
YEAR
15

Countdown to Year 15

Lease-purchase programs make sense for affordable housing investors

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Affordable housing has come a long way in the past 19 years. The sea change began in 1986, when Congress enacted the Low Income Housing Tax Credit (LIHTC) program as part of the Tax Reform Act of 1986. This new law provided investors with an unprecedented opportunity to do good work while still making a reasonable return on their investment – by putting their money into affordable housing.

The LIHTC program allows investors in qualified rental housing to take credits on their tax returns. The credits are spread over 10 years, and can be worth up to 90 percent of the total investment made in construction or renovation. This fundamentally changed the business case for affordable housing. Through the tax credits, the federal government was providing a tangible means of offsetting investor fears of low returns on their investment in affordable housing.

In exchange for these incentives, the federal government requires that a project remain affordable for 15 years. The program also requires that investors continue to own the project for this 15-year period unless the investor posts a bond to guarantee that the affordability requirement will continue to be met. And for projects that received tax credits after 1989, federal requirements extend housing affordability for an additional 15 years, for a total of not less than 30 years. However, investors could sell their interest in the project after the initial 15-year period of ownership without posting a bond.

But what happens when Year 15 arrives? That's the big question for many investors and developers now that properties are reaching the Year 15 milestone.

Nobody can doubt the results of the LIHTC program. Over 1.6 million affordable housing units have been built nationally since the inception of the program, and nearly 100,000 units are built every year, with an annual investment of over $6 billion. The socially motivated for-profit and non-profit developers are able to sell the tax credits to investors to raise the equity needed to build or renovate the affordable housing.

But by the time Year 15 arrives, the tax benefits associated with a project have been exhausted. At this point, most investors are interested in ending their involvement in projects and focus their resources on new projects or on other ventures. For these investors, there are a number of disposition strategies that they can employ. These include selling the property to the developer to continue to operate as affordable housing, selling the property to a charitable organization or government entity at a bargain price, or finding new investors to reinvest in the property with new tax credits to upgrade it for the next 30 years. There are several other options that have varying degrees of appeal.

And then there is the innovative option that creates homeownership opportunities for tenants in projects funded by a program that what was originally structured only to provide affordable rental housing. Under this option, residents are given a chance to buy their units at the end of the 15-year compliance period.

If the project consists of single-family homes, the units can be sold directly to the individual tenants at a very affordable price. Alternatively, multifamily properties can be transferred to a tenant-sponsored cooperative, or a condominium association could be formed to acquire the property. By selling to the tenants through one of these means, the goals of fostering homeownership and enhancing community stability can be achieved.

In some cases, projects were planned from the beginning ultimately to be sold to their low-income tenants. Projects were set up under a "lease-purchase" concept, with the tenants understanding from the beginning that they would be able to buy their units when the project reached the 15-year milestone. Lease-purchase programs can be sound business strategies for developers for a number of reasons. Developers are responsible for day-to-day oversight of LIHTC properties (or at least for hiring apartment professionals to manage the properties), and a

lease-purchase exit strategy provides significant operational benefits that begin on Day One and last for all 15 years of a project's lifecycle. Lease-purchase programs can positively impact everything from occupancy rates to maintenance costs to renter profiles.

For instance, residents who plan to buy their units tend to be more likely than typical renters to take care of their unit, and may even invest their own funds in maintenance and upgrades. Lease-purchase programs also help attract responsible residents who want to improve their lives. And the carrot of affordable home ownership encourages long-term rentals, as residents who plan to buy their units are less likely to move out. This helps sponsors maintain very high occupancy rates for the duration of a project and minimize vacancy loss and expenses.

CHN: Pioneers in lease-purchase

In 1987, the Cleveland Housing Network (CHN), a partner with my firm, The Enterprise Social Investment Corporation (ESIC) in 20 separate projects, linked the Low Income Housing Tax Credit to a lease-purchase option for residents in several projects. To date, CHN has assisted 2,100 low-income families in Cleveland, Ohio move up and out of poverty, thanks in large part to the stability and wealth created by affordable home ownership.

CHN's program is built upon a long-standing "hand up" strategy that promises eventual homeownership after 15 years of responsible residency. Since its inception, CHN has leveraged over $120 million in direct capital investment in Cleveland's neighborhoods. The program is specifically designed to keep monthly payments for residents as low as possible.

In January 2005, CHN began selling its latest group of 50 lease-purchase homes, which were developed in 1990 and reached the Year 15 milestone in 2004. CHN expects to succeed in selling 90 percent of these units to lease-purchase residents.

Conclusion

The business of affordable housing has changed dramatically since the nation's first LIHTC project was completed in Pittsburgh 17 years ago. ESIC has raised more than $4.7 billion in LIHTC equity since 1987, and orchestrated the investment of these funds in over 1,200 projects providing over 65,000 apartments and homes affordable by low and moderate income households. ESIC is currently undertaking over 120 projects annually. From the outset, ESIC's intention has been that projects sponsored by non-profit corporations would be sold to their non-profit sponsor after the end of the 15-year compliance period to avoid potential low-income tenant displacement or loss of affordable housing options, and also to create affordable homeownership opportunities.

As the LIHTC program celebrates its 19th birthday, many projects initiated in the early days are coming to Year 15. ESIC's first three projects hit Year 15 in 2002, and through 2004 ESIC has transferred 17 projects to their non-profit sponsors. By 2007, that number will have grown to over 80 projects, and it's heading higher in the coming years, ultimately reaching over 100 projects annually.

The issue of Year 15 is here to stay and will continually evolve as developers and investors think through their exit strategies. Giving families the opportunity to improve their lot in life through homeownership is one way that the LIHTC program is furthering the goals of community stability and also giving low-income tenants a chance to share in the American dream.

Developers, investors and housing professionals interested in learning more about the Year 15 issue can visit www.esic.org. AP

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