A Study on Income Averaging and Its Use For Affordable Housing

URBAN LAND CONSERVANCY

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REPORT SUMMARY

This report explores the use of income averaging in conjunction with Low-Income Housing Tax Credit developments. As an organization grounded in and driven by the growing needs of displaced communities, Urban Land Conservancy is always searching for new equity-driven approaches in creating affordable housing. When income averaging became a ready-to-use tool in 2017, ULC was the first organization in Colorado to put it to use.

In 2017 ULC needed to rehabilitate The Villas at Wadsworth Station, an affordable housing development ULC purchased in 2012. If traditional financing were to be used, ULC would have been forced to displace some of the building's residents who no longer fit into the median income structure. But ULC used income averaging to ensure existing residents remained in place. The renovations were successfully completed in 2019.

In partnership with Columbia Ventures, ULC used income averaging again, with LIHTC, at the 48th and Race property. The development, Viña, broke ground in October 2020 and opened for occupancy in March of 2022 with 150 affordable apartments and community-serving space, including Tepeyac Community Health Center. Using income averaging allowed for a deeper level of affordability without having to rely on Section 8 housing vouchers.

As ULC looks to the future of income averaging, it hopes to build on the success of these two projects and share with others the effectiveness of this tool.

The Villas at Wadsworth Station

CONTENTS

INTRODUCTION

A recent Urban Land Conservancy (ULC) report examined how ULC has deftly employed a combination of Low-Income Housing Tax Credits (LIHTC) and a community land trust (CLT) to increase the stock of permanently affordable rental housing in and around Denver. Over the past four years, ULC and developer partners have had access to a new tool created by the December 2017 federal tax reform law, which provides more flexibility in affordable housing development.

This tool is widely known as income averaging, and its use in two recent ULC communities will be the focus of this report. First, income averaging allows the use of federal and state tax credits for developments that house people with a wider range of incomes than had been possible under previous laws.

Instead of affordable units in development being set aside only for individuals or families earning 60 percent or less of Area Median Income (AMI), income averaging allows people earning up to 80 percent of AMI to rent in affordable developments, as long as the overall average income for affordable apartments in a given development stays at or below the 60 percent AMI threshold.

Income averaging offers developers and residents several advantages. First, and most importantly, it makes it financially feasible to provide a substantial number of apartments in any given development for extremely low-income (ELI) people—those at or below 30 percent of AMI—without having to scrap for scarce federal housing vouchers. For example, in Denver, the current 30% AMI for a household of three people is $27,000 a year.

Second, it allows essential workers like teachers and firefighters, many of whom earn at or below 80 percent of AMI and who previously would have earned too much money to qualify for affordable housing, to rent an apartment in affordable developments. Again, this helps those essential workers remain in a city with increasingly unaffordable housing costs.

“Income averaging provides greater flexibility in several ways,” says Aaron Miripol, ULC’s President and CEO. “It allows us to reach very low-income households without having to rely on Section 8 vouchers, which are always in short supply. And just as important, it allows residents who otherwise can’t qualify for a voucher to get an affordable home.”

This report will focus on the first two ULC communities to use income averaging. The first is the Villas at Wadsworth Station in Lakewood, a 100-unit development ULC bought in 2012 and rehabilitated. Using income averaging, ULC avoided displacing any of the building’s residents, some above the 60 percent AMI income threshold.

The second community is Viña, part of a large-scale development at East 48th Avenue and Race Street in the Swansea-Elyria neighborhood. Viña, which opened for occupancy in March 2022, offers 150 permanently affordable homes, half of which will be available to people earning under 50 percent of AMI, with 30 percent of all the apartments set aside for ELI residents.

The remainder of this report details how these deals came together and what they portend for the future of affordable housing. But, first, we will provide a brief overview of how income averaging works.

INCOME AVERAGING ON LIHTC PROJECTS

Permission to use income averaging in LIHTC developments resulted from the passage of the 2017 tax reform law which took effect on January 1, 2018. One of the main reasons Congress approved this change was explained in an article from Novogradac, a real estate professional services firm:

“In high-cost jurisdictions (like Denver), many people at 80 percent AMI have difficulty affording any kind of market-rate housing. The result is an unusual circumstance where there are options for those with very low and very high incomes, but not those in between.

An objective of some community revitalization plans is to bring in higher-income households. Having LIHTC units serve those at the lower end of the spectrum is at least as important as the goals above. However, doing so means reduced rental income. Income averaging would allow LIHTC properties to offset the revenue reduction and make more affordable rental housing developments financially feasible.”

In other words, there are a few complimentary benefits to income averaging.

First, it allows for a healthier mix of incomes in affordable housing developments. Second, it will enable employed people of moderate income to find affordable housing in gentrifying areas. And third, it allows developers to turn a profit by providing rental housing for very low-income people without relying on federal housing vouchers.

ULC was the first organization to take advantage of income averaging in Colorado on a property it was remodeling along a transit line and had already owned for several years.

THE VILLAS AT WADSWORTH STATION

ULC purchased the Villas at Wadsworth Station in 2012 for $7 million to preserve the apartments as affordable. It was the organization's first property acquisition in the Denver suburb of Lakewood. The development sits adjacent to the Wadsworth Light Rail Station connecting Downtown Denver to Golden, which opened two years later, in 2014. The station also features an under-utilized RTD 1,000-car parking garage. When ULC purchased the two buildings, it was outdated and needed significant upgrades.

Still, buying the apartments made sense to ULC's Miripol. Affordable housing adjacent to public transit—known as transit-oriented development (TOD)—was one of ULC's main areas of focus as it worked to acquire properties for long-term community benefit.

"We liked the buildings because they were adjacent to the West light rail line, and we believed Denver's Transit-Oriented Development Fund needed to expand beyond the City limits and go regional," Miripol shares.

Denver's Affordable Housing TOD fund was created in 2010. The first such fund anywhere in the U.S., it was spearheaded by ULC, the City and County of Denver, Enterprise Communities (a national nonprofit focused on affordable housing), and several philanthropic and banking investors. While the $15 million fund (which later grew to $24 million) was initially set up to serve only acquisitions within the Denver city limits, Miripol was among those pushing from the outset for a metro-wide approach. He saw the Villas at Wadsworth Station as an ideal investment for the TOD fund and hoped to receive a $6.3 million loan from the fund toward the $7 million purchase price—or 90 percent loan to value.

But other fund partners balked, which Miripol laments as a missed opportunity to this day. "We have a TOD fund with money, and we can't use it? Here was an opportunity to take it regionally. It seemed like common sense, but a lot of this isn't common sense," he says.

With the TOD fund off the table, ULC had to turn to more traditional—and expensive —sources of financing for the purchase. Citywide Bank provided a $5.25 million loan, which funded the bulk of the purchase. ULC had to raise the other $1.75 million with subordinate debt and its own cash. Eventually, the project received $1 million from the Colorado Division of Housing covering a portion of ULC's investment.

The next step was financing the rehabilitation of the 100 apartments. When the purchase closed, ULC worked with two nonprofit partners. Community Resources in Housing Development Corporation (CRHDC) would act as developer, and Rocky Mountain Communities would manage the property. Each organization put $200,000 into the acquisition.

Initially, ULC and its partners thought the bulk of financing would come through four-percent federal low-income housing tax credits. The more attractive, competitive nine percent credits weren't available for a preservation/renovation deal like the Villas at Wadsworth Station.

In addition, state credits often used to augment four-percent deals, were not available at that time. Two years after the acquisition, CRHDC determined that using only four-percent federal tax credits, wouldn't work for them financially and stepped out of the deal

Once CRHDC pulled out, ULC looked at using tax-exempt bond financing for the renovation. However, using tax-exempt bonds wouldn't have brought in enough cash to do the critical upgrades—only offering about $5,000 per apartment—when $20,000 per apartment ($2M total) was what the buildings needed.

Ultimately, ULC returned to four-percent tax credits, which were received in early 2018. These credits would allow renovations at just over $20,000 per unit, which attracted investors to the deal through New York-based Richman Capital, a tax credit syndicator.

While Miripol found the five years of delay frustrating, it turned out to be a blessing in disguise. The tax reform law passed by Congress and signed into law at the end of 2017 meant that the Villas at Wadsworth Station could use income averaging, a feature of that massive bill, to keep the current residents of the development in place, rather than having to relocate 14 residents whose incomes exceeded the strict LIHTC levels.

"The value in a rehab project like this is that it helps preserve naturally affordable housing that is not covenant restricted like traditional LIHTC projects," says Laura Clark, whose firm, SB Clark Companies, helped ULC pull together the project financing. "One of the advantages of income averaging is that in a project like this, you can update capital needs using tax credits without having to displace anyone."

ULC's nonprofit mission and its pledge not to displace any residents helped the organization acquire the property in 2012 from the extended California family that owned it. "Several family members said the fact that we were a nonprofit and that we were going to do everything possible to keep the current residents in place helped them choose us as the buyer of their buildings," Miripol says.

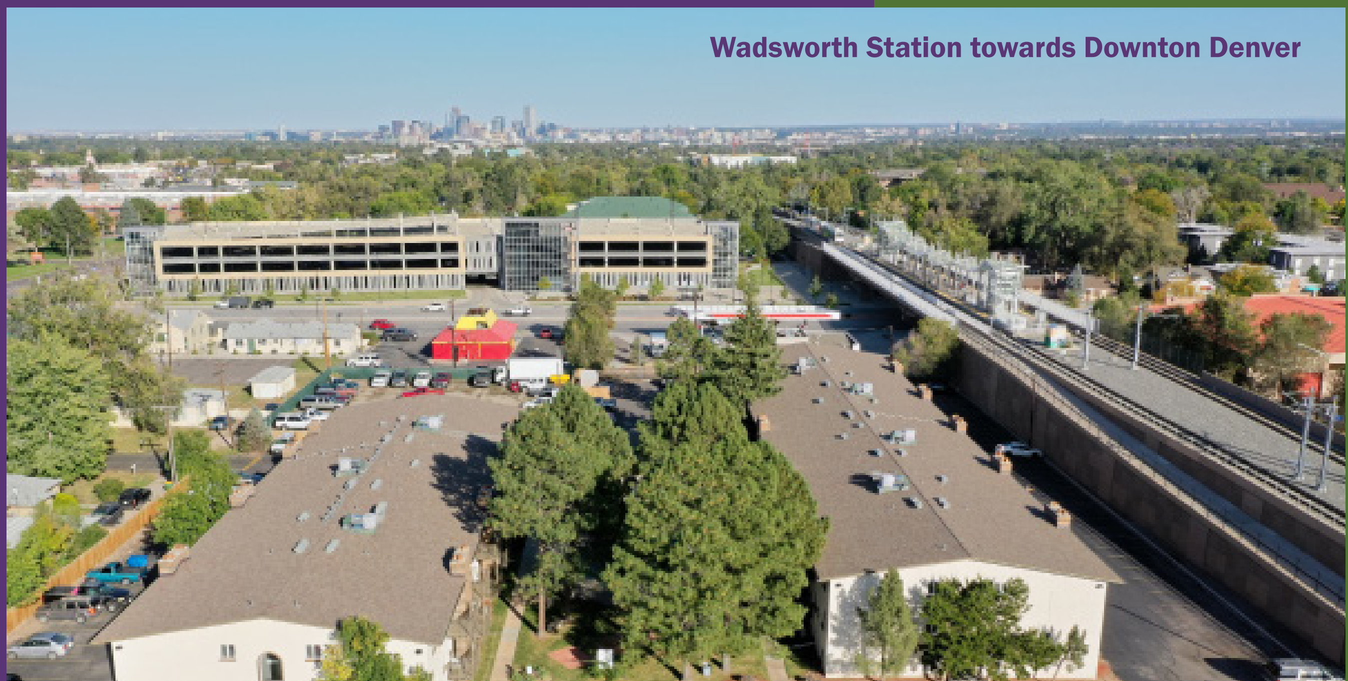
Today, the Villas at Wadsworth Station's 100 apartments average about 55 percent of the AMI. Some residents are as high as 75 percent of AMI, and a number are at 30 percent AMI. The building holds 72 one-bedroom apartments and 28 two-bedrooms. "Residents are a very diverse group. We have young families with up to five people and seniors living alone," Miripol says.

The two buildings, constructed in the early 1970s, suffered from deferred maintenance and required a new roof and a paint job. In addition, apartments needed new flooring, HVAC units, appliances, kitchens, cabinetry, and bathrooms.

Rather than move families out, the renovation project created temporary "hospitality units" where families could relocate for a week or so while their apartments were renovated.

The renovations began in the spring of 2018 and were completed in early 2019.

Miripol says the Villas at Wadsworth Station are worth $16 million, more than twice what ULC paid for the building more than ten years ago.


Wadsworth Station towards Downton Denver

VIÑA AT 48TH AND RACE


Viña Apartments

ULC and its partners also used LIHTC and income averaging for a 150-unit affordable housing development which sits on a two-acre parcel in the Elyria-Swansea neighborhood near East 48th Avenue and Race Street.

The development, Viña, broke ground in October 2020 and opened for occupancy in March 2022. It is part of a larger, six-acre piece of land ULC bought in March 2015 for $5.5 million after Denver's economic development office brought the opportunity to ULC's attention. It sits just two blocks east of the N Line Regional Transportation District rail station connecting downtown Denver to the suburb of Thornton.

The development will also feature a significant expansion of Tepeyac, a longstanding and highly regarded North Denver neighborhood community health center. Viña will also include 5,400 square feet of retail, likely to include some kind of fresh food market—a bodega or a carneceria. The market will be of enormous benefit to the area, which has long been a food desert.

"The City and County of Denver viewed this development as a specific opportunity to help mitigate the displacement of residents from the Elyria-Swansea neighborhood," says Erin Clark, ULC's former Vice President of Master Site Development who worked extensively on the deal. "All of these public investments (most notably the National Western complex) were coming online and would severely impact a neighborhood that already is physically disconnected from other parts of the city by Interstate 70 and train tracks."

The land purchase was financed by a $1.5 million skyline loan from the City and County of Denver and a $4.2 million loan from the Calvert Foundation, $1 million of which was offset by a participation agreement from the Colorado Health Foundation.

As part of its agreement with the city, ULC promised that 51 percent of the housing would be reserved for people earning below 80 percent of AMI and that the development of the entire six-acre parcel would ultimately create 26 permanent jobs.

FINDING A DEVELOPER

As is true with many large real estate transactions, assembling the development portion of the deal took time and perseverance. Soon after ULC bought the land, it searched for a master developer and a community benefit tenant. Tepeyac signed on early and has remained a steadfast partner.

ULC found its development partner, Columbia Ventures of Atlanta, through Tony Pickett, Clark's predecessor. Columbia Ventures is a large, Black-owned mixed-used developer that, until the ULC deal, had never operated west of the Mississippi. But Columbia Ventures had extensive experience with transit-oriented development, having built several communities along Atlanta's MARTA transit lines, so Pickett recognized a potential fit.

Dillon Baynes, Columbia's managing partner, said when Pickett made overtures, his company was immediately intrigued. "Generally, we want to operate within a two-hour drive or flight of Atlanta," Baynes says, listing Savannah and Augusta, Georgia, and Jacksonville, Florida as other cities where Columbia has done developments. "But when we came out and saw this property, learned about the project, and got to know all the partners involved, we thought the opportunity was compelling."

Baynes also said the TOD angle was "super-relevant" in piquing Columbia Ventures' interest in the project.

SECURING TAX CREDITS

It is often the case that securing tax credits is the most challenging piece of affordable housing financing. With Viña, however, the need for affordable housing in the rapidly gentrifying Globeville-Elyria-Swansea area was so apparent that ULC knew it had a strong argument for the credits. "Our pitch to CHFA (Colorado Housing Finance Authority) was that this community cannot wait any longer," Clark says of ULC's 2019 application.

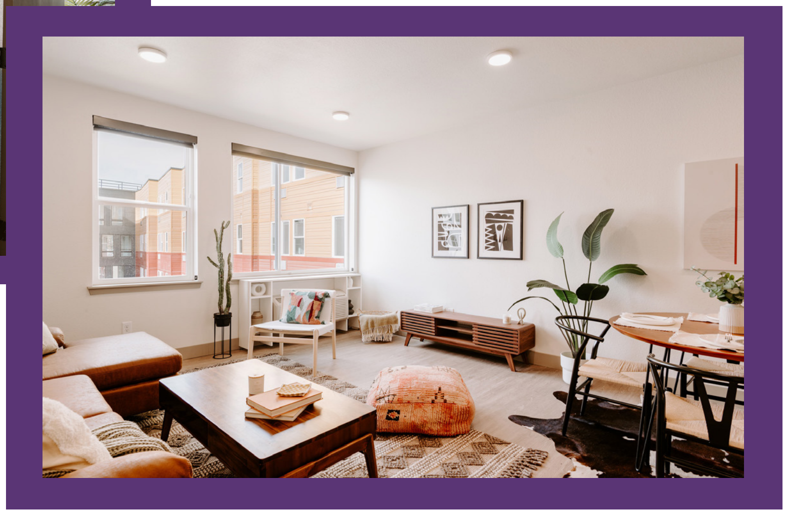
"At this point, we were four years in to owning the land. Property values were skyrocketing, and many long-time residents were facing push-out caused by rising property taxes. And this development is such a unique model, marrying affordable housing and access to healthcare in the same building. We told CHFA, 'this is a community on the edge, and we need to get going.'"

What came out of the engagement work was the need to get far more units for households at 30 percent AMI and below without using federal HUD vouchers.

Clark said evidence of the urgency was reflected in the rapidly escalating value of ULC's six-acre parcel. Purchased in 2015 for $5.5 million, it appraised at $8 million in 2017 and at $12 million in March 2020.

In May 2019, CHFA awarded Columbia four percent federal tax credits and four-percent state credits. (See the companion report for a detailed explanation of LIHTC). While tax credits covered a substantial portion of construction costs, Columbia also needed a City Department of Housing stability loan of $3.75 million to complete the deal. That's where the slowdown happened. Denver City Council didn't approve the loan until the late summer of 2020, more than a year after awarded credits, delaying the start of construction until October 2020.

As part of its tax credit application, Columbia committed to serving a substantial number of very low-income people. Forty-five units are income-restricted to households earning up to 30 percent of the area median income, up to $21,000 for a single-person household or up to $30,000 for a four-person household. Thirty units are income-restricted for households earning up to 50 percent of the AMI, and 75 units are restricted for those earning up to 80 percent AMI.



HOW INCOME AVERAGING MADE VIÑA POSSIBLE

Viña is also among the first income-averaging developments approved in Colorado using the new income-averaging option.

The beauty of income averaging becomes apparent in the allocation of apartments for people earning 30 percent or less of AMI. The new law, which allows those 75 apartments at up to 80 percent of AMI, essentially subsidizes the lower-income families and avoids the uncertainty that comes with vouchers given out by the U.S. Department of Housing and Urban Development (HUD).

"The issue is that tax credits go only so far, and if we had to rely only on the tax credits, we never would have been able to achieve 150 apartments, and we wouldn't be able to get 45 apartments dedicated to households below 30 percent AMI, without vouchers," says Baynes, of Columbia Ventures.

For us, it was simple: This is the way we get to the number of 30 percent that we need without depending on the federal government for housing vouchers," ULC's Clark explains. "And, the importance of having a mixed-income development, of not wanting to concentrate poverty in any particular building. So, we saw that as a real plus, to have that income mix."

Baynes said the 80 percent units also fill what has long been an unmet need in gentrifying areas: Affordable housing for working people with moderate incomes—people who often are essential workers.

"The upper limit picks up teachers, firefighters, people of that income level who want and need to be able to live in proximity to where they work," he says. "The other two income bands address deeply needed sectors in Denver."

Viña quadruples the supply of permanently affordable housing in the area.

THE IMPACT OF TEPEYAC COMMUNITY HEALTH CENTER

Having a full-service health clinic built into Viña's ground floor is one of its most unique and appealing features. Tepeyac is a community health center in Globeville currently operating at capacity.

"Many of our patients are essential frontline workers who are integral to our economy and live with disproportionate health risks, like COVID-19," says Jim Garcia, Chief Executive Officer of Tepeyac. "Our families often need a combination of services and resources that we will be able to offer in this new and significantly larger Tepeyac facility."

The new clinic, 24,500 square feet, will feature 20 medical exam rooms, a dental suite, and a behavioral health suite, including dedicated space for art therapy and play therapy. There will also be a full-service pharmacy on-site. The original, much smaller Globeville clinic will remain open as well.

Garcia said the new clinic would increase Tepeyac's physical plant by a factor of five and will eventually more than triple the number of people it can serve each year.

"This project made a lot of sense for us in several ways," Garcia says. "We have been committed to staying in the Globeville-Elyria-Swansea area, and with the new light rail, we can continue to serve people from all over the metro area. It is a great, central location for us."

The clinic is set to open in Fall of 2022.

Tepeyac
Community
Health Center

THE FUTURE OF INCOME AVERAGING

As an organization grounded in and driven by the community, ULC is always searching for new equity-driven approaches to affordable housing.

"After learning that income averaging would allow us to decrease our reliance on housing vouchers and increase our impact across the AMI level, we knew we had to give it a shot," says Aaron Miripol.

"Developers are not always quick to jump to new financing options when they have readily available tools that are tried and tested, so we were especially grateful to Columbia Ventures for entering new territory with us and using Income Averaging at Viña Apartments," Miripol adds.

In fact, Miripol regards ULC's use of income averaging for the Villas at Wadsworth Station and Viña projects as a blueprint for future affordable housing developments. "It's another powerful tool for us, and one that we will certainly look at using whenever possible," he says. "We're excited to see how it takes shape in the years to come."

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