Long-Term Viability and Affordability of Multifamily Rental Housing

by Jeffrey Lubell

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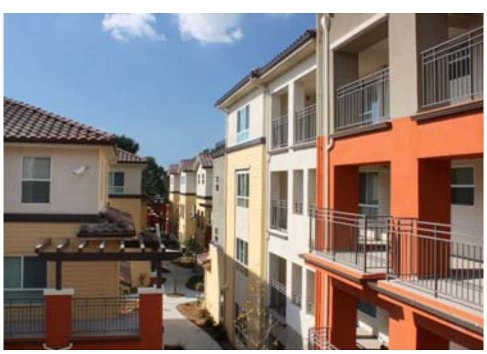
At the Center for Housing Policy, we have long been interested in whether "long-term affordability" could be used as a strategy for getting more "bang for the buck" and increasing the number of families that can be served with fixed levels of affordable housing funding. For the most part, our examination has focused on affordable homeownership programs, where our analysis suggests that, over a 30-year period, shared equity approaches (such as community land trusts or long-term resale restrictions) can provide affordable ownership opportunities to two to three times as many homebuyers as an equivalently funded grant program.

But I've written about shared equity homeownership before. Today, I want to consider long-term affordability in the context of affordable rental housing.

Can long-term affordability likewise be used as a strategy for serving more families at current funding levels if applied to affordable multifamily rental housing? On the face of it, it seems logical to think that it might. After all, if you can get 50 years of affordability, rather than 15 or 30 years, from the same initial investment, doesn't that improve efficiency and decrease the costs of each year of affordability?

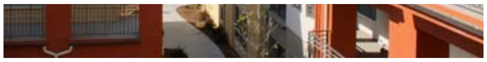
When I've discussed this issue with practitioners, they have raised a number of practical obstacles - mostly notably, the fact that affordable rental properties are typically financed in a way that ensures they remain financially viable for only 15 to 20 years, at which point they need a new injection of capital. Typically, this is accomplished with low-income housing tax credits (often the less-costly 4 percent credits) which extend both the financial viability of the property and the duration of its affordability covenant.

These recapitalizations can be expensive, both because of the new allocation of tax credits and because of the soft costs (lawyers, accountants, etc.) associated with getting the transaction completed. Wouldn't it be less expensive overall if affordable rental properties could be financed initially so as to remain financially viable over their full lifecycle (say, 50 years), thus avoiding the need for these expensive recapitalization events?



A new suite of materials about "lifecycle underwriting" provide the tools for examining this and other related questions, and I invite you all to take a look at the materials and help us consider their import for policy and practice.

Lifecycle underwriting is the name we've given to a new approach to underwriting, developed by our research



partner the Compass Group, that considers the viability of a multifamily affordable rental property over the course of its full lifecycle. We've chosen to look at a 50-year lifecycle, but you can choose to look at lifecycles of a different length. The basic idea is to project the capital needs of a property over its full lifecycle and consider whether the property has sufficient funds available to meet those needs. If not, we calculate the amount of additional funds that would need to be deposited into the initial replacement reserve to ensure the property can meet those projected needs over its full lifecycle.

We applied this methodology to a convenience sample of more than 250 multifamily affordable properties and came to some interesting conclusions.

As you might expect, most properties were not likely to be viable beyond 15 years without accessing their cash flow or the proceeds of a refinancing. If given access to cash flow and refinancing proceeds, however, about half of the properties would be viable over a 50-year period. This underscores the importance of considering cash flow and refinancing as strategies for ensuring long-term viability.

We next looked at how much more it would have cost at the time of project development to make the remaining properties viable over a full 50-year lifecycle -- again, assuming access to cash flow and refinancing proceeds as needed during the lifecycle. The answer, for these particular properties, was about $6,558 per unit (in 2009 dollars). This represents a 4.3 percent increase in initial project cost for about half of the properties in our sample (or roughly a 2 percent increase in initial costs if amortized over the full sample of properties, including those that did not need any infusion).

This seems like a small price to pay for extending financial viability from 15 to 50 years, especially since it avoids the need for costly recapitalizations (the public cost of which we estimate at $63,985 per unit based on data for properties in our sample). It also facilitates long-term affordability covenants of 30, 40 or even 50 years, which can reduce the costs of each year of affordability.

There are obviously many questions and issues that need to be fully considered before this approach is adopted. For this reason, we've prepared a paper examining the practical and policy implications of lifecycle underwriting. Take a look and let us know what you think, we're eager for your feedback.

The full suite of materials, available at nhc.org/lcycle, includes four products:

- L-Cycle -- a free online tool for applying lifecycle underwriting to specific properties. The tool enables users to examine whether specific properties are likely to be viable over a 50-year lifecycle and if not, how much of an additional deposit would be needed to the initial replacement reserves to ensure viability.

- The policy implications paper described above that considers the implications for policy and practice of lifecycle underwriting.
- An overall summary of the research that produced lifecycle underwriting, including the application of this approach to compare two methods of producing multifamily affordable rental housing: new construction and acquisition-rehab. (Quick summary: among the 200+ low-income housing tax credit properties in our sample, new construction was 25 to 45 percent more expensive.)
- A technical paper describing the lifecycle underwriting methodology in depth.

The study team consisted of researchers at the Center for Housing Policy, The Compass Group and Summit Consulting, with our colleagues at the National Housing Conference joining us for the policy analysis. We are deeply grateful to the John D. and Catherine T. MacArthur Foundation for funding this work, but any errors or opinions expressed in the materials are those of the authors alone.

We'll look forward to your input on these materials, as well the ideas in this column.

Join the conversation by commenting on this post on the NHC Open House Blog

About *Moving Forward*

"Moving Forward" is a monthly column about ideas for the future of U.S. housing policy by Jeffrey Lubell, Executive Director of the Center for Housing Policy. The column offers perspectives on the government role in housing and on broader housing market trends likely to shape future housing policy.