

## EXECUTIVE SUMMARY

### **Closing the Gap: Financing Affordable Housing in the Chicago Area**

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Across the nation and in the Chicago area the supply of housing affordable to lower-income families has decreased. Overall, there is less rental housing in the Chicago area and the demand for low-cost rental housing far exceeds the supply. The shortage is expected to increase as about 18,000 units of Chicago public housing is being demolished with only a fraction of replacement housing intended for the very poor. In Illinois, between 30-39 percent of the population cannot afford fair market rent for a two-bedroom apartment. The poorer the family, the greater the problem, with the majority of extremely low-income families having to apply more than 50% of their income to rent. With the dramatic increase in demand for affordable housing in the past ten years, why is the production of affordable units so low?

This paper addresses the challenges that developers face when they attempt to construct affordable housing. A financing “gap” occurs when either for-profit or not-for-profit developers of affordable housing attempt to finance projects using traditional financing sources. These “traditional” financing sources—such as market-rate mortgages—don’t provide enough financing for developers or nonprofit community development corporations (CDCs) to complete an affordable housing project.

The main reason that market-rate tools fail to address the financing gap is the low incomes of the families for whom the housing is produced. The rents they can afford to pay mean low rental income from the proposed project. The problem is, then, most acute in building housing affordable for the lowest income families, the population suffering the greatest need for affordable housing in the Chicago area.

Constructing any type of affordable housing requires numerous subsidies. It is not unusual for a developer to utilize more than seven different sources of funding -- sometimes referred as the “layered” or “lasagna” method of completing financing of a project. This layering of subsidies is common in affordable housing and necessary to close the financing gap. Most developers currently combine federal money disbursed through local and state governments, a housing block grant program (HOME), and the Low Income Housing Tax Credit (LIHTC). The current system’s complexities are the direct result of changes in housing policy that occurred in the 1980s and early 1990s.

#### **Background of current affordable housing financing policies**

Previous affordable housing programs emphasized public housing as a solution to the affordable housing problem, or relied on federal appropriations and planning for production-based models. These federal programs began to fall out of favor for two

important reasons: (1) they tended to be expensive; and (2) fiscal control of the programs remained in the hands of the federal government.

Although the seed of change in housing policy occurred prior to the 1980s, the most substantial changes occurred under the Reagan and subsequent Republican administrations. The Republican administrations favored policies that increased the public-private partnership and shifted monetary control from the federal government to the state or local authorities. One result of this shift was a focus on Section 8 vouchers, which allow low-income families to find private-market housing on their own while the federal government pays the difference between the cost of a Fair Market rent and what the low-income family can pay. Although this program helps low-income people to pay more for a rental unit thereby making more housing choices available to them, it does not help to *produce* more housing in a city that already faces an affordable housing crisis.

Another policy change during the Reagan administration was the implementation of the Low Income Housing Tax Credit, which exemplifies the public-private partnership. These tax credits provide a dollar for dollar offset against future taxes. Developers often utilize third parties, or syndicators, who sell these tax credits to companies searching for tax shelters. In this way, the sale of the tax credits is converted into equity that developers can use to help finance low-income housing. Since the LIHTC is a tax credit, it tends to escape federal budget cutting as the credit represents income that the government never collects. The LIHTC remains “invisible” since monies need not be allocated from the federal budget.

The third major change that occurred in the last fifteen years is the creation of the HOME program, which directly allocates funds to state and local governments, thus giving the local authorities the power to decide which affordable housing proposals to support. This allows the local government to choose which projects are most feasible and allows them to partner with private developers and not-for-profit community development corporations.

While this process has its advantages—in particular more control by local governments and less “interference” by the federal government—one of the difficulties of the current system is its extreme complexity. Developers must apply to several agencies (state and local) in order to achieve total financing for their project. In addition, competition for funding is fierce, especially considering the expertise needed to complete a deal. Although there are few (less than 20) developers who primarily produce affordable housing in Chicago, proposals for funding outstrip funding sources by a three to one ratio.

The Illinois Housing Development Authority and the Chicago Department of Housing rank the allocation of subsidies. These agencies allocate scarce subsidies among developers based on their previous work with affordable housing, project feasibility and local political approval. For newcomers to affordable housing development, navigating the approval process is complex, especially since funding for subsidies is limited.

## **Recommendations for easing the affordable housing financing gap**

In order to close the financing gap and help ease the affordable housing crisis, we offer these recommendations:

- Streamline the financing process. A new public or non-profit agency is needed to serve as an information clearinghouse to help developers and community development corporations package deals and to educate them in their financing options. Streamlining the process is not enough, however.
- To close the financing gap in affordable housing, funding for each program subsidy must be increased.
- Focus attention on the needs of extremely low-income renters where the need is greatest and the supply most wanting. Target some of the Low-Income Housing Tax Credits, the largest housing subsidy program, to this group.
- In addition, provide increased funding directly to CDCs, who may lack sufficient resources to compete with for-profit developers. Adequate program and subsidy funding is essential for developers and community development corporations to access the subsidies that are clearly needed in order to finance affordable housing in Chicago.