CRA AT FORTY

Together Is Better: Affordable Housing through Partnership

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All banks, regardless of size, should consider becoming involved in lending to or investing in affordable housing projects, particularly those supported by Federal Low-Income Housing Tax Credits ("LIHTC"). Not only does this work provide much needed affordable housing to the community, it provides CRA credits for the bank – and it can provide a good earning asset for the bank's balance sheet. For a bank that lacks the expertise in underwriting the credit, partnering with another bank or a banking consortium like HOPE of Kentucky can provide that expertise.

LIHTC OVERVIEW

The LIHTC program was implemented through the 1986 Tax Reform Act. It provides for 10 years of Federal tax credits to be allocated to affordable housing projects that comply with IRS regulations of leasing to tenants whose incomes are at or below either 60 percent or 50 percent of Area Median Income.

Unfortunately, there is a perception that these projects are public housing or Section 8 properties, which is not the case. These programs consist of housing where all or a portion of the occupants' housing cost is paid directly by the government. LIHTC properties, on the other hand, do not provide direct payment assistance to the renters, but alternately, the LIHTCs are used to finance the construction, not the operation, of the properties. Unlike public housing, tenants of LIHTC developments tend more to be workforce employees who can make up to $30,000, depending on community average incomes and family sizes. As we often tell bank management, a good portion of your employees will likely qualify to live in a LIHTC property.

The tax credits from LIHTC deals are "sold" to investors, typically larger banks and insurance companies, for prices ranging from $0.80 to over $1.00 per dollar of credit. These investment dollars are injected into the project as equity, typically providing 60 percent to 75 percent of the necessary funding. This allows for permanent loans to be a relatively small part of the financing which enables the rents to be 30 percent or more below comparable market rate projects.

The relatively small amount of leveraging required for LIHTC projects greatly reduces the credit risks in lending to them. In addition, significant reserves are required to be funded by both lenders and investors and available for future needs. A typical project will need at least six months of operating expenses, including debt payments, to be funded into an operating reserve. Also, a repair and replacement reserve of $350 to $400 per unit will be funded annually. This allows for adequate funds to be available for capital needs that typically occur 10 to 15 years after construction is completed.

A 2014 study by a national CPA firm that specializes in LIHTC developments surveyed LIHTC projects since inception of the program in 1986. The cumulative default rate was less than 0.06 percent, much less than any other commercial real estate category. The Office of the Comptroller of the Currency (OCC) referenced that study in 2014 in their publication “Insights,” encouraging banks to invest in and/or lend to LIHTC projects. The OCC publication provides a good explanation of how LIHTC works and the legal structure they employ.

THE IMPORTANCE OF A LOAN CONSORTIUM

While many community banks may be interested in participating in LIHTC projects, the application and administration costs of LIHTCs can be burdensome. This is where a loan consortium can become a powerful community development engine.

At HOPE of Kentucky, we have created a consortium of 26 banks from across Kentucky to pool loan funds to make permanent loans on affordable housing projects financed principally utilizing equity generated from the sale of LIHTCs. One of the key benefits for community banks is that they can diversify and limit their overall credit and interest rate risks but still earn the benefits of positive CRA credit and overall community development. A loan consortium like ours allows banks to participate in a highly technical aspect of the affordable housing industry without the need to employ that expertise on their own staff.

WHY IT MATTERS

After the recent Great Recession and beyond, the need for affordable housing has never been greater. A number of studies have identified a large percentage of households paying 50 to 70 percent of their income toward housing related expenses. This leaves little for other needs. In communities throughout the United States, from our largest cities to smaller towns, we are experiencing an affordable housing crisis, which is forcing many people to make difficult choices, including leaving their hometowns for more affordable housing options.

LIHTCs can be a powerful solution to this affordable housing dilemma. LIHTC projects limit household rents and utilities to 30 percent of income. A majority of the properties we work on at HOPE of Kentucky have an average occupancy of 95 percent or higher, many with large waiting lists, further demonstrating the strong demand. The opportunities far outweigh the current capacity.

Given the urgency of our nation’s need for affordable housing, LIHTC developments and loan consortiums are an effective way to begin addressing this growing issue on a wide scale. We believe all banks, and thereby their communities, can benefit from lending to or investing in affordable housing projects. It can not only be profitable and provide CRA Credits, but it’s one of a few areas where a bank can do well by doing good.

ABOUT THE AUTHOR

BILLIE WADE is a CPA and former banker who has 20 years of experience in lending and investing in affordable housing projects. He is the Executive Director of HOPE of Kentucky, a nonprofit loan consortium offered through the Kentucky Bankers Association. Prior to joining HOPE of Kentucky, Billie was the President and CEO of Citizens Union Bank. He is active in his community, currently serving in a leadership capacity with the Housing Partnership Inc., and the Collaborative for Teaching and Learning.

ABOUT THE BOOK

This article first appeared in **CRA at 40: Views on the Present and Future of Community Reinvestment**, published by findCRA in November 2017. The book was created in celebration of the 40th anniversary of the Community Reinvestment Act. It tells the stories of community development, from the perspective of those working in our communities who bring their knowledge and passion to bear every day in confronting the most critical problems facing communities in need. The book is about real-world experiences told in plain language by those who live them to provide a lens for readers to see CRA at work, ideas for its future and most importantly, what it means in people's lives. To access the full text or order copies of the book, please visit www.findCRA.com/CRAat40.