New Revenue Sources for Affordable Housing

Town of Chapel Hill

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New Revenue Sources

Introduction

This report evaluates potential new revenue sources for affordable housing development and preservation in Chapel Hill. North Carolina State law curbs the authority of local governments to levy new taxes, limiting the Town's options for raising revenues by imposing new taxes and fees. For example, the real estate transfer tax is a common source of funding for affordable housing trust funds nationwide, but State law permits only a handful of local governments in North Carolina to impose this tax, and the Town and Orange County are not among them. Similarly, nationwide some jurisdictions look to hotel occupancy taxes to support affordable housing, with several local governments moving to tax short-term rental services such as Airbnb specifically for this purpose. The Town is one of few local governments authorized by the State to levy an occupancy tax, but it does so at the maximum rate State law allows 3 percent.[1] While transfer and occupancy taxes may represent future affordable housing funding sources, they are not realistic funding options at this time, as they would require amendments to State law specifically giving the Town new taxing authority. Accordingly, we focus our discussion of new revenue sources on options currently available to the Town under existing State law.

The following discussion evaluates four new revenue and financing opportunities for affordable housing:

1. Tax increment financing (TIF)
2. Special assessment districts (SAD)
3. General obligation bonds (G.O. Bonds)
4. Public housing investment

The first three opportunities outlined above (TIF, SAD and G.O. Bonds) are local funding programs, relying primarily on property tax revenues, and in the case of

[1] The Town may currently have the authority to levy an occupancy tax on most short-term rentals, but this is unlikely to generate significant revenues. Airbnb reports 300+ units in Chapel Hill with an average rate of $66.

G.O. Bonds, property taxes and other general revenues. The fourth opportunity, public housing investment, presents detailed guidelines for developing and implementing a public housing revitalization plan that will ultimately position the Town to tap resources such as RAD and 9 percent and 4 percent LIHTCs.

Summary of Findings and Recommendations

Tax Increment Financing

Tax increment financing offers promise as a financing source for new development on previously vacant and/or public land. This may be appropriate for the redevelopment of one or more the Town's public housing sites, many of which are currently developed at very low densities and which may offer opportunities for higher density development that can accommodate replacement of existing public housing units as well as an increment of new market-rate housing development.

The relative merits of a particular approach are highly contextual and depend on factors such site and development characteristics, development time frame, ownership composition, financing requirements, approval requirements (i.e., referendum or LGC) and more. We note in particular that challenges related to securing LGC approval could make a conventional TIF strategy impractical for the foreseeable future. A synthetic approach using an incentive grant agreement, similar to the approach previously used by the Town for other projects, may offer the greatest promise. DRA recommends that TIF be explored further for use on appropriate sites.

General Obligation Bonds

In November 2016 Orange County voters authorized the issuance of $5 million in G.O. Bonds to support affordable housing in the County. In addition, the Town reports that it will not be in a position to issue general G.O. Bonds for another 2-3 years. Given the above, an affordable housing G.O Bond program appears to be neither an immediate option nor an impending need. Yet, over the course of this engagement, DRA and the Town have identified and discussed various affordable housing needs, and we have quantified the funding gaps that the Town must fill in order to address these needs. These needs will undoubtedly be present 2-3 years from now, and they will almost certainly exceed resources, if any, then available from the County G.O. Bond program.

With a population of just over 58,000, the Town is probably not large enough to support a housing G.O. Bond program with recurring funding cycles. However, G.O. Bonds may be appropriate as a funding source for supporting a targeted development initiative, validated by a capital plan, in which the Town invests bond proceeds on pre-identified projects and initiatives and over a specified timeframe. Examples of initiatives include:

- A public housing redevelopment initiative that requires an infusion of subordinate debt financing over a limited duration. Ideally, the program should be designed to leverage other resources such as 9 percent and 4 percent LIHTCs.
- An affordable homeownership program used to enhance affordability at designated redevelopment sites, or perhaps in conjunction with delineated neighborhood revitalization areas.

Special Assessment Districts

It does not appear that any North Carolina municipality or county has formed an SAD to finance affordable housing, and nationally we think the practice is rare. Yet, for reasons discussed in the SAD section of this report, an affordable housing SAD may make sense for Chapel Hill.

The practicality of SAD financing as an affordable housing funding option is subject to the interplay of a variety political and real estate market factors that exist in would-be SAD locations. Also, assuming there have been no previous efforts to establish an affordable housing SAD in North Carolina, several legal questions need resolution.

Important issues to consider when evaluating SAD opportunities include:

- **Applicable property types.** DRA believes that SADs formed to provide funding for affordable housing projects should only impose special assessments on nonresidential properties. To the extent that the Town wants to use market-rate residential development to provide more affordable housing beyond current levels supplied under its inclusionary zoning program, it could do so by increasing its inclusionary zoning requirements, requiring developers to provide more affordable units and increasing the in-lieu fees, rather imposing a special assessment on new residential development.

- **SAD petition approval requirements.** The Town will need to evaluate the likelihood of securing SAD approvals from property owners. Obviously, the petition process will be easier and more predictable when fewer property owners are involved.
- **Financing approval requirements**. The Town should review Local Government Commission (LGC) financing approval requirements.
- **Financial risk associated with commercial development**. Elevated risk accompanies commercial development and increases the possibility of lower than anticipated property tax collections. To guard against this risk, the Town should carefully underwrite commercial development, and structure SAD financing at a conservative debt coverage and build-out assumptions.
- **Project selection.** Given the uncertainties that accompany the affordable housing development process, the Town should understand the legally required level of specificity for describing the SAD project and the project financing structure when initiating a SAD petition. It should also understand the level of flexibility it has to authorize revisions to the project and project financing elements after SAD approval.
- **Assessment methodology.** If the Town decides to create an affordable housing SAD, it will need to establish an assessment methodology that complies with the requirement that each property is assessed according "to the benefits conferred upon it by the project for which the assessment is made."

Public Housing Redevelopment

To address the redevelopment needs of the existing public housing communities while also tapping the value and development potential of the public housing sites, DRA recommends the development of a strategic and capital plan. DRA also recommends the submittal of a RAD application for one of the Town's public housing sites, such as Craig-Gomains. This will place Chapel Hill on the waiting list for the RAD program as additional HUD authorization becomes available.

Analysis of New Revenue Sources

The following discussion provides a detailed analysis of the new revenue options summarized above.

Tax Increment Financing

Recommendations

There are a variety of advantages and disadvantages associated with each TIF strategy described below. The relative merits of a particular approach are highly contextual and depend on factors such site and development characteristics, development time frame, ownership composition, financing requirements, approval requirements (i.e., referendum or LGC) and more. We note in particular that challenges related to securing LGC approval could make a conventional TIF strategy impractical for the foreseeable future.

As a financing tool for affordable housing development, tax increment financing (TIF) is most valuable in situations were development occurs on vacant parcels with low base-year taxes or on tax-exempt, publicly-owned, properties that will be entering the property tax rolls by virtue of new private development. In addition, since State law authorizes full or partial property tax abatements for affordable rental developments, TIFs will also have greater value if the affordable housing development is part of a larger mixed-income or mixed-use development. Market-rate components of such a project generate incremental tax revenues that can be used to subsidize affordable developments.[1]

North Carolina state law supplies local jurisdictions with two general alternatives for financing projects with tax increment: project development financing and

[1] Affordable housing projects with nonprofit general partners qualify for a full property tax abatement. When the general partner is a for profit entity, G.S. 105-277.16. requires assessors to use the income approach, rather than the cost or sales approach, as the method of valuation for LIHTC properties.

"synthetic" TIF. We review both of these options below and consider their usefulness as affordable housing finance tools.

Conventional TIF: Project Development Financing

The Project Development Financing Act of 2003 (GS 159-101 to 159-113) serves as the State's official TIF law, detailing procedures for establishing TIFs, specifying eligible uses of TIF funds and describing permitted TIF financing mechanisms. Project development financing employs the traditional TIF security structure: a pledge of incremental tax revenue generated within the TIF district. By cross-reference to G.S. 159-48(d)(7) (the Local Government Bond Act), Section 159-103(a) of the Project Development Financing Act establishes affordable housing as one of the eligible uses of TIF, thereby making TIF affordable housing requirements identical to the affordability requirements that apply with the use of general obligation bonds. [1]

In order to create a TIF district, the statute requires the local government to secure the approval of North Carolina's LGC, a requirement that introduces an element of uncertainty into the TIF formation process and that may discourage participation. However, neither the formation of a TIF district nor the issuance of TIF bonds requires a voter referendum.

Our review of the TIF literature in North Carolina suggests that jurisdictions frequently eschew the State's official TIF program in favor of synthetic TIF options discussed below. Three features of the TIF statute may be responsible for discouraging local governments from establishing TIF districts. These are:

- The 20 percent limit on retail space within the TIF district;

[1] The affordable housing requirements that appear in G.S. 159-48(d)(7) authorize local jurisdictions to borrow funds using TIF or general obligation bonds to, among other things, pay any capital cost connected with "Providing housing projects for the benefit of persons of low income, or moderate income, or low and moderate income, including without limitation (i) construction or acquisition of projects to be owned by a city, redevelopment commission or housing authority, and (ii) loans, grants, interest supplements and other programs of financial assistance to persons of low income, or moderate income, or low and moderate income, and developers of housing for persons of low income, or moderate income, or low and moderate income. A housing project may provide housing for persons of other than low or moderate income, as long as at least twenty percent (20%) of the units in the project are set aside for housing for the exclusive use of persons of low income. No rent subsidy may be paid from bond proceeds. "

- The 5 percent limit on total city area that may be within a TIF district; and perhaps most importantly
- The LGC approval requirement.

One advantage of the TIF statute is that it allows local government to enter into a minimum assessment agreement with a private developer, an option that enhances the security of a TIF loan and that is not available with synthetic TIFs. The relative virtue of synthetic TIFs may also be less a function of deficiencies in the State's official TIF program, and more a reflection of the greater flexibility and ease of implementation of synthetic TIF structures. However, as a financing tool for affordable housing, conventional TIFs may warrant closer review because the advantages of synthetic TIF structures appear to apply mostly to investments in public infrastructure and facilities.

One outstanding question is whether the Town can make a collateral assignment of the pledge of tax increment to a developer for the developer to use to secure a TIF loan, and whether this would require LGC approval.

Synthetic TIFs

State law also contains options for "synthetic" forms of TIF that have many of the economic and financial characteristics of the official TIF program, but instead of pledging tax increment as security for the TIF loan, the local government either pledges a security interest in the underlying asset that is being financed or, less frequently, it pledges its full faith and credit. When establishing a synthetic TIF the local government still expects to repay the loan from tax increment, but it secures that loan with different collateral.

Synthetic TIFs: Installment Financing

Under State law, a local government uses "installment financing" when it secures a loan with a pledge of the underlying asset financed with the proceeds of the loan. Installment loans must adhere to the installment financing provisions of GS 160A-30, a key feature of which is the requirement that a government entity purchase or already own the property that is being financed with the installment loan. The statute further limits the types of government entities that can use installment financing. Notably missing from this list are public housing authorities and quasi-government agencies. For Chapel Hill, this limitation may not be a concern because its PHA is effectively a Town agency, and it does not have an independent board. Still, this requirement limits the usefulness of installment financing for affordable housing. For example, it may disqualify LIHTC projects of any type given that LIHTC projects require the participation of a for profit limited partner.

Finally, in order to enter into an installment contract, a local government must receive the approval of the Local Government Commission if the term of the contract extends for five or more years and the installment contract obligates the government entity to make payments of at least $500,000 (G.S. 159-148). Many, if not most, affordable housing loans are likely to exceed one or both of these thresholds.

Synthetic TIFs: General Obligation Bonds

General obligation bonds may also be used as a synthetic TIF financing mechanism. Unlike installment financing, general obligation bonds require a voter referendum but not LGC approval. Since they are backed by a full faith and credit pledge, they will have lower interest rates than installment loans. The affordability requirements are identical to the requirements applicable to projects that receive conventional TIF financing (i.e., Project Development Financing loans).

Other Tax Increment Strategies

A common feature of the conventional and synthetic TIF strategies discussed above is that they all involve some form of borrowing, either by the Town or by a developer, with repayment coming from anticipated future tax increment. An alterative approach, requiring neither LGC nor voter approval, would be for the Town to make a programmatic/budgetary commitment to deposit increment generated in designated locations into a housing trust fund, which would in turn loan the funds out to affordable housing projects. It is a misnomer to call this a TIF, since there is no financing involved (no monetization of tax increment). Yet it is a tax increment strategy nonetheless. One programmatic approach that the Town could consider would be to set aside a percentage of increment generated from new commercial and market-rate development on land owned by the Town (including public housing sites). The City of Austin, Texas provides an example of this approach, dedicating 40 percent of all city property tax revenue from developments on City-owned land to its affordable housing trust fund. This is a pay-as-go strategy and its main disadvantage is that it does not monetize future tax increment to support current investment.

Financing Example

Table 1 below provides an example of the debt that could be supported by a site-specific synthetic tax increment financing approach for development of new market-rate housing on land that was previously not on the tax roles, such as an existing public housing site, a portion of which is sold or ground-leased for market rate development. In this example, the property taxes generated by the increase in assessed value on the market-rate portion of site could be used to provide subsidy capital to assist with affordable housing development on the remainder of the site. This may be appropriate for the redevelopment of one or more the Town's public housing sites, many of which are currently developed at very low densities and which may offer opportunities for higher density development that can accommodate replacement of existing public housing units as well as an increment of new market-rate housing development.

Table 1
Site-Specific Tax Increment Financing Example
Market-Rate Housing Development

Market-Rate Units	40
Estimated Market Value Per Unit	$230,000
Total Market Value	$9,200,000
Property Tax Rate, Town of Chapel Hill	0.524%
Projected Annual Tax Increment to Town	$48,200
Tax Increment Available for Debt Service (1.2 DCR)	$40,200
Supportable Debt (5% Interest, 20 Years Amortization)	$507,600

Source: Town of Chapel Hill; DRA.

General Obligation Bonds

Recommendations

With a population of just over 58,000, the Town is probably not large enough to support a housing G.O. Bond program with recurring funding cycles akin to the Charlotte Housing Trust Fund[1]. Given the Town's population, we recommend adopting a clear capital plan for expending bond proceeds on pre-identified projects and initiatives and over a specified timeframe of no more than 7 years[2]. Yet, a housing G.O. Bond program may be appropriate as part of a comprehensive affordable housing production and preservation initiative that imposes funding requirements over a limited time period that exceed existing Town and State financing resources. Examples of initiatives include:

A public housing redevelopment initiative that requires an infusion of subordinate debt financing over a limited duration. Ideally, the program should be designed to leverage other resources such as 9 percent and 4 percent LIHTCs.

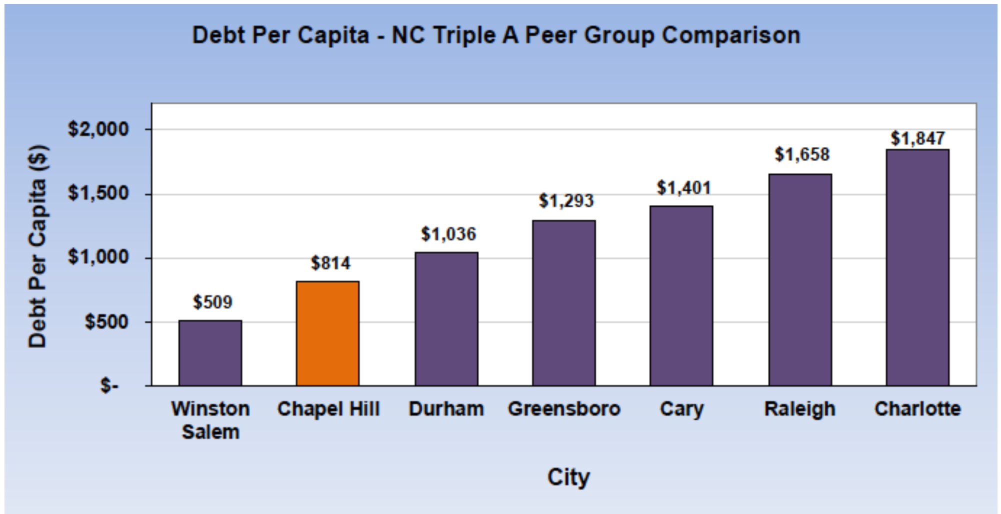
An affordable homeownership program used to enhance affordability at designated redevelopment sites.

Linking an affordable housing G.O. Bond program to development on specified redevelopment sites allows the Town to present the G.O. Bond initiative to the public as a synthetic TIF. That is, the Town's incremental debt service obligation is offset (entirely or partially) by the incremental property tax revenues generated from the redevelopment project area.

Copied below is an exhibit from the Town's 2015-16 Adopted Budget, comparing Chapel Hill's debt per capita among a peer group of North Carolina Jurisdictions with AAA ratings.

[1] The CHTF was established in 2001 and is periodically funded through voter-approved bonds, with the most recent approval in 2014 for $14 million.

[2] Bonds must be issued within seven years after approval by voter referendum (G.S. 159-64).



The 2015-16 Adopted Budget also reports $25,662,000 in outstanding general obligation bonds (G.O. Bond), which is less than 1 percent of the total assessed value of its property tax base, and $57 million in total outstanding debt. The Town's AAA bond rating and comparatively low debt levels give some indication of additional G.O. Bond borrowing capacity.

However, there does not appear to be an immediate opportunity for an affordable housing G.O. Bond program. The Town has $40.3 million of G.O. Bond authority from the 2015 authority and $30 million of installment financing projects in its capital plan for which it will be issuing debt in the next five to seven years. In November 2016 Orange County voters approved a $5 million G.O. bond to support affordable housing in the County. This is the County's second affordable housing bond program.[1] However, the County's resources may be inadequate relative to the Town's affordable housing investment goals. Consideration of a Town G.O bond may be warranted in the future to help it to achieve its affordable housing objectives, particularly with respect to long-term redevelopment of its public housing properties.

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[1] In 2001 the voters approved a $4 million in general obligation bonds for affordable housing.

Special Assessment Districts

Recommendations

We do not believe any North Carolina municipality or county has used the new SAD law to finance affordable housing. Nationally, the practice is rare, possibly because jurisdictions at liberty to do so choose to impose residential impact fees on commercial development and inclusionary zoning on residential development, finding the combination of impact fee and inclusionary zoning to be more efficient than SADs.[1] It is also likely that SAD laws in many, if not most, states prohibit the expenditure of SAD proceeds on affordable housing. However, given the limited authority of local governments in North Carolina to impose impact fees, the new SAD law could be seen as an alternative to impact fees.

The practicality of SAD financing as an affordable housing funding option is subject to the interplay of a variety political and real estate market factors that exist in would-be SAD locations. Also, assuming there have been no previous efforts to establish an affordable housing SAD in North Carolina, as we are not aware of any, there are also several legal questions that need resolution.

There are two special assessment district (SAD) options authorized by North Carolina statutes: the "traditional" form and the Special Assessments for Critical Infrastructure Needs law, enacted in 2008 in Chapter 160A-239, Article 10.[2] Only the latter authorizes municipalities (and counties) to impose special assessments for affordable housing. Like the Project Development Financing Act (the TIF law), the new SAD law incorporates the affordable housing provisions of the Local Government Bond Act by cross-reference. The new SAD law also appears to permit a jurisdiction to use SAD funds to finance projects outside the SAD if the use directly benefits private development in the SAD.[3]

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[1] The obvious benefit of impact fees and inclusionary zoning in-lieu fees (or units) is that the developer pays the fee (or delivers the units) upfront.

[2] The Article contains sunset provisions, which have been extended to July 1, 2020.

[3] In describing eligible projects, G.S. 160A-239.2(a) cross-references G.S. 159-103 (the TIF law), paragraph (a) of which provides that debt instruments may be used outside a district if

Method of Assessment

Section 160A-239.2 states that "The city council must establish an assessment method that will most accurately assess each lot or parcel of land subject to the assessments according to the benefits conferred upon it by the project for which the assessment is made." This particular provision raises a question: When an SAD-financed project is affordable housing, how does a jurisdiction comply with the requirement that assessments be proportional to benefits conferred when the most direct beneficiaries—the households residing in the affordable housing units—are different than the taxpayers paying the special assessment? In the context of commercial development—retail and office—the answer may be that both employers and merchants directly benefit when employees and consumers live in places with convenient access to jobs and services. However, it is less clear how to comply with this requirement with regard to market-rate residential development, because it is harder to claim that homeowners and renters derive benefits (economic at least) when they pay a special assessment to support affordable housing. Another and arguably more important reason for not imposing a special assessment on residential properties is that the Town's inclusionary zoning program already uses a form of assessment on market-rate residential development, arguably making it inappropriate to impose an additional special assessment on residential development for affordable housing.

The new SAD law appears to sanction assessment methods that take into account a property's use, thus enabling the Town to impose the special assessment on some uses, say commercial and retail, while excluding uses such as residentialThis should be confirmed, and is not clear from our review of the law if an assessment can be structured to apply only to new development.

Approval Process

A local government may not impose a special assessment under the new SAD law unless it receives a petition for the projects to be financed by the assessment from at least a majority of the owners of real property to be assessed and who represent at least 66 percent of the assessed value of all real property to be assessed. The petition must identify the project proposed to be financed by the assessment and its estimated cost. The law does not specify special approval provisions applicable to

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the use directly benefits private development forecast by the development financing plan for the district.

situations in which the Town or other public entity owns the property, and it is not clear that the Town, as property owner, has the authority under the law to sign a petition.

Financing

The new SAD law authorizes local government to pay the costs of a project for which an assessment is imposed using one or more of the following sources:

1. Project Development financing instruments issued under the Project Development Financing Act (discussed in the TIF section above);

2. General Obligation Bonds;

3. General Revenues; and

4. Revenue Bonds issued under G.S. 160A-239.6. (DRA does not believe this financing option is available for affordable housing because affordable housing is not listed as a permitted revenue bond project under G.S. 159-81(3)).

The financing alternatives indicated above are subject to the approval requirements enumerated in their respective authorizing statutes, with project development financing requiring LGC approval and G.O. Bonds would requiring a voter referendum.

Important issues to consider when evaluating SAD opportunities include:

- **Applicable property types.** For the reasons noted above, DRA believes that SAD's formed to provide funding for affordable housing projects should only impose special assessments on nonresidential properties. To the extent that the Town wants to use market-rate residential development to provide more affordable housing beyond current levels supplied under its inclusionary zoning program, it could do so by increasing its inclusionary zoning requirements, requiring developers to provide more affordable units and increasing the in-lieu fees, rather imposing a special assessment on new residential development.

  As noted above, it is not clear if an assessment can be structured to apply only to new development. This is an important question to resolve, as it has ramifications with regard to feasibility, district boundaries and assessment method.

- **SAD petition approval requirements.** The Town will need to evaluate the likelihood of securing SAD approvals from property owners. Obviously, the petition process will be easier and more predictable when fewer property owners are involved. The Town should seek legal guidance on the question of whether prior to conveying a property to a developer, the Town (or other public entity) can sign a petition in its capacity as property owner. The Town should also seek legal guidance regarding whether it can make execution of an SAD petition a requirement for receiving permit and zoning approvals.
- **Town ownership of property.** If the Town intends to convey Town-owned land to private developer, it should recognize the impact of a special assessment on property valuation. It may be in the best financial interest of the Town to forgo a special assessment in exchange for a higher sale price. This option may not be permitted if a SAD is comprised of a combination of Town- and privately-owned properties that will become subject to the special assessment, since the law does not appear to allow an assessment method based on the identity of the seller.
- **Financing approval requirements**. The Town should review LGC financing approval requirements. Requirements may include securing a minimum bond rating, obtaining a bank letter of credit and more.
- **Financial risk associated with commercial development**. Elevated risk accompanies commercial development and increases the possibility of lower than anticipated property tax collections. To guard against this risk, the Town should carefully underwrite commercial development, and structure SAD financing at a conservative debt coverage. The Town can mitigate property tax collection risk by using financing instruments issued under the Project Development Financing Act, which allows a local government to enter into a minimum assessment agreement with a private developer.
- **Project selection.** Many uncertainties accompany the affordable housing development process, particularly in the early stages when a developer will likely be revising and refining project type, size and financing structure. There will be additional and much greater uncertainty if a proposed SAD project depends on an allocation of 9 percent LIHTCs. Given these uncertainties, the Town should

understand the legally required level of specificity for describing the SAD project and the project financing structure when initiating a SAD petition. It should also understand the level of flexibility it has to authorize revisions to the project and project financing elements after SAD approval.

- **Assessment methodology.** If the Town decides to create an affordable housing SAD, it will need to establish an assessment methodology that complies with the requirement that each property is assessed according "to the benefits conferred upon it by the project for which the assessment is made." In order to fulfill this requirement the Town will need to conduct a study that measures benefits to non-residential tenants (and landlords) attributable to the development of nearby affordable housing. The nature of the benefits for employers is workforce proximity. For retailers and service providers, the benefit is increased demand for goods and services. Although used primarily for new development, the non-commercial nexus methodology for determining affordable housing impact fees represents a potential template for conducting this type of analysis. The non-residential nexus methodology uses economic models to quantify the number of new worker households of low and moderate income levels associated with the employees that work in a building of a given size and land use type. It also measures increased demand for local-serving retail and services by the new employees. Similarly, economic models can also measure increased demand for local-serving retail and services resulting from new residential development.

Public Housing

Recommendations

To address the redevelopment needs of the existing public housing communities while also tapping the value and development potential of the public housing sites, DRA recommends the development of a strategic and capital plan. DRA also recommends the submittal of a RAD application for one of the Town's public housing sites, such as Craig-Gomains. This will place Chapel Hill on the waiting list for the RAD program as additional HUD authorization becomes available.

The Town's public housing portfolio of 336 public housing units distributed among 13 properties is a critical affordable housing preservation investment priority. Additionally, situated on low-density, underdeveloped properties in strong housing market locations, the Town's public housing sites also present significant opportunities for the development of mixed income communities, providing the Town with value capture opportunities that it can draw upon to invest in public housing and other affordable housing efforts. Potential value capture opportunities include TIF, SADs, increased inclusionary requirements and land sales. Addressing the redevelopment needs of the existing public housing communities while also tapping the value and development potential of the public housing sites requires the development of a strategic plan. The affordability gap and economic analysis of a potential public housing RAD prototype will provide initial per unit subsidy cost estimates to consider in development of this plan. Below, we describe some of the key elements of a strategic plan.

- **A preliminary statement of development goals and policies for the portfolio as a whole and for each site.** The Town should approach this initial effort to establish goals and policies with the understanding that subsequent revisions may be warranted in response to future market and financial analysis and funding opportunities. The goal and policy setting process should be guided by a communications and outreach plan to ensure that key stakeholders, including public housing tenants and community groups, have an opportunity to contribute to goal and policy formulation. Listed below are important elements of a statement of goals and policies:

  - Public housing preservation goals as measured by total units and households, unit size and household size, and housing support type: public housing (ACC) or RAD (project-based rental assistance or project-based vouchers);
  - Number of public housing/RAD units to be rehabilitated or replaced with new units;
  - Number of public housing units to be replaced on-site versus alternative off-site locations;
  - Proposed income distribution, overall and by site: public housing/RAD, affordable non-public housing and market rate; and
  - Housing type distribution: rental, ownership, family senior and supportive housing.

- **Analysis of the market and development potential of each site.** This analysis includes the following elements:
  - Housing demand by income cohort and housing sector;
  - Attainable rents and sale prices;
  - Valuation estimates of public housing properties; and
  - Tax increment estimates.

- **The formulation of a capital plan**. The capital plan is an aggregation of development financing plans for each public housing site and, if applicable, off-site location. The plan will include an estimate of development costs and proposed financing sources. In addition to public housing resources such as RAD, the capital plan will look at other local, state, federal and private funding sources, including 4 percent and 9 percent LIHTCs, HOME, AHP, CDBG/Section 108, TIF, special assessment districts, general obligation bonds, private debt, and any State of North Carolina housing programs.
- **An expression of the Town's roles and responsibilities.** The strategic plan will need to describe the Town's role, both as municipality and housing authority, with regard to ownership, development, management

and financing of the various development components comprising each public housing site (or off-site location). To the extent that the Town's redevelopment proposal employs RAD, LIHTC or private debt financing strategies, the Town will need to decide if it will use third-party developers and managers to develop and operate the properties, or if it seeks to have a more active role in development, ownership and/or management. The Town will also have the option of using a ground lease structure, retaining ownership of public housing sites, while project partnerships and homeowners own the improvements.

One critical issue that the Town will need to address with respect to RAD conversions is whether it will continue to serve as property manager for converted properties. According to its 2015-16 Adopted Budget, the Town's annual public housing operating expenses are approximately $6,225 per unit, significantly higher than, for example, the projected operating expenses of Greenfield Commons of $4,350 per unit.[1] Lower operating expenses enable a project to support a larger first mortgage, making a project less reliant on gap financing. For example, a $1,00 per unit reduction in annual operating expenses will yield approximately $13,000 in additional loan proceeds per unit or $1.3 million per 100 units.[2] Leveraging private debt financing is a critical element of the RAD program. Expenses that are appropriate to the market will be an important element of a competitive RAD application.

- **Implementation Plan.** The implementation plan includes procedures for selecting third party developers, a description of the preliminary financing plan for each site, a development timeframe for each site and more.

At the end of this subsection we provide a graphical depiction of this strategic planning process in the illustration titled Chapel Hill Public Housing Redevelopment Business and Capital Planning Process. References to CHHA refer to the Town's role as a housing authority.

The Town's Public Housing strategy can potentially integrate many of the financing approaches discussed in this report, and it can also incorporate several components of DRA's research on housing need and local housing market

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[1] Greenfield Commons is a 69-unit senior housing LIHTC development that will be constructed on Fordham Boulevard,

[2] Assumes a 30-year fully amortizing loan with an interest rate of 5 percent and a debt coverage of 1.2.

conditions. Implementing one or more of these financing programs (TIF, G.O. Bonds, SADs, etc.) will allow the Town to execute a public housing redevelopment strategy more quickly and confidently, as they will enhance project financial feasibility when included as part of a RAD and 4 percent LIHTC strategy.

RAD

HUD currently has the statutory authority to approve 185,000 units for RAD conversion and has received applications for approximately 200,000 units. Although HUD continues to accept RAD applications, it intends to place submissions on a waiting list until Congress increases the statutory cap. While there is uncertainty regarding the timing for raising or removing the cap, we believe there is high confidence that the program will continue to expand and that the Town should consider committing resources to undertake the analysis and planning necessary to complete a RAD application. Below, we outline a four-stage process for evaluating RAD feasibility, completing a RAD application and closing a RAD transaction.

Phase 1: Review RAD application submission requirements.

- Meet with HUD field staff to review application submission requirements and review procedures and timeframes for applications submitted during the waitlist period. In addition, consult with HUD regarding advantages and disadvantages of submitting one or more RAD conversion applications.

Phase 2: Using project pro forma financing analysis and HUD's RAD assessment tools, identify one or more projects for RAD conversion.

- Determine financing and ownership structure for each RAD Project.
- Determine Town development and financing role for each RAD project (e.g., general partner, co-general partner, guarantor, lender, ground lessor, others).

Phase 3: Complete RAD applications

The RAD application contains multiple components related to development and financing plans, management and organizational matters, tenant notification and relocation issues and more.

Phase 4: Securing RAD conversion commitment through closing

Phase 4 will commence at such time that the Town's projects are no longer waitlisted and HUD has agreed to move forward with the full RAD review and conversion process.

The ***Affordability Gap and Economic Analysis Report*** analyzes the value of RAD as a potential financing source for a prototypical development on the Craig-Gomains site.

Chapel Hill Public Housing Redevelopment Business and Capital Planning Process

(1) Define Development Goals & Objectives

- Total number of projects and units
- Development locations
- Offsite development
- Project types: rental, ownership, density, conventional affordable vs. Public Housing etc.
- Income & unit mix
- Development timeframe & priorities
- Ownership and management role
- PBV strategy

(2) Real Estate Market & CHHA Portfolio Analysis

- **Market Analysis**
  - Attainable rents & sale prices
  - Supply & demand
  - Housing needs by income & household type
  - Development costs
  - Operating costs
- **CHHA Portfolio Analysis**
  - Physical needs
  - Site development potential & local market conditions, opportunities and needs

(3) Analysis of Programs and Financial Resources

- CHHA resources: Operating & Capital Funds, RHFF etc.
- HUD programs/ funds (e.g. RAD)
- 4% and 9% LIHTCs
- Tax increment financing
- Inclusionary zoning
- Other state & local funds

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Chapel Hill Public Housing Redevelopment Business and Capital Planning Process (continued from previous page)

(4) CHHA Capacity Analysis

- **Administrative Capacity**
  - Project development
  - Property management
  - Project underwriting
- **Financial Capacity**
  - Financial audit/budget and annual report review (income statement, balance sheet, liquidity)
  - Unrestricted assets & capacity to provide financial guarantees

(5) Development Options & Strategies

- **CHHA development role:**
  - Co-GP
  - Turnkey
  - Guarantor
  - Property manager
  - Lender
- **Formulate strategies and programs by site**
  - Reaffirm or revise development objectives and goals enumerated in Step 1 based on analysis in steps 1-4
  - Determine development financing plan by site
  - Implementation timeframe by site

(6) Business & Capital Plan

- Based on preceding analysis, prepare a comprehensive report and projections showing financing sources and uses and housing investment and production over time.