Mixed-income public development: an overview

The challenge

In most cities, the amount of affordable housing that can be built is limited by the amount of subsidies from Congress. Unfortunately, these programs, such as the Low Income Housing Tax Credit (LIHTC) or the HOME Investment Partnerships Program are routinely oversubscribed. Each year, affordable housing that communities desperately need goes unbuilt due to lack of available funds. To increase affordable housing production, the public sector needs to be creative and entrepreneurial to find ways to increase the supply of new affordable homes.

The opportunity

Across the country, cities and states are exploring new ways to position the public sector as an investor and owner in mixed-income developments, securing new permanently affordable housing by leveraging public financing and tax relief in partnership with local developers.

This type of approach starts by considering what it takes to build a financially sustainable market rate development. The public entity can then bring to bear lower-cost public financing through a revolving loan fund and tax abatements to enable roughly 30 percent of the units to be designated affordable at the property without jeopardizing its financial sustainability or requiring ongoing subsidies.

Crucially, these types of projects can be built without tapping scarce federal resources. A mixed-income public development model should be seen as **a complement, not a competitor** to existing affordable housing production.

What does this look like in practice?

In Montgomery County, Maryland, the Montgomery County Housing Opportunity Commission (HOC) opened the Laureate, a 268-unit apartment complex in 2023 using this model. The building came about through a partnership between the public housing authority and a private developer when the developer found themselves unable to secure financing to move a traditional market rate project in their pipeline forward.

The Laureate, HOC's 268-unit mixed-income project completed in 2023 in partnership with Bozzuto and EYA

HOC stepped forward to invest in the project through their revolving loan fund, called the Housing Production Fund, in exchange for majority ownership of the project. As majority owner, HOC set the standards for affordability, sustainability, and quality of design, while the day-to-day property management for the project is handled by their development partner. The project was underwritten to support the maximum number of affordable units without jeopardizing the long-term financial viability of the project.

25 percent of the units in the building are affordable to households making 50 percent of the Area Median Income (AMI), and five percent are affordable to households making 70 percent of AMI, with the remaining units serving residents paying market rate. Because the units produced through this process are publicly-owned, they can remain affordable in perpetuity.

Meanwhile, HOC's initial investment from the Housing Production Fund made at construction will be returned to the fund and can be put toward another future development.

What does a community need to implement this model?

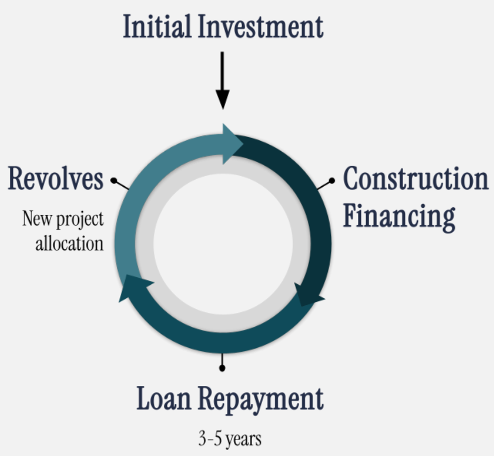
1. A **public entity** such as a public housing authority, land bank, or public development authority to own the real estate assets, keep them affordable, and access tax relief.

2. A **revolving loan fund** to provide short-term lower-cost loans during the construction period of the project.

3. A **strong rental market**. The market rate units in the property help offset the lower affordable rents. The model works best in places where private development is already taking place.

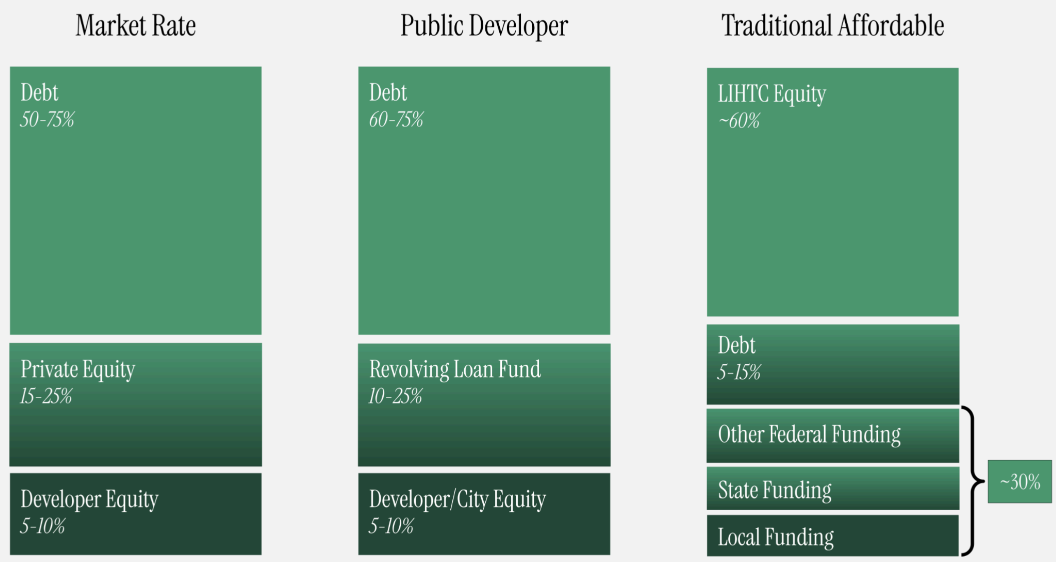
A revolving loan fund provides ongoing benefits

A key component of this model is a revolving loan fund for construction. Financing the construction of multifamily housing typically occurs in two parts. The first, construction financing, involves the equity and debt a developer assembles to complete pre-development and construction activities. In a market rate transaction,the majority of these costs are paid for by a short-term (12-18 month) construction loan from a bank, which could cover the majority of costs. Second, once a project is built and leased, the project would convert to permanent financing, paying off and replacing the construction loan with a longer-term note. Because there is less risk involved with a completed building, permanent financing carries lower interest and is typically paid for out of the cash flow in the building.



In the current interest rate environment, the size of construction loans is decreasing. In better financial conditions, construction mortgages might cover two-thirds of a project's cost. In today's conditions, that loan-to-value ratio can [be much lower], closer to just 50 percent. This requires developers to rely on private equity investments to cover the gap, which often come with expectations of double-digit returns, driving up the overall costs of construction. The public mixed-income development model overcomes this hurdle by replacing the private equity investment with funds from a publicly-funded revolving loan fund. The revolving loan fund provides roughly 20 percent of the construction costs and then is replaced and "revolves out" when the project converts to permanent financing, allowing the fund to make further investments.

Not only does this reduce or eliminate the reliance on scarce federal resources, it can also significantly reduce the complexity. Developers typically need to layer three to four additional sources of federal, state, and local funding into projects to get a LIHTC project to work, whereas this model offers a more direct execution.



An emerging model ready to scale

HOC was the first to pilot this model, and Center for Public Enterprise has worked closely with them to help other cities and states to bring this model to their jurisdictions and adapt it to their needs. Other communities actively pursuing this model include Atlanta, through the Atlanta Urban Development Corporation, Chattanooga, Seattle, Chicago, Raleigh, Kingston, Syracuse, the state of Rhode Island, the state of Hawaii, and the state of Michigan. The model has been recognized and elevated by the U.S. Department of Housing and Urban Development and the White House. By our estimate, there is roughly $283 million of public investment in revolving loan funds for construction finance and over 5,000 units built or in project pipelines using this model.

Flexible pathways to development

The original model established by Montgomery County can be adapted to fit many jurisdictions. For example, cities can structure outright ownership models in which the city oversees project financing, development, and long term management. The model can also be adapted to enable the city to function as a partial majority owner by partnering with private developers. In this partial ownership model the city provides low-cost financing to their projects in exchange for ownership and affordability.

Who we are

Center for Public Enterprise is a nonprofit organization based in New York that generates research on innovative public-driven economic development programs, and provides direct technical assistance to agencies seeking to design and implement new programs. Center for Public Enterprise has established itself as a national leader in advising public agencies on housing and energy development programs.

Contact

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