

Proposed Modifications to South Carolina's Low Income Housing Tax Credit Qualified Allocation Plan (LIHTC)

Introduction:

Since the inception of the LIHTC in 1986, \$1.88 Billion of LIHTC has been awarded in the State of South Carolina. However, many South Carolina communities are experiencing critical shortages of workforce and affordable housing, threatening some economies.

The attached analysis identifies changes necessary for areas with critical housing and workforce shortages, especially tourist destinations, to successfully access the LIHTC through the State of South Carolina's Qualified Allocation Plan that is administered by the South Carolina State Housing Finance and Development Authority.

A summary of the recommended changes are as follows:

- Prioritize Demand in scoring applications for the LIHTC
- Measure Accessibility and Availability in scoring Positive Site Characteristics
- Create a Workforce Housing Set-Aside
- Analyze Development Costs by prevailing Construction Cost Conditions
- Redefine Underserved Areas

Please consider the recommendations outlined above and discussed in this analysis for incorporation into the Qualified Allocation Plan for the State of South Carolina or implementation into the 2019 LIHTC application round.

Thank you. We are available at any time for further discussion.

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BACKGROUND INFORMATION:

- The **Low Income Housing Tax Credit (LIHTC)** is a Federal Program initiated by the **Tax Reform Act of 1986** and outlined in **Section 42 of the Internal Revenue Code**. It has been the most productive and successful housing program in the nation during the past three decades. (See National Association of Home Builders White Paper: http://services.housingonline.com/nhra_images/LIHTCWhitePaper_Oct%202011_FINAL.pdf)
- The **LIHTC** is administered by a specified entity in each state of the United States. In South Carolina, the **LIHTC** is administered by the **South Carolina State Housing Finance and Development Authority**. (**SCHousing**: <https://www.schousing.com/>)
- Since the inception of the **LIHTC** program, South Carolina has allocated total annual tax credits in the amount of \$187,691,787 for a **consolidated total of \$1.88 Billion in LIHTC**. (The tax credits allocated are an annual amount. The actual amount of credit taken is ten times that, as the allocation is available annually for a 10-year period.)
- Since the inception of the **LIHTC** program, South Carolina has allocated total annual tax credits to **Hilton Head Island, South Carolina** in the amount of \$720,767, for a **consolidated total of \$7.2 Million in LIHTC**.
- Since the inception of the **LIHTC** program, South Carolina has funded the new construction or rehabilitation of **26,838 LIHTC units**.
- **Hilton Head Island is one example of a community unable to utilize the LIHTC to meet its workforce and affordable housing crises.**
 - Since the inception of the **LIHTC** program, South Carolina has funded the new construction of **48 LIHTC units on Hilton Head Island** and the subsequent rehabilitation of the same **48 LIHTC units**.
 - **Hilton Head Island, SC** has received less than four-tenths of 1% of the **LIHTC** allocated in South Carolina. Only one **LIHTC** development has been financed, the original new construction (1992 allocation) and the subsequent rehabilitation of **48 units of LIHTC**.

- **Southern Beaufort County** is a fast-growing region of the State of South Carolina. In 2014, Southern Beaufort County had **585 LIHTC units**. Since then it has lost 341 units and gained 40 units, for a **current inventory of 284 LIHTC units**, a 52% decline.
- **Hilton Head Island is an important and integral municipality in South Carolina!**
 - Hilton Head Island has **WORLD-WIDE name recognition**
 - Hilton Head Island is **Conde Nast Traveler's 2017 Top Island in the United States and Travel + Leisure Magazine's 2017 #1 Island in the Continental U.S. and #2 Island in the World** (<https://www.hiltonheadisland.org/conde-nast-traveler-readers-choice2017/>)
 - Hilton Head Island's economy is **Tourism-based**. Leisure and Hospitality is one of South Carolina's **top five non-farm industries** based on number of employees (<https://www.sccommerce.com/research-and-data> and <https://www.bls.gov/eag/eag.sc.htm>)
 - Hilton Head Island's year-round population includes a stable and **significant number of retirees** creating demand for healthcare and other services
 - Hilton Head Island has **thousands of jobs openings** in a variety of sectors of its economy

POSITION STATEMENT:

Hilton Head Island is one example of a South Carolina municipality with an acute lack of affordable housing and qualified workforce. The results are a dampened ability to achieve the economic growth potential inherent in our uniqueness and the depressed and slowed recovery of our real estate assets. Second-home owners pay premiums in property taxes to fund the state of South Carolina and our visitors generate significant revenues and recognition for the State.

The acute demand for affordable housing and workforce availability is in large part attributable to Hilton Head Island being effectively excluded from the **LIHTC** through the **SCHousing**. The **LIHTC** is often the largest component of financing for the production of affordable workforce housing and is the gateway to securing a large assortment of sources of additional support. This accessibility barrier is clearly evidenced in the data presented in the Background Information above.

Although South Carolina is in double-digit low rankings in most every other category, it is near the top of **U.S. News and World Report's Best States category of ECONOMY** (<https://www.usnews.com/news/best-states/south-carolina>). Beaufort

County is in the top 22% of all U.S. counties in terms of innovation (<http://www.statsamerica.org/ii2/overview.aspx>). Sustaining this positive momentum in the economy will surely work to move South Carolina's standings in the other categories of life quality. However, this depends in large part on South Carolina's ability to attract and maintain a qualified work force.

The Leisure and Hospitality industry, while thriving, pays wages well below most other industries in South Carolina, clearly fitting in the lowest ranges of those for whom the LIHTC program was established. (https://www.bls.gov/oes/current/oes_sc.htm)

RECOMMENDED ACTION:

The **SCHousing LIHTC Allocation Plan (the QAP)** should be modified to adequately, accurately, fairly and dynamically allocate this precious resource to where it is both most needed and best invested, all while maintaining both the spirit and the letter of the LIHTC.

There are critical evaluation criteria either absent or inequitably considered in the **SCHousing LIHTC QAP**. If modified, the **SCHousing LIHTC QAP** would allow more communities with no current meaningful participation in the program to have equal access to the LIHTC.

Modifications in five primary areas of consideration would open the gateway to accessing the LIHTC in areas where it is currently sealed shut, allowing communities like Hilton Head Island to almost immediately access the LIHTC to address its critical need for affordable workforce housing.

1. **DEMAND** - Demand is the most important indication of the need for this valuable resource and should be the fundamental driver for LIHTC allocations. The LIHTC was created because there is a need for affordable housing. **SCHousing** affirmatively states in its Introduction and Purpose section of the QAP that **SCHousing** "is responsible for developing the guidelines and priorities that *best address the need for affordable housing throughout the state...*" (*emphasis of this author*).

Vacancy rates below 5% and low capture rates indicate a critical shortage of housing units. For example, Hilton Head Island has a 0% vacancy rate. Under the current QAP, LIHTC applicants receive only 1/2 point if the vacancy rate is between 6% and 9% and 1 point for vacancies between 0% and 5% (the same amount of points received for fully completing the form). Compare this to an applicant within 1/2 mile of a convenience store that receives 4 points or the 3 points that are awarded to an applicant whose project is within 1/2 mile of a bowling alley and you will see that demand is insignificant under the current QAP. (See fuller discussion of

Site Characteristics and corresponding points below.) Allocations of **LIHTC** are predominantly awarded to applications scoring on average within 1/2 to 1&1/4 points of the maximum optional points available. That is effectively 86.5 points for new construction and 90.5 points for rehabilitation when the mandatory 110 points are removed from the overall total. In the current **QAP**, the importance of allocating **LIHTC** to communities experiencing acute crises of approximately 5% or less vacancy is eliminated.

RECOMMEND:

- A logarithm should be identified or written based upon occupancy levels and capture rates taken from a reliable and comprehensive source of data from South Carolina rental properties. Critical intervals should be identified, even as precise as 1/2 to 1 percent of each other.
- In the body of the application, points sufficient to prioritize critical demand areas should be awarded in amounts necessary to eliminate the currently existing imbalance evidenced above.
- In the tie-breaker section of the **QAP**, which is regularly triggered, demand should become a primary tie-breaker item.

ADDITIONAL DISCUSSION:

- The Market Study Criteria of the **SCHousing LIHTC Qualified Allocation Plan** does not address demand as anything more than a threshold requirement. In total, a maximum of only 1 point may be awarded based upon demand.
- Although Capture Rate, Market Advantage, Overall Vacancy Rate and Absorption/Lease-Up Periods are individually addressed, they are given no weight in awarding the **LIHTC** beyond 1 point.
- If demand were prioritized, **SCHousing** would still meet the requirements of Section 42 of the Internal Revenue Code and its own State preferences.
- As a side note, Market Advantage is arbitrary, easily manipulated and potentially harmful to the very residents **SCHousing** seeks to house — very low income households. This criterion could cause huge rent increases to at-risk residents during their first few years of occupancy.

2. **POSITIVE SITE CHARACTERISTICS** - The static list of Site Characteristics identified as desirable or necessary by the **SCHousing QAP**, combined with the incremental 1/2 to 3 mile distances preferred and the disparately high point values associated with them guarantees traditional urban settings will receive allocations while unique areas with acute demand, like Hilton Head Island, are effectively disqualified. Hilton Head Island is an example of a community with no site available that would allow an applicant to receive an allocation of **LIHTC** regardless of acute demand, and a current, historically-high need for workers. However, again using Hilton Head Island as an example, award-winning schools, beautiful parks, miles of bike and leisure

trails, recreational and cultural opportunities, excellent emergency and other services and all the necessary infrastructure for a great place to live are available.

Currently, 34.5 out of a maximum competitive 86.5 points for new construction (or 40%) are based upon these Site Characteristics (or 34.5 points out of 90.5 for rehabilitation projects). In comparison, 1 point out of 86.5 competitive points (1%) is the maximum achievable for demand. No other of the application's criteria carries such weight except the Development Characteristics, which are NOT OPTIONAL. The required minimum and maximum points for Development Characteristics are both 110. An applicant must score at least 110 and cannot count any more than 110 points in this category.

RECOMMEND:

- The list of Site Characteristics should be augmented and edited to reflect actual delivery mechanisms and future trends of vital services such as education, emergency response services, health and wellness, and access to food.
- In the body of the application, points for Site Characteristics should be greatly reduced so as to eliminate an award based on something like the proximity of a cinema over a demonstrable critical demand.
- In the body of the application, points for Site Characteristics should be awarded because of ACCESS AND AVAILABILITY, not physical location. For instance, the availability of transportation for students traveling to and from school, not the driving distance, or the availability and usability of online healthcare and banking services. (The municipal government employees of the Town of Hilton Head Island have access to real-time physicians online and Gen X and Millenials often don't use brick and mortar banks.)
- Site Characteristics should be removed from its preeminent position as the #1 tie-breaker. It's current position doubles its importance and impact above all other criteria.

ADDITIONAL DISCUSSION: Urban areas certainly do have a need for affordable housing. However, the preferences they receive in this section of the **QAP** eliminate the creation of affordable housing opportunities in areas where greater demand exists. There already is a designated **SCHousing** set-aside for "Large Population Urban." (This section also awards additional points for items that should be available to other developments. For example, free services on-site are always beneficial and should be encouraged in every category of the **QAP**.) Large Population Urban areas receive preference in their own set-aside and then again if they don't score high enough in the set-aside and are returned to the general pool of applications. Finally, real estate professionals will agree that for purposes of development, **JOBS** lead. First jobs are created, housing follows and services arrive.

3. **WORKFORCE HOUSING** - Critical workforce demands are unaddressed in the **SCHousing QAP**. Jobs that drive the need for housing are a good sign of economic growth and opportunity.

RECOMMEND:

- Components of Workforce Housing demands should be analyzed and included in the **SCHousing QAP**.
- Create a Workforce Housing Set-Aside in the **QAP**. Consider parameters and indexes such as those in the Indiana **QAP** for consideration in the new set-aside (<http://www.in.gov/myihcda/files/FINAL%202018-2019%20QAP.pdf> and <http://www.statsamerica.org/ii2/overview.aspx>)
- In the body of the application, add criteria to score points for growing workforce demand.
- Use some component of workforce demand in the tie-breaker section of the application.

4. **DEVELOPMENT COSTS** - The development cost calculations used twice in the tie-breaker section of the **SCHousing QAP** arbitrarily excludes Hilton Head Island and other high development cost areas proposed affordable housing communities from consideration in the event of a tie-breaker.

Logically, an area that experiences high development costs per unit (assuming similar quality of construction) would most need resources to bridge the gap in financing that exists between the amount low income renters may pay and the costs to develop. Using cost standards by type of building without incorporating location considerations penalizes coastal areas. For example, Hilton Head Island is an island. It's unique conditions and needs should be addressed, not dismissed. It is connected to the mainland by a bridge. It is surrounded by water. The environment is sensitive. Severe weather factors add to the need for more costly construction, including hurricane force winds and storm surges. To build a high quality development on a barrier island or along the coast will cost more than most other places in South Carolina. But the need is great.

RECOMMEND:

- Assemble a variety of sound resources that are available to assess the reasonableness of construction costs. More precise measurements using more data would produce better results that may address the demand for affordable housing in higher cost areas.
- Modify one construction cost tie-breaker to compare developments by type and area in order to incorporate location specific costs.
- Remove the second construction cost tie-breaker to limit its ability to eliminate developments in coastal construction areas.

ADDITIONAL DISCUSSION: The **SCHousing** should use the **LIHTC** to support the development or rehabilitation of the most affordable units with the least amount of **LIHTC — ALL OTHER THINGS BEING EQUAL**. Some equitable cost comparisons are necessary and reasonable. However, the **SCHousing** should consider the exacerbation of demand for affordable housing in high cost areas as potentially multiplying if not addressed. Shrinking economies could produce more instability in resources available to secure housing. Workers in high development cost areas are more likely to need help initiating independent residency, but if the residency is initiated, the result may be a positive multiplier for available workers.

5. **UNDERSERVED AREAS** - Hilton Head Island, which has only received 48 units of **LIHTC** housing in three decades, is not considered “Underserved” by the **SCHousing QAP** and does not receive the points and preference associated with that designation. Hilton Head Island is part of a county, but it is also an island, separated from the mainland by a single bridge and itself an incorporated municipality. How should the effects of decades of lock-out from the **LIHTC** be addressed?

RECOMMEND:

- Analyze other municipalities with significant economic impact to the State of South Carolina to determine pockets of areas underserved by the **SCHousing LIHTC**.
- Identify additional municipalities/requirements for consideration in the Underserved Areas set-aside.
- Award points in the body of the application to municipalities which have not benefitted from the **LIHTC** program for some period of time for no reasons other than the preferences of the **QAP** that are not required by Section 42 of the Internal Revenue Code or the State of South Carolina’s documented preferences.
- Award points in the body of the application, or preference in the tie-breaker, to municipalities or areas that have experienced stagnation or reduction in the number of **LIHTC units**.

Final Note:

This analysis is not an exhaustive review of the SCHousing Qualified Allocation Plan. The focus areas above represent the criteria that, if modified, would have the most impact upon areas with acute demand, available services, high development costs and a need for more workforce that have been effectively excluded from the LIHTC Program in South Carolina. Other testing of the QAP should occur to determine if the LIHTC awarded by South Carolina is consistent with the three preferences prescribed in

Section 42(m)(1)(B)(ii)(I through III) and the stated Mission and Purpose of the SCHousing and its QAP.

Services Scored in QAP	Max Points	Availability on Hilton Head Island
Full Service Grocery Stores	4	We have 11 Full Service Grocery Stores on the Island, or .27 per square mile. Additionally, we have 3 year round or seasonal farmer's markets and many specialty grocers.
Pharmacy or Drug Store	4	We have 12 qualifying locations.
Convenience Store <u>and</u> Gas Station	4	We have 12 Convenience Store/Gas Station combinations. Additionally, we have a Full Service Grocer with a Gas Station.
Restaurants with tables and chairs	3	As a resort destination, we have hundreds of restaurants where food can be consumed on site.
Entertainment Venues	3	We have more entertainment venues than this definition allows with daily live music shows and outdoor entertainment.
Retail Shopping Areas	3	We have 24 retail shopping areas.
Doctor's Office/Medical Office including a hospital and minute clinics staffed with full time General or Nurse Practitioner	3	We have 9 qualifying locations.
Public Schools - elementary, middle or high school	3	All Hilton Head Public Schools are located on a single, multi-school site with no new development opportunities within the required distance. All Public Schools have bus service.
Fire Station	1.5	We have 7 fire stations.

Services Scored in QAP	Max Points	Availability on Hilton Head Island
Full Service Banks	3	We have 24 full service banking centers.
Public Park or Playground with commercial playground equipment and/or walking trails/bike paths.	3	Depending upon whether or not the beach is considered a walking trail/bike path, we have as many as 20 qualifying recreational sites/facilities.