Soft Financing

For tax credit properties, once permanent debt financing and equity are considered, there is often a financing gap between the total costs to develop the property and the supportable debt plus tax credit equity that needs to be filled. To bridge the gap, developers often must obtain funding from a variety of federal, state and local sources, that can be used to finance the creation and preservation of affordable housing. Often referred to as “soft financing” or “soft debt,” funding from these sources often have more favorable financing and repayment terms than conventional loans. There are, however, requirements that need to be met, in addition to the LIHTC income and affordability requirements, in order to take advantage of these funding sources. When utilizing funds from multiple programs to finance the same property, developers must ensure compliance across all programs in terms of tenant eligibility, certifying income, determining rents, and managing the unit mix, above and beyond what is required by the LIHTC. Developers must also keep in mind that the most restrictive requirements of each financing source will have to be met to stay in compliance, which adds a level of complexity.

There are numerous programs, too many to list here, that developers can avail themselves of. Examples of soft financing include, but is not limited to:

- **U.S Department of Housing and Urban Development (HUD) administered programs**
  - *Block grant programs*
    Both the HOME Investment Partnership Program (HOME) and the Community Development Block Grant (CDBG) are formula-driven block grant programs where states and localities are provided funds for a number of eligible activities – while HOME was created to address housing affordability issues, and CDBG has a much more varied list of activities, both programs’ funds can be used to support affordable housing activities, including rental properties for low- and very low-income households. As such, both can be used to fill the financing gap for LIHTC developments.
  - *Project-based assistance*
    HUD administers a variety of project-based rental assistance programs where the subsidy is tied to homes within rental properties. The two largest are the Project Based Rental Assistance Program (PBRA) administered by the Office of Housing where HUD contracts directly with private rental housing owners, and project-based vouchers (PBVs) administered by the Office of Public and Indian Housing where HUD contracts with public housing agencies (PHAs), which in turn allocates the PBVs to a specific property. These subsidies can be used to finance affordable rental housing in conjunction with the LIHTC. HUD’s Office of Housing also administers two supportive housing programs that are often used in conjunction with LIHTC to serve specific populations—the Section 202 Supportive Housing for the Elderly and the Section 811 Supportive Housing for People with Disabilities.

- *Assistance to serve special needs populations*
  Under the McKinney-Vento Homeless Assistance Act, HUD's Office of Special Needs Assistance Programs within the Office of Community Planning and Development administers programs to provide outreach, shelter, transitional housing, supportive services, short and medium-term rent subsidies, and permanent housing for people experiencing homelessness, and in some cases for people at risk of homelessness. Funding for these activities is distributed by formula to jurisdictions for the Emergency Solutions Grants program, and competitively for the Continuum of Care process. Project-based resources authorized under McKinney-Vento are often used as soft financing sources with the LIHTC. HUD also administers the Housing Opportunities for People with AIDS (HOPWA), which sometimes is used with the LIHTC.

- **U.S. Department of Agriculture (USDA) multifamily housing programs**
  The USDA's multifamily housing programs fund developments in rural communities for low-income households. A number of financing options are provided, including Section 515 Multifamily Housing Direct Loans and the Section 538 Multifamily Housing Loan Guarantee program. Direct loans provide competitive financing for affordable, multi-family rental housing for low-income, elderly, or disabled individuals and families in eligible rural areas. The loan guarantee program works with qualified private-sector lenders to provide financing to qualified borrowers to increase the supply of affordable rental housing for low- and moderate-income individuals and families in eligible rural areas and towns. Both programs are used with the LIHTC.

- **Federal Sources authorized by the Federal Housing Finance Agency (FHFA)**
  Though administered by HUD, Treasury and Federal Home Loan Bank member institutions, these programs are discussed together as they are funded by contributions from Fannie Mae, Freddie Mac, and the Federal Home Loan (FHL) Banks, the housing government sponsored entities.

  - *National Housing Trust Fund (HTF)*.
    HUD allocates HTF funding by needs-based formula to states for the production or preservation of affordable housing for very low-income households.

  - Capital Magnet Fund (CMF)
    The CMF competitively awards money to nonprofit housing organizations and Community Development Financial Institutions (CDFIs) to finance affordable housing for low-income households and related economic development, including community service facilities.

  - Affordable Housing Program (AHP)
    Each FHL Bank must establish an AHP and dedicate 10% of its annual earnings to this program. Funds can be used for the purchase, construction, or rehabilitation of rental housing.

- **State and Local Sources**

  - *State LIHTC programs*.
    In addition to the federal LIHTC, there are separate state programs – currently there are 18 state housing tax credit programs, with additional programs proposed – that can be used to finance affordable rental housing properties. State programs can vary widely, with different compliance periods, recapture stipulations, funding caps and more.

- *State and local affordable housing bonds*
  To support the development and preservation of affordable housing, cities, counties and states can chose to issue bonds to provide subsidies for affordable housing projects or fund other affordable housing programs or other related purposes. State and local governments may have laws and provisions that require taxpayer approval for the issuance of new bonds or bonding authority and as such, this form of financing for rental housing is not as common as state housing tax credits.

- *Other state and local sources*
  in addition to housing tax credits and bonds states and local funding sources can include: local trust funds or state housing trust funds; assistance provided to developers in the form of relief from their property taxes; state and local rental assistance programs; and, tax increment financing.

- **Deferred Developer Fees**
  Another way of filling the funding gap between the amount of permanent debt that can be supported by a project and equity contributions is to defer the payment of developer fees owed to the developer until after the project has been placed in service. Where market rate housing developers are compensated by a portion of the asset appreciation and cash flow, in LIHTC properties, developers are compensated by a specific fee as set by state agencies. Sometimes, given the financing needs of a particular property, instead of receiving the fee upon completion, some or all of the fee is deferred and paid over time.

- **Seller Notes**
  The purchase price of a LIHTC property is typically the appraised value, in order to constitute an arm's length transaction. The seller may decide to only require a portion of the purchase price to be paid in cash. When the seller of a property agrees to finance the remaining portion of the sale, a note is issued detailing the terms under which they will be repaid by the buyer.