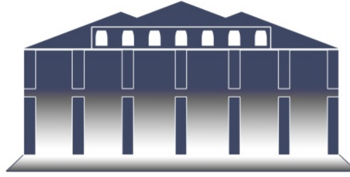
North Carolina Housing Finance Agency Can Improve the Effectiveness of Its Rental Development Programs

Final Report to the Joint Legislative Program Evaluation Oversight Committee

Report Number 2020-07

June 8, 2020



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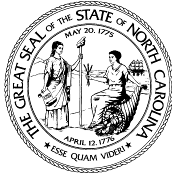

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June 8, 2020

Senator Brent Jackson, Co-Chair, Joint Legislative Program Evaluation Oversight Committee
Representative Craig Horn, Co-Chair, Joint Legislative Program Evaluation Oversight Committee

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Honorable Co-Chairs:

The 2018 Work Plan of the Joint Legislative Program Evaluation Oversight Committee directed the Program Evaluation Division to evaluate the efficiency and effectiveness of the North Carolina Housing Finance Agency (NCHFA). This report is third in a three-part series on the efficiency and effectiveness of NCHFA. This report focuses on findings related to NCHFA's rental development programs, which create affordable rental units throughout the state and are an important part of NCHFA's overall programmatic activities.

I am pleased to report that NCHFA cooperated with us fully and was at all times courteous to our evaluators during the evaluation.

Sincerely,

John W. Turcotte
Director

Mandatory Evaluation Components

Report 2020-05: North Carolina Housing Finance Agency Should Improve Performance Management and Reexamine How It Distributes Resources to Localities

Report 2020-06: General Assembly Should Improve Oversight of Housing Finance Agency Funds and Expenditures

Report 2020-07: North Carolina Housing Finance Agency Can Improve the Effectiveness of Its Rental Development Programs

N.C. Gen. § 120-36.14 requires the Program Evaluation Division to include certain components in each of its evaluation reports, unless exempted by the Joint Legislative Program Evaluation Oversight Committee. The table below fulfills this requirement and, when applicable, cross-references where the component is discussed in the report.

N.C. Gen. § 120-36.14 Specific Provision	Component	Program Evaluation Division Determination	Report Page
(b)(1)	Findings concerning the merits of the program or activity based on whether the program or activity		
(b)(1)(a)	Is efficient	The North Carolina Housing Finance Agency (NCHFA) could improve its operating efficiency by eliminating or reducing certain expenditures. In 2017 and 2019, the Special Inspector General for the Troubled Asset Relief Program found waste in NCHFA's administration of the Hardest Hit Fund, raising questions about certain Agency expenditures. As a result, the Program Evaluation Division reviewed NCHFA expenditures and found that although the Agency has made some policy changes intended to prevent waste, areas of concern still exist, including distribution of gift cards to employees, purchase of employee meals when not in travel status, contributions to nonprofit organizations, and additional employee benefits.	Report 2020-06, pp. 8–16
(b)(1)(b)	Is effective	Shortcomings in both strategic planning and performance management prevented the Program Evaluation Division from being able to objectively gauge the success of NCHFA programs. NCHFA does not have defined measurable goals or objectives by which to assess its performance or a performance management system that provides data on programmatic outcomes. Performing proper strategic planning followed by developing an effective performance management system would provide a means for stakeholders such as the General Assembly to assess the effectiveness of NCHFA.	Report 2020-05, pp. 20–23
(b)(1)(c)	Aligns with entity mission	The mission of NCHFA is to create affordable housing opportunities for North Carolinians whose needs are not met by the market. NCHFA's programs generally fit within this mission except for the Construction Training Partnership, a workforce development program partially funded by NCHFA that does not advance the Agency's mission.	Report 2020-05, pp. 3–13 Report 2020-05, pp. 30–32
(b)(1)(d)	Operates in accordance with law	NCHFA generally operates in accordance with the law. However, the Program Evaluation Division determined that NCHFA has spent funds from the Homeownership Assistance Fund on the Construction Training Partnership, which is outside of the Homeownership Assistance Fund's statutory purpose. In addition, it is unclear whether NCHFA should comply with the State Budget Manual—	Report 2020-06, pp. 10–12 Report 2020-06, pp. 16–18

		NCHFA contends that it is exempt. The State Budget Manual, compiled by the Office of State Budget and Management (OSBM), contains standards for acceptable state agency expenditures. OSBM asserts that all state agencies are subject to the State Budget Manual. The Program Evaluation Division recommends the General Assembly clarify that NCHFA is subject to the State Budget Act and direct the Agency to begin complying with the State Budget Manual.	
(b)(1)(e)	Does not duplicate another program or activity	NCHFA programs are not generally duplicative of other state programs. The one exception is the Construction Training Partnership, which is duplicative of construction training programs provided through North Carolina's community colleges. There is overlap among some NCHFA programs, but where overlap exists, the programs serve different populations or utilize different funding sources. For example, the Displacement Prevention Program, Essential Single-Family Rehabilitation Loan Program, and Urgent Repair Program all fund repairs to qualified homeowners, but serve different populations, differ in the amount of funds provided, and in the case of the Essential Single-Family Rehabilitation Loan Pool utilize federal funds rather than state funds.	Report 2020-05, pp. 3–13
(b)(1a)	Quantitative indicators used to determine whether the program or activity		
(b)(1a)(a)	Is efficient	NCHFA's lack of an activity-based cost accounting system means that efficiency measures cannot be calculated.	Report 2020-05, p. 28 footnote
(b)(1a)(b)	Is effective	NCHFA does not track outcomes for its programs. The Program Evaluation Division's report identifies potential quantitative measures NCHFA could begin tracking as part of a performance management system.	Report 2020-05, pp. 20–23
(b)(1b)	Cost of the program or activity broken out by activities performed	NCHFA does not have an activity-based cost accounting system and budgets operations and programs separately and across different time periods. For example, NCHFA budgeted $153.4 million for programs in calendar year 2019. Separately, NCHFA budgeted roughly $22.1 million for its operations in Fiscal Year 2019–20.	Report 2020-05, p. 28
(b)(2)	Recommendations for making the program or activity more efficient or effective	The General Assembly should direct NCHFA to examine the funding model for its community partner programs to take into consideration differences in local capacity. NCHFA's scoring criteria for affordable housing projects based on proximity to certain amenities lacks a clear rationale and may prevent developers and municipalities from siting affordable housing in high-opportunity areas. The Program Evaluation Division recommends directing NCHFA to examine modifications to its amenity scoring policy. NCHFA awards Rental Production Program funding outside of its established policy for the program, preventing the Agency from ensuring funds go where they will be most effective. The Program Evaluation Division recommends NCHFA create a process for awarding funds to projects that may not fit the established process.	Report 2020-05, pp. 13–20 Report 2020-07, pp. 10–18 Report 2020-07, pp. 18–20
(b)(2a)	Recommendations for eliminating any duplication	The Construction Training Partnership is a workforce development program which duplicates community college construction education programs. The Program Evaluation Division recommends discontinuing the Construction Training Partnership or transferring the program to the Community College System.	Report 2020-05, pp. 30–32
(b)(4)	Estimated costs or savings from implementing recommendations	Eliminating the Construction Training Partnership would save $130,000 per year.	Report 2020-05, pp. 30–32

PROGRAM EVALUATION DIVISION
NORTH CAROLINA GENERAL ASSEMBLY

June 2020 | Report No. 2020-07

North Carolina Housing Finance Agency Can Improve the Effectiveness of Its Rental Development Programs

Highlights

IN BRIEF: The rental development programs of the North Carolina Housing Finance Agency (NCHFA) have created thousands of affordable rental units throughout the state. However, NCHFA does not have a strategy in place to address the increasing number of affordable housing units that may no longer be affordable upon exiting the Low-Income Housing Tax Credit (LIHTC) program at the end of the 30-year affordability period. In addition, the amenity policy that helps determine where LIHTC projects are located lacks a clear rationale and may prevent projects from being developed in otherwise high-opportunity locations. The Program Evaluation Division also identified administrative issues with two loan programs that help fund development projects—the Rental Production Program and the Workforce Housing Loan Program.

BACKGROUND: The North Carolina Housing Finance Agency's (NCHFA's) rental development programs annually create more than 4,000 rental units for low-income households. NCHFA's central rental development program is the federal Low-Income Housing Tax Credit (LIHTC) program. Through LIHTC, developers receive credits on their federal tax liability in exchange for constructing multi-family rental housing units and setting rents at affordable levels. Developers must apply to NCHFA for the tax credits and must follow federal and state requirements for the program. North Carolina also supports LIHTC developments with supplemental loan programs, including the Rental Production Program and the Workforce Housing Loan Program.

The Low-Income Housing Tax Credit and associated programs have created thousands of affordable rental units throughout the state, but NCHFA needs to adjust its strategy to address a rising number of units exiting the affordability period.

NCHFA requires LIHTC developments to maintain affordable rents for 30 years as a condition of receiving tax credits. The first LIHTC developments were placed in service soon after the program's establishment in 1986 and therefore units have begun to exit the affordability period. Developments that exit the affordability period may reposition as market-rate units, thereby partially offsetting potential gains from new affordable rental construction. NCHFA needs to adjust its strategy to address the increasing number of affordable units reaching the end of the 30-year affordability period.

Recommendation: The General Assembly should direct NCHFA to research options to modify its strategy for preserving the affordability of LIHTC units; track LIHTC units in the state that remain affordable and those units that have been repositioned as market-rate housing; and report on its updated strategy to the Tax Reform Allocation Committee.

The local amenity policy for Low-Income Housing Tax Credits lacks a clear rationale and may prevent the siting of projects in otherwise advantageous locations.

Although two exceptions exist, developments applying for 9% tax credits generally need to be located within one to two miles (depending on the size of the town) of specific grocery stores, pharmacies, and shopping amenities to be competitive, per the State's Qualified Allocation Plan. There is no empirical research supporting the heavy emphasis the Qualified Allocation Plan places on these specific amenities. The strict distance limitation and short list of acceptable stores mean some otherwise amenity-rich or high-opportunity sites are excluded from receiving tax credits.

Recommendation: The General Assembly should direct NCHFA to study modifications to the amenity policy in the Qualified Allocation Plan and report the study results to the NC Tax Reform Allocation Committee.

NCHFA does not always adhere to established policies and procedures in awarding Rental Production Program funding.

Through the Rental Production Program, NCHFA provides low-interest or zero-interest loans to LIHTC projects with state and federal funds. This program is administered as part of the LIHTC award process. NCHFA made five awards during a five-year period that did not adhere to established policy and were made outside of the competitive process.

Recommendation: The General Assembly should direct NCHFA to develop policies and procedures dictating when, if ever, Rental Production Program loans may be made outside of the Qualified Allocation Plan.

The Agency does not follow its stated procedure in assigning income designations to counties for the purpose of allocating Workforce Housing Loan Program funding.

The Workforce Housing Loan Program is a state program that supplements LIHTC financing. The authorizing legislation for the program caps loan amounts based on whether a development is located in a low-income, moderate-income, or high-income county as designated by NCHFA. The Agency uses median family income to make these designations, but NCHFA has improperly designated counties in each of the last four years as high-income despite those counties having median family incomes consistent with moderate-income counties. This misclassification reduced the amount of Workforce Housing Loan Program funding available to projects in those counties by $1.25 million.

Recommendation: The General Assembly should direct NCHFA to update its stated criteria for income designations to ensure the criteria are specific, measurable, and transparently and uniformly applied.

Purpose and Scope

The 2018 Work Plan of the Joint Legislative Program Evaluation Oversight Committee directed the Program Evaluation Division to evaluate the efficiency and effectiveness of the North Carolina Housing Finance Agency (NCHFA). NCHFA is a public agency and instrumentality of the State that is governed by a 13-member board of directors. Its mission is to create affordable housing opportunities for North Carolinians whose needs are not met by the market.

This report is third in a three-part series on the efficiency and effectiveness of NCHFA. This report focuses on findings related to NCHFA's rental development programs, which create affordable rental units throughout the state and are an important part of NCHFA's overall programmatic activities.

For this report, the Program Evaluation Division collected and analyzed data from several sources including:

- statutes and regulations;
- Low-Income Housing Tax Credit program data;
- NCHFA Qualified Allocation Plans and associated data;
- studies and academic literature related to the Low-Income Housing Tax Credit;
- NCHFA financial data and budgets;
- NCHFA board meeting minutes; and,
- interviews with NCHFA staff and executive leadership, housing experts, NCHFA local partners, and stakeholders.

Background

During the past five years, the North Carolina Housing Finance Agency's rental development programs financed more than 4,000 affordable housing units annually on average; last year, these programs generated more than $7 million in operating revenue for the Agency. The Agency manages 16 programs and partners with the Department of Health and Human Services in managing 5 additional programs. Program fee income from rental development represents the largest source of operating revenue for the Agency. This report focuses on three programs that work in conjunction in the development of multifamily rental housing:

- the Low-Income Housing Tax Credit program;
- the Workforce Housing Loan Program; and
- the Rental Production Program.

The centerpiece of the Agency's low-income rental development is the federal Low-Income Housing Tax Credit program (LIHTC). Established in 1986, the LIHTC program allows developers to claim a deduction on their federal tax liability in exchange for capping rents at levels affordable to households earning below the median income for their county. This tax credit equity allows developers to assume less debt in financing projects, in turn enabling them to set rents below market rates.

The LIHTC program is a long-running and productive source of affordable housing for the United States. Whereas many earlier housing programs

lasted less than a decade, the LIHTC program has been in place for more than 30 years. In that time, the program has produced more than two million units of affordable rental housing for low-income households nationwide. In recent years, the LIHTC program has supported the development of about one-third of all new multifamily rental housing built in the United States.

There are two types of low-income housing tax credits, known as 9% credits and 4% credits. Though commonly known by the names "9%" and "4%," the actual value of these tax credits varies based on market conditions.

- The 9% credits are adjusted to deliver a subsidy equal to 70% of a project's qualified basis, or cost of construction, over 10 years. These credits are competitive in North Carolina.
- The 4% credits deliver a subsidy equal to 30% of a project's qualified basis over 10 years. Historically, these credits have not been competitive in North Carolina.

The subsidy values are set in the Internal Revenue Code, which governs the LIHTC program.

The federal government allocates 9% tax credits to each state according to its population. In 2019, the per-person allocation was $2.75625, with a minimum allocation of roughly $3.2 million to states with small populations. The 4% credits are packaged with tax-exempt bonds and are not subject to the per capita allocation.

In North Carolina, the Federal Tax Reform Allocation Committee is responsible for allocating low-income housing tax credits.[1] The Committee has a memorandum of understanding with NCHFA that makes NCHFA the administrative agent of the LIHTC program. Each year, NCHFA drafts a Qualified Allocation Plan that dictates how the credits are awarded. The Qualified Allocation Plan is then adopted by the Tax Reform Allocation Committee and signed by the Governor.

Once the Tax Reform Allocation Committee awards the tax credits, developers have 24 months to develop the project and lease the units. At that time the project is said to be "placed in service." The developer begins claiming the tax credits once the project is placed in service. Developers generally sell the credits to investors for equity rather than claim the credits directly. Projects developed in North Carolina must remain affordable to low-income households for 30 years.

The rents that owners of LIHTC properties may charge are determined by the Median Family Income of the county where the development is located. The U.S. Department of Housing and Urban Development calculates Median Family Income, better known as Area Median Income (AMI), using income data from the American Community Survey. For rent to be affordable, it must be at or below 30% of a household's income. Developers must set rents in a portion of the units in their LIHTC developments such that the rents are affordable to households earning 50% or 60% of Area Median Income. Developers must set aside more

[1] The Tax Reform Allocation Committee is comprised of the Secretary of the Department of Commerce, the State Treasurer, and the executive assistant to the Governor for budget management. It is housed within the Department of Commerce.

units if they choose the higher income level. In North Carolina, the remaining units may be targeted to households earning anywhere from 20% of Area Median Income to 80% of Area Median Income. Developers may include market-rate units in limited circumstances.

In addition to federal program requirements, developers proposing projects in North Carolina who wish to take advantage of the LIHTC program must follow the requirements in the State's Qualified Allocation Plan. One of these stipulations is the Targeting requirement. Under this requirement, developers must set aside at least 10%, and no more than 20%, of their units for persons with disabilities or persons experiencing homelessness. In partnership with the Department of Health and Human Services (DHHS), NCHFA administers a rental assistance program to support tenants in Targeting units. Known as Key Rental Assistance, the program pays the difference between 25% of the tenant's income and the Key payment standard, which is the total rent the owner may collect. DHHS coordinates supportive services for Key tenants.

Other NCHFA programs support LIHTC developments with additional financing:

- **The Workforce Housing Loan Program** is the largest state-funded program to support LIHTC developments. Funded by a $20 million appropriation from the General Assembly, the program provides a 0% interest, 30-year loan for tax credit projects. [2] Developers may receive up to $250,000 in high-income counties, up to $1.5 million in moderate-income counties, and up to $2 million in low-income counties. The county designations and other application guidelines for the program are part of the State's Qualified Allocation Plan. Developers do not apply separately for the Workforce Housing Loan Program but request funds as part of their Low-Income Housing Tax Credit application.
- **The Rental Production Program** also is administered through the State's Qualified Allocation Plan. The Rental Production Program provides fixed-rate loans of up to $800,000 for tax credit developments.

Together, the LIHTC program and the State's supplementary loan programs comprise the primary source of new low-income rental housing in North Carolina.

The need for affordable housing has increased dramatically since the LIHTC program began, with North Carolina currently in what one affordable housing developer called a period of "hyper need." The North Carolina Housing Coalition reports that in 2019, 45% of renters were cost -burdened. In only three counties in North Carolina can renters working full-time and earning the mean wage for renters in their area afford a two-bedroom apartment at the market rate. Across the state, the gap between what a renter can afford and the fair market rent for a two-bedroom apartment is, on average, $88 per month. The LIHTC program is the primary source for affordable rental housing to address this gap in North Carolina.

[2] The Workforce Housing Loan Program was not funded for the 2019–2020 fiscal year.

Findings

Finding 1. The Low-Income Housing Tax Credit program and associated rental development programs have created thousands of affordable rental units throughout the state, but NCHFA needs to adjust its strategy to address a rising number of units exiting the affordability period.

To summarize the finding below, the Low-Income Housing Tax Credit (LIHTC) program subsidizes the development of rental housing. Owners of LIHTC housing rent units at rates that are based on Area Median Income by county so they can be affordable to the local population. Rental units developed in North Carolina using LIHTC must remain affordable for 30 years once they are placed in service. After that period, developers may charge market-rate rents, at which point the units would no longer be affordable to the low-income households for whom the units were originally built. Units have begun to exit the affordability period in the last few years. Although projections show that North Carolina can still expect a net gain in affordable housing units through the construction of new LIHTC units, the gains will be smaller than in past years because they will be partially offset by units exiting the affordability period. Population growth and increased demand for affordable housing may put further pressure on the affordable rental housing market.

Once a LIHTC project is placed in service, the 15-year compliance period begins. Per federal regulations, for the first 15 years the project is in service the project owner is subject to recapture or loss of LIHTC tax credits if the project does not remain affordable to low-income households. Once the 15-year compliance period has ended, a 15-year extended use period begins. During this time, a LIHTC property owner must continue to charge rents set at affordable rates but is no longer subject to the recapture of credits if the project does not remain affordable. Federal regulations permit LIHTC property owners to follow a prescribed process to leave the program after the initial 15-year compliance period has ended. However, in 2003, NCHFA began requiring developers to waive their option to leave the program after 15 years as a condition of receiving tax credits. Thus, since 2003, NCHFA has required LIHTC units to effectively remain affordable for 30 years.

When the 30-year period ends, there are three possible scenarios for LIHTC-subsidized properties:

- properties exit the program but remain affordable to low-income residents;
- properties are recapitalized with public subsidies, which generally bring new affordability restrictions; or
- properties are repositioned as market-rate housing or no longer serve as rental housing.

In the first two scenarios, affordable housing units are not lost, though allocating public subsidies to already existing housing means allocating fewer resources to creating new affordable housing. In the last scenario, however, affordable housing units are lost.

Properties without a mission-driven owner or other public financing are likely to be repositioned as market-rate housing. Mission-driven

owners, such as nonprofits and some community-focused for-profits, are less likely to reposition developments as market-rate housing because it is their mission to create and maintain affordable housing. Properties using other public financing, such as Rural Housing Service Section 515 loans, may have other affordability restrictions in place that keep them affordable past LIHTC's 30-year period. However, the remaining properties may be repositioned as market-rate units. This outcome is most likely when the local market will support rents substantially higher than LIHTC rents, or when the land on which the housing complex sits is more valuable than the units that have been built on it. If units are repositioned as market rate, they will no longer be affordable to the low-income households for whom the project was originally developed.

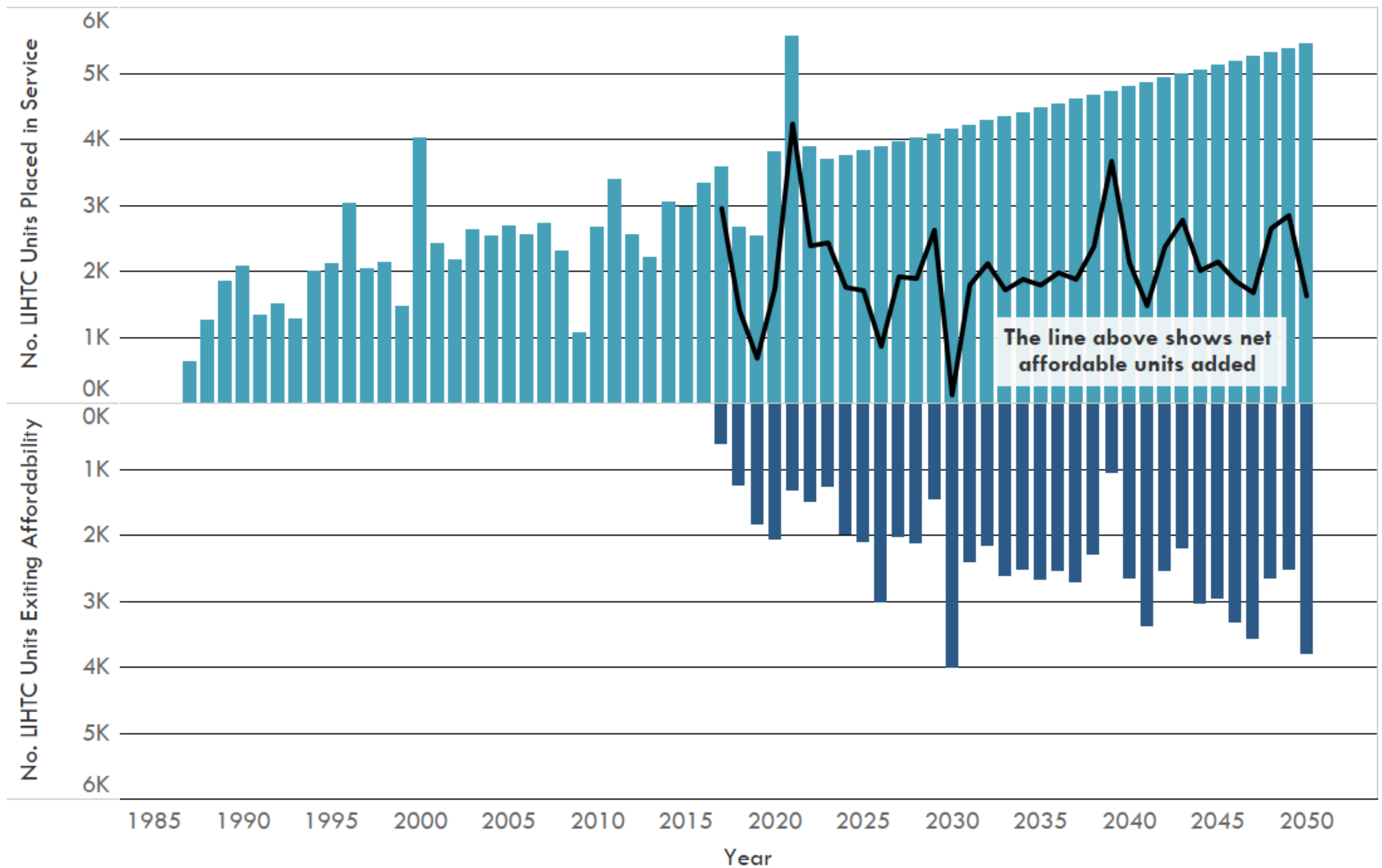
If property owners opt to refinance these LIHTC properties with public subsidies, NCHFA will have to choose between allocating credits to refinance existing properties, thus preserving the stock of affordable housing, or allocating credits to new developments, thus increasing the stock of affordable housing. A HUD-funded study identified this choice as a great challenge facing state housing finance agencies:

> *"State HFAs will come under great pressure as the large stock of LIHTC housing ages. Restricted by finite resources, state policymakers are going to have to make choices."*

The LIHTC program began in 1987, and therefore the first projects placed in service have begun exiting the 30-year affordability period. In fact, some early projects may have exited the program after 15 years. The Internal Revenue Code contains a provision that allows projects to exit the program after 15 years. In 2003, North Carolina began stipulating that new projects remain affordable for the full 30-year period in order to receive credits, but projects that were awarded credits before 2003 may have already exited the program. NCHFA tracks projects for 30 years for compliance monitoring but has not tracked what happens to developments after the 30-year period.

Regardless of whether those early projects will have remained affordable for 15 or 30 years, the State is facing an increasing number of projects exiting the program. Exhibit 1 illustrates this trend, assuming all projects remained affordable for 30 years.

Exhibit 1: Projected Growth in Low-Income Housing Tax Credit Rental Units Will Be Dampened by Units Exiting the Program



Note: The Program Evaluation Division projected LIHTC units placed in service in future years based on the assumption that tax credits allocated to the State would grow with projected state population growth and that federal tax credit policies will otherwise remain static. Growth in the state's population also may contribute to greater need for affordable housing.

Source: Program Evaluation Division based on NCHFA-provided data.

Though it is reasonable to assume that the number of units placed in service in North Carolina will continue to increase given population growth, units exiting the program and being repositioned as market-rate housing means that the net increase in units will likely be smaller moving forward. As an example, the Program Evaluation Division estimates that in 2020, as many as 2,000 of 3,800 new LIHTC units that may be awarded credits will simply be offsetting the number of units leaving the affordability period and potentially being repositioned as market-rate housing. The LIHTC program is the largest source of new affordable housing construction in North Carolina, and therefore a projected decrease in net growth of LIHTC units has important implications for affordable housing in the state.

North Carolina will face an additional challenge given the historically low numbers of LIHTC awards that have been made to nonprofit developers. All state HFAs are required to award no more than 90% of their LIHTC allocations to for-profit entities. Until this year, NCHFA capped its nonprofit allocation at 20%. NCHFA has recently removed the cap on

credits to nonprofits, but the Agency has awarded fewer credits to nonprofits than most other state housing finance agencies. From 1995 to 2009, nearly 28% of all LIHTC properties placed in service nationally had nonprofit sponsors. More recently, in 2017, 32 states awarded more than 20% of their LIHTC allocations to nonprofits and the average state allocation to nonprofits was 32.4%. Nonprofits are viewed as being more likely to maintain affordability after the 30-year restrictions end, so the comparatively lower number of projects awarded to nonprofit developers in North Carolina likely increases the probability of units being repositioned as market-rate after 30 years relative to other states.

There are potential strategies to deal with these challenges. For one, the Housing Finance Agency could increase the rehabilitation set-aside. Currently, the Agency limits the credit allocation for projects proposing to rehabilitate existing housing to up to 10% of the State's credit allocation. The Agency could increase the rehabilitation set-aside so that more of the State's credits go to rehabilitating existing LIHTC properties. When existing properties receive credits for rehabilitation, another 30-year affordability period begins. The trade-off to this option would be fewer credits being available for new construction. However, a 2018 report by Abt Associates on LIHTC costs found that acquisition and rehabilitation projects had consistently lower costs than new construction projects. Therefore, focusing more resources on rehabilitation may represent a more cost-effective option to provide affordable housing units.

Other states have established longer affordability periods for LIHTC projects. Eleven states require all units to remain affordable for between 30 and 50 years. California and New Hampshire require all units to remain affordable for over 50 years. Four states do not require affordability beyond 30 years but do give preference to projects that propose remaining affordable for longer periods. However, projects may require an infusion of capital after 30 years, which means requiring longer affordability periods may increase demand for credits from the rehabilitation set-aside. As a result, NCHFA would potentially have to expand the rehabilitation set-aside in conjunction with requiring longer affordability periods. Putting more credits towards rehabilitation would leave fewer credits available for new construction, and therefore the costs and benefits of such an option would need to be weighed.

NCHFA also could increase the amount of credits going to mission-driven developers, including nonprofit developers. These developers are viewed as being less likely to reposition units as market rate after the affordability period ends. As discussed above, the Agency recently removed the cap on nonprofit developers. NCHFA could go further, however, and raise the minimum allocation to nonprofits as some states have done. In 2017, 12 states set minimum nonprofit set-asides above 10%. Four of these states set minimums above 20%.

Another alternative is to award extra points to projects that agree to give a mission-focused developer the right of first refusal to acquire the project at the end of the 15-year compliance period or the full 30-year affordability period, thereby increasing the likelihood that the units remain affordable after exiting the program. Virginia awards additional points in its Qualified Allocation Plan for projects with at least

a 10% ownership interest by a local housing authority or qualified nonprofit that has an option or right of first refusal to purchase the project at the end of the 15-year compliance period for a price not to exceed the outstanding debt and exit taxes of the for-profit entity. Virginia's policy represents another way to increase the likelihood that projects will remain affordable after exiting the LIHTC program.

Recommendation 1: *The General Assembly should direct NCHFA to study modifications to its strategy for preserving the affordability of LIHTC units; track housing units in the state that remain at affordable rents and those that are no longer affordable; and report back on its strategy to the Joint Legislative Oversight Committee on General Government and the NC Federal Tax Reform Allocation Committee, which oversees NCHFA's administration of LIHTC, within one year of the passage of legislation.*

Finding 2. The local amenity policy for Low-Income Housing Tax Credits lacks a clear rationale and may prevent projects from being developed in otherwise advantageous locations.

To summarize the finding below, due to intense competition for Low-Income Housing Tax Credits, North Carolina's Qualified Allocation Plan effectively requires projects to be located within very close proximity to a grocery store, pharmacy, and shopping amenity. With two exceptions, housing projects generally need to be located within a mile of these amenities in order to receive 9% tax credits, except for projects in small towns with fewer than 10,000 people, in which case projects must be within two miles of the listed amenities. This policy, though well-intentioned, limits where projects can be located despite there being little evidence in literature to support placing such a high degree of importance on these particular amenities. The policy can also prevent LIHTC projects from being sited in certain high-opportunity neighborhoods that are lacking one of the primary amenities within sufficiently close proximity. Research suggests that living in high-opportunity neighborhoods improves certain outcomes for residents.

NCHFA's site selection policies as contained in the Qualified Allocation Plan (QAP) can be limiting. NCHFA made major revisions to the way it awards tax credits in 2012, including creating a revised scoring system for amenities based on distance. Prior to the revision, the scoring system for amenities was more subjective. Several affordable housing developers applauded NCHFA's change to an objective scoring system but also noted some problems with the present amenity scoring system that can create unintended or unjustified outcomes.

The current scoring system awards points based on distance from primary and secondary amenities. As Exhibit 2 shows, primary amenities receive a range of scores based on their distance from the LIHTC project. These distances are measured as driving distances in Google Maps.

Exhibit 2

Sites Generally Must Achieve a Maximum Amenity Score to Be Competitive

	Driving Distance in Miles			
Primary Amenity	**≤ 1**	**≤ 1.5**	**≤ 2**	**≤ 3**
Grocery	12pts.	10 pts.	8pts.	6pts.
Pharmacy	7pts.	6pts.	5pts.	4pts.
Shopping	7pts.	6pts.	5pts.	4pts.
Primary Amenity, Small Town	**≤ 2**	**≤ 2.5**	**≤ 3**	**≤ 4**
Grocery	12pts.	10 pts.	8pts.	6pts.
Pharmacy	7pts.	6pts.	5pts.	4pts.
Shopping	7pts.	6pts.	5pts.	4pts.

Note: Small towns, which are defined as municipalities with populations of fewer than 10,000 people, have a separate scoring system whereby the maximum number of points is awarded for being within two miles of the amenity rather than one mile for towns with more than 10,000 people.

Source: Program Evaluation Division based upon the 2020 Qualified Allocation Plan.

Although there is no strict requirement that projects must have amenities within the closest specified distance (one mile, or two miles for small towns), intense competition for tax credits functionally means that projects must receive a maximum site score in order to ensure they are competitive to receive an award. A maximum site score requires being within the shortest specified distance of each amenity. For example, in 2019, all but 2 of 131 proposed 9% projects achieved a maximum site score. For many locations, a maximum site score can only be obtained by receiving the maximum possible score for two subcategories—primary amenities and secondary amenities.[3] Some counties have few or even zero sites that can achieve maximum primary and secondary amenity scores. For example, Gates County has never had a LIHTC project and, at present, does not appear to have any sites that could achieve a maximum primary amenity score.

The rationale for the high priority placed on the shopping amenity in particular is unclear. Shopping is narrowly defined by the Qualified Allocation Plan to include dollar stores and certain discount retailers. The full list of qualifying shopping amenities in the 2020 Qualified Allocation Plan is:

- Big Lots
- Dollar General
- Dollar Tree
- Family Dollar
- Fred's Super Dollar
- Kmart
- Maxway
- Ollie's Bargain Outlet
- Roses
- Roses Express
- Target
- Super Target
- Walmart
- Walmart Supercenter

[3] A site can receive a maximum amenities score without achieving a maximum primary or secondary amenities score if it has either 1) a commitment of at least $250,000 in tribally-appropriated funds or 2) a bus/transit stop that is within 0.25 miles walking distance with continuous sidewalks and crosswalks; is in service six days a week, including 12 consecutive hours on weekdays; and is at a fixed location with a covered waiting area. Each of these options is worth six points. Meeting all bus/transit criteria except for having a covered waiting area results in two points.

The shopping amenity does not include many types of retailers such as clothing stores, department stores, hardware stores, or auto parts stores. A grocery store and drug store are already required under primary amenities, and these stores tend to overlap with the type of merchandise found in certain discount retailers such as dollar stores. One affordable housing developer interviewed by the Program Evaluation Division expressed frustration with having a good site in a metro area with high demand for affordable housing that met all of the criteria except for the nearest shopping amenity being more than one mile away. Another developer expressed the belief that it is objectionable to assume that tenants who live in affordable housing only want to shop at dollar or discount stores.

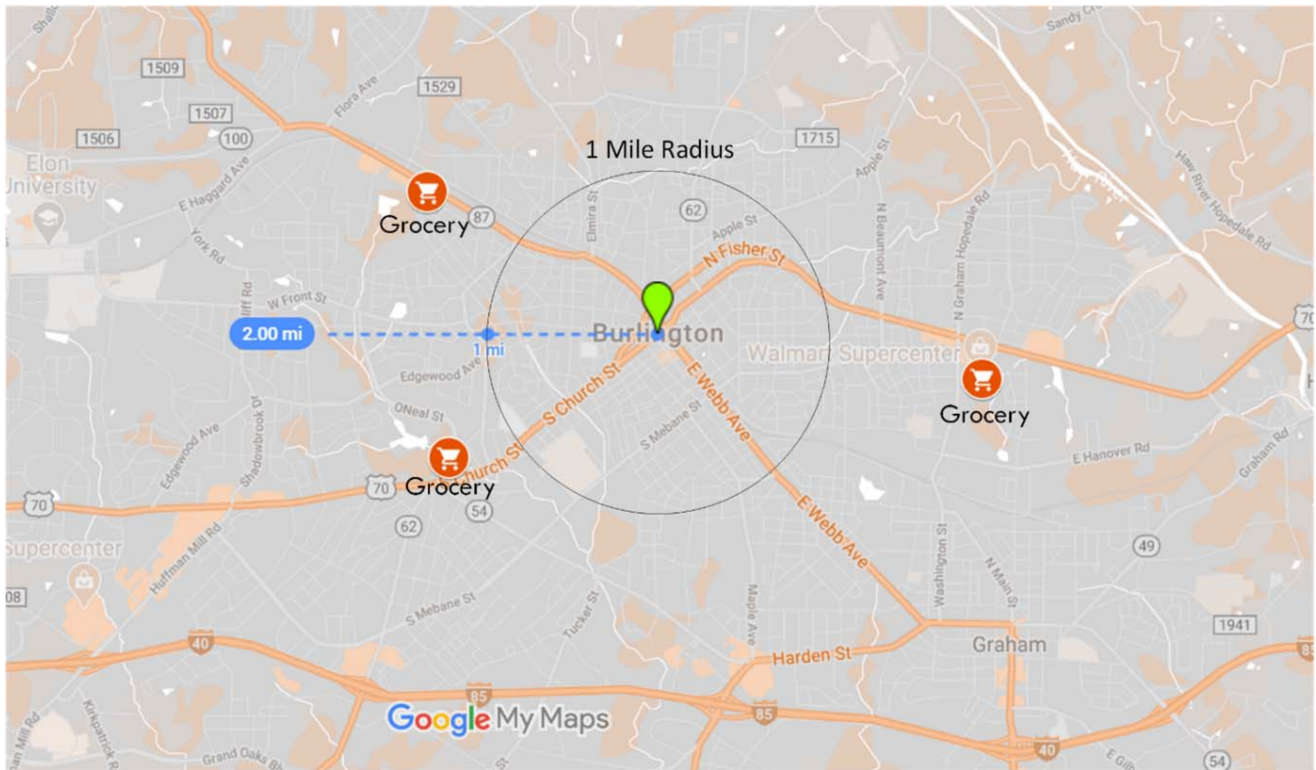
The limited number of sites that can meet the amenities requirements could be driving up the cost of land for affordable housing developments, though more empirical data is needed to determine if this phenomenon is occurring. In interviews with the Program Evaluation Division, some affordable housing developers stated that in their experience realtors and landowners often know which properties can achieve a maximum primary amenities score for LIHTC projects. These developers argued that the relative scarcity of such qualifying sites, particularly in more urbanized areas, has driven up the cost of these properties because sellers know there is a limited supply. One developer noted that the proximity to retail amenities required by the Qualified Allocation Plan generally means that affordable housing projects are competing with retail developments for available land, further driving up costs. NCHFA notes that affordable housing developers have nonetheless still been able to find sites within one mile of primary amenities. The number of applicants achieving perfect site scores each year confirms that there continues to be a sufficient number of sites at present, though it does not mean that those sites are not also costing more.

Proximity to amenities does not ensure walkability. Although primary amenities must be within one mile of a project to achieve the maximum primary amenities score, there is no stipulation that residents must be able to easily access these amenities without personal transportation. Specifically, there is no requirement in the Qualified Allocation Plan that sidewalks exist between project site and amenities.

Further, the existence of retail amenities can be short-lived, raising the question of whether they should play such a large role in determining suitable sites. One affordable housing developer expressed frustration with having an amenity retailer go out of business during the LIHTC application process. In fact, several of the retailers featured in the 2020 Qualified Allocation Plan have closed stores in North Carolina within the past five years. For example, Kmart is reportedly closing its last store in North Carolina in 2020. Competition in the grocery business has resulted in store closures by several different grocers in North Carolina, a trend that is expected to continue. Although new stores may open that serve the same geographic market, these new stores may not be in precisely the same proximity to a LIHTC project, raising questions as to whether proximity to specific retailers should factor so highly into the location of LIHTC projects.

Affordable housing developers also argue that the primary amenities policy can preclude LIHTC projects in otherwise desirable downtown areas or urban infill sites. Downtowns are often amenity-rich and are often centers of employment, but some may lack the three specific primary amenities included in the North Carolina Qualified Allocation Plan. For example, smaller cities such as Burlington and Shelby presently both lack a grocery store that would allow downtown sites to achieve a maximum primary amenity score. The Department of Commerce's NC Main Street and Rural Planning Center promotes the development of downtowns in smaller North Carolina cities. Through its Downtown Associate Community program, the Department of Commerce offers economic development planning assistance, technical support, and training. Exhibit 3 shows how downtown Burlington, which is a Main Street America Community, would not be able to achieve a maximum primary amenity score at present because it does not have a grocery store within one mile. Burlington's downtown has bus service that serves each of the three nearby grocery stores, yet it only operates Monday through Friday and therefore does not receive any points in the Qualified Allocation Plan. Other amenities in downtown Burlington such as an Amtrak station, library, theater, and retail shopping locations do not help Burlington achieve a maximum amenity score because the town cannot overcome the limitation of not having a grocery store within one mile of downtown. The primary amenities policy thus prevents the town of Burlington from incorporating LIHTC into its other downtown revitalization efforts. Research shows that investment in affordable housing can contribute to the revitalization of low-income neighborhoods, particularly when combined with other investments.

Exhibit 3: Downtown Burlington Provides an Example of an Area That Cannot Achieve a Maximum Amenity Score; There Are Three Grocery Stores Within Roughly Two Miles but None Within a Mile



Note: Proximity to amenities in the Qualified Allocation Plan is based on driving distance, not the most direct path.

Source: Program Evaluation Division based on Google Maps data.

North Carolina's Qualified Allocation Plan makes a distinction in its scoring of primary amenities and secondary amenities that lacks clear rationale. In order to receive the maximum score for the primary amenities category, a project must receive a maximum score for each primary amenity. By contrast, no single secondary amenity is required to achieve the maximum secondary amenity score. In addition, having a second primary amenity (such as a second pharmacy) is more valuable than any of the other secondary amenities. Exhibit 4 details the maximum point values of different primary and secondary amenities.

Exhibit 4

Secondary Amenities Are Worth Fewer Points and No Single Secondary Amenity is Required to Achieve a Maximum Score

Primary Amenities	Secondary Amenities
Grocery Store – 12 pts max score Pharmacy – 7pts max score Shopping – 7 pts max score	Other Primary Amenity – 5 pts Service – 3 pts max score Healthcare – 3 pts max score Public Facility – 3 pts max score Public School (family) – 3 pts max score Senior Center (senior) – 3 pts max score Retail – 3 pts max score
Points available: 26 Points required for maximum score: 26	Points available: 20 Points required for maximum score: 12
Each primary amenity is necessary to achieve a maximum primary amenities score	Four secondary amenities are necessary to achieve a maximum secondary amenities score

Notes: For each row under Primary and Secondary Amenities, only one establishment/amenity can count towards the site's score. For example, an application for a site with a public park, library, and community center can only receive a maximum of 3 points from the Public Facility row. Public facilities are strictly defined in the Qualified Allocation Plan and only include community centers, public parks, and libraries.

Source: Program Evaluation Division based on the 2020 Low-Income Housing Tax Credit Qualified Allocation Plan for the State of North Carolina.

The rationale for prioritization of certain primary amenities over secondary amenities in the Qualified Allocation Plan is also unclear. For example, having two separate shopping amenities near a LIHTC project can contribute a maximum of 12 points (7 primary and 5 secondary) whereas having three nearby public facility amenities, such as a community center, public park, and library, would only contribute a maximum of 3 points.

The Program Evaluation Division was unable to identify empirical research prioritizing grocery, pharmacy, and shopping amenities over secondary amenities such as parks, public schools, or senior centers in terms of consumer preference or in terms of health outcomes, education outcomes, or income outcomes. Empirical research does suggest one amenity—high-performing schools—may lead to improved life outcomes for children. However, public schools are a secondary amenity in the Qualified Allocation Plan, and the plan does not distinguish between low-performing schools or high-performing schools.

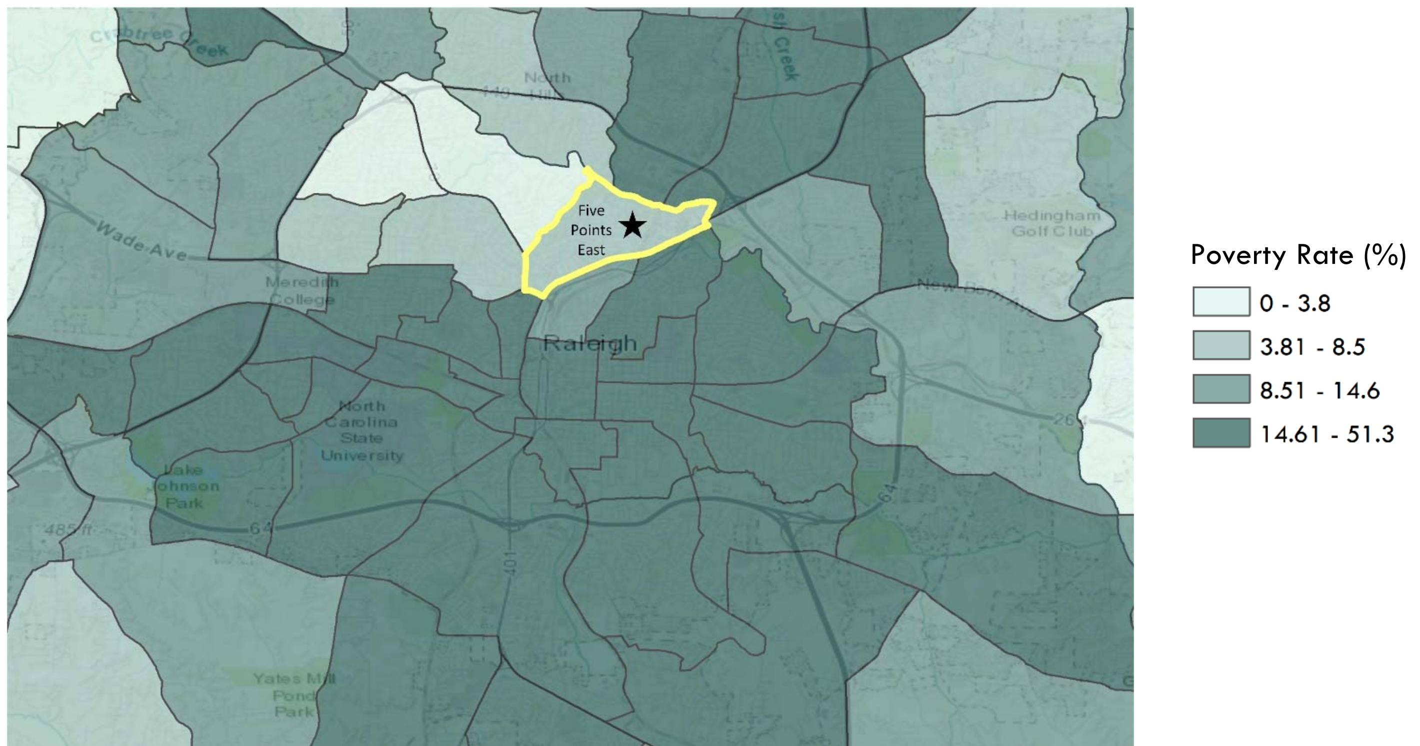
Scholarship examining the siting of housing focuses on opportunity rather than amenities. Research shows that areas with low poverty rates, low crime rates, and high-quality schools can all lead to positive outcomes for residents. By contrast, NCHFA's Qualified Allocation Plan determines site selection by prioritizing location relative to grocery stores, pharmacies, and shopping amenities. If a project can achieve a high score using this methodology, NCHFA does place some emphasis on low-poverty census tracts through a tiebreaker provision, which determines tax credit allocations when multiple projects achieve the same score. The first tiebreaker in the 2020 Qualified Allocation Plan favors the project in the census tract with the lowest percentage of families below the poverty rate.

The peril of effectively requiring sites to have a maximum primary amenities score is that some housing sites in high-opportunity areas can be excluded. Researchers debate the definition of a high-opportunity area, but it often includes access to quality schools, high levels of income, or low levels of poverty.[4] Sites that lack the capacity to achieve a maximum primary amenities score, regardless of whether they are otherwise good housing sites, are unlikely to be pursued by affordable housing developers because of the low chance of receiving an award and the high cost of applying. Although it may not be an intended effect, the rigidity of the Qualified Allocation Plan, particularly with respect to primary amenities, can cause high-quality sites to become "unbuildable" when the site cannot achieve a maximum score.

Exhibit 5 shows an existing LIHTC site in Raleigh that was awarded credits in 1991 that would be "unbuildable" today because it cannot achieve a maximum site score. Despite having a nearby park, public schools, and senior center, being served by a nearby bus stop (without a covered waiting area), and being in the Five Points East census tract, which has a low-poverty rate of 8.5%, this site cannot achieve a maximum primary amenity score because the nearest grocery store and pharmacy are both approximately 1.4 miles away. This site is located in what could be described as a high-opportunity neighborhood, which housing research suggests can lead to improved outcomes for affordable housing residents.

[4] "Opportunity" has multiple meanings in community development literature. This report discusses opportunity as a concept that suggests life outcomes can be affected by the places where individuals live. For example, research shows that the neighborhoods in which children grow up play a role in shaping their future earnings and college attendance rates.

Exhibit 5: Existing LIHTC Project in the High-Opportunity, Low-Poverty Five Points East Neighborhood in Raleigh Would Not Be Possible Under Current Amenity Requirements



Source: Program Evaluation Division based on the U.S. Census Bureau, poverty rate 2012–16.

The rigidity of the amenity policy may prevent developers from siting projects in desirable locations. Historically, LIHTC projects have been disproportionately concentrated in low-income neighborhoods and underrepresented in high-opportunity neighborhoods. As discussed earlier, siting projects in high-opportunity neighborhoods has the potential to lead to positive outcomes for residents. At the same time, there are also reasons for siting projects in low-income areas, such as to help revitalize a neighborhood. As a result, many stakeholders argue for a need to balance the two options. One way to help achieve such a balance is to ensure that high-opportunity neighborhoods are not excluded as a result of strict amenity requirements. Viewing amenities more broadly also may allow communities working toward revitalization to qualify for LIHTC projects when they have several community amenities but do not yet have, for example, a grocery store or shopping location within one mile.

Other states have found ways to more broadly construe what makes an affordable housing site desirable as part of their Qualified Allocation Plans. Some states use more inclusive criteria for determining LIHTC sites compared to North Carolina. These approaches more broadly examine what may make a particular site a desirable place to live or may provide opportunity to residents.

- Texas uses a combination of amenities and measures of opportunity as part of its opportunity index. Sites are first scored based on the poverty rate of the census tract. Sites can then earn additional points for being in proximity to amenities (public park, public transit, grocery store, pharmacy, health-related facility,

licensed child-care facility, public library, an accredited college or community college, indoor recreation facility, or outdoor recreation facility) or meeting other criteria such as being a lower crime rate census tract; meeting a threshold of adult associate degree attainment within the census tract; proximity to a community, civic, or service organization that meets certain criteria; proximity to an "A" or "B"-rated general enrollment public school; or being within the service area of Meals on Wheels.

- Ohio includes a number of priorities in scoring site locations. For example, its urban sub-pool category awards points based on transit; school district quality; number of units with three or more bedrooms; inclusivity of tenant selection; proximity to amenities (supermarket, restaurant or café, public recreation center, public park, public library, cultural facility, church or religious institution, public school); being a low-poverty area; and access to jobs.

There is no one perfect scoring system, but these systems in other states demonstrate it is possible to look more broadly than simply allowing the proximity of specific retail amenities to effectively determine where LIHTC projects are built. Further, these approaches show that existing, publicly-available data can improve decision making about which sites should qualify.

Recommendation 2: *The General Assembly should direct NCHFA to study modifications to amenities policies in the Qualified Allocation Plan. Potential modifications NCHFA should study include: 1) eliminating the shopping category or deprioritizing and more broadly defining it, 2) eliminating the distinction between primary and secondary amenities, and 3) creating a threshold score that includes amenities and measures of opportunity. NCHFA should report to the NC Federal Tax Reform Allocation Committee and, based on the results of the study, the Tax Reform Allocation Committee should propose any recommended modifications as part of the 2022 Qualified Allocation Plan.*

Finding 3. NCHFA does not always adhere to established policies and procedures in awarding Rental Production Program funding.

To summarize the finding below, the Rental Production Program (RPP) provides long-term loans at favorable interest rates to qualifying projects that receive Low-Income Housing Tax Credits (LIHTC). According to NCHFA policy, these awards are made at fixed interest rates of up to 2% for a period of up to 20 years. Funding for RPP comes from several sources, including state appropriations to the North Carolina Housing Trust Fund and federal grant programs. Policy states that RPP loans are made as part of the LIHTC award process, yet the Program Evaluation Division observed five instances in which NCHFA bypassed policy in making awards, which creates the risk of awards going to projects that would not merit funding if forced to adhere to a competitive process.

The Rental Production Program is administered through the same process that governs application for Low-Income Housing Tax Credits. For the 2019 cycle, NCHFA awarded $15.9 million through RPP. As

discussed previously, NCHFA annually produces the Qualified Allocation Plan, a publicly available document which details the criteria and scoring for proposed tax credit properties and also contains RPP program policies. The Qualified Allocation Plan states that all projects applying for RPP funds must be eligible for and receive a tax credit allocation. There is a cap of $800,000 per project.

During a five-year period, NCHFA made five awards that bypassed the established process. Exhibit 6 provides information on projects NCHFA awarded outside of the established process from Fiscal Year 2014–15 through Fiscal Year 2018–19. Including the five awards shown below, NCHFA made 73 RPP awards during this five-year period.

Exhibit 6: Five NCHFA Rental Production Program Awards Bypassed Established Process

Project Name/County	Loan Amount	Interest Rate	Term	Award Date
The Village at Washington Terrace Wake County	$1,700,000	0%	18 years	02/11/16
Asbury Park Edgecombe County	$200,000	0%	20 years	06/29/17
Bellamoor at the Park Mecklenburg County	$333,000	0%	20 years	06/29/17
Varita Court Wilson County	$500,000	0%	20 years	06/29/17
Capital Towers Wake County	$2,000,000	0.05%	20 years	12/13/18
Total	**$4,733,000**			

Source: Program Evaluation Division based on NCHFA Rental Production Program award data from Fiscal Year 2014–15 to Fiscal Year 2018–19.

Public communications involving RPP do not indicate that there may be exceptions to the RPP dollar threshold or that awards may be made outside of the process stipulated in the Qualified Allocation Plan. For example, NCHFA's website simply states,

> *"RPP loans are awarded through an annual competitive cycle that ensures equitable distribution among the three geographic regions of the state and between metropolitan and urban areas. You do not need to apply separately for RPP financing—you request this loan on your application for Housing Credits. Once your development is approved for federal Housing Credits, you will automatically be considered for this program."*

An internal document describing the RPP program states that there may be exceptions to RPP awards being part of a 9% tax credit award as well as exceptions to the $800,000 threshold, but the document does not specify the circumstances under which these exceptions can be made.

In making RPP awards that bypass the regular process, NCHFA creates a risk that awards will go to projects that would not merit funding

through a competitive process. Beyond this risk, there is also a question of opportunity because not all rental housing owners or developers may be aware that NCHFA occasionally provides RPP loans for projects that do not adhere to the established criteria or process. Without requiring all applicants to follow the same established process, it is unclear what would warrant a project being worthy of receiving funds without conforming to the Qualified Allocation Plan.

In response, NCHFA officials stated that some projects or properties do not fit within the policies of existing programs. NCHFA officials also mentioned that these awards still go through an underwriting process. Some of the unique circumstances under which NCHFA provided RPP loans included

- projects that received Low Income Housing Tax Credits but experienced a drop in equity pricing,
- a property surrendered to HUD by the owner, and
- a hurricane-damaged property whose costs were not fully covered by insurance.

These circumstances may warrant funding. However, without established procedures outlining criteria for exceptions to Qualified Allocation Plan policy, there is no way to know what other applicants may have had similar or otherwise unique circumstances that also may have merited funding.

NCHFA should have policies and procedures in place for all RPP loans, including those it makes outside of the Qualified Allocation Plan. These policies and procedures would establish the criteria for when such loans are to be made and an alternative process for owners or developers to use when applying. NCHFA could then publicize this alternative process through its website and in the Qualified Allocation Plan so potentially interested parties would be aware that this funding source exists for unique circumstances.

Recommendation 3: *The General Assembly should direct NCHFA to develop policies and procedures governing when RPP loans may be awarded outside of the process contained in the Qualified Allocation Plan. NCHFA should provide a copy of the new policies and procedures to the Joint Legislative Oversight Committee on General Government and publish them on its website within one year of the passage of legislation.*

Finding 4. NCHFA does not follow its stated procedures in assigning income designations to counties for the Workforce Housing Loan Program and has excluded moderate-income Metro counties from accessing funding.

To summarize the finding below, NCHFA has not uniformly applied its criteria for designating counties as low income, moderate income, or high income as part of its administration of the Workforce Housing Loan Program. According to its stated criteria, NCHFA has improperly designated at least two counties as high income despite those counties having median incomes consistent with moderate-income counties.

Incorrectly designating these counties limits the amount of Workforce Housing Loan Program funding for which they are eligible.

In 2014, the General Assembly gave the NC Housing Finance Agency the authority to designate counties as low-income, moderate-income, or high-income as part of its administration of the Workforce Housing Loan Program.[5,6] The Workforce Housing Loan Program (WHLP) is a loan program for rental developments that receive the 9% Low-Income Housing Tax Credits (LIHTC).[7] WHLP provides an additional subsidy to LIHTC projects in the form of interest-free loans, which helps make projects more financially viable, particularly in low-income and moderate-income counties. The LIHTC program requires developers to set rents at levels based on the Area Median Income of the county where the project is located. Because developers of projects in low-income and moderate-income counties are required to set rents at levels lower than in high-income counties, they often find it more difficult to recover project costs and pay for upkeep. WHLP funding proves particularly helpful in these circumstances.

The relatively greater need for the Workforce Housing Loan Program in low-income and moderate-income counties is reflected in the statutory maximums for each income designation. The maximum loan amount made through WHLP is capped based on each county's income designation as follows:

- $2 million for developments in counties designated as low-income by NCHFA;
- $1.5 million for developments in counties designated as moderate-income by NCHFA; and
- $250,000 for developments in counties designated as high-income by NCHFA.

Since 2017, NCHFA has used Area Median Income data from the prior year for its income designations. In the 2020 Qualified Allocation Plan, for example, NCHFA states the criterion for designating counties as low-income, moderate-income, or high-income is the Fiscal Year 2019 Median Family Income, or Area Median Income, from the U.S. Department of Housing and Urban Development. Using Area Median Income is a reasonable standard because it is directly tied to the rents that developers can charge and therefore to the financing needs of the developments.

NCHFA also assigns counties to geographic set-asides for the LIHTC program. This set-aside is separate from the income designation and is used to ensure tax credits are distributed throughout the state. NCHFA uses four geographic set-asides in its administration of the LIHTC program:

[5] Before the creation of the Workforce Housing Loan Program, NCHFA administered the State Tax Credit and designated counties as low -income, moderate-income, or high-income as part of its administration of that program.
[6] Though not mandated to do so, NCHFA also uses the Workforce Housing Loan Program county income designations to determine how much funding projects are eligible to receive from the Rental Production Program, with projects in high-income counties eligible for less funding than those in moderate- and low-income counties.
[7] The Workforce Housing Loan Program is funded through non-recurring state appropriations and was not funded for the 2020 project cycle.

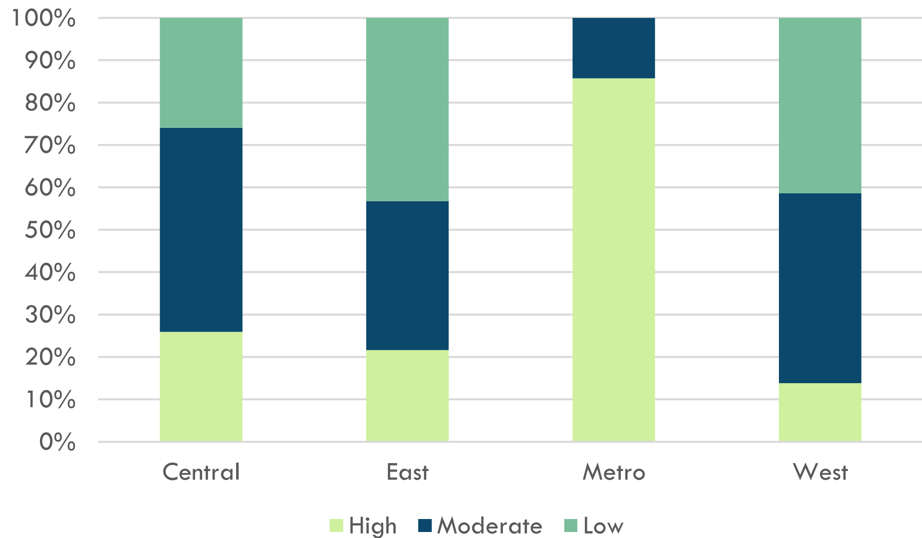
West, Central, East, and Metro. The Metro set-aside consists of the following seven counties:

- Buncombe,
- Cumberland,
- Durham,
- Forsyth,
- Guilford,
- Mecklenburg, and
- Wake.

As seen in Exhibit 7, there are high- and moderate-income counties in each set-aside, meaning there are high-income counties throughout the state.

Exhibit 7

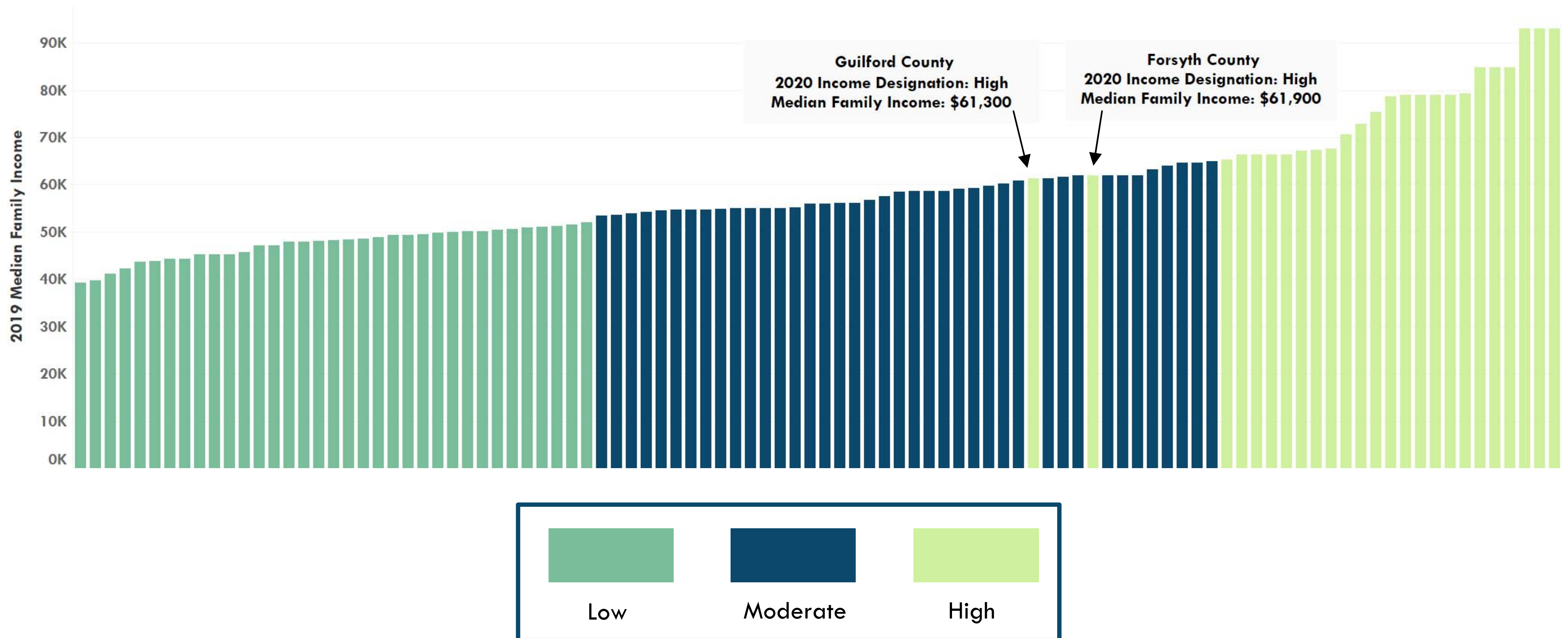
High-Income, Moderate-Income, and Low-Income Counties Are Spread Throughout the State



Source: Program Evaluation Division based on the 2020 Qualified Allocation Plan.

A comparison of Area Median Income data and NCHFA's corresponding income designations reveals the Agency has not consistently applied these designations. In 2017, Lee County and Pasquotank County both had an Area Median Income of $57,000. Despite stating that its rankings relied on Area Median Income, NCHFA designated Lee County as high income while designating Pasquotank as moderate income. Further, in 2018, 2019, and 2020, NCHFA designated at least two Metro counties as high income despite having Area Median Incomes consistent with counties designated as moderate income. Exhibit 8 shows how NCHFA designated Forsyth and Guilford Counties in 2020.

Exhibit 8: In 2020, NCHFA Designated Forsyth and Guilford Counties as High-Income Despite Both Counties Having Median Family Incomes Consistent with Moderate-Income Counties



Source: Program Evaluation Division based upon the 2020 Qualification Allocation Plan and HUD Fiscal Year 2019 Median Family Income data.

NCHFA designated both Forsyth and Guilford Counties as high-income counties in 2018 and 2019 as well, despite those counties having AMIs in both years consistent with counties designated as moderate income. In 2019, Buncombe County also was designated as high income. However, the Area Median Income in Buncombe County in 2019 was equal to or lower than the median incomes of seven counties designated as moderate income. Appendix A provides more detailed information on Area Median Incomes and income designations of moderate-income counties in 2018, 2019, and 2020.

Designating counties as high income when AMI data show they are moderate-income counties reduces the amount of Workforce Housing Loan Program funding for which projects in those counties are eligible. Projects in high-income counties are eligible for a maximum of $250,000 in WHLP funding instead of the $1.5 million those developments could receive in moderate-income counties, a difference of $1.25 million per county. WHLP funding is important in low-income and moderate-income counties because developments in those counties cannot charge the same rents as developments in high-income counties. Therefore, designating moderate-income counties as high income deprives projects in those counties of needed funding.

In the 2020 Qualified Allocation Plan, NCHFA has taken the further step of making all Metro counties ineligible for Workforce Housing Loan Program funding. Cumberland County had been eligible for $1.5 million in WHLP funding as a moderate-income county but will not be eligible for any WHLP funding in the future if NCHFA maintains this policy. Forsyth, Guilford, and Cumberland Counties all have Area Median Incomes in line with counties designated as moderate income and therefore LIHTC rents in these three counties produce less revenue over 30 years to support project costs and maintenance than rents in high-income counties. As a result, LIHTC projects in these three counties have the same financial viability challenges based on rent income levels as other moderate-income counties.

NCHFA has stated that the Metro counties, including Forsyth and Guilford Counties, have access to funding resources such as HOME Investment Partnership funds and Community Development Block Grant funds, and that access to these funds reduces the need for WHLP in these counties. However, neither Forsyth nor Guilford County directly receives Community Development Block Grant or HOME funding. The largest cities in those counties, Winston-Salem and Greensboro, are direct recipients of HOME and Community Development Block Grant funding. The situation differs in Cumberland and Wake Counties, which are direct recipients of funding, as are the cities of Fayetteville and Raleigh within those counties. Appendix B details the counties and municipalities which receive one or both sources of funding.

A set of clear and consistent criteria to determine WHLP funding is needed. High-income counties that are not in the Metro set-aside are still eligible for WHLP funding. Further, some municipalities located within those high-income counties receive Community Development Block Grant and HOME funding. Thus, if receiving Community Development Block Grant or HOME funding should be sufficient cause to exclude certain

moderate-income counties (based on AMI) from WHLP funding, it is unclear why some counties that are in the high-income category and have a municipality that receives CDBG and/or HOME would still be eligible to receive WHLP. As an example, Greensboro and Wilmington both receive CDBG and HOME. The 2019 AMI of Guilford County (Greensboro) is more than $11,000 lower than that of New Hanover (Wilmington). Nevertheless, Guilford County is not eligible for WHLP, whereas New Hanover is eligible.

In summary, the rationale and criteria NCHFA uses to label counties as low-income, moderate-income, and high-income are unclear, as is the rationale for excluding all Metro counties from WHLP funding, regardless of Area Median Income. NCHFA's decision to first label Forsyth and Guilford as high-income instead of moderate-income and then disqualify all Metro counties (which includes Cumberland as well) from receiving WHLP funding will disproportionately affect these three counties. NCHFA needs to transparently state and apply consistent criteria in making these determinations.

Recommendation 4: *The General Assembly should direct NCHFA to update its stated criteria for Workforce Housing Loan Program income designations to ensure these criteria are specific, measurable, and transparently and uniformly applied.*

Appendices

Appendix A: Area Median Incomes and Income Designations for Counties with Incomes Similar to Forsyth and Guilford

Appendix B: 2019 Recipients of Community Development Block Grants and/or HOME Investment Partnership Grants in North Carolina

Agency Response

The Program Evaluation Division submitted a draft of this report to the North Carolina Housing Finance Agency and the NC Federal Tax Reform Allocation Committee for review. Their responses are provided following the Appendix.

Program Evaluation Division Contact and Acknowledgments

For more information on this report, please contact the lead evaluator, Jeff Grimes, at jeff.grimes@ncleg.net.

Natalie Garrett, Jennifer Hausman, and Jim Horne made key contributions to this report. John W. Turcotte is the director of the Program Evaluation Division.

Appendix A: Area Median Incomes and Income Designations for Counties with Incomes Similar to Forsyth and Guilford

Table A1: Income Designations for 2018

County Name	2018 Income Designation	2017 Area Median Income
Gates County	Moderate	$56,700
Davie County	Moderate	$56,900
FORSYTH COUNTY	**HIGH**	**$56,900**
Stokes County	Moderate	$56,900
Yadkin County	Moderate	$56,900
Granville County	Moderate	$57,000
Pender County	Moderate	$57,100
GUILFORD COUNTY	**HIGH**	**$57,200**
Randolph County	Moderate	$57,200
Brunswick County	Moderate	$57,400
Lee County	High	$58,100

Source: Program Evaluation Division based on the 2018 Qualification Allocation Plan and HUD Fiscal Year 2017 Median Family Income data.

Table A2: Income Designations for 2019

County Name	2019 Income Designation	2018 Area Median Income
Granville County	Moderate	$60,100
Davidson County	Moderate	$60,500
GUILFORD COUNTY	**HIGH**	**$60,500**
Randolph County	Moderate	$60,500
Buncombe County	High	$61,300
Henderson County	Moderate	$61,300
Madison County	Moderate	$61,300
Pitt County	Moderate	$61,400
Davie County	Moderate	$62,500
FORSYTH COUNTY	**HIGH**	**$62,500**
Harnett County	Moderate	$62,500
Stokes County	Moderate	$62,500
Yadkin County	Moderate	$62,500
Craven County	High	$63,100

Source: Program Evaluation Division based on the 2019 Qualification Allocation Plan and HUD Fiscal Year 2018 Median Family Income data.

Table A3: Income Designations for 2020

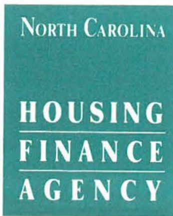
County Name	2020 Income Designation	2019 Area Median Income
Lee County	Moderate	$60,900
GUILFORD COUNTY	**HIGH**	**$61,300**
Randolph County	Moderate	$61,300
Alamance County	Moderate	$61,600
Davie County	Moderate	$61,900
FORSYTH COUNTY	**HIGH**	**$61,900**
Pender County	Moderate	$61,900
Stokes County	Moderate	$61,900
Yadkin County	Moderate	$61,900
Granville County	Moderate	$63,300
Lincoln County	Moderate	$64,000
Craven County	Moderate	$64,600
Gates County	Moderate	$64,600
Harnett County	Moderate	$65,000
Watauga County	High	$65,300

Source: Program Evaluation Division based on the 2020 Qualification Allocation Plan and HUD Fiscal Year 2019 Median Family Income data.

Appendix B: Recipients of Federal Community Development Block Grants and/or HOME Investment Partnership Grants in North Carolina in 2019

Counties	Metro County (Y/N)	Community Development Block Grant	HOME
Cumberland	Y	Y	Y
Mecklenburg	Y	Y	
Orange	N		Y
Surry	N		Y
Union	N	Y	
Wake	Y	Y	Y
Municipalities			
Asheville		Y	Y
Burlington		Y	
Cary		Y	
Chapel Hill		Y	
Charlotte		Y	Y
Concord		Y	Y
Durham		Y	Y
Fayetteville		Y	Y
Gastonia		Y	Y
Goldsboro		Y	Y
Greensboro		Y	Y
Greenville		Y	Y
Hickory		Y	
High Point		Y	Y
Jacksonville		Y	
Kannapolis		Y	
Lenoir		Y	Y
Morganton		Y	
New Bern		Y	
Raleigh		Y	Y
Rocky Mount		Y	Y
Salisbury		Y	
Wilmington		Y	Y
Winston-Salem		Y	Y

Source: PED based on 2019 data from the Department of Housing and Urban Development and the 2020 Qualified Allocation Plan.



May 5, 2020

A self-supporting public agency

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Mr. John Turcotte, Director
Program Evaluation Division
300 North Salisbury Street, Suite 100
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Dear Mr. Turcotte:

Thank you for the opportunity to comment on the Program Evaluation Division's Report No. 2020-07. We appreciate that the report notes both the great and growing need for affordable housing in North Carolina and the successful role the Low-Income Housing Tax Credit has played in meeting that need.

The North Carolina Housing Finance Agency (NCHFA) has a solid, successful record of stewardship of public funds. In the almost 50 years since its creation by the General Assembly, NCHFA has financed more than 293,000 homes and apartments worth $25 billion, producing a significant return on investment for the state. This work has supported more than 256,000 jobs and generated $2 billion in state and local tax revenue. For every dollar in state funds, the Agency leverages an additional $8 in federal and private investments.

NCHFA has achieved this while keeping its operating costs to less than 2% of the housing financed and has a AA+/Aa1 bond rating. Our debts and obligations are independent of those of the state.

North Carolina's need for affordable and available housing is critical, with a shortage of over 191,000 units for low-income renter households.[1] In no county can a person earning minimum wage afford a two-bedroom apartment at the fair market rate set by HUD.[2] The situation is exacerbated by a significant population increase of 12.1% over the last ten years compared to the relatively small amount of available funding.

In the last five years, the North Carolina Housing Finance Agency has managed $178.4 million in state appropriations. In the same period, the Agency financed the purchase of 31,749 homes and the rehabilitation or construction of 23,920 apartment homes with a real estate value of $9.9 billion. The Agency's work prevented 16,429 foreclosures, preserving $2.1 billion of property values. These activities have sent $3 billion of wages into the economy, generating $226 million in tax revenue for the state and supporting 75,300 jobs.

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[1] National Low Income Housing Coalition. (2020). The Gap: A Shortage of Affordable Homes. Retrieved from: https://reports.nlihc.org/gap/2018/nc

[2] National Low Income Housing Coalition. (2019). *Out of Reach 2019: North Carolina*. Retrieved from: https://reports.nlihc.org/oor/north-carolina

Since 1986, the Low-Income Housing Tax Credit (LIHTC) has financed 3.2 million affordable apartments nationwide, providing homes to roughly 7.4 million low-income households while transferring risk from the government to the private sector. LIHTC is the major source of funding for producing and preserving affordable rental housing. In North Carolina, LIHTC has generated $9 billion in wages and business income since its inception.[3] LIHTC also spurs private investments, saves public health care dollars by providing healthier homes with better access to care and increases positive medical and educational outcomes.

LIHTC investments yield significant benefits to the state and its citizens beyond the housing created. A policy brief commissioned by NCHFA shows that every dollar invested in LIHTC development generates three dollars of health care savings.[4] In addition, a recent ground-breaking study by the Joint Committee on Taxation concluded that each additional year spent in LIHTC housing as a child is associated with an average 3.9 percent increase in the likelihood of attending a higher education program for four years or more and a 5.2 percent increase in future earnings. [5]

A national study conducted in 2018 on per-unit total development costs revealed that NCHFA was one of, if not the most, efficient allocators of LIHTC in the nation, producing housing below the average per-unit cost in every region of the nation.

LIHTC Unit Total Development Cost Analysis

State/Region	*25th Percentile*	*50th Percentile*	*75th Percentile*	*Mean*
North Carolina	$102,299	$122,411	$133,005	$118,605
Division 1: New England	$174,277	$234,101	$305,138	$251,197
Division 2: Middle Atlantic	$169,068	$237,375	$292,601	$233,935
Division 3: East North Central	$110,333	$152,596	$208,776	$166,856
Division 4: West North Central	$125,220	$168,564	$200,744	$169,762
Division 5: South Atlantic	$98,435	$129,018	$171,546	$141,247
Division 6: East South Central	$93,307	$127,952	$172,664	$133,382
Division 7: West South Central	$114,172	$135,104	$151,740	$137,409
Division 8: Mountain	$146,605	$183,192	$207,206	$179,157
Division 9: Pacific	$167,820	$218,107	$284,934	$241,160

Source: Abt Associates, Variation of Development Costs for LIHTC Projects, 2018
Note: Figures are inflation adjusted into constant 2016 dollars

[3] Affordable Rental Housing A.C.T.I.O.N. (2019) The Low-Income Housing Tax Credit's Impact in North Carolina 1986-2017 Fact Sheet. Available at https://static1.squarespace.com/static/566ee654bfe8736211c559eb/t/5d1cf02a97b8a6000130e09d/1562177579627/ACTION-NC-2019.pdf

[4] North Carolina Housing Finance Agency (2018). The Impact of the Low Income Housing Credit in North Carolina. Available at: https://www.nchfa.com/sites/default/files/page_attachments/LIHTCPolicyBrief1.pdf

[5] Derby, Elena (2019) Does Growing Up in Tax-Subsidized Housing Lead to Higher Earnings and Educational Attainment? Available at SSRN: https://ssrn.com/abstract=3491787or http://dx.doi.org/10.2139/ssrn.3491787

Finding 1. The Low-Income Housing Tax Credit program and associated rental development programs have created thousands of affordable rental units throughout the state, but NCHFA needs to adjust its strategy to address the rising number of units exiting the affordability period.

As one of the most efficient allocators in the nation, NCHFA appreciates the recognition that LIHTC and our associated programs have created almost 100,000 affordable apartment homes for working families and seniors in our state.

NCHFA has a long-standing strategy in place to preserve existing affordable housing stock and address properties approaching the end of the 30-year LIHTC affordability period with the Rehabilitation Set-Aside found in the state's Qualified Allocation Plan (QAP).

NCHFA recognizes the importance of preserving existing affordable housing, but must balance preservation with the need for construction of new housing as well with limited resources.

Under the Rehabilitation Set-Aside in the QAP, priority is given for existing LIHTC properties. Thus far, demand for rehabilitation awards is much lower than for new construction awards. Should demand increase, NCHFA has the ability to increase the amount of tax credits set aside for rehabilitation and preservation through the annual public review process for the QAP. It should also be noted we have made good use of the 4% credit in North Carolina for rehabilitation and preservation and will continue to do so. Since 2011, we have funded the rehabilitation and preservation of 113 properties and 8,166 units through the use of 4% credits and tax-exempt bonds.

The Program Evaluation Division (PED) suggests in its report that NCHFA extend the affordability period for LIHTC properties beyond 30 years, which on its face seems a simple solution. However, 30 years is about the maximum period of time that a property can operate without a major overhaul of structural systems. These properties would either need a capital infusion between year 20 and 30 or a much larger reserve fund, which would require significantly more funding on the front end if the goal is to effectively double the useful life of the property to 50 years. As PED notes, these choices are not without trade-offs. Without additional resources, this would significantly reduce the state's new production of rental units. Requiring a longer affordability period is not a near-term preservation strategy as it would only apply to future properties and would have no impact on existing properties.

The report also suggests increasing the amount of credits going to mission-driven developers. NCHFA asserts that all of our developers are mission-driven. Unlike market rate properties, which often have much shorter holding periods and are sold more frequently, LIHTC developers, both for-profit and nonprofit, have made the decision to develop affordable housing and to commit to all the rules and regulations associated with this federal program for a minimum of 30 years. They must compete for very limited resources where three out of four applications go unfunded each year, and are subject to oversight by the local, state and federal governments as well as private investors and lenders.

It should also be noted that a property exiting the LIHTC program does not necessarily translate to a loss of affordable housing. Many properties may have other affordability restrictions or, in some cases, the properties are in communities where there is no difference between market and affordable rents. These properties are often referred to as naturally occurring affordable housing (NOAH).

Finding 2. The local amenity policy for Low-Income Housing Tax Credits lacks a clear rationale and may prevent projects from being developed in otherwise advantageous locations.

NCHFA believes that there is a clear rationale for encouraging the siting of new housing developments in proximity to amenities such as supermarkets and pharmacies, and this rationale has never been more striking or evident than during the current pandemic.

Annual development of the QAP is a rigorous process that garners a great deal of public review and oversight. NCHFA has always taken a collaborative approach that considers stakeholder participation and attempts to balance varied interests that are competing for a resource that is extremely limited.

Based on feedback from stakeholders, the QAP shifted in 2012 from a more subjective site scoring process to a more objective one that includes the scoring of amenities based on distances. Applicants made it clear through public comments and hearings that they wanted the ability to self-score and increase the predictability of their overall score.

The rationale behind distance to amenities is to recognize the importance of access and availability to shopping and services. Lower income households often face transportation challenges that can limit their access to employment, food, healthcare, education and public services. All of these items are included as amenities in the QAP. While the current system does prioritize grocery, shopping and pharmacy, it is with the recognition that rarely do these businesses exist as stand-alone businesses. More often than not, you find these stores as anchor tenants who become a draw to other small businesses. Many of these smaller businesses may not only provide services for families and seniors living in these LIHTC communities, but also serve as employment opportunities. Within the site scoring criteria, there is also a provision that recognizes the importance of public transportation that can make up lost points for distance.

The rationale behind the site scoring categories is to encourage good real estate investment. As has been acknowledged throughout this report, the LIHTC program requires a 30-year commitment from all parties, and the policies outlined in the QAP help ensure these very limited resources are invested in good locations.

A 2014 report on Food Desert Zones by the Legislative Research Commission of the North Carolina General Assembly noted "the consequences of food deserts could be enormous for public health, the economy, national security, and more." The importance of access to supermarkets, especially by low-to-moderate-income households, has only been underscored by the current pandemic.

PED concedes that no QAP process is perfect, but the approach employed in North Carolina is evidence-based, fully transparent, fair and incorporates significant stakeholder input. We will continue to consider the perspectives and suggestions of developers, property managers, investors, lenders, local governments, housing advocates and the residents we serve when formulating the QAP.

Finding 3. NCHFA does not always adhere to established policies and procedures in awarding Rental Production Program funding.

The policies and procedures referenced in the report were the guidelines intended for Rental Production Program (RPP) loans awarded in conjunction with the LIHTC program. For clarity, NCHFA will amend the RPP guidelines to address PED's concerns.

In its report, PED identified five properties that received RPP funding outside of the process established in the QAP. In each instance, there were unique facts and circumstances that required additional and immediate funding to prevent the loss of housing units or to create additional units intended to serve a particular population.

- The loan to the Village of Washington Terrace in Raleigh provided 17 additional units for individuals seeking housing under the Community Living Initiative/DOJ settlement and was approved in conjunction with The NC Department of Health and Human Services using the Community Living Housing Funds (this pilot loan lead to creation of the Integrated Supportive Housing Program).

- The loan to Bellamoor at the Park, a 116-unit family property in Huntersville, filled a significant funding gap due to an unexpected drop in tax credit equity pricing that put the property at risk of moving forward.

- Asbury Park, 48 apartments in Princeville, was flooded during Hurricane Matthew and the RPP loan used funding from the DRA16 provided by the General Assembly to fill the financing gap to help the owner get these units back on line.

- The loan for Varita Court in Wilson allowed the Wilson Housing Authority to assume ownership and preserve a historic 24-unit senior property that had been surrendered to HUD by the previous owner.

- The loan to Capital Towers in Raleigh was to ensure the preservation of 297 apartments for seniors. The property was financed utilizing 4% credits and bonds, and was facing significant shortfalls due to rising construction prices and delays.

Historically, NCHFA has used RPP as the umbrella program for its rental property loans. As was the case for each of these properties, unique situations arise that require action outside of normal program rules and timelines. In each case the proposed loan is reviewed and fully underwritten by our program staff prior to presentation to our Board for approval.

It should also be noted that none of these loans impacted the funding available through the competitive LIHTC cycle.

Finding 4. NCHFA does not follow its stated procedures in assigning income designations to counties for the Workforce Housing Loan Program and has excluded moderate-income Metro counties from accessing funding.

The statute governing the Workforce Housing Loan Program (WHLP) states that NCHFA is responsible for the county income level designations. While NCHFA believes that there was sufficient language in the QAP to allow us the flexibility to adjust county designations for WHLP, we have strengthened the wording in the draft of the 2021 QAP to better clarify that

HUD median income designations are used as a guide and not the only criteria used when setting county income designations.

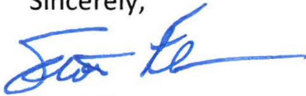
After a PED study and concurrent draft legislation, NCHFA disengaged from Commerce's Tier System and began using HUD's Median Income for county income designations for the Workforce Housing Loan Program (WHLP) as a guide for determining these designations.

The median incomes for Forsyth and Guilford Counties would put them at the upper end of the moderate-income or the low end of high-income. These counties or the major cities within these counties have access to dedicated housing resources (such as HOME, CDBG or local funds), reducing the need for WHLP funding to make a development viable. Therefore, we have designated them as high-income counties in 2018, 2019 and 2020.

It is important to note the county income designations are subject to public comment and considerable review, as are all sections of the QAP. The QAP changes are also discussed during a public hearing and as part of the annual developer's workshop. We received no comments recommending any changes to the county income designations relating to Forsyth, Guilford or any other county in response to the 2018, 2019 or 2020 QAP.

Thank you for the opportunity to respond to this report. We will use your recommendations as appropriate to continue effectively and efficiently serving North Carolinians with their affordable housing needs.

Sincerely,



Scott Farmer
Executive Director

NORTH CAROLINA
DEPARTMENT *of* COMMERCE

Roy Cooper
GOVERNOR

Anthony M. Copeland
SECRETARY

May 5, 2020

Mr. John W. Turcotte, Director
Program Evaluation Division
300 N. Salisbury Street, Suite 100
Raleigh, NC 27603-5925

Dear John:

The Program Evaluation Division has shared with the North Carolina Federal Tax Reform Allocation Committee (TRAC) a draft version of Report Number 2020-07 ("North Carolina Housing Finance Agency Can Improve the Effectiveness of Its Rental Development Programs") and extended an opportunity for the TRAC to submit a formal response. As Chairman of the TRAC, I am grateful for the opportunity to add an additional voice to the process.

By virtue of its responsibility to chair the TRAC, the NC Department of Commerce has enjoyed a long relationship with the leadership of the North Carolina Housing Finance Agency. During this time, Commerce has found them to be professional individuals who are dedicated to best serving the diverse range of stakeholders that its programs are intended to serve.

The draft report notes two areas which the Housing Finance Agency has been asked to study, and to report to the TRAC the results of those efforts. The report also states it believes no Qualified Allocation Plan is perfect. Based on the TRAC's experiences in the past, we have full confidence the Housing Finance Agency will be thoughtful and deliberate in the way in which it approaches these matters. We have equal confidence its process will be inclusive of all relevant stakeholders.

At the appropriate time, the TRAC looks forward to discussing the results of the Housing Finance Agency's efforts and, if necessary, taking action. In the meantime, I am grateful to you and your staff for the work that you do and am available should you need anything in the future.

Sincerely,

George Sherrill for

Anthony M. Copeland
Secretary, North Carolina Department of Commerce

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