Rebuilding the Bond Market for Mixed-Income Housing

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While mixed-income housing often is discussed as a means to transform areas of concentrated poverty, it can also advance housing opportunity and racial equity in higher-income and gentrifying neighborhoods. Some localities have attempted to expand access to affordable housing in these neighborhoods through inclusionary zoning, which requires developers to build affordable units as part of a market-rate project. However, these projects often are contested, and high rates of inclusionary units can make a development financially infeasible.

We believe that "80-20" deals—a use of tax-exempt bonds to finance mixed-income housing that was popular in the 1970s and 1980s—offer a promising means to generate and preserve low-cost income-restricted housing in opportunity neighborhoods. Due to their structure, 80-20 deals can be used to increase access to higher-income neighborhoods as well as to preserve affordable housing in gentrifying neighborhoods. Moreover, they rely on an underutilized source of funding: Each year, states leave billions of dollars in bond authority on the table.

Tapping into this potential will require building the capacity of the affordable housing and community development industry to do market-rate rental development or to partner with market-rate developers, since 80-20 deals require large projects and experienced teams from both the private and public sectors. This is due largely to the high fixed costs of bond financing and the complex federal administrative and compliance regulations that come with bonds. Nonetheless, we believe that this is an opportune time to reconsider the potential of mixed-income, bond-financed deals. Expanding public and private sector capacity to arrange 80-20 deals would tap into an underutilized funding stream without reducing the resources for 100% affordable projects. Furthermore, as cities increasingly turn to inclusionary zoning and other policies to expand the supply of affordable housing, 80-20s may help make more projects financially feasible.

In this essay, we explain what 80-20s are and how these deals are structured, trace the reasons for the rise and fall in their popularity, provide examples of current 80-20 deals and programs, and suggest steps that private and public actors can take to make better use of this type of deal.

What Are 80-20s and How do They Work?

"80-20" is a shorthand term for housing projects that combine market-rate units (usually 80% of total units) and affordable units (usually 20% of the units reserved for families at or below 50% of the Area Median Income) in a single deal funded through tax-exempt private activity bonds. These bonds—issued by a state Housing Finance Agency or similar allocating body—provide a subsidy for affordable housing because the interest paid to the bond investors is not taxed at the federal or (usually) state level, allowing investors to accept a lower rate on the bond. This lower interest rate translates into lower costs to finance the development; the savings are passed on to the project, thus facilitating the construction or acquisition of projects that are a mix of market-rate and affordable housing. In addition, the large size of 80-20 projects (which are rarely fewer than 100 units) gives these developments a catalytic effect on neighborhoods, increasing demand and land values for adjacent properties and property tax receipts.

80-20s are an effective means for state and local governments to provide access to opportunity neighborhoods for low- and moderate-income families. These deals work where there is adequate demand for the market-rate units; as a result, they work well in neighborhoods that tend to be higher-income and with stronger labor markets. 80-20s tap into this market demand by providing high-quality (often luxury) projects that are affordable to both the market-rate tenants and the low- and moderate-income tenants. The affordable units expand housing accessibility in neighborhoods that are otherwise often closed off to lower-income households, thereby disrupting entrenched patterns of income segregation. As long as the affordable units are identical to the market rate units and are scattered across the building, residents report no substantial frictions among tenants based on income.[1]

80-20s may also promote racial inclusion. Black[2] and Latinx households in particular, are more likely to be both low-income and renters. The neighborhoods that are best suited for 80-20 development have more stable and/or higher rents, which tend have a higher share of non-Latinx white residents. Thus the affordable units of 80-20s can be a means of providing minority renters access to whiter or more integrated neighborhoods. Local governments and nonprofits can further this goal by ensuring that the affordable units are marketed to a racially diverse group and that tenant selection and income verification practices do not disadvantage minority groups.

States do not have limitless ability to issue tax-exempt bonds for housing. The federal government allocates to each state an annual "volume cap" and restricts how the funds can be

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[1] Julie Satow, "Living in the Mix," *The New York Times*, August 29, 2014, https://www.nytimes.com/2014/08/31/realestate/affordable-housing-in-new-yorks-luxury-buildings.html.
[2] Editor's note: All references in this essay to black/African-American, white, or Asian populations refer to non-Hispanic/Latinx individuals unless otherwise noted.

used.[3] In many states, the majority of these funds have gone to support first-time homebuyer and multifamily rental housing.[4] In 2018, states received $37.1 billion in new volume cap—a considerable sum in comparison to the $950 million allocated for the HOME Investment Partnerships Program (HOME), $3 billion for Community Development Block Grants (CDBG), and approximately $10 billion for Low-Income Housing Tax Credits (LIHTC) in 2018. Apartment buildings financed with volume cap must set aside at least 20% of their units for low-income families.

Perhaps because of these restrictions, a significant share of this bond authority is left on the table. While exact numbers are hard to come by, estimates suggest that at least $4.7 billion of volume cap went unused in 2018 because it was not allocated in time.[5]

Why Have 80-20 Deals Become Less Common Since the 1970s and Early 1980s?

In the 1970s and early 1980s, 80-20 deals were popular across the United States. The first state Housing Finance Agencies (HFAs) and local issuers were established in the 1960s, and by the mid-1970s most states had an HFA. In 1974 Congress authorized the issuance of tax-exempt bonds for privately owned apartment buildings. The exceptionally high interest rates of the 1970s and the early 1980s (e.g. 16.5% for a Freddie Mac 30-year fixed mortgage in 1981) caused demand for tax-exempt mortgage debt to spike, and state and local issuers responded by issuing large quantities of tax-exempt bonds.[6]

The Tax Reform Act of 1986, however, instituted an entirely new system of financing low-income rental housing by establishing LIHTC, setting limits to the amount of private activity bonds a state could issue, and restricting the uses of tax-exempt bonds for housing finance. Annual multifamily bond issuance (bond issues to finance apartment complexes) fell from a peak of $21.8 billion ($51.77 billion today) in 1985 to just $2.84 billion ($6.40 billion today) in 1987.

Since then, issuers have slowly regained capacity and authority as new sources of federal funds have flowed in and their volume cap authority increased. 80-20 deals, however, remain relatively rare. This is likely because using bonds to finance housing can be complex. The most effective 80-20 programs involve state agencies with substantial balance sheets and staff capacity, which not all state (or local) issuers possess. Furthermore, from the perspective of

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[3] For a more in-depth description of volume cap and multifamily volume cap deals in general, see: Justin Cooper, *Multifamily Rental Housing: Financing with Tax-Exempt Bonds* (Orrick Herrington & Sutcliffe LLP, 2010), https://www.orrick.com/Insights/2010/06/Multifamily-Rental-Housing-Financing-With-Tax-Exempt-Bonds.
[4] Other uses include certain kinds of industrial development, nonprofit hospitals, and student loans.
[5] Council of Development Finance Agencies, *CDFA Annual Volume Cap Report: An Analysis of 2018 Private Activity Bond & Volume Cap Trends.* (Council of Development Finance Agencies, 2019), https://www.cdfa.net/cdfa/cdfaweb.nsf/ord/201910-2018VolumeCapReport.html/$file/CDFA%202018%20Volume%20Cap%20Report.pdf.
[6] Trevor W. Nagel and Walter J. St. Onge, "Housing Bonds and Tax Reform: The Perils of a Partial Analysis of Low-Income Housing Programs," *Yale Law & Policy Review* 6, no. 2 (1988): 287–08.

LIHTC investors, market-rate units add additional risks because these units have uncertain demand relative to the constant and strong demand for affordable units. There are also tricky tax credit allocation issues for LIHTC investors if they are investing in projects where a substantial portion of the units are market rate.

Examples of Successful 80-20 Programs

While the number of 80-20 deals has decreased overall since the late 1970s and early 1980s, evidence from a few states and localities suggests that they still can be successful, at least in certain markets.

New York. New York has the longest-running and highest-production 80-20 programs and has demonstrated that 80-20s are a flexible, effective method of generating mixed-income housing. There are two major types of mixed-income bond financing programs in New York. Both programs are in high demand, primarily because of a large tax abatement provided by New York City. The first program is a traditional 80% market rate, 20% affordable housing program run by the New York State HFA, which is subsidized only by the bonds. From 2005 to 2013, this program produced over 12,000 units in New York City. The majority of these units are sited in stable, high-opportunity areas with high market rents. Over the past two decades the HFA has adjusted this program to provide just enough subsidy to make 80-20s more attractive to developers than 100% market-rate deals.

The other mixed-income bond program is run by the local issuer, the New York City Housing Development Corporation (HDC). HDC uses mixed-income bond financing differently from the state, establishing programs that require a third income band for middle-income households (a disproportionately housing-cost burdened group in New York City). This program has found success in neighborhoods that, while not the hottest markets, are seeing increased investment. The additional income-restricted units require additional subsidies, which HDC provides in the form of subsidy mortgages funded from its corporate reserves.

San Antonio, Texas. While New York's program focuses on integrating affordable units into higher-market rent, in neighborhoods of San Antonio, TX the San Antonio Housing Trust, the local bond issuer, has established a pipeline of mixed-income bond deals with a focus on neighborhood revitalization. San Antonio structures its deals with multiple income tiers, including substantial market-rate portions, and seeks to site them in neighborhoods that market-rate developers may still be wary of approaching without subsidies. The 80-20 deals have served to "prove" their neighborhood markets, catalyzing nearby investments while locking in affordable units down to 30% of Area Median Income. San Antonio makes these deals work by bundling them with the LIHTC 4% credit, other federal subsidies (e.g. HOME), and a local property tax abatement.

Minnesota. Issuers in Minnesota have used mixed-income bond deals to further their policy goals of deconcentrating affordable housing development and supporting transit-oriented development. Recent projects in the Twin Cities have highlighted both the challenges of mixed-income deals and the measures that can be taken to address these challenges. When LIHTC investors made it clear they would not accept the risk that came from the market-rate portion of the projects, developers used creative financial structures to shield these investors.[7] Additional local subsidies also were required so the state and local governments used Tax Increment Financing (TIF) notes to cover this gap. TIF notes proved well-suited to these developments, as the market-rate component of the deals generated a large tax increment that could be used to support the affordable component.

As these examples illustrate, 80-20s have the potential to support a variety of policy objectives by boosting the financial viability of mixed-income projects and expanding access to affordable housing in opportunity neighborhoods. 80-20s tap into latent demand for the market-rate units; in effect, they work with the market to expand access to affordable housing rather than enforcing new siting patterns through a LIHTC Qualified Allocation Plan.

Although there has not been a systematic review of the location of 80-20 deals, anecdotal evidence suggests that these projects face less community opposition than 100% affordable deals because of their large market-rate component. 80-20 projects tend to have high-quality design and physical components, since potential tenants for the market-rate units are choosing between the 80-20 project and other amenity-rich market-rate properties. As a result, 80-20 projects may be more effective in overcoming NIMBY objections than other affordable projects and could work in concert with the Affirmatively Furthering Fair Housing rule (AFFH) and other policies that seek to expand the supply of housing in higher resourced neighborhoods. However, they are not a panacea for building in communities with restrictive or exclusionary zoning ordinances that limit larger scale multifamily rental developments. Undoing longstanding patterns of resident segregation will ultimately require sustained attention to local land use controls and/or the use of fair share housing policies, such as Massachusetts' Chapter 40B,[8] which provide a "stick" for localities resistant to new affordable housing supply.

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[7] One deal was divided into two components, one 100% affordable and the other 100% market rate, to provide two separate financings for a single project. Another deal was split into one 100% affordable building and another 100% market-rate building on the same property, with separate but linked financings. For more detail on the first project and other mixed-income projects in the Twin Cities, see: Mariia Zimmerman, "Twin Cities Mixed-Income Housing Case Studies," https://static1.squarespace.com/static/5021cc16e4b0c203353d08c5/t/568d2181c647ad1e518a2fac/1452089729125/MIH_final_Oct+2015+final+draft.pdf

[8] Chapter 40B is a state statute that enables local zoning boards of appeal to approve affordable housing developments under flexible rules if at least 20-25% of the units have long-term affordability restrictions.

Aligning Market, Subsidy, and Policy

Mixed-income bond deals require capacity among a diverse set of government and market actors. These deals are complex, expensive to do at smaller scale, and often use multiple sources of equity and debt. Deals generally require some amount of subsidy beyond the tax-exempt debt, and these subsidies usually are provided by the state or local government or the issuer itself. Deals also often require the affordable deal partners to be comfortable with (or shielded from) the market-rate component of the deal and the market-rate deal partners to be comfortable with (or shielded from) the affordable component. The current affordable housing development ecosystem is set up to do 100% LIHTC projects, meaning that the incentives to do mixed-income development that is driven by the market side is limited. This is a missed opportunity because 80-20s benefit from market mechanisms that help ensure the projects are high-quality and well-sited.

What needs to happen to rejuvenate the use of 80-20 deals? First, state and local issuers and policymakers play an essential role in supporting and driving demand for 80-20 programs. New York City and San Antonio's 80-20 programs have succeeded in large part because of local tax abatement programs that drive demand for bond financing and make the projects more financially feasible. But, as the case of Minnesota shows, local governments have a wide range of other policy levers that can promote 80-20 development, including Tax Increment Financing, inclusionary zoning, density bonuses, and local subsidies. State governments can provide additional subsidy through state housing tax credits, state housing trust funds, or directly through state HFAs. California's HFA, for example, has recently created the Mixed-Income Program a subsidy debt product specifically for bond-financed mixed-income housing. While many states already prioritize housing in their volume cap allocations, some do not and some even discourage 80-20 developments, preferring only 100% affordable projects while their volume cap allocations expire.

State and local policymakers also have a role to play in ensuring that 80-20s have appropriate affordability restrictions and in overseeing some management aspects of the affordable units. The affordability protections that come with the bonds themselves are minimal, providing no guarantee of below-market rents for the low-income tenants and relatively short periods of income-restriction. It is the responsibility of the issuer to create and enforce a regulatory agreement that ensures that the affordable units' rents are set at appropriate levels and kept affordable for a substantial time period. Developers of 80-20 deals often have little or no experience marketing units to low-income tenants, selecting tenant, and certifying incomes. Issuers can direct developers to partner with organizations that have experience with these tasks.

Second, the federal government has a major role in promoting the development of mixed-income housing. The most significant recent action was the 2018 Consolidated Appropriations Act which—in addition to increasing LIHTC allocations—included provisions that allow for

income averaging in LIHTC projects, making mixed-income in 9% LIHTC deals more feasible. A number of additional actions could also have substantial impacts. A slight change in the tax code that facilitates the "recycling" of tax-exempt bonds, for instance, could dramatically expand the amount of volume cap and LIHTC available for all tax-exempt bond-financed rental housing projects, without requiring an increase to the volume cap limits.[9]

Federal Housing Administration (FHA) and Ginnie Mae serve an important role in 80-20 deal development in a number of ways, including by providing a construction-to-permanent loan product and through established risk-sharing programs with Fannie Mae, Freddie Mac, and many state HFAs that help to speed the origination of FHA multifamily loans. Additionally, FHA has recently piloted discounted insurance premiums to mixed-income projects. Housing affordability is central to FHA's mission, and the agency is willing to work in tertiary markets that many private lenders might avoid.

Fannie Mae and Freddie Mac currently play the broadest range of roles in multifamily bond deals and could take many different actions to support 80-20 developments nationwide. Currently Fannie and Freddie provide credit enhancement, buy the mortgages used in bond deals, buy the bonds themselves, and have recently re-entered the tax credit equity markets. Their market power, affordable housing goals, and diverse roles in the market provide them with many powerful means of promoting 80-20 projects including: new credit enhancement products, new mortgage product types, and new bond-buying or LIHTC-investment programs tailored to 80-20s.

Issuers have a range of options to promote the generation of 80-20 deals. All issuers can signal to the market that they are interested in 80-20s and have volume cap and associated LIHTC to support these deals. Many issuers, however, have limited ability to generate deals themselves. Almost all local and many state issuers are conduit issuers for multifamily deals, meaning that they are intermediaries but not lenders themselves. The most productive 80-20 programs are pooled issuances in which the issuer is the lender, allowing the issuer to establish the terms of its mortgage products. This structure requires the issuer to have a balance sheet, maintain staff capacity, and assume financial risk, but allows them to compete in the market and build up assets that can be deployed as additional subsidy. For example, from 2003 to 2015 the New York City Housing Development Corporation provided $1.5 billion in subsidy loans to support over 80,000 units of affordable housing. Knowledge sharing between state and local

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[9] Allowing "recycled" bond proceeds to be used for all allowable uses of volume cap (presently they can only be used for housing) could allow states to allocate more of their volume cap to housing (and receive more 4% LIHTC) without diminishing tax-exempt bonds resources for non-multifamily uses. Legislation has already been introduced with this change, see Mark A. Willis and Luis Hernandez, "Proposed Legislation Expands Private Activity Bond Recycling," *The Stoop* (blog), *NYU Furman Center*, July 9, 2019. https://furmancenter.org/thestoop/entry/proposed-legislation-expands-private-activity-bond-recycling.

issuers, particularly between pooled issuers and conduit issuers, could be a useful first step in building capacity.

Banks commonly provide credit enhancement and loans in bond deals and play an important role in 80-20 development. Regional banks, commercial and investment banks, and some non-bank financial institutions are all active in traditional multifamily bond deals, but many are unfamiliar with 80-20s. The Community Affairs Office of the Federal Reserve System, however, could play a role in raising the visibility and knowledge of this financing product, and regulators more generally could clarify that these deals would be eligible for Community Reinvestment Act credit. Improved capacity for underwriting these deals and structuring mortgage products could play a part in reinvigorating the 80-20 market.

Conclusions

80-20 deals are not a panacea and will not address all the gaps in affordable rental housing. Nor will they likely lead to dramatic changes in patterns of residential segregation that still characterize many U.S. cities. However, they do provide an opportunity to expand mixed-income housing by integrating more affordable units into market-rate deals. More research is needed to help clarify the barriers to expanding 80-20 practices, and more financial analysis to identify the markets in which 80-20 deals work best, to support the expansion of this tool. This could have multiple benefits: achieving affordability and inclusion in markets that clearly have market demand/opportunity, stemming displacement in gentrifying areas, working with local incentives to get more affordable homes built with much less per-unit subsidy, and maximizing the use of existing subsidies.

It is likely that many neighborhoods across the United States could support 80-20 developments. The right programs and products to generate these developments will look different from city to city, based on differences in the market and policy priorities. But the impact of these programs could be substantial. A robust 80-20 pipeline should improve the siting of low-income units by tapping market forces to generate deals. It should increase the total volume of affordable housing generated by using currently unused tax-exempt bonds and associated tax credits. It may increase the total volume of all housing (both affordable and market-rate) generated in opportunity neighborhoods by better aligning local policies with financing programs. It should lead to measurable positive spillover effects in neighborhoods by proving market and catalyzing additional investment. It should also limit displacement in rising markets. Mixed-income deals have been shown to provide all these benefits. Establishing a public and private sector financing ecosystem that promotes instead of stymies mixed-income development will help expand access to affordable housing and support the goals of income integration.

Implications for Action

Implications for Policy.

- State and local policymakers can implement a range of programs and policies to drive demand for 80-20s including implementing regulations like inclusionary zoning, and providing additional subsidies such as TIF financing. Governments also can provide oversight capacity on 80-20 deals, ensuring that the properties have appropriate affordability restrictions.
- State and local policymakers can pursue zoning reforms that prevent exclusionary (higher-income) communities from denying building permits for apartments and other denser forms of housing.
- State and local bond issuers can begin to advance 80-20 development by sharing knowledge with other issuers, showing the market they are eager to allocate private-activity bonds for this purpose, and eventually considering becoming direct lenders themselves.
- The federal government can take steps to advance 80-20 development by enacting legislative changes that promote increased use of recycled bonds and creating financial products to support 80-20s from FHA and Ginnie Mae.
- Fannie Mae and Freddie Mac can establish new credit enhancement products, new mortgage product types, and new bond-buying or LIHTC-investment programs tailored to 80-20s.

Implications for Research and Action.

- There is very little research on 80-20s in general. Studying who the low-income residents of these properties are and what their social and economic outcomes are relative to similar families would help clarify the public benefits of these projects and may help improve management practices.
- Financial analysis can determine market and policy conditions are most conducive to 80-20 developments, assisting state and local governments in crafting 80-20 programs suitable to local conditions and needs.

Implications for Development and Investment.

- Both affordable and market-rate developers can become more familiar with 80-20 deals and consider this deal type when examining potential projects.
- Banks and other financial institutions can build capacity for underwriting and provide new mortgage products to support 80-20 deals.

Implications for Residents and Community Members.

- Residents living in 80-20 properties can share their experiences of the benefits and challenges of living in these types of mixed-income communities.
- Community members, advocates, and community organizing groups can be pro-active in tackling the exclusionary politics that prevent 80-20 buildings to be approved, especially in communities where more affordable housing is needed.

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