Sound Transit Affordable Housing Revolving Loan Fund

Needs Assessment

April 2020

LISC
LOCAL INITIATIVES SUPPORT CORPORATION

Introduction

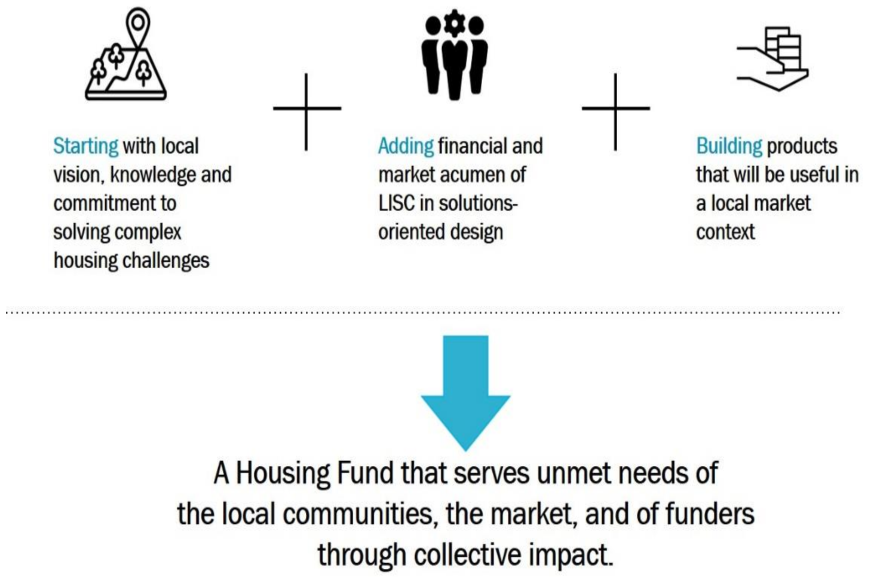
About Revolving Loan Fund (RLF)

In 2015, the Washington state legislature adopted RCW 81.112.350 directing Sound Transit to advance an equitable Transit Oriented Development (TOD) strategy, setting forth specific requirements and giving new tools to Sound Transit to advance equitable development through prioritizing affordable housing. The legislation states Sound Transit must contribute at least four million dollars each year for five consecutive years to a revolving loan fund to support the development of affordable housing opportunities.

In 2019, Sound Transit's Office of Land Use Planning and Development (OLUPD) solicited a competitive bid to bring on a partner that would help in the development of the Revolving Loan Fund Business Plan Framework; that partner is the Local Initiatives Support Corporation (LISC).

Approach to Fund Design

LISC is working collaboratively with and supporting Sound Transit in developing, leveraging, administering and promoting a RLF to support the development of affordable housing opportunities related to equitable transit-oriented development (TOD) within the Sound Transit district.



Sound Transit Revolving Loan Fund Goals

The Sound Transit team has established five goals for the Revolving Loan Fund ("RLF"). The following goals will provide key guidance in the RLF program development process and evaluation of performance outcomes

1. Sound Transit will identify partnership opportunities for the programmatic development and administration of the RLF.
2. The RLF is a self-replenishing pool of money, utilizing interest and principal payments on old loans to issue new ones.
3. Sound Transit will leverage its contribution to the RLF by seeking additional funding from public and private sources.
4. The RLF will facilitate the development of equitable transit-oriented development on Sound Transit properties.
5. The RLF will support strategies that minimize displacement of individuals from properties near Sound Transit investments

Executive Summary

LISC is pleased to present the enclosed assessment of the current state of regional affordable housing financing resources in the state of Washington (the "Needs Assessment").

To compile relevant data for this Needs Assessment, LISC performed the following tasks:

- Conducted interviews and focus groups with 37 affordable housing stakeholders in Washington's government, nonprofit, and for-profit sectors;
- Identified available financing resources, existing funds and fund structures;
- Analyzed existing local, regional, and national housing projects to determine which would meet Sound Transit's future goals; and
- Identified best practices employed in successful transit oriented development (TOD) and revolving loan funds around the country.

As a result of LISC's research, LISC has been able to identify the strengths and challenges in Washington's affordable housing financing system, and has formulated a process by which LISC and Sound Transit may work together to design the Revolving Loan Fund (RLF) to meet Sound Transit's goals and facilitate regional equitable transit-oriented development.

LISC analyzed financing gaps at each stage of development from acquisition to occupancy and identified the following three challenges in the market hindering production of affordable housing: high land costs, availability of subsidy and patient capital. Although every city has a unique development market the three challenges listed above were echoed by stakeholders at both state and municipal levels.

Summary of Methods for Needs Assessment and Timeline

LISC used a mixed-methods approach to conduct a needs assessment of the current state of regional affordable housing financing resources with the objective of identifying gaps, challenges, and strengths of the funding system. All Sound Transit's five geographic sub-areas (Snohomish County, North King County, East King County, South King County, and Pierce County) were considered independently for their policies and available resources, as well as part of the larger funding and affordable housing ecosystem. The methods used included stakeholder interviews, focus groups, a review of 15 LIHTC project proformas (projects placed in service between 2015 and 2019), extensive analysis of public policies and resources that affect affordable housing, and an analysis of the funding gaps that exist.

Stake Holder Interviews and Insights

To date, the LISC team has completed interviews and focus groups with 38 stakeholders, including developers of affordable housing, public housing authorities, City and County representatives, investors, CDFIs, and philanthropic groups. Interviews helped shape our understanding of the challenges that developers of affordable housing face in terms of acquiring and holding land, capital availability, and partnerships/joint ventures. The following is a summary of learnings from these interviews.

Property and Land Acquisition + Holding Challenges

> *Developers of affordable housing do not have an efficient or affordable way to acquire parcels near transit; these parcels exist but they are widely considered cost prohibitive and often purchased with investor cash.*

> *The financing landscape outside of the City of Seattle is very different: developers do not have access to the same resources and public subsidy.*

> *Though there are a variety of funds available for financing projects in transit-rich locations, the tools are not currently aligned to effectively ramp up affordable housing production at future TOD sites.*

> *Even if acquired, the holding costs for land financed by banks is very expensive. Many developers cited that most projects do not move forward because they will "never recover the cost of the land" in the deal.*

Capital Strengths and Challenges

> *There are a multitude of small (mostly local and regional) funds and resources for affordable housing but these are generally considered by developers to be very competitive.*

> *Due to the competitiveness of subsidy-like resources, developers do not always know what resources they will be able to secure early enough in the process, which drives up project holding costs or makes a project infeasible before property can even be purchased.*

> *A specific gap identified by many developers is that of medium-term project financing, such as 7-10 year financing.*

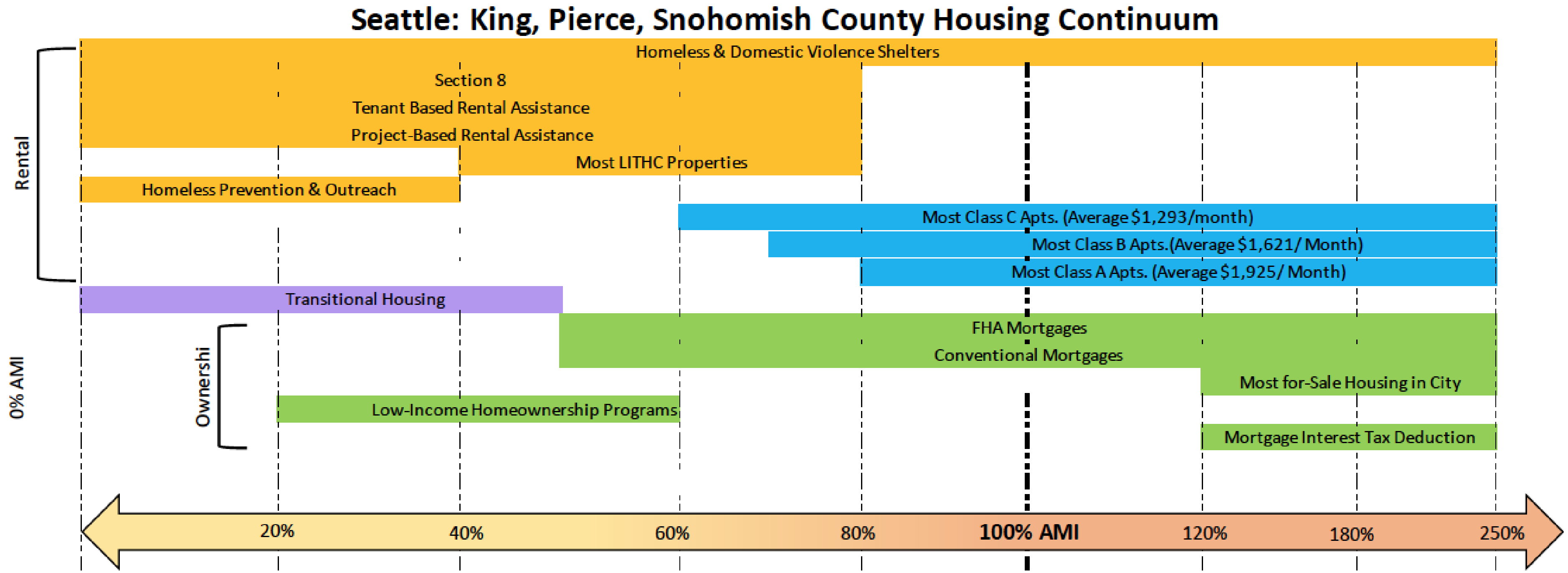
Development Partnership Strengths and Challenges

> *The nonprofit developers are also very adept at delivering quality affordable housing against a very complicated regulatory environment and in an expensive market. Many struggle to produce more than 1 or 2 projects a year on their own without partners*

> *In the face of limited capital availability, many non-profit affordable housing developers have turned to for-profit partners to add development capacity and capital to complicated development projects.*

Greater Seattle Market Housing Continuum

The Team reviewed the full range of market-rate and affordable rental and homeownership opportunities in the market. The review includes shelter housing and temporary housing. LISC created the Housing Continuum which is intended to pair the availability of housing options with the Area Median Income (AMI) for a family of four. The chart uses the industry standard—30% of income—as the limit that a household should pay toward rent or a mortgage. Households paying more than 30% of income toward housing costs are considered “burdened.” Households paying more than 50% of income toward housing costs are considered “severely burdened.”
(Data sources: Novogradac, HUD/ FHA Income limits, Co-Star).



Family of 4						
Annual Income	$19,827	$39,653	$59,480	$79,307	**$99,133**	$118,960
Max Affordable Rent:	$496	$991	$1,487	$1,983	$2,478	$2,974
Max Affordable Mortgage:	$496	$991	$1,487	$1,983	$2,478	$2,974

Affordable Housing Need + Rent Burden King County

HUD 2019 Household Income Limits				
	1 Person	2 People	3 People	4 People
30% AMI				
Household income	$22,800	$26,070	$29,310	$32,580
Monthly Rent	$570	$651	$732	$814
50% AMI				
Household income	$38,000	$43,450	$48,850	$54,300
Monthly Rent	$950	$1,086	$1,221	$1,357
80% AMI				
Household income	$60,800	$69,520	$78,160	$86,880
Monthly Rent	$1,520	$1,738	$1,954	$2,172
100% AMI				
Household income	$76,000	$86,900	$97,700	$108,600
Monthly Rent	$1,900	$2,172	$2,442	$2,715

Affordable Housing Summary of Need: King County

The population in King County and surrounding counties have been experiencing consistent growth for the past few years. The growth in population can be attributed to the burgeoning economy of the Seattle metro area that is headquarters to many nationally recognized companies: Amazon, Microsoft, and Starbucks to name a few. In 2018, the county was home to nearly 2.2 million residents growing 13% from 2010. In addition to new residents, the county's household income has also increased form 17% from $85,600 for a family for four in 2010 to $103,400 in 2018.

King County is comprised of 790,000 households of those, 59% are homeowners, while 41% are renters. Household types through the county have also been affected with the influx of new resident to the county 41% of the population reside in nonfamily households and 58% of households are related. This is in contrast with only 30% of the population living alone meaning 10% of the population are living in roommate situations which could be a result of no affordable housing stock. White residents holding 74% of homeownership in the county, while all other minorities, with Asian residents as the only exception, are the majority renters versus homeowners predominantly hold home ownership in the county.

In 2018, the AMI for the county for a family of four was $103,400; the median income of the county has been on a steady increase by 17% since 2010. The average rent for a three-bedroom unit in the county is $2,254, cost burdening households earning less than 80% of AMI, who can reasonably afford $2,172 in rent. The chart to the left demonstrates what low income households can contribute to housing cost.

A comparison of affordable rents and average rental rates in the market highlights those households below 80% AMI cannot reasonably afford housing units in the county without additional subsidy. In King County the hourly wage necessary to afford, a three-bedroom unit at market rate in 2019 was $ $52.56 per hour and an annual income of $109,320. For minimum wage household to afford a three bedroom in this market they would need to work 175 hours per week (Source: Out of Reach, NLIHC) . Rising rental costs seen across the county is putting mounting pressure on low-income residents and making it increasingly more difficult to stay in their communities. The cost of an average unit has seen an increase of 28% since 2010. Vacancy in the market was 4.7% for the year 2019. There are currently 35,059 LIHTC units in the Sound Transit King County sub areas.

Affordable Housing Need + Rent Burden- *Pierce County*

Pierce County 2018 Household income limits				
	1 Person	2 People	3 People	4 People
30% AMI				
Household income	$15,660	$17,910	$20,130	$22,380
Monthly Rent	$391	$447	$503	$559
50% AMI				
Household income	$26,100	$29,850	$33,550	$37,300
Monthly Rent	$652	$746	$838	$932
80% AMI				
Household income	$41,760	$47,760	$53,680	$59,680
Monthly Rent	$1,044	$1,194	$1,342	$1,492
100% AMI				
Household income	$52,200	$59,700	$67,100	$74,600
Monthly Rent	$1,305	$1,492	$1,677	$1,865

Affordable Housing Summary of Need: Pierce County

Pierce County, Washington was home to 891,299 residents in 2018. The population in the county has seen an increase on 11% since 2011. This growth in population can be attributed to the growth in economic opportunity in neighboring King County, Washington. As rent prices rise in Central Puget Sound renters are being pushed further away and relocating to more affordable areas in Pierce County.

Although population has been on a steady increase, median income in the areas has only increased by 7%, from $69,600 for a family of four in 2010 to $74,600 in 2018. The average rent for a 3-bedroom apartment in Pierce County is $1,675 per month, putting a cost burden on families making below 80% AMI. Thirty eight percent of households in Pierce County regardless of household size are below 80% AMI. The income limits and reasonable rent as express by HUD (30% of income for housing costs) is shown below.

Households in the area that pay over 50 % of their income for housing costs are extremely rent burdened. For the Sound Transit sub region of Pierce County 21.6% of renters are extremely rents burdened. A household must earn $35.17 per hour in order to afford a market rate three bedroom unit in Pierce County. A renting household must work 117 hours per week to afford this unit, in a double income household that amounts to 58.5 hours each. (low income housing coalition). As rental prices increase, approximate 19% since 2010, many middle-income households can still find market rate housing that is affordable, it may be located much further from transit services or employment lowering quality of life.

The vacancy rate for in the market is considerably low at 4.4% compared to the state rate of 5.2%. In 2017 there were 312,839 households in Pierce County of those 61% of households are homeowners. Homeownership is predominately held by white residents making up 48% of all homeowners. There is significantly larger portion of the white population that are owner as opposed to renting. While other minorities in the county are split with a higher percentage of their population renting or split equally between homeowners and renters.

Affordable Housing Need + Rent Burden- *Snohomish County*

Snohomish County 2018 Household income limits				
	1 Person	2 People	3 People	4 People
30% AMI				
Household income	$21,720	$24,810	$27,930	$31,020
Monthly Rent	$543	$620	$698	$775
50% AMI				
Household income	$36,200	$41,350	$46,550	$51,700
Monthly Rent	$905	$1,033	$1,163	$1,292
80% AMI				
Household income	$57,920	$66,160	$74,480	$82,720
Monthly Rent	$1,448	$1,654	$1,862	$2,068
100% AMI				
Household income	$72,400	$82,700	$93,100	$103,400
Monthly Rent	$1,810	$2,067	$2,327	$2,585

Affordable Housing Summary of Need: Snohomish County

Snohomish County population has increased by 12% since 2010, as of 2018 the county is home to 814,901 residents. These residents make up about 284,477 households in the county, the majority of households are made up of two people (34%), followed by four or more persons (25%). Households in Snohomish are 68% related family households one-third of which are renters and two-thirds homeowners. Over half of homeowners in the county are white.

HUD considers households earning 80% or less of AMI as low-income household. We use this standard to define a low-income household. Based on the average market rates in the county those households earning less than 50% of AMI could face difficulty finding and affordable homes in the private market. The need for affordable housing is growing rapidly in Snohomish County. The median income for this area is $103,400 and 54% of households in the county are living below AMI for a family of four and 30% where below 50% AMI. In 2017 21% of these households were severely cost-burdened.
The county saw a 28.4% increase in rent from 2013–2016 but income during that time frame only increased by 1%. Drastically rising rent and stagnant wages by indicate a shortage of affordable rental housing.

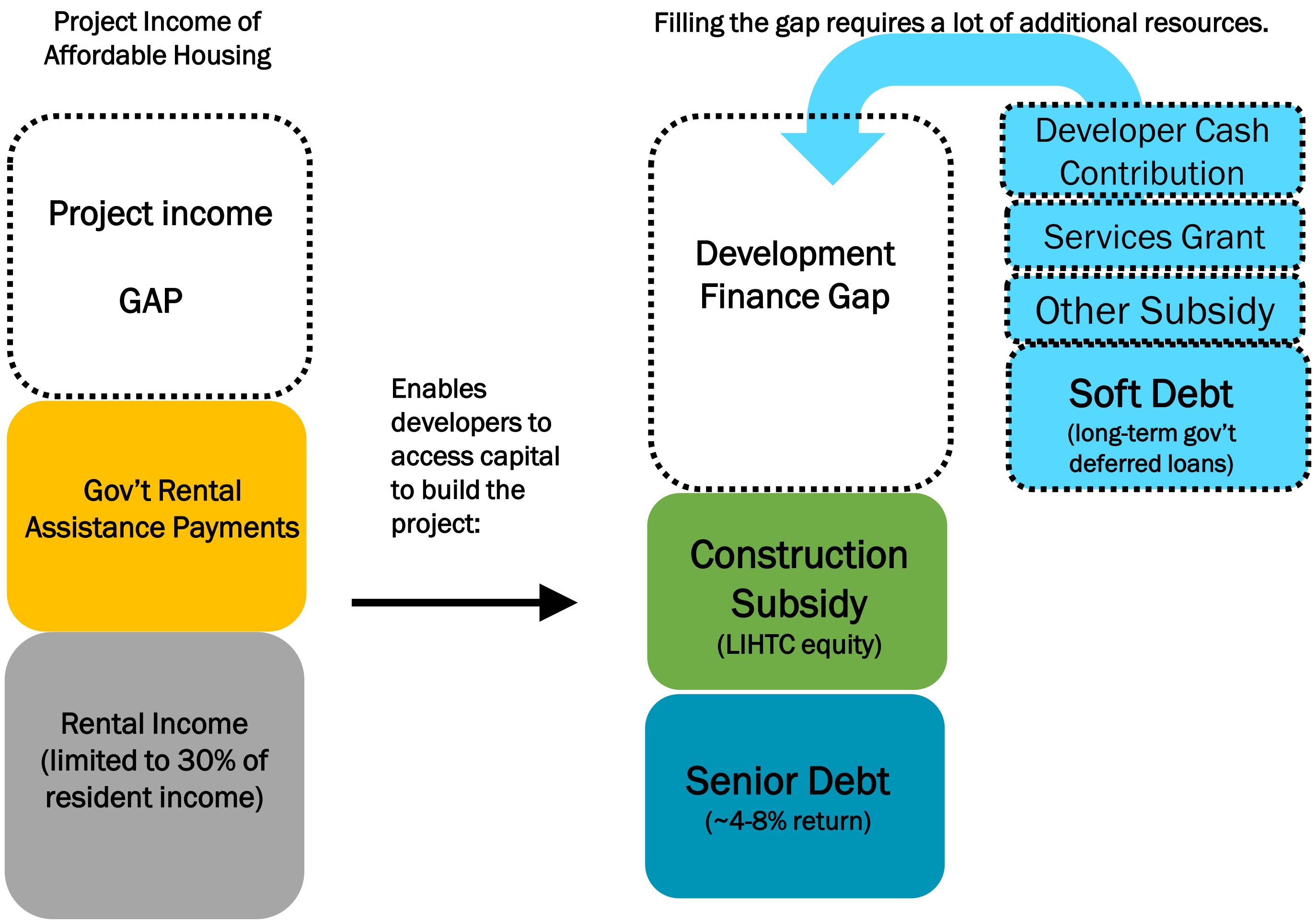
Table 1: Snohomish County Affordable Housing Inventory, 2017

CATEGORY	0–30% AMI	31–50% AMI	51–80% AMI	ALL
TOTAL	7,049	4,864	8,780	20,693
Rental	2,259	4,358	7,881	14,497
Vouchers	4,764	457	101	5,323
Homeowner	0	5	541	546
Tulalip	26	14	192	232
Manufactured	0	30	65	95
Shelter Beds	447	0	0	447

(Source: Housing Snohomish County Project Report).

Distinguishing market-rate and affordable housing capital stacks in the greater Seattle market

The Team reviewed the capital stacks of 15 recent LIHTC projects (placed in service between 2015 and 2019). The capital stack of the typical affordable housing project that utilizes LIHTC in the Seattle market is very complex, with several types of sources that must be aligned and deployed, particularly for the 4% projects because the LIHTC equity is significantly less than the 9% credit. The lack of available preferred and common equity that meets the impact targets for affordable housing is significant. Equity in the greater Seattle market wants significantly higher returns than affordable housing can support. The projects have less income potential due to the affordability of rents and can therefore carry less debt. To fill the "gap," developers rely heavily on public subsidy, including Housing Trust Fund and City funding.



Finance gaps exist at each stage of development.

Who is typically providing the resource?

Phase	Most Acute Gap/Pressures	Market-Rate Development	Affordable Development
Land Acquisition	> *High land prices* > *Carrying costs, expiring options/site control* > *Hold time waiting for LIHTC or other subsidy (2-4 years)*	Equity Partners/ Joint Ventures Commercial Banks	Public Entities
Predevelopment	> *Interest carry burden for nonprofit s waiting on LIHTC equity* > *Uncovered environmental/Geotech issues that balloon costs* > *Securing construction financing and subsidies (rate lock not always available)* > *Securing perm debt/bond financing*	Commercial Banks Developer Equity	*CDFIs*
Construction	> *Construction costs at all time high with shortages in labor* > *Timing concerns (tax credit delivery)* > *Completion difficulties + value engineering during construction* > *Conversion to permanent financing*	*Conventional Bank Debt*	*CDFIs* *Risk Adjusted Bank Debt*
Mini-Perm	> *Lack of patient financing to help AH developers lease up and stabilize at an affordable rate that allows for secondary market update.*	Developer Equity	*CDFIs*
Permanent Financing	> *Affordable, rate-lock permanent financing options needed* > *Realizing deferred fees for continued operations* > *Equity cycle very short, 5 years, pressures on sales of property* > *Refinance events* > *Expiring subsidies, federal program complications*	*Freddie Mac/ Fannie Mae* *Conventional Local/ Regional Banks*	*FHA*
Ongoing Services/Operations	> *Lack of supportive services grants* > *Lack of public resources to develop and operating housing to serve highest needs populations*	*Government*	*Philanthropy* *Corporates / Large Institutions*

LISC identified the following three challenges as the most acute market and financing conditions that are hindering more affordable housing production.

1

LAND COSTS

- Very limited capital in the market for acquisition of developable land
- Highly competitive land acquisitions and "cash on cash" purchasers
- Affordable housing developers particularly limited in access to acquisition capital
- Limited amounts of public land
- Limited amounts of donated or free land available
- High environmental remediation costs

2

SUBSIDY AVAILABILITY

- 9% LIHTC limited and oversubscribed
- 4% LIHTC as of right with tax-exempt bond issuance, but limited by volume cap
- Subordinated debt, "soft" debt and other state/municipal sources of debt limited and competitive
- Ability of 100% affordable projects to support hard debt without subsidy remains negligible

3

"PATIENT" CAPITAL

- Acquisition and predevelopment funds are short-term in nature and often have shorter maturities than needed for projects awaiting the subsidies needed to make a project feasible
- Average acquisition and predevelopment loan is 18/24 months in length
- Carrying costs, including interest on loans, renewal of options/contracts, architectural and geotechnical fees can be hard for nonprofit s to afford

Preview of strategic choices for Sound Transit to consider as we move into business planning.

Key Components		And/Or Choices
Goals and Aspirations	> *What are the leveraging goals and what terms and conditions should apply to the initial $20M investment?* > *What should be the size and scope of the Fund?*	$20 MM; >$20 MM
Role	> *What role should Sound Transit play in the market and in a Fund?* > *What should or could be done through partners?*	General Partner; Fund Administration; Policy Leader
Sector Focus	> *What income-levels should the RLF target?* > *What is the tradeoff in serving lower-income households? See definitions below.*	Low Income; Workforce; ELI; Mixed Income; Affordable (below 80% AMI)
Asset Class Focus	> *What asset class (if any) and products should be available through RLF?*	Debt; Sound Transit Owned Land; Equity; Preservation / NOAH
Investor Focus	> *Who is the target investor if Sound Transit selects the leverage approach?* > *What risk and rate of return will be attractive to investors?* > *Are those returns compatible with Sound Transit RLF goals?*	Institutional Investors; HNWI / Family Offices; Corporates / Large Institutions; Government; Philanthropic Investors; Bank/ Retail
Geographic Focus	> *Based on this approach, what geographic strategy is appropriate? What limitations/restrictions should Sound Transit consider with regard to geography targets?*	Which Sub Areas and with what phasing?

HWNI= High Net Worth Individuals ; CDFI= Community Development Financial Institution; NOAH= Naturally Occurring Affordable Housing; ELI= Extremely Low Income (<30%AMI), Low Income= 30%-80% AMI, Workforce=80%-120% AMI, Mixed Income= 30-120% AMI

Summary of financing problems contributing to low production levels of affordable housing in the greater Seattle market

1. Producing affordable housing that serves households below 50% AMI is particularly difficult due to need for additional subsidy and, in many cases, associated on-site social services costs. Though affordable housing serving households at 60-80% of AMI requires fewer public subsidies because it is able to support debt service, cannot serve populations with the greatest need (30-50% of AMI). It takes developers two or three times as long to assemble a Permanent Supportive Housing (PSH) project.
2. LIHTC is a limited resource, and increasingly insufficient to meet demand. The 9% LIHTC provides significant resources in the market, but the Sound Transit geographic sub-areas only average about 2 projects per year (Pierce County averages one project per year).
3. It is estimated that 9 of the 23 currently qualified 4% LIHTC TEB projects will not get funding this year, due to the Bond cap being exceeded. This might be an annual problem going forward, depending on if the Bond cap can be changed.
4. Stagnant renter incomes and rising rents in all of the five geographic sub-areas drive project-level income potential of AH properties down, making the projects unable to take on sufficient debt to finance projects.
5. Severely cost-burdened renters (50% or more of income toward housing costs) on the rise in all of the geographic sub-areas (Snohomish 20%, NKC 21%, SKC 24.1%, EKC 17.8%, Pierce 21%).
6. Significant construction labor shortages, high construction and land costs, regulatory and environmental/safety/geotechnical barriers have a more pronounced effect on nonprofits and developers of affordable housing. This is in part because their capital stacks are much more complicated and unlike many for-profit developers of market rate housing, AH developers cannot just pay out of pocket for cost overruns.

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