter, president of an affordable housing consulting firm based in Bayside, NY says that he has seen "owners that are choosing to opt out of the programs in some measure out of frustration with HUD."[70] These types of delays and inefficiencies can affect the success of a preservation deal because they create burdensome procedures and delay. For example, a waiver to apply LIHTC as the main source of new capital to a preserve a HUD-subsidized project is usually needed, but increasingly difficult to obtain. Private investors who invest in the LIHTC program then might not invest in HUD Multi-family properties if the application of and uncertainty over the waiver is unduly burdensome.

Thus, reporting requirements, lack of transparency and minimal oversight lead to a level of inefficiency common at varying levels to all three programs and have been known to be a determinative factor on whether preservation deals are successful.

6. <u>Other Use Restrictions</u>

An owner assessing whether to opt out of an affordability contract will look to what restrictions exist on the rent he can charge once the building undergoes market conversion. New York State's rent stabilization law limits what owners can charge for rent but only for buildings

[69] Anderson, Bendix. "HUD Hurdles Threatened Affordable Housing Stock," *Affordable Housing Finance*, Sept. 2007.

[70] *Id.*

built before 1974. While many federally-subsidized buildings do fall under rent-stabilization laws, there are 68,100 units in the city that do not, as the following table indicates. While several initiatives have been undertaken by Mayor Bloomberg to apply rent stabilization efforts to expiring Mitchell-Lamas, they have been rejected by the State legislature. This means that owners can charge market rents in the post-1973 expiring buildings.[71]

Table 7: HUD-Subsidized Units Not Subject to Rent Stabilization (Post-1973)[72]

Program Built Under	Number of Developments	Number of Units
Mitchell-Lama	55	31,900
Older mortgage subsidy programs (Section 236, 221)	44	5,700
Section 8, non-Mitchell-Lama	264	30,500
TOTAL	**363**	**68,100**

Moreover, many of the assisted properties in the three portfolios examined maintain affordability restrictions due to participation and financing from other programs. For example, as discussed earlier, approximately 100 LIHTC properties in New York City were also financed with tax-exempt bond financing,[73] and may be subject to additional use restrictions. These properties have less immediate risk of increasing rents to market.

[71] Lamport, Joe. "A Tough Month for Housing Advocates", *Gotham Gazette*, June 29, 2007 *available at* http://www.gothamgazette.com/print/2218

[72] Victor Bach, "Why the Mayor's Legislation Should Protect Both Mitchell-Lama Rental and HUD-Subsidized Housing. CSS Policy Memorandum. Dec. 15, 2003.

[73] Database of LIHTC Units. Downloaded from U.S. Department of Housing and Urban Development (HUD), September 20, 2007.

D. Typology and Framework

The choice of a strategy or set of strategies for a particular property will also depend upon the goal of the preservation effort. The two general options can best be understood as a tradeoff between providing affordable housing for current residents versus using existing resources to provide long-term affordable housing options for future residents. The first set of strategies focus on the protection of affordability for current residents in a building by ensuring the affordability of their rent, and protecting their ability to remain in their homes. Proponents of this goal argue that many of the current residents in the assisted stock served as pioneers to stabilize and improve once deteriorated sections of the City and deserve to enjoy the benefits of neighborhood improvements. These families find themselves no longer able to afford to live in the neighborhoods they helped to rebuild if expiring contracts are not renewed. Moreover, proponents of the benefits of mixed-income communities within the City decry the detriment that would result from the displacement of low- and moderate-income tenants that would further increase the already high levels of income segregation present in New York City.

Another set of strategies attempts to ensure the long-term affordability of the units for low- and/or moderate-income households in the future. Proponents of this preservation goal argue that the City already lacks sufficient affordable units and that the affordable stock is being depleted at alarming rates. By preserving the affordability of the units themselves for any given tenant who may live there, these strategies contribute to the affordable housing stock and allow the City to accommodate its projected growth of more than a million new residents by 2030. While it is not always clear that these strategies will directly benefit current residents, proponents

of the long term affordability strategy argue that there is no stated right to affordable housing in this City and that limited government resources should be spread as broadly as possible. Particularly in high rent areas where the cost of preservation would be high, long-term affordability advocates argue that resources should be spent to assist the greatest number of families and that may mean targeting resources to low rent areas where they will have a broader impact.

In order to organize these different pieces of information we have developed Typology of Properties Chart that provides a means for understanding the characteristics of different buildings and accurately applying the various present and proposed preservation strategies that will be discussed in the following sections. The chart is built on the six affordability risk factors that were discussed in this section with the assumption that a project containing a higher level of risk in each category possesses a higher overall risk of being lost as affordable housing.

For instance, a property that is subject to rent stabilization, is in good repair with low operating costs that is located in a relatively affordable neighborhood, and is operated by a stable non-profit organization facing few administrative burdens would be at relatively low risk for opting out of programs and losing affordability restrictions. Conversely, a non rent stabilized building run by a for-profit owner in need of extra income to cover high operating costs and major repairs would have a high incentive to leave a program they found as administratively burdensome.

Figure 1: Typology of Properties

Affordability Risk Factors	High (+) vs. Low (-) Risk Characteristics	Preservation Goal	
		Protect Current Tenants	Preserve Long-Term Affordability
Strength of Market	(+) Market Rents Far Exceed Affordable Rents		
	(-) More Affordable Market		
Rehabilitation Needs	(+) Extensive Needs		
	(-) Minimal Needs		
Operating Expenses	(+) High Operating Expenses		
	(-) Low Operating Expenses		
Involvement of Preservation-Oriented Entity	(+) No Involvement		
	(-) Presence of a Preservation Partner or Interested Purchaser		
Administrative Hurdles	(+) Burdensome Administrative Requirements		
	(-) Minimal Administrative Requirements		
Other Use Restrictions	(+) No Additional Use Restrictions		
	(-) Rent Stabilization or other Subsidy Program Restrictions		

Once the characteristics of the building have been described, policy makers can evaluate the utility of any particular strategy based on its ability to accomplish the goals of either protecting current tenants or preserving long term affordability. While the process of making decisions between these two admirable goals would require a larger citywide discussion, we believe this framework of understanding can inform this discussion by first allowing interested parties to understand unique characteristics of different projects and evaluate the relative risks of the development leaving affordability restrictions. Second, this chart will also provide the basis for the effective and appropriate targeting of affordability strategies to the circumstances. In the

next two sections we will explore the current and proposed options for preserving the affordability of developments and try to match them to the different types of risks that may be faced by a building. In total, we believe this will serve as a useful tool for understanding and evaluation of strategies for preserving affordable housing in New York City.

IV. Existing Tools for Preservation

Our conversations with government officials indicate that the City is in the early phases of developing comprehensive strategies for addressing the loss of affordable housing units.[74] There has however been the roll-out of a few tools that attempt to continue the operation of an expiring subsidy program with affordability restrictions through the provision of various forms of incentives.

These tools generally attempt to take one of two broad strategies. Most of the current tools seek to leverage existing programs to provide additional levels of subsidies on the developments and provide for its financial stability. This insight builds from the previous finding that buildings with higher levels of subsidy tend to be less at risk of the leaving affordability restrictions. The second set of tools are best described as "one off" approaches that address individual risk factors but do not currently serve as a comprehensive strategy for preserving the affordability of the developments.

While these general strategies are a start, they do not allow for more specific targeting of subsidies to make sure they are applied most appropriately and effectively. In this section we will review the various strategies currently being used by preservation entities and place them with in the typology matrix discussed before to better understand the category of risks that each tools address and the type of preservation goal it accomplishes.

A. Restructuring of Financing

Mortgages are a large part of the costs that the owner must take into account when making decisions about the leaving the program. Both in the creation of affordable housing and

[74] Confidential Interview with Senior HPD Official.

now as an incentive to maintain the affordability of housing, the government is able to use a number of strategies to offer low- or below-market interest loans to owners often at rates as little as one percent. Given that even at their lowest, market rate mortgages were between 4 and 6 percent interest, the government has used its ability to provide low interest mortgages to its advantage by tying the extension of the mortgage with the continuance or refinancing of a low interest mortgage.

In an example of an adaptation of an existing tool, the government is able to extend these mortgage benefits to owners upon the potential expiration or pre-payment of the currently subsidized mortgage. These low interest rates translate into lower monthly mortgage payments that serve as a subsidy of the operating costs of the development. The government allows owners or purchasers of affordable housing units to keep their mortgage subsidies in exchange for extended affordability terms, usually for a 5-year or longer period past the original expiring mortgage term.[75] In addition, owners must commit to renewing any project-based Section 8 contracts for that extended use period as a condition of this benefit. This provision works to ensure that current residents with Section 8 subsidies are protected from displacement.

Loan restructuring and re-syndication of tax credits are tools that also fit under this general category and are used to achieve similar results as the process described above.

1. *Loan Restructuring*

In 2004, the City and HDC put together a two-part initiative for preservation of Mitchell-Lamas. At a cost $75.5 million, this plan refinances existing mortgages and offers $50 million in loans for capital improvement if the owners of the buildings decide not to leave the program for an

[75] "Stemming the Tide: A Handbook on Preserving Subsidized Multifamily Housing," Local Initiatives Support Corporation, Sept. 2002, p. 8-10 [hereafter "Stemming the Tide"].

additional 15 years.[76] Debt restructuring offers the ability to reduce rents or acquire a capital infusion for repairs or to reduce operating expenses. The pro-forma below demonstrates the general economics of debt restructuring and its ability to reduce rents for the tenant in a particular example where a bifurcated second mortgage is taken out.[77] Note that the outstanding debt remained the same after the debt was restructured, even though the rent was decreased by $200.

Figure 2: Debt Restructuring Example

	Before	**After**
Rent	$800	$600
Less: Operating Expenses	-400	-400
	-------------	-------------
Net Operating Income	400	200
Available for Debt Service (90 percent)	360	180
Cash Flow	40	20
1st Mortgage	10 percent, 40 years	8 percent, 25 years
	40,000	25,000
2nd Mortgage (Deferred)	N/A	10,000
	-------------	-------------
Total Debt	40,000	35,000
Outstanding Debt	35,000	35,000

[76] "Financing Deal for Mitchell-Lama Landlords," *NY Times*, June 29, 2004 *available at* http://query.nytimes.com/gst/fullpage.html?res=9D00E3DF1538F93AA15755C0A9629C8B63&n=Top/Reference/Times%20Topics/Subjects/M/Mortgages

[77] Stemming the Tide, *supra* note 26 at p. 4.

2. *Re-syndication of LIHTC with 4% Credits for Substantial Rehabilitation*

Re-syndication is another type of subsidy layering approach that is used for LIHTC units. New York has a certain percentage of its tax credits earmarked for preservation through the Qualified Allocation Plan (QAP). These tax credits are similar to the other restructuring exercises in that they subsidize the operating cost of development through savings on taxes. Re-syndication has not been widely used however because of difficulties in effectively applying the credit. Enterprise estimates that this is not a viable strategy for properties with rehabilitation needs less than 10% of the acquisition cost, or $3,000 per low-income unit.[78] For example, only 10% of LISC's Year 15 properties have been re-syndicated.[79]

Other concerns center around the future of the tax syndication market. As stated earlier, investors are currently paying about $0.94 per dollar of the present value of the ten-year stream of tax credits, down from a high of about $0.97 per dollar at the end of 2006. Industry insiders – such as Stephen B. Smith of the Richman Group Affordable Housing Group – expect values to remain stable as long as the Treasury rate remains stable.[80] However, others view that LIHTC market as remaining tentative and potentially susceptible to more value declines.[81] Other concerns about the potential equity influx through LIHTC re-syndication include questions about whether financially-struggling banks may begin to pull back some of the investments that they make through LIHTC syndicators.[82]

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[78] Online presentation by Gregory Griffin and Marian O'Conor from Enterprise Community Investments, "Year 15: Nonprofit Transfer Strategies for Expiring LIHTC Properties," May 16, 2007.

[79] "Refinanced and Reborn," Local Initiatives Support Corporation (LISC), 2006, p. 5.

[80] Kimura, Donna, "LIHTC Market Steadies," *Affordable Housing Finance*, Sept. 2007.

[81] "National Housing Trust Fund Bill Introduced," *Affordable Housing Finance,* Aug. 2007.

[82] Interview with Jon Salony, Vice President in Community Development, JP Morgan Chase, November 12, 2007.

3. *Evaluation of Restructuring Type Tools*

While low interest mortgages are useful in both high and low market areas, this tool has mostly been used as an primarily a preservation tool in strong markets as an incentive for owners considering prepayment or opting-out of their mortgage-based subsidies. It is useful in circumstances where there are high operating costs and where the majority of those cost were related to mortgage interest payments. This tool would also allow the owner to refinance for larger mortgage amounts that could provide some limited capital, but only for low or moderate repairs because they are unlikely to cover the cost of a major rehab. Because this tool is designed for use by buildings that would otherwise exit the program, it is not useful in instances where the primary risks to the development's affordability come from the lack of other affordability restrictions or presence of high administrative burdens since it is likely that these conditions would still persist despite the usage of this tool.

Finally this is a tool that would primarily work to the benefit of existing tenants. This would not serve as a good long-term strategy. This is because the loan terms would have to be re-negotiated constantly, decreasing the power of the incentive as market rents improve past the value of the mortgage subsidy over time. This tool does however have the political advantage of not requiring new budget authority since it is simply reusing an existing subsidy source.

B. CROSS-SUBSIDIZATION (MIXED-USE OR MIXED-INCOME HOUSING)

Another strategy is the cross-subsidization of the development through the introduction of relatively higher income tenants whose market rate rents subsidize the rents of the other residents. As will be discussed in the following case study of Ruppert and Yorkville Towers on the Upper East Side of Manhattan, the particular risk factors of a property may warrant the

preservation of a portion of the units, while the remaining units are allowed to charge market rents. Ruppert and Yorkville Towers, both Mitchell-Lama developments, were able to utilize this strategy due to the moderate incomes of a portion of their tenants, the presence of market-rate professional and retail spaces, and a high-market neighborhood. In terms of equity, expanding opportunities for moderate-income households may help to smooth out some of the affordable housing gains made in recent years among various income groups. Low-income households earning less than 60 percent of AMI and higher-income groups made greater gains in the share of affordable housing available to them, compared to households making roughly 80 to 120 percent of AMI.[83] However, this strategy has not been employed on a consistent or systematic basis. Instead, it has primarily been employed through tenant negotiations. Moreover, as will be discussed in the case study, the strategy may be susceptible to individual tenants' interests that can supersede long-term preservation goals.

The strategy of mixing incomes to cross-subsidize may not be effective for all properties. Specifically, for HUD Section 8 properties nationwide, the owners of projects with a minority of subsidized units were as much as four times more likely to opt-out of their contracts than owners of projects where the majority of the units were subsidized.[84] The GAO determined that this data is consistent with the views of owners about their desire to continue receiving guaranteed payments that Section 8 provides.[85] Especially because HUD Multi-family units are not usually found in high market areas, an owner would prefer to receive the secured subsidy income than depend on higher market renters to cross-subsidize affordability.

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[83] City Limits, Hard Costs: The Rising Price of an Affordable New York, Spring 2007, p. 26.

[84] GAO Report, *supra* note 65 at p. 18.

[85] *Id.* at p. 17.

The effectiveness of cross-subsidizing affordable units with market rents is also limited in some of the lower market areas, due to low demand for market-rate units and low market rents. Pat Conley, from Community Preservation Corporation notes, "In the Bronx, most of those neighborhoods, the market is a low-income market, so there is no flexibility here. Eighty percent AMI or higher, that's market rent."[86]

In addition, monitoring of income mixes within the building would actually increase rather than reduce the administrative and reporting burden on owners without necessarily providing the large infusion of capital needed to make major improvement on the building and thus attract higher income tenants for the market rate units.

C. FEDERAL TOOLS

A third group of strategies provide leverage of the federal Section 8 voucher program. As discussed previously the project-based Section 8 program provides a rental subsidy for the residents of a development to cover the difference between the full rent of the apartment and what the current resident can afford. The creatively named, Mark-to-Market, Mark-Up-to-Market and Mark-Up-to-Budget HUD programs are variations on the themes to continue providing subsidies through rental assistance based on restructured rents in the project.

1. Mark-to-Market

This program is targeted to buildings which are thought to be charging above market rents. While this program mandates that above-market rents be reduced to market upon contract

[86] City Limits, Hard Costs: The Rising Price of an Affordable New York, Spring 2007, p. 24.

renewal, it provides several incentives to offset this loss in rent.[87] The main incentive is debt restructuring where the mortgage is bifurcated into supportable and unsupportable debt, the amount of which HUD retains as a second mortgage. In exchange for this innovative restructuring (see Figure 2 above), owners are required to renew their Section 8 contracts for 30 years. Other incentives include HUD underwriting allowable costs and fees, and mortgage forgiveness for qualified non-profit purchasers. The goals of this program are to extend Section 8 contracts by longer periods, like 30 years, while providing an incentive for non-profits to purchase the properties.

While the program has several powerful tools for preservation wrapped up in it, it is only appropriate in weak markets where owners already have incentives to renew Section 8 contracts anyway. In strong markets, owners can reduce the rent necessary to qualify for renewal of a Section 8 contract without needing to reduce their existing debt and bind themselves to the 30-year renewal period required by any debt restructuring.[88]

2. Mark-Up-to-Market

The Mark-Up-to-Market program, begun as an emergency initiative but enacted into law in 1999, provides incentives to owners with below-market rents to remain in Section 8 program upon expiration. Based on 5-year minimum contract commitments, this program allows owners to increase rents to comparable market rents and modifies or eliminates the original limited dividend restriction for participating owners.[89] In exchange, owners commit to affordability and

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[87] Stemming the Tide, *supra* note 26 at p. 5-8.

[88] *Id.*

[89] *Id.* at p. 4.

are prohibited from opting out of mortgage prepayment in buildings with mortgage subsidies.[90] Particularly suitable in strong market, this tool provides owners with increased cash flow that can be used for distributions or refinancing or to facilitate preservation sales.[91]

3. Mark-Up-to-Budget

A variation on the Mark-Up-to-Market program**,** Mark-Up-to-Budget allows non-profit owners to increase rents to market comparable rents based on the project's budget but capped at 150 percent of FMR. The program provides incentives for non-profit participation and preservation and is limited to two circumstances: acquisition of the property by a non-profit, or capital repairs where the owner is a non-profit. Based on 20-year minimum contract terms and use agreements, these subsidies allow non-profit owners and purchasers in strong markets to take on new debt for capital repairs or acquisition while preserving their participation in project-based Section 8.

All three of these programs use project-based Section 8 subsidies which means that when a tenant leaves the building, the subsidy remains in the unit and is available for the next resident. Project-based subsidies offer a long-term preservation strategy because of the ability to remain with the original unit but offer few protections for the current residents. It is also important to note that these Section 8 subsidies do not address the administrative burdens for an owner and may actually increase them by adding an additional level of administrative oversight in the administration of the Section 8 subsidies.

4. Enhanced Section 8 Vouchers

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[90] *Id.* at p. 6.

[91] *Id.* at p. 8.

The above group of strategies used a project-based Section 8 subsidy and were aimed at opt-out prevention is projects with federal subsidies. However, when owners pre-pay their HUD-subsidized or insured mortgage, or opt out of their project-based Section 8 contract, tenants are given Enhanced Section 8 vouchers that pay the difference between their contribution at the point of prepayment or opt-out and prevailing market rent. Tenants residing in Mitchell-Lamas with opted-out or prepaid Section 236 interest subsidies are also eligible for the vouchers, in addition to HUD Multi-family residents. Owners of Mitchell-Lama projects, especially, are resorting to "vouchering out" their tenants and opting-out of their expiring contracts.

These vouchers are very different than project-based vouchers because they "stick" to the tenant instead of to the project, meaning that the tenant can take the voucher subsidy with them once they move from the project. Unlike standard Section 8 vouchers, which are primarily targeted to very low-income households (incomes of no more than 50 percent of area median income (AMI)—$31,400 for a family of four), Enhanced Vouchers are available to households with incomes of up to 95 percent of AMI, currently $59,660 for a family of four. [92]

The Enhanced Section 8 Voucher program represents a strategy that primarily supports the affordability of housing for current residents but is not as successful at preserving the affordability of the unit. Once the current tenant leaves the owner is able to charge the full market rent to the next tenant. However, the Enhanced Vouchers could be used in conjunction with other affordability strategies, like LIHTC, if the owner has decided to opt-out despite other incentives to stay in the programs. Still, Enhanced Voucher attrition in projects leads to decreasing affordability indicators of the project overall. In addition, while the Enhanced

[92] NYC Department of Housing Preservation and Development Website, visited November 20th 207 available at, www.nyc.gov/hpd under Residential Building Owners Link for Section 8 Information.

Vouchers are entirely subsidized by the federal government and thus are of no cost to the City, the fact that they are subject to annual contract authority and appropriation by Congress make them a tenuous fallback for affordability ills that plague the City. Our concern is that over time the Federal government may reduce the City's regular Section 8 allocation in order to make up for budget over runs on the Federal side. This could create a tradeoff between assistance for current Mitchell-Lama units and the rest of the City's residents.[93]

D. NON-SUBSIDY PRESERVATION TOOLS

The City's primary tool for maintaining the affordability of apartments is through the rent stabilization program. Rent stabilization laws were first created in 1969 and are designed to protect tenants against dramatic increases in rent. Rent stabilization laws apply retroactively to all buildings built before 1974 and after 1947. Rent stabilization currently covers over one million apartments throughout the City, including many of the buildings in the programs reviewed. Rental units covered by rent stabilization are regulated by the Rent Guidelines Board which sets annual increases each year. Units are required to remain under these regulations until the rent increases beyond $2000. Many Mitchell-Lama properties completed after 1974 and all LIHTC properties are subject to rent stabilization, providing a buffer for their tenants in the event of an opt-out.

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[93] "The Future of Enhanced Vouchers: Cost and Considerations for a City Program to Supplement Federal Section 8 Rental Assistance," New York Independent Budget Office Report *available at* http://www.ibo.nyc.ny.us/iboreports/enhancedVouchers.pdf

E. ADDITIONAL FUNDING

In addition to preservation strategies described above, direct cash infusions are also an approach to include in the mix. HPD secured $14 million in its 2008 Capital budget for repair and preservation of HUD housing.[94] In addition, the $230 million New York City Acquisition Fund is a collaborative initiative between banks, the City and philanthropic organizations that has as one if its goals the preservation of affordable housing.[95] The Fund, and its $40 million "guarantee pool," is used to secure loans made by financial institutions to non-profit developers seeking to purchase and preserve affordable housing. Thus, non-profit developers are able to secure quick access to below-market or competitive financing to cover their costs, and thus can compete with profit-motivated developers.

F. ROLLOVER OR SALE OF LIMITED PARTNER INTEREST TO NON-PROFIT GENERAL PARTNER FOR LIHTC

As of 2006, LISC reports that approximately 87% of the LIHTC Year 15 transitions in their syndicated tax credit portfolio were executed as transfers for the Limited Partner to the sponsoring General Partner – generally non-profit community development corporations (CDC's) in this case – with the General Partner assuming the debt on the property and continuing operations as before. Ten percent of the properties that experienced Year 15 transitions required re-syndication to fund capital improvements or settle debt obligations, and only 3 percent of properties were converted to market rate properties.[96]

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[94] "Council, HPD Announce Funding for the Repair and Preservation of Affordable Housing." Press Release, The Council of the City of New York Office of Communications, Aug. 20, 2007.

[95] "Preserving Government-Assisted Affordable Housing," The New York City Department of Housing Preservation and Development, Feb. 2006, p. 4.

[96] Local Initiatives Support Corporation (LISC). *Refinanced and Reborn*, 2006, p. 5.

Transfer of the partnership interest is generally easier and more cost-effective method than a sale since the deed is not transferred and transfer taxes can often be deferred or avoided.[97] Other intermediary organizations are also using alternative transfer methods to allow LIHTC investors to take advantage of the tax benefits of transferring their partnership interest, while still earning a financial return. One example of this alternative strategy is exchanging interest in a particular property for shares in a more general affordable housing investment pool.[98]

This tool is primarily focused on addressing the issue of the owner's commitment to preserving affordable housing. This, however is only one of the six risk factors we have identified and as such does not adequately address other issues that may be present with a particular project.

G. Conversion to Low-Income Co-op

A final option has been the attempt to transfer ownership of the building to residents through the conversion of the building to a low income co-operative. This strategy has been tried in a number of cases but the tenants have however found it difficult to raise the capital needed to purchase the building and there is currently no dedicated source of City funding for this purpose.

John Brandenburg at Enterprise Community Investments identifies several advantages of the strategy, including increasing stability in a community, encouraging improvement, and reducing operating expenses, tenant turnover, and neighborhood crime. He also warns of factors that must be taken into consideration before introducing a co-op conversion, including debt on the property, rehabilitation needs, and financing availability for tenants to purchase shares in the co-

[97] Enterprise Community Investments, *Year 15 Q&A*.

[98] Interview with Joseph Reilly, CEO of Community Development Trust, November 16, 2007.

op.[99] This strategy may be especially useful for properties in emerging neighborhoods that could benefit from stabilization, with moderate-income tenants who may have some access to traditional financing, and limited rehabilitation needs that would keep purchase prices low for existing tenants.

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[99] Brandenburg, John, "Year 15: Tax Credit Preservation and Exit Strategies," *Affordable Housing Finance*, July 2005.

V. Case Studies and Lessons Learned

In this section, we discuss two case studies to demonstrate ways in which the tools in the City's preservation arsenal may or may not be combined most effectively to address preservation goals.

A. Ruppert and Yorkville Towers

Two adjacent properties in Yorkville, on the Upper East Side in Manhattan, first occupied in 1974 and 1975, applied to buy out their $65 million Mitchell-Lama mortgage in 1998,[100] which the property owner, the DeMatteis Organization, said at the time had been their plan since they had built the properties. They had developed the properties as long-term investments, and were eager to capture the financial gains of the neighborhood's improvement and increase in market rents.[101]

Although the property owner applied to buy out their mortgage and end their Mitchell-Lama contract in 1998, and hoped to realize market rents starting in 1999, tenants took action against the conversion to market. The properties were not subject to rent stabilization, so the tenants realized that they would have no buffer against the conversion to market rents. However, the DeMatteis' argued that the existing tenants had moderate to high incomes and a higher ability to pay than the tenants portrayed. They contended that almost 90 percent of tenants had incomes of $50,000 or more, and almost one-third earned more than $100,000.[102] By 1998, the rental market in Yorkville had appreciated such that the property owner stood to gain as much as

[100] Anthony Ramirez, "Tenants Worry Rents May Rise at 2 Big Towers," *New York Times*, July 19, 1998.

[101] Rachelle Garbarine, "Deal Struck in Yorkville to End Limits on Rents," *New York Times*, April 6, 2001.

[102] Ramirez, *supra* note 120.

$2,000 to $4,000 per month for each of the more than 1,200 units by converting to market,[103] a gap that would be difficult to overcome with government subsidy.

The tenant's lawsuit against the developer centered on a land disposition agreement in which they had agreed to maintain affordability for low- and moderate-income individuals for 40 years. The lawsuit delayed rent increases for two years, which lawyers estimate saved the tenants $80 million.[104] Despite the restriction in the agreement, the City was not able to maintain the affordability of all of the units, losing more than 800 affordable units in the tenants' settlement with the developer.

In 2001, the two sides reached a compromise after nearly a year of negotiations, allowing tenants who could afford it to purchase their units at a discount, and other low- and moderate-income tenants to maintain affordable rents.[105] Under the plan, 830 of the units were converted to condos,[106] with existing tenants receiving a 20 percent discount plus a 10 percent improvement allowance. Since those tenants had the right to sell their discounted units for a profit immediately after purchase, it is unclear whether many of those tenants remained in the buildings.[107] Therefore, all of the condos sold – two-thirds of the units – can be considered to have been permanently lost to the affordable stock. To maintain affordability for tenants who opted not to purchase their units, HPD agreed to provide subsidies to limit monthly rent to 30 percent of income for existing tenants with incomes up to 80 percent of AMI, at a cost of

[103] Garbarine, *supra* note 121.

[104] Nadine Brozan, *New York Times*, "Tenants Adjust to Life After Mitchell-Lama, January 26, 2003.

[105] Garbarine, *New York Times*.

[106] Natalie Keith, *Real Estate Weekly*, "Team Closes 880 Sales in 3 Weeks," February 19, 2003.

[107] Brozan, *New York Times*.

approximately $3 million per year. In turn, the developer agreed to subsidize rents for tenants with income between 80 and 100 percent of AMI, at an annual cost of about $10 million.[108] The developer was able to support the subsidies through market rate retail and office spaces leased within the properties. The total annual public subsidy per affordable unit is approximately $8,300. The properties retained the mix of rental and condo units that resulted from the repositioning at the Mitchell-Lama buyout.

Based upon the characteristics and risk factors of the particular properties, there may have been additional solutions that would have maintained the affordability of a larger percentage of the units. Had the City reached out to the property before its opt-out date, it could have played a larger role in the negotiations and could have better articulated the City's preservation goals. By relying primarily on negotiations between the tenants and the property owner, the goals articulated were, by default, those in the interest of the current tenants. Based upon the strong market characteristics of the Yorkville neighborhood, alternative strategies may have been to limit the number of condos that could be sold, or to impose minimum holding periods or sales price restrictions for the discounted condos to preserve long-term affordability, while still benefiting current tenants.

B. INDEPENDENCE PLAZA NORTH

In June of 2003, Laurence Gluck purchased Independence Plaza North (IPN) for $156 million dollars and expressed his intention to take the building out of the Mitchell-Lama program. IPN is located in the Tribeca neighborhood of downtown Manhattan and includes 1,337 units of housing with over 3,000 residents. The exit of IPN from Mitchell Lama represented an

[108] Garbarine, *New York Times*.

large number of subsidized units lost in a fast gentrifying section of the City and highlighted the impact of opt-outs in high rent areas of the City. Prior to the opt-out, rents in the building averaged $600 for studios, $800 for one bedrooms and $1,000 for two bedrooms. The market value of these units however, came in at $2800 for a one-bedroom and $3765 for a two bedroom.[109]

Faced with the opt-out, the residents of IPN quickly organized and leveraged their political power to bring attention to the opt-out and get support in their fight to preserve affordability of the units. The tenants' initial strategies attempted to stop the proposed opt-out through a lawsuit and then offered to purchase their units from the new owner. This strategy was rejected. In the end, all income eligible residents received Enhanced Section 8 Vouchers and were required to pay either 30 percent of their income or their old rent for the unit.

Over two-thirds of the buildings residents were found to be eligible for the vouchers and used them to remain in the building. Some tenants who occupied apartments that were deemed too large for their family size were relocated to small apartments. As pointed out in the discussion introducing Enhanced Vouchers, above, they do not achieve the long-term affordability of the apartments since there is attrition of vouchered tenants. On the other hand, it is doubtful whether any of the other existing preservation strategies would have been successful in incentivizing the owner to continue with the Mitchell-Lama program given the impossibly high gap between the restricted rent under the program and un-rent regulated market rent.

[109] Wilson, Claire. "Still Quiet, Even with all the Children," *New York Times*, Jan. 1, 2006.

VI. Alternative Approaches to Preservation

In the two previous sections we discussed strategies and reviewed cases that demonstrate the City's use of its traditional tools in an attempt preserve affordable housing. Although the existing strategies for preservation have been effective for a portion of properties, owners continue to opt out of all three programs and to take units out of the restrictions that made them affordable to low- and moderate-income families. The continuation of these trends suggests that the current set of strategies fail to address a range of circumstances that apply to the different typology of properties, and may indicate that the City and other preservation partners may be inefficiently allocating their resources in their attempt to work on this issue. In this section, we will try to list out some alternative tools that can be used by the City to provide for the preservation of affordable housing units. In general the set of alternatives we offer seek to alter the incentive structure for opting-out of affordability restrictions. In particular these proposed tools would also seek to address some of the preservation risks present in our typology that we do not believe are adequately addressed with the City's existing tools.

A. Limiting Owner Returns on Opt-Out

As Tom Waters from the Community Services Society indicated, the preservation approach should combine "regulatory sticks" in addition to the preservation incentive "carrots."[110] In other words, this approach suggests that conversion to market should be disincentivized by lowering the profit that can be made by opting out of the contract.

These measures have the advantage of being extremely cost-effective, because there are few fiscal costs to implementation and the owners would be able to gauge whether the costs of

[110] Interview with Tom Waters.

the fees out-weigh the benefits of leaving the program. In either event, the City would be able to benefit, either through keeping the owners under the affordability restrictions or using the fees to develop or subsidize affordable housing for other residents. This strategy is sensitive to the differences in local markets and adds minimal administrative burden in its implementation. While we think this is reasonable recommendation there are, however, constitutional takings and notice issues involved with post-facto restrictions on programs. They have largely not been successful as legislative actions in New York. The following are several options considered in New York or implemented elsewhere.

1. Fees and Transfer Taxes

One variation that lowers opt-out profits is the imposition of fees on owners who are opting out or prepaying their contracts. In addition to long notice periods, places like San Francisco and Seattle require owners that are opting out to pay relocation fees to tenants while Rhode Island and Maryland require moving costs.[111] Portland used to require the owner to pay a $30,000 replacement housing payment. In addition, transfer taxes for programs leaving subsidy programs can be increased to affect the profitability of a market conversion. These fees and taxes are directly aimed at increasing the cost of the conversion transaction for the owner to deter the conversion.

2. Rent Regulation

Several initiatives in New York have dealt with extending rent stabilization to all projects opting-out of their Mitchell-Lama contracts, even those constructed post-1973. This measure was proposed by Mayor Bloomberg in response to worries over the Starett City conversion.

[111] Equitable Development Toolkit. "Expiring Use: Retention of Subsidized Housing," Policy Link *available at* www.policylink.org/EDTK/ExpiringUSe/policy.html, last visited Nov. 18, 2007.

However, this measure did not pass at that time due to lack of political support and a strong landlord lobby against it. During the contemplation of this measure, the Community Service Society also advocated that rent stabilization laws also be applied retroactively to converting HUD buildings as many of the same resulting problems are shared by HUD and Mitchell-Lama conversions.[112] Applying rent regulation to subsidized developments would provide existing tenants, particularly those in high rent areas with protections against high rent increases and would to an extent provide midterm affordability if the rent regulations carried over to future tenants. While this is a not a comprehensive strategy, it does add additional levels of restrictions that could factor in to the owner's decision on whether to opt-out, or at the very least, provide a buffer to tenants faced with market conversions in their buildings.

3. Statutory Leases

In this alternative, owners in converted buildings must give tenants mandatory temporary lease renewals at rent levels roughly equal to those before the opt-out. Rhode Island, Maryland and Maine use different versions of this strategy.[113] This tool would have the benefit of giving protections to current residents but do not afford for long-term affordability. If policy makers wanted to focus on protections for current residents particularly in areas where the tenants are well organized and vocal, would be a useful approach.

B. ADMINISTRATIVE REFORM TO SIMPLIFY RE-SYNDICATION AND LOWER COST OF REPORTING REQUIREMENTS

[112] Bach, Victor. "Why the Mayor's Legislation Should Protect both Mitchell-Lama Rentals and HUD-subsidized Housing," CSS Policy Memorandum, Dec. 15, 2003.

[113] Equitable Development Toolkit, *supra* note 131.

The use of public funds generally comes with various restrictions to insure that those funds are being used appropriately. Owners and developers in these programs have often complained that the restrictions placed on them are often overly onerous and duplicative.[114] Tenants' social security numbers and birth certificates do not generally change every year but owners operating under federally subsidized programs are required to resubmit verification of this information to government agencies for the same tenants each year. This is a time consuming process and a few uncooperative tentative can preventive an owner from accessing thousands of dollars in rental subsides each month.

One strategy for providing incentives for remaining in the program is to reduce the regulatory burden for owners to continue operating in the program. This can be done through the streamlining of documentation requirements and allowance of electronic submission of tenant data. In addition, information that rarely changes could be switched to a notification of change basis rather than be resubmitted each year. Rather than requiring verification for all tenants, audits of a random sample of families could provide sufficient assurances that affordability contracts are met.

Moreover, agencies can work together to consolidate requirements of various programs that may have been layered to finance a particular project. DHCR has begun to research ways to cede its authority under a number of affordable housing financing programs to other agencies that have regulatory authority for projects under other programs. By consolidating regulatory

[114] Interview with Perry Chen, formerly of Richman Group. September 2007.

authority and reporting requirements under a single entity, DHCR hopes to simplify operations under affordable housing programs for property owners.[115]

C. REDUCE COST FOR NON-PROFIT OF ACQUIRING AN EXPIRING-USE BUILDING IN EXCHANGE FOR AFFORDABILITY

The City has to some extent, but could continue to build upon mechanism to support non-profit acquisitions of expiring projects. Projects that should receive this type of targeting are those that are not HUD-subsidized and thus do not have access to the Mark-Up-to-Market tools that have proved generally effective for preservation goals because they respond to the market. Specific methods to continue facilitating non-profit acquisition of affordable projects are to lower taxes or lower utility rates charges to non-profit owners.

D. COORDINATE WITH NYSERDA TO ENCOURAGE AND PROVIDE INCENTIVES FOR ENERGY EFFICIENCY IMPROVEMENTS

By encouraging property owners to focus renovations on building system upgrades and other improvements with energy saving potential, a preservation agency can help guide owners to utilize their limited rehabilitation dollars on improvements that can lower their operating expenses over the long run. Moreover, a preservation agency can play a role in connecting property owners to available incentives through the New York State Energy Research and Development Authority (NYSERDA) to provide greater incentive for energy efficiency upgrades. Through its Multifamily Performance Program, NYSERDA offers $10,000 plus up to $1,200 per affordable unit for multi-family properties with more than five units that increase energy efficiency by 20 percent. The program offers only half the level of incentives for market

[115] Presentation by DVA, October 31, 2007.

rate units.[116] Property owners can also take advantage of low-interest loans of up to $5,000 per unit for energy efficiency improvements through the New York Energy $mart Loan Fund, with interest rate reductions of 6.5 percent. With no incremental funding from affordable housing funds, property owners can receive a significant amount of support for one-time capital improvements that will reduce a substantial portion of ongoing operating expenses by 20 percent, and low-cost financing for a portion of the rehabilitation that many of properties in the assisted stock need. DHCR has started to incorporate referrals to NYSERDA programs as part of their outreach to and negotiations with owners of assisted properties that have rehabilitation needs, which has contributed to their preservations successes.[117]

E. Utilize sale of inclusionary housing credits to fund rehabilitation and ongoing operations by non-profit owner

A community group in Williamsburg, Brooklyn is utilizing this strategy to raise capital to preserve the affordability of an LIHTC property in its 15th year for which they are the General Partner. The property has 33 units, 100 percent of which are affordable to tenants with income at or below 60 percent of AMI. The group needs to pay off the loan that is currently held by its Limited Partner, Enterprise Community Investment, to perform some necessary renovations, and to continue to subsidize any necessary operating expense differentials going forward. The group has decided not to re-syndicate their tax credits for the renovation because their renovations are not extensive enough to warrant the loss of full ownership and the resulting complication of operations. Instead, the group will sell inclusionary housing credits to developers who seek to purchase their affordable housing requirement under the Greenspoint-Williamsburg Inclusionary

[116] NYSERDA website. http://www.getenergysmart.org/buildingowners/existingmultifamily/incentives.asp

[117] Presentation by Deborah VanAmerongen, Commissioner of DHCR, October 31, 2007.

Housing Program off-site. At $200 per square foot, a 700 square foot unit could raise as much as $150,000 in capital. The strategy could be applied to properties across the City, under the citywide 421-a program.[118] One complication to applying this approach more broadly is a potential conflict with new affordable housing production seeking to benefit from the purchase of off-site credits. Moreover, the strategy is vulnerable to the possible softening of the condo market in the City, which could slow production of market-rate units, and make the affordable housing density bonus less profitable and less attractive to condo developers.

F. ADVOCATE FOR THE PASSAGE OF AFFORDABLE HOUSING PRESERVATION TAX RELIEF LEGISLATION

Both the House and the Senate currently have bills under consideration to address preservation of LIHTC properties through the forgiveness of exit taxes in exchange for sale of properties to qualified buyers who will commit to maintaining the affordability of the property. This legislation would create a more even playing field for non-profit and for-profit developers in the bidding process for LIHTC properties, potentially creating opportunities for non-profits to purchase properties solely by covering the existing debt on the property.[119] Although this legislation is a promising preservation strategy, individuals knowledgeable about the relatively long history of such legislation have noted that the likelihood of Congress passing the legislation is highly uncertain.[120]

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[118] Interview with Elizabeth Zeldin, Advisor to Community Group, October 28, 2007.

[119] Millennial Housing Commission. *Meeting our Nation's Housing Challenges.* May 2002, 34-36.

[120] Interview with Joseph Reilly, Community Development Trust, October 12, 2007.

VII. Policy Recommendations

The findings presented in this paper focus on several overarching themes:

- Owners of properties in the Mitchell-Lama, HUD Multi-family Rental, and LIHTC assisted portfolios are choosing to leave these programs at alarming rates.
- There are many tools available for keeping a unit affordable, but they are not always available or appropriate given particular circumstances.
- Various preservation tools can be combined in multiple combinations to achieve different preservation goals depending on the circumstances.

To address these themes, the recommendations presented here must go beyond individual programmatic responses to the problem of preservation to identify larger, process-related strategies to improve the City's response.

A. Make a commitment to preserving units in the affordable stock, despite the need to expand affordable housing stock in New York City

The Mayor has set housing goals to create or preserve 165,000 units of affordable housing by 2013, with approximately $7.5 billion in funding. About 73,000 of those units are aimed at preserving existing units. Since 2004, the City has made significant progress towards preserving those units, achieving about half of the goal, with much less progress towards the new construction goal due to rising costs of new construction, and uncertainty in the LIHTC market, a primary source of funding for new affordable construction.[121] Although the City has had

[121] New York City Independent Budget Office, "Mayor's Housing Plan: Progress to Data; Prospects for Completion," *Inside the Budget,* November 9, 2007.

considerable success in preservation compared to new construction of affordable units in the past few years, the City must continue its commitment to preserving all the units it can, and must pursue some of the alternative preservation strategies that will contribute to preservation with less investment from the City's affordable housing budget.

Significant barriers to constructing new affordable housing exist, and extraordinary amount of capital in the form of subsidies are typically required to support new construction, compared to preservation. For example, at a potential cost of up to $180,000 per affordable unit,[122] it would cost upwards of $4 billion to build the 25,000 LIHTC units that will reach Year 15 by 2020, compared to an estimated funding gap of about $577 million to preserve the same units.

It is important to note that the two goals are not necessarily mutually exclusive. With careful planning and consideration of the particular risks and characteristics of a property, the City may be able to achieve both goals simultaneously in many circumstances. For example, in the case of Ruppert and Yorkville Towers, the City allowed the tenants to negotiate an agreement with the property owners that protected all of the current tenants, while preserving long-term affordability for only one-third of units. At the same time, two-thirds of the tenants – those who were able to purchase their units – received a substantial windfall at the expense of more than 800 units for the future affordable housing stock. However, if the City had considered introducing a more nuanced alternative – such as allowing the condo sales, but limiting the equity gain for the tenants who bought condos – it could have protected all current tenants and preserved a level of long-term affordability for all of the units.

[122] City Limits, *Hard Costs: The Rising Price of an Affordable New York*, Spring 2007, p. 12.

B. Conduct Outreach to Property Owners Prior to Expiration of Subsidies

The median rent for unsubsidized units in the Bronx increased by 2.5% annually from 2002 to 2005. Currently, the median rent in the Bronx is just slightly above LIHTC rents. However, some community groups in the South Bronx, where average rents are some of the lowest in the City,[123] now note that real estate speculation is beginning to spread into their neighborhoods and that they expect that building owners will have to raise rents to avoid losing money.[124] More than 80 percent of the units that will reach Year 15 in the Bronx by 2020 will do so in the next 9 years. Timing is critical – owners of properties that are currently considered low-hanging fruit in financial terms could soon be facing a much higher cost of maintaining affordable rents. Early outreach could help to encourage owners to begin the preservation process before their subsidies expire.

For example, many experts in the field have identified the time period around year 10 as the most important time to begin identifying Year 15 challenges and crafting a preservation strategy.[125] Then, in Year 13, the Year 15 disposition process on its LIHTC properties should begin.[126] DHCR officials have begun to take a more proactive approach to preservation by reaching out to property owners in their assisted housing portfolios prior to the expiration of their affordable rental contracts. The strategy has been so successful in obtaining preservation

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[123] Been, Vicki, et. al., *State of New York's City's Housing and Neighborhoods, 2006,* Furman Center for Real Estate and Urban Policy, 2007, p. 27

[124] Discussion with Greg Jost, University Neighborhood Housing Program, October 1, 2007.

[125] Online presentation by Gregory Griffin and Marian O'Conor from Enterprise Community Investments, "Year 15: Nonprofit Transfer Strategies for Expiring LIHTC Properties," May 16, 2007.

[126] Enterprise Community Investments, "Year 15 Q&A."

commitments that DHCR reached its administrative capacity for the remainder of the 2007 calendar year in October.[127]

C. Create a Mayoral Office or an Office Within HPD to Oversee Preservation and Implement a Preservation Process Based on Best Practices

Based upon our research and discussions with experts in the field, it is clear that each assisted portfolio, and each property within those portfolios, has unique challenges and risks in terms of preserving affordability. Moreover, at any given time, the City may seek to meet a specific preservation goal, either to protect individual current tenants or to preserve the affordability of units for the long term. As such, preservation strategies cannot be one-size-fits-all. Without a framework for understanding the challenges and risks of a given property, the City runs the risk of spending more subsidy dollars than necessary or losing the affordability of units that could be saved – as in the case study of Ruppert and Yorkville Towers.

This paper proposes a framework to begin to understand the typology of a particular property within the context of its individual characteristics and the City's preservation goals. This paper recommends that a new office, or re-organized existing office utilize a similar typology to identify the risks to a particular property, and implement the most appropriate existing and alternative programs that can address those risks to best promote preservation.

Various entities involved in preservation of these portfolios are currently using this consulting-based strategy successfully. For example, Enterprise Community Investments, a major player in the field of Year 15 dispositions for LIHTC, works closely with the sponsors of LIHTC properties to introduce strategies to preserve affordability past the initial 15-yer

[127] Presentation by Deborah VanAmerongen, Commissioner of DHCR, October 31, 2007.

compliance period. The custom disposition plan created by Enterprise might include transfer strategies, refinancing for properties with capital and ongoing operational needs, re-syndication of tax credits for properties with greater rehabilitation needs, and lease-purchase strategies for properties whose tenants can afford to purchase their units.[128] HPD is currently not employing this consulting-based process. They have, however, hired a consultant to identify process-based issues for preservation, but those findings will not be available for several months.[129]

D. TYPOLOGY FRAMEWORK IN PRACTICE

The following is an example of a fictionalized property to illustrate how the Typology might be utilized to characterize the risks of a property and identify the most appropriate preservation strategies.

Property A is located in Manhattan, below 96th Street, in a very strong real estate market, with extensive rehabilitation needs and high operating expenses. The property is a Mitchell-Lama development that was built after 1974, and is owned by a for-profit developer with no preservation interest.

[128] Enterprise Community Investments, "Year 15 Disposition Strategies."

[129] Confidential Interview with Senior HPD Official.

Property A: Typology

Affordability Risk Factors	High (+) vs. Low (-) Risk Characteristics	Preservation Goal	
		Protect Current Tenants	**Preserve Long-Term Affordability**
Strength of Market	(+) Market Rents Far Exceed Affordable Rents		
	(-) More Affordable Market		
Rehabilitation Needs	(+) Extensive Needs		
	(-) Minimal Needs		
Operating Expenses	(+) High Operating Expenses		
	(-) Low Operating Expenses		
Involvement of Preservation-Oriented Entity	(+) No Involvement		
	(-) Presence of a Preservation Partner or Interested Purchaser		
Administrative Hurdles	(+) Burdensome Administrative Requirements		
	(-) Minimal Administrative Requirements		
Other Use Restrictions	(+) No Additional Use Restrictions		
	(-) Rent Stabilization or other Subsidy Program Restrictions		

The for-profit ownership of the property, the administrative hurdles of the Mitchell-Lama program, and the strong rental market in the area suggest that the property owner's opt-out incentive is high. However, there are opportunities to work with the property owner in the rehabilitation and operating expense needs of the property, as well as rent restrictions that will be placed on the property should it move to market rents.

Typically, if Property A were eligible for Section 8 subsidies, the City would allow the property to opt-out of the program, and to move to market-rate rents. The City would utilize Enhanced Section 8 Vouchers from HUD to protect the current residents. The long-term

affordability of the units would not be protected under this strategy. Moreover, there is a high burden in using Enhanced Section 8 Vouchers in a high market area, which may preclude future Section 8 allocations for new tenants, creating a potential equity issue. Moreover, the rehabilitation needs of the property and the high operating expenses suggest a great need for up-front capital to improve the housing stock, in addition to on-going operating subsidies. Providing Section 8 subsidies alone does not preserve the housing stock, either in quality or quantity.

Therefore, in this case, it might be most appropriate to start with the opportunities to work with the property owner. The property's rehabilitation needs[130] and high operating expenses may present a barrier to viably marketing the units at market rents. The preservation office could offer incentives such as energy efficiency improvement incentives through NYSERDA that would offer an influx of capital dollars of $1,200 per affordable unit and $600 per market-rate unit, as well as on-going operating expense savings, and a below market interest rate loan for the remaining rehabilitation and repositioning of the property. These incentives will not exceed the pull of market-rate rents in Manhattan. This is an instance where allowing an income mix in the building for cross-subsidization could provide great benefit. Given the more moderate income levels that the Mitchell-Lama program was designed to serve, a percentage of the units containing higher income households – up to 100 percent of AMI – might be allowed to move to market-rate rents, under the protection of rent stabilization, and a portion might be kept at affordable levels for households with incomes closer to 60 percent of AMI.

[130] Total rehabilitation needs are assumed to be $5,000 per unit.

To test the strategy, we chose an income split of 20 percent of units affordable to households with incomes of 60 percent of AMI, and 80 percent of units affordable to households with incomes of 100 percent of AMI (which approximate market rents in a selected neighborhood in Manhattan – the Upper East Side). Under this set of strategies, the City could potentially preserve the affordability of the development with $30,000 to $35,000 per unit. Given the existing income mix that Mitchell-Lama developments were designed to serve, this set of strategies has the potential to protect current tenants, as well as preserve long-term affordability at a reasonable cost to the City's affordable housing budget.

Therefore, it may be possible to preserve units that may be thought to be too expensive an investment at first glance. There may be instances where the price per unit is too high to justify preservation, but a good look at opportunities that exist will help preserve additional units.

VIII. Conclusion

This paper is by no means an exhaustive review of preservation strategies that the City can and should practice. Models of other cities facing the same expiring contracts in affordable housing should be compared to extract best-lessons and most innovative tools. We have learned through our discussions with agency representatives that the City has retained a consultant to aid in the formulation of strategic policies that the City will begin implementing next year. The scope of the consultant's work is similar to ours in that it will try to modify old and create new strategies to prevent the loss of affordable housing as the City continues in the development or rehabilitation of new units. While the team did not have access to the level of privileged data the consultant will, we believe that the agency exploring these issues should expand upon the research in this paper using their own data and assumptions.

In the assignment of this paper topic and the beginnings of a Citywide discussion on the preservation of affordable housing, we see an evolution of housing policies that once tried to prevent the implosion of City, now grappling with the success of these initiatives and subsequent revitalization of the City. A lesson of this evolution in thought is that the diversity of the City is key to its resurgence compared to other once great urban centers. To ensure its future the City must preserve the gains that have been won in the past and create new tools to protect the long term success of its efforts today, through more strategic approaches to preserving the affordable housing needed to house the diversity of its population.