LOW INCOME HOUSING TAX CREDITS AND LEASE PURCHASE AS A MEANS TOWARD HOME OWNERSHIP IN PARK HEIGHTS

by

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Abstract

Homeownership has long been synonymous with both individual and collective catalytic financial opportunity. Homeownership carries both a communal benefit shared among neighbors, as well as an individual opportunity to build wealth in the form of home equity. Recently, government policy has shifted away from income support to programs designed to increase access to, and opportunity for wealth building. In the real estate arena, this wealth building vehicle is homeownership.

Regardless of political party, presumably all can agree that government subsidies should be directed toward policy and programs that carry the greatest catalytic affect. If it is true that communities improve and individuals build wealth as a result of home ownership, tax policy and subsidy programs should funnel a disproportionate amount of resources to home ownership programs. For a variety of reasons and at a variety of stages in life, not everyone is meant to own a home therefore rental programs will always have a place. However, this paper will seek to determine if home ownership is superior for low-income purchasers from the standpoint of a) the community at large and b) the individual seeking financial return. For those low-income tenants that are appropriately identified and adequately prepared for homeownership, this paper will propose that a Community Development Corporation spearhead a lease-purchase program in which Low Income Housing Tax Credits (LIHTC) are utilized to replace inadequate housing with viable, affordable units in the Park Heights neighborhood of Baltimore City.

Is Homeownership Superior?

In order to determine if homeownership carries benefit to a community, there must be a measurable matrix to determine one community’s superiority to another. In terms of real estate, this variable is property value. Because real estate is fixed in location, unlike other commodities, the value of a
given property weighs tremendously on the value of surrounding properties, purely for the fact that it can not be moved. Property values are linked among neighbors, for better or worse. In order to determine if home ownership developments financially benefit communities, we must determine if property values rise as a result of proximity to owner-occupied units.

A 2001 study funded by the Fannie Mae Foundation examined the impact of two New York City homeownership programs on surrounding property values. The study compared the sales prices of properties in small rings surrounding homeownership sites to the prices of comparable properties in the same community districts outside of the concentric rings. Based on the analysis of 300,000 property sales, the study determined that homes near to homeownership sites rose significantly relative to properties in their comparable community districts (Ellen, 2007).

To assume the increase is attributable to home ownership rather than general blight removal which could have been accomplished by rental units, the analysis must go one step further. Several recent studies find that proximity to subsidized rental housing may in fact depress property values, but there is no true consensus (Ellen, 2007). According to a 2006 study, both theory and existing evidence suggest that neighborhood impacts from subsidized rental housing will differ depending on where it is built, the scale of the development, the characteristics of the tenants, and the nature of the ownership and management (Ellen, 2006). Without being able to hold all other variables constant and simply examine the property value affects of owner-occupied versus rental units, it is difficult to arrive at an irrefutable conclusion.

Property values arguably encompass and account for all quality of life factors such as schools, public amenities, cleanliness, and community involvement, however, it is worth mentioning other studies that have returned results that assert a direct relationship between home ownership levels and these non-financial indicators of value. According to the Joint Center for Housing Studies of
Harvard University, there is strong and consistent evidence to indicate that homeowners are more likely to: a) be satisfied with their homes and neighborhoods; b) participate in voluntary and political activities; and c) stay in their homes longer, contributing to neighborhood stability (Rohe, 2001). Studies link this residential stability to higher rates of school readiness and academic achievement (Rohe, 2006). At the opposite end of the spectrum, foreclosed and vacant homes carry heavy negative impacts on neighborhoods. A recent study has shown that each REO property reduces the values of other properties within one-eighth of a mile by roughly one percent (Immergluck and Smith, 2006). The decrease in property values leads to lower tax revenues for the local government, which in response may be compelled to cut back services it provides in the area. Vacant properties also attract elements of crime and vandalism and may pose health and safety concerns for the nearby residents (Levi, 2009). However, again, rental units can replace blight as easily as owner-occupied units. The real question is whether or not one has a greater catalytic affect than the other and research to date does not offer a conclusive answer.

From the perspective of the individual purchaser, home equity is traditionally viewed as the cornerstone of household wealth. According to the Federal Reserve Board’s Flow of Funds report, home equity constituted 19 percent of household wealth at the end of 2003—nearly as great as the share of stocks and mutual funds combined (Belsky, 2005).

Whether or not purchasers are able to build wealth through home ownership is dependent on several factors including time of purchase and sale, mortgage rates, refinance behavior, and tax treatment. These factors will be considered as they relate to low-income purchasers specifically.

The theory of wealth building is based on the premise that home ownership allows low-income buyers the opportunity to leverage small amounts of money to acquire costly assets. At high loan to value ratios (currently first-time homebuyers can access 100% financing) buyers can build equity in
a property with little or no up front cash. Front and back-end ratios as well as credit scores are important considerations for lenders to determine if the borrower can support the mortgage debt, but provided a steady stream of income exists, a return on investment is possible for both the bank and the borrower. The level of return (and its positive or negative value) is dependent on a number of factors.

Creating a return on investment through home equity assumes appreciation in the value of the property. As discussed above, the level of investment undertaken at surrounding properties will have a measurable impact on the subject property’s potential for appreciation. Normal market cycles will also apply and will cause some price fluxuation. Selling at the wrong time in the cycle, will yield a loss. Quality of materials and construction, maintenance and competitive supply will also contribute to appreciation levels. Other inherent assumptions in the wealth building potential of home ownership are that the purchasers will remain in the home long enough to amortize transaction costs. Fortunately low-income purchasers are more likely to have longer holding periods (Belsky, 2005).

Mortgage interest rates will obviously impact whether or not low-income buyers can expect to build wealth in their properties. Low-income and minority borrowers have traditionally lacked access to affordable mortgage products. (This population) is today disproportionately served by government-backed, subprime, or manufactured home lending, and exposed to new threats linked to rising rates of mortgage delinquency and default and a noticeable uptick in abusive lending practices (Apgar, 2004). Between 1993 and 2001, the subprime share of home purchase loans reached 10.3 percent in low-income areas, double that of the percentage in high income areas (Belsky, 2005). The subprime products targeted at these populations carry higher interest rates and less favorable terms than conventional prime loans resulting in financial hardship and exponentially failing credit amongst low-income borrowers. Further, low-income borrowers tend to be less likely to take advantage of
refinance opportunities to capture the benefits of lower rates by replacing high cost mortgages with lower cost loans (Belsky, 2005).

One of the key benefits to home ownership is its favorable tax treatment. Mortgage interest payments and real estate taxes can be claimed as itemized deductions to lower one’s overall tax liability. If deductions are not itemized, the standard deduction is applied. The standard deduction is tied to the consumer price index and is aimed at simplifying tax preparation. Low-income homeowners typically do not benefit from mortgage and property tax deductions because the value of the standard deductions exceeds the value of these itemized deductions to them (Belsky, 2005).

Taking the above factors into account, in order to determine the viability of wealth building through home ownership by low-income households, the returns are best viewed in relation to the costs of renting. Even owners that earn positive returns may have benefited more from investing their down payment in a different investment vehicle while renting a comparable property. This is a difficult comparison to undertake considering the variety of investment vehicles available and the combination of factors that influence the financial success of an individual home purchase. Once again, several factors are in play and limited data exists on a single variable comparison. One study prepared for the Affordable Homeownership symposium at the University of North Carolina in 2003 concluded that low-income purchasers are not dimensionally different from high to moderate income buyers, in that the decision to rent versus own must be made based on a variety of factors and desired outcomes. According to the study, the real question is not whether to promote home ownership, but what can be done to help inform all interested homebuyers – low-income individuals among them- so that they make the choice best suited to them, as well as what can be done to ensure that those who select homeownership do so at the lowest possible cost with the greatest chances of maximizing their risk-adjusted returns (Wiranowski, 2003). Low-income purchasers
with limited resources to leverage must make a calculated decision as to the potential return associated with owning a home versus renting.

**The Role of the Public Sector**

The various studies discussed above indicate that while additional research would further serve to illustrate an argument for homeownership as an individual and community wealth vehicle for low-income purchasers, a case can certainly be made that with the right combination of education and opportunity, appropriate candidates can benefit individually and collectively from owning a home.

The recent rise in foreclosure rates attributed to subprime, “predatory” lending has garnered attention for public and private sector intervention to repair and restore the real estate market. While the attention is new, the concept of government intervention in the housing market is not. Numerous products exist on the federal and state level to assist renters and home purchasers in bridging the gap between market price and income level. The US Department of Housing and Urban Development (HUD) offers mortgage insurance, subsidized rental programs, home ownership counseling, grants, loans and tax credits among their vehicles for subsidy.

Obviously barriers exist and not everyone is meant to own a home at all points in their life, but public efforts should be directed toward individuals with the capacity for homeownership that have traditionally lacked access to favorable rates and quality products or have fallen victim to the recent foreclosure crisis as a result of irresponsible lending and/or borrowing.

A relatively underutilized structure known as lease-purchase offers potential home buyers the opportunity to rebuild their credit history and establish a reputation for consistent, timely payments while building equity in a rental property. From the community perspective, lease-purchase mirrors
homeownership in its proclivity for pride of ownership which generally results in improved upkeep of properties translating to preservation of property value. From the individual perspective, the lease period can serve as an opportunity to build equity prior to taking ownership of the property.

This paper will further examine the financial and managerial feasibility of a CDC utilizing Low Income Housing Tax Credits (LIHTC) to manage the acquisition, development, and disposition of properties through lease-purchase in a heavily vacant area of the Park Heights neighborhood of Baltimore City. The properties would be developed by a private entity and would function as affordable rental for the required 15 year tax credit period after which qualified tenants would purchase the property for the amount of the remaining debt and assume the existing equity in the property. The proposed product will leverage the minimal acquisition price to eliminate blight and place properties in the hands of able, but previously unqualified buyers.

**Barriers to Entry**

The combination of Low Income Housing Tax Credits and lease-purchase, responds to several of the existing barriers to entry for potential low-income home purchasers. A consistent barrier for potential low-income home buyers is poor credit or lack of credit history. The latest sub-prime mortgage meltdown has left approximately 2 million homeowners at risk of foreclosure due to a combination of irresponsible lending and irresponsible borrowing (President and Fellows of Harvard College, 2009). Higher risk borrowers with poor credit had easy access to sub-prime, adjustable rate mortgages that eventually resulted in upside-down loan-to-values and in many cases, foreclosure. The lease-purchase model allows a tenant the opportunity to build a significant track record for timely payment of rental expenses. The original mortgage on the property is held by the CDC, therefore it is their credit worthiness that is evaluated, rather than the tenant who would not be able to achieve as favorable of a borrowing rate.
Price point can function as a barrier of entry to home ownership, although financial institutions and federal and state governments have several methods to combat this. Utilizing LIHTC requires that rental levels be held to below qualified income levels based on an area’s Median Family Income (MFI). The US Department of Housing and Urban Development (HUD) establishes maximum rents based on maximum incomes and household size. The MFI for the Baltimore City MSA for 2009 is $82,100 annually. This number is assumed for a family of four and then adjusted upwards or downwards from there depending on the number of individuals in the home. Therefore 50% of MFI is $41,050 for a family of four, and 60% of MFI for the same family is $49,260. This translates to a maximum rent for a three-bedroom property of $1,026/month at 50% of MFI based on allowable rents of 30% of the tenant’s gross income.

**Park Heights**

Park Heights is a 1,500-acre community in northwest Baltimore bounded on the south by Druid Park Drive, on the north by Northern Parkway, on the west by Wabash Avenue, and on the east by Greenspring Avenue. The area is located approximately 10 miles northwest of downtown Baltimore and is comprised of twelve neighborhoods that contain approximately 66,358 residents. The average median family income is $33,646, which is over 50% less than the Baltimore/Towson MSA. The neighborhood’s largest demographic segment consists of children under 18; nearly half of them being raised in single-parent households. The percentage of children born to 10- to 17-year-olds is roughly 30% higher than the city average. The population is 80% African American. 69% of the population holds a high school degree and 16% hold a bachelor’s degree or higher. 20% of families are considered below the poverty level.

Neighborhood assets include Sinai Hospital (a major employer), Pimlico Racetrack (home of the
Preakness) and Druid Hill Park, Baltimore’s first and largest municipal park and site of the Maryland Zoo.

Approximately half of the housing units in Park Heights are owner-occupied (13,160). According to a study conducted by the Baltimore Housing Authority in partnership with TRF, a national leader in the financing of neighborhood revitalization, a neighborhood is considered stable when vacancy factors are below 1 percent and homeownership rates are between 60-80 percent. There are 3,113 vacant housing units or lots in Park Heights, 600 of which are located within a targeted redevelopment area, and 400 of which are controlled by the Mayor and City Council or Baltimore City Housing Authority (Park Heights Master Plan).

In February of 2006 the Baltimore City Planning Department adopted the Park Heights Master Plan. The Master Plan included a call for a “Scatter Sites RFP” through which bundles of City-owned properties would be offered to capable investors/developers in the Park Heights stabilization area. The goal of the program is to renovate and occupy vacant City-owned properties with homeowners and facilitate blight elimination on stable blocks in Park Heights (Park Heights Master Plan). A CDC called Park Heights Renaissance (PHR) was formed to implement the Master Plan in conjunction with the City Planning Department. Among its programs, PHR offers a no-interest Home Improvement Loan to qualified residents interested in making improvements to their property. Repayment of the loan is forgiven if the tenant operates the home as their primary residence for a period of 10 years from the date of the note.
Acquiring economies of scale has been the greatest challenge associated with the redevelopment of Park Heights. As the master plan describes, “In the past, strategies have been attempted in this area that addressed individual houses or even entire blocks, but they have not been successful because they have not addressed the massive scale of the vacancy problem in this area.” PHR, the City, and the community have long sought a “first-in” developer to acquire properties of a scale which creates a transformative event in Park Heights. As a strategy toward acquisition and development, PHR has identified the Major Redevelopment Area as a priority to serve as the catalyst toward development. The Area encompasses 75 acres, includes 900 buildings and lots, 500 of which are vacant and 350 of which are publicly owned. Properties have been offered within this area but a developer has yet to come forward with the necessary capital and the appropriate plan for the comprehensive redevelopment.

The Major Redevelopment area is a large nut to crack. Attempts at scaling a homeownership project of that size resulted in a potential tenant shortage. Finding 100+ qualified, potential homeowners left too great a risk in lease-up time and potential project failure. Without the economies of scale, a less successful, smaller project would result in the few participants being committed to a failing asset—a situation far worse than renting at an affordable level. The proposed product will attempt to capture the proper balance between building value, and providing the appropriate number of units to achieve fast and efficient lease up. A significant determinant in the viability of the project will be the proposed location which is in close proximity to a stable neighboring community known as Cylburn, and a major employer in Sinai Hospital.

A connection to Cylburn will be critical based on a comparison of property values between Central Park Heights and Cylburn. From January to June of 2009, average sales price for homes in Park Heights was $63,067 (Live Baltimore Home Center, 2009). The proposed project will
create housing units with an average rehabbed assessed value of +96,000, which creates an obvious disconnect in which a new market would need to be created to establish a new sales base in order for the developed properties to maintain their value. For that reason, providing affordable home buying opportunities amongst concentrated struggling blocks is not an opportunistic or sustainable use of public subsidy. In fact, creating ownership opportunities may serve as a dis-service to buyers looking to build equity. Instead of utilizing public dollars to create an opportunity for financial sustainability for a low-income family, isolated owner-occupied development may in fact tie families to failing assets in an even more dangerous way than renting in the same neighborhood.

Due to the weak housing demand in Central Park Heights, redevelopment may not be the proper strategy for addressing the significant number of vacant properties. (In a cold market) due to weak demand for housing, “land-banking” demolition, or greening of space, may serve as a more appropriate strategy in seeking to bring the housing market more in balance (Levi, 2009). Redevelopment is more appropriately aimed at perimeter pockets in close proximity to relative strength offering the greatest opportunity for new properties to hold value and contribute to future neighborhood recovery. According to a 2009 study, Levi writes that CDCs should be mindful of the more stable warm market neighborhoods within cold market regions, where demand may be higher and where reuse of properties may stabilize a community experiencing downturn. The warm market in this instance is the Cylburn community. The strategy is to build on existing strength in Cylburn as a means to begin to infiltrate Central Park Heights.

Cylburn is located to the east of Central
Park Heights directly south of Sinai Hospital. The neighborhood is bounded by Greenspring Avenue (east), Laurel Avenue (west), Oakley Avenue (north) and Rosalind Avenue (south). Average home sales for January-June of 2009 were $127,666 (Live Baltimore Home Center, 2009). This represents a trending upward from 2008 when average home sales were $96,375. Prior to the real estate market downturn, average home sales for 2007 were $137,973. The area is characterized by 1950s-era detached houses, some of which have been converted to duplexes. There are an insignificant number of vacant City-owned properties in Cylburn and homes are approximately 60% owner occupied.

Currently Pimlico Road functions as a significant division between Central Park Heights and Cylburn. Between Dupont Road and West Garrison Road, Pimlico is a single-lane in each direction running north-south. There are sidewalks on both sides of the street with on-street parking on the south bound side. Because of its manageable scale, the road is not a major physical barrier but has traditionally functioned as a significant mental barrier between the neighboring communities. Revitalizing frontage on Pimlico Road will be the first step in bridging the barrier between Cylburn and Central Park Heights.

This project calls for the acquisition, development and lease-purchase of 19 units on Pimlico Road between Thorndale and Oakley Avenue. The properties face Pimlico Elementary School which serves grades PK-7. To the rear of the properties is an affordable rental project owned by Pecovic Properties, LLC. Typical units are 2-stories, 2-3 bedrooms with 1-2 bathrooms and front porches. Units are approximately 1,500 square-feet and sit on lots that are 16 feet wide and between 89-100 feet deep. The rowhouse construction characteristic of Park Heights will be maintained on Pimlico Road. While there is an over-supply of rowhomes in Park Heights, the size of the Pimlico Road lots makes them appropriate for attached homes. Properties on Woodland
Avenue (to the Southwest of the project) sit on 180-foot deep lots which makes them appropriate for unique, possibly detached, design and construction that takes advantage of the lot size.

Three of the 19 Pimlico Road units are owned by the Mayor and City Council of Baltimore. Additionally, two units are vacant. The remaining units are privately owned, with the majority occupied by non-owners. In order to advance the development, funds will be utilized to acquire
the 14 properties that are privately held and to relocate the existing tenants to comparable replacement properties.

The process for acquisition will be performed by the City and reimbursed by the development entity. The typical process for acquisition calls for the use of the higher of two appraisals to assign a value to the property. Property owners that own their property free and clear are entitled to the value of their property and the purchase price of a comparable relocation property. The transaction is aimed to be mortgage neutral meaning the owner is provided with a new property free and clear to reflect the value held in the property being acquired. According to former Park Heights Renaissance director, Phil Croskey, renters are entitled to $40,000 and vacant houses typically cost $20,000 to acquire. The properties owned by the Mayor and City Council will be acquired for $1. For the purposes of this analysis, the comparable replacement property for relocating tenants is represented by 2466 Lakeview Avenue. According to Baltimore City policy, the comparable replacement property must share size and housing type characteristics and must be in a non-impacted, stabilized community. Stability is defined for this purpose as having less than 30% vacancy. The Lakeview Avenue property is located in the Reservoir Hill section of Baltimore City which has a vacancy rate of 26% (US Census, 2000). 2466 Lakeview Avenue shares comparable features with the Pimlico Road properties; both are attached homes with 3 bedroom and 1 bathroom. The property is listed at $119,900 which will be used as the budgeted cost to acquire all owner-occupied units within the development.

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<tr>
<th>Property</th>
<th>Subject Property</th>
<th>Comparable Replacement</th>
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<tr>
<td>Property</td>
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<td>2466 Lakeview Avenue</td>
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<tr>
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This analysis assumes that all but five units are occupied by either renters or owners. When dealing with private owners there can be many factors at play in terms of negotiating an acquisition cost. The replacement cost is used for purposes of this analysis, but it should be noted that some owners may refuse all reasonable offers resulting in lengthy mediation and/or court proceedings. On the other hand, there may be some properties that are in fact vacant and held by investors who can be incented to sell through the issuance of code violations. To incent property owners to sell, City Code Enforcement will make a targeted effort to cite owners for non-compliance. Owners that can not justify additional investment in their properties to meet code requirements may take advantage of the opportunity to sell. Park Heights Renaissance has had success in relocation by educating tenants and communicating clearly the process and benefits associated. In 2007, voluntary relocation packages were offered to targeted tenants in the Major Redevelopment Area. Of the 16 tenants offered, 14 chose to relocate indicating that with the proper communication and use of trained relocation specialists, tenants in Park Heights are willing to relocate.
The Pimlico Road properties are in varying levels of disrepair, with some in need of 100% gut rehab and others in need of more cosmetic improvements. This analysis will assume 50% gut rehab ($86/SF) and 50% partial rehab ($65/SF). The triangular green lot bounded by Thorndale Avenue and Pimlico Road will become a community green space with aesthetic plantings and a community vegetable garden. Community gardens have been successful in Cylburn and Cylburn residents and Pimlico Elementary students will be invited to participate in the establishment of a new garden.

Drawing on the established stable values of the Cylburn neighborhood, the goal of this project would be to bridge the gap delineated by Pimlico Road between Cylburn and Park Heights. By identifying an area of stable property values and aesthetic appeal provided by Pimlico Elementary School, the proposed development has the opportunity for success that an otherwise isolated redevelopment in the heart of Central Park Heights may not. The proposed project aims to redevelop the full block of homes into properties averaging $96,530 in assessed value. This is a slight discount from neighboring Cylburn properties. The discount is appropriate given the fact that Pimlico Road will feature rowhome construction as opposed to single-family. To infiltrate Park Heights, the goal is to draw from strength to stabilize perimeter blocks and let market forces react slowly to achieve measurable results.
Woodland Avenue east of Pimlico (Cylburn)

4800 Block of Pimlico Road (Central Park Heights)
Low Income Housing Tax Credits

Low Income Housing Tax Credits will be utilized as equity for this project. The Low Income Housing Tax Credit (LIHTC) program was enacted under the Tax Reform Act (TRA) of 1986. A major feature of the TRA was the elimination of much of the favorable tax treatment of real estate, however law makers recognized the importance of maintaining incentives for the construction of affordable rental housing (Cummings, 1999). The LIHTC program is a dollar-for-dollar reduction in an owner’s federal tax liability for those who construct or rehabilitate low-income rental housing units. Via a third party syndicator, this credit is utilized by an investor who purchases an ownership interest in the real estate in exchange for equity into the development project.

The federal Treasury Department administers the program nationwide and delegates local agencies to authorize and allocate the tax credits to eligible projects that provide low-income housing to qualified recipients. For 2010, Maryland received $12 million in credits (Kimura, 2009). Applications for tax credit allocations are evaluated based on six categories; capacity of the development team, public purpose, location and marketability, development quality, construction and rehabilitation costs (potential point deduction for project costs above established limits), and leveraging and long term subsidies. Local authorities evaluate projects on their merits and private investors validate the conclusions.
Under a lease-purchase structure, tax credits are used to subsidize the rental costs in years 1-15. When the tax credit is exhausted, the CDC buys out the syndicator’s equity interest in the project for the remaining amount of debt plus any exit taxes due. The property is appraised with the assumption that the value will have increased and significantly exceed the remaining debt on the property. The tenant will seek a mortgage in the amount of the remaining debt to purchase the property from the CDC. The existing equity (the appraised value of the property minus the remaining mortgage) becomes an instant windfall for the purchaser.

**The Development Entity**

A Community Development Corporation (CDC) will serve as the project manager for the program with various functions outsourced for efficiency. Characterized by an IRS 501(c)(3) non-profit tax-exempt status, a volunteer board, and an emphasis on physical redevelopment, CDCs missions traditionally focus on rebuilding communities devastated by capitalist disinvestment (Stoecker, 1996).

In recent years, CDCs have sought ways to expand their roles into revenue generating functions to raise capital that can be re-invested into the communities they serve (President and Fellows of Harvard College, 2004). For example, some CDCs have developed direct lending practices to earn a profit by originating and servicing a handful of mortgages. However, without economies of scale and properly trained staff, the wrong function can hurt a CDC more than it helps. In too many instances, a mis-match of skills to services diverts subsidy dollars that should go to communities to compensate for inefficiencies in the agencies administering the investment (President and Fellows of Harvard College, 2004). CBO (Community Based Organizations) in search of fee income to support overall program operations must exercise care in selecting those
business ventures suitable for small scale operations and that take advantage of having a visible
and trusted presence in their community (Apgar, 2004).

To achieve an efficient skills match for the lease-purchase program, acquisition, tenant
qualification and home ownership counseling would be managed by the CDC. Development and
property management will be out-sourced via a Request for Proposals (RFP) to a development
entity seeking a development and management fee.

Acquisition of private property will be a multi-step process most easily navigated by a CDC
closely aligned with City government. The City’s higher of two appraised values plus
replacement home costs will be utilized to acquire occupied units. In December of 2008 under
City Council Ordinance 08-0158, the Park Heights Urban Renewal Plan granted disposition
authority of all City-owned property within the boundaries of the Master Plan to the Baltimore
City Housing Authority. Presumably, in the interest of development and associated tax benefits,
the City would be willing to sell these properties for $1.

Tenant qualification will also be performed by the CDC. Based on existing relationships in the
community, the CDC should have ample access to potential tenants. Tenants will be screened
according to a minimum credit score, employment status, and outstanding financial burdens.
100% of the units participating will need to meet the income qualification of 50% below MFI for
a family of four. This translates to no more than $41,050 per household annually. The Baltimore
City Department of Housing and Community Development and Park Heights Renaissance (PHR)
both maintain waiting lists for tenants with various income qualifications. These groups will also
be engaged for access to their databases. PHR currently offers priority to existing community
residents and individuals who are being relocated in order to assemble parcels for disposition and
redevelopment. To maintain the character of the existing neighborhood, this project would be
consistent with PHR’s prioritization of existing community residents provided they meet the necessary income qualifications.

Tenant qualification will be no small task. According to Julius Colon, President and CEO of Park Heights Renaissance, approximately 1-in-20 applicants meet the necessary thresholds for credit-worthiness and freedom from existing debts. Careful qualification of tenants will be imperative to the success of the project and should be undertaken thoroughly.

Development services will be performed by a qualified development entity drawing on previous experience and relationships. It will be imperative to select an experienced partner as capacity of the development team carries the largest potential point total under the State’s LIHTC evaluation criteria (Maryland Department of Housing and Community Development, 2008). By utilizing an established development firm, the project will benefit from economies of scale in terms of materials and subcontracting relationships. Existing architectural, engineering and construction relationships should yield favorable pricing and services to the benefit of the project. Also, overhead of personnel is mitigated through outsourcing. Partial personnel salaries will be accounted for in the development fee, however the project will be staffed through an off-site relationship eliminating the need for physical office space and the additional costs associated with staffing beyond salaries (insurance, benefits, etc).

Property management will be outsourced due to the significant costs associated and skills required. Management of scattered sites can place a heavier burden on a project than a multi-unit property due to the physical distance between properties as well as the inherent variety in homes (Levi, 2009). Similarly, marketing the units will carry the additional burden of travel time and diversity of product. The project will target a property management firm with units already in the area since it would be difficult for a management firm to justify on-site staff for a limited number of
units. The first source of a potential management partner will be sought through the neighboring Pecovic Properties.

A significant aspect of the management of the properties will be the annual re-certification of tenants to remain in compliance with LIHTC standards. This is a time and labor intensive process that must be completed no less than once a year and must be completed by the first day of the month that the tenant moved into the project (Maryland Department of Housing and Community Development, 2006). Income certification requires third party verification of all sources of income declared by the household. As the Tenant Specialist, the member of the management team assigned to the tenant re-qualification process must also monitor any changes in income levels during the year to prevent instances of non-compliance. If the income of a tenant of a low-income unit in the project increases above the limit allowed in Section 42(g)(2)(D)(ii), the next available unit of comparable or smaller size in the project was, must be rented to a tenant having a qualifying income (Maryland Department of Housing and Community Development, 2006). The CDC will be charged with overseeing numerous other criteria that must be maintained in order to remain in compliance with LIHTC standards, and will need to work closely with the Tenant Specialist working through the management entity for those issues related specifically to the tenant.

Maintenance of the properties will also be the responsibility of the management entity. Fortunately since all of the properties to be developed are substantial to complete gut renovations, uniformity will be sought in materials and construction to streamline maintenance and upkeep of the properties. Lease-purchase programs have also traditionally sought to share partial maintenance responsibilities with the tenant. From a cashflow perspective, this helps to maintain achievable rent levels and since the goal is for the tenant to remain in and eventually purchase the property, it is logical that they participate more heavily in its upkeep than a traditional renter. One national developer currently operating 650 lease-purchase units across the country requires
tenants to sign a Contract of Care Agreement committing them to maintenance responsibilities including maintaining landscaping, replacing screens, cleaning carpets, caulking sinks and tubs, etc.

Homeownership counseling will be a mandatory condition for participation in the lease-purchase program. Tenants will be expected to attend quarterly sessions on topics including credit repair and financial planning. Currently Park Heights Renaissance offers monthly financial literacy programs and home buyer workshops. Participants in the project will be invited to these sessions as well as those offered in partnership with local lending institutions interested in generating future mortgage business.

As a financial motivation for this undertaking, the CDC will see the bulk of its benefit in terms of growth in the tax base by replacing blighted homes with newly renovated properties of a significantly higher assessed value. The proposed development will also create jobs, generate permit, recordation and utility taxes, and tangibly improve a neighborhood in need of catalytic, “first-in” investment. As a result, the financial return will be minimal to the CDC with any existing “fat” offered to the private entity to entice the most qualified developer to the table. Whether that entity is a for profit or non-profit developer will be determined by the market. Competing proposed projects will determine the appetite for a project of this level of anticipated return. A 13% development fee has been budgeted. According to executives at Pennrose Properties, standard development fees for affordable housing projects are between 12-15%.

The decision to apply a market rate development fee is confirmed by a 1999 study conducted by City Research and published by the Fannie Mae Foundation stating that LIHTC projects developed by nonprofits are 20.3 percent more expensive than those developed by for-profits (Cummings, 1999). The additional cost is a function of the risk profile of the project. Controlling
for a variety of project characteristics, returns to equity investors are higher for rehabilitation projects and projects developed by nonprofits, perhaps reflecting the greater risks associated with rehabilitation versus new construction and with developers who generally have less of a track record than for-profit developers (Cummings, 1999). Civic-minded agencies may also seek to develop in more distressed neighborhoods, target lower income tenants, or develop in traditionally underserved, fringe areas. Responding to additional public “agendas” can increase the risk profile, and therefore the price, of the project.

There are also benefits to utilizing a nonprofit as the development entity for a LIHTC project. As required by IRS code 42(h)(5)(A) a minimum of 10% of the total Tax Credits available for allocation will be set aside annually for projects involving qualified nonprofit organizations (Maryland Low Income Housing Tax Credit Program: Qualified Allocation Plan, 2008). States often give priority to nonprofit developers because of their broader mission which leads them to tackle more difficult projects (Cummings, 1999). Nonprofits may also have more of an appetite for deals with thin margins for revenue generation. LIHTC projects are traditionally tightly run, with revenues just covering costs for many projects; 22.5 percent of the projects had negative cash flows in 1995 (Cummings, 1999).

To achieve an efficient skills match, the tasks associated with the lease-purchase project will be divided among the CDC and selected private entities. While a non-profit entity will be the likely respondent given their mission and commitment to community revitalization, depending on their risk profile, portfolio, backlog, and interest in breaking into a market, the deal may be attractive to for-profit developers as well.

**Tenant Pool**
To achieve 100% lease-up, this project will seek 19 families with the interest in making a long-term investment in future homeownership in Park Heights. The rental rates are calculated to be achievable for current residents of Park Heights. However, the significant vacancy currently plaguing the neighborhood indicates that it will be necessary to attract individuals from outside the neighborhood in order to populate and stabilize the community. According to interviews with the former director of Park Heights Renaissance, true market rate for a 3-bedroom home in Park Heights is between $1000-$1100. Comparable properties include the following.

<table>
<thead>
<tr>
<th>Property Name</th>
<th>Property Address</th>
<th># BR</th>
<th># BA</th>
<th>Rent</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Multi-Unit Rental</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wabash Manor</td>
<td>3804 Wabash Avenue</td>
<td>2</td>
<td>1</td>
<td>$725</td>
</tr>
<tr>
<td>Coldspring Station</td>
<td>2530 Edgecombe Circle</td>
<td>2</td>
<td>1</td>
<td>$725</td>
</tr>
<tr>
<td>Greenlyn Apartments</td>
<td>4936 Lanier Avenue</td>
<td>3</td>
<td>1</td>
<td>$995</td>
</tr>
<tr>
<td><strong>Ingram Manor Apartment Homes</strong></td>
<td>7301 Park Heights Ave</td>
<td>3</td>
<td>2</td>
<td>$2,130</td>
</tr>
<tr>
<td><strong>St. Charles at Olde Court</strong></td>
<td>7900 Brookford Circle</td>
<td>3</td>
<td>2</td>
<td>$1,195</td>
</tr>
<tr>
<td><strong>Single Family Rental</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4002 Oakford Ave</td>
<td></td>
<td>3</td>
<td>1</td>
<td>$900</td>
</tr>
<tr>
<td>2654 Park Heights Terrace</td>
<td></td>
<td>3</td>
<td>1.5</td>
<td>$945</td>
</tr>
<tr>
<td>3032 N. Grantley</td>
<td></td>
<td>3</td>
<td>1</td>
<td>$1,200</td>
</tr>
<tr>
<td>2475 Shirley Ave</td>
<td></td>
<td>3</td>
<td>2</td>
<td>$900</td>
</tr>
<tr>
<td>4008 Edgewood Road</td>
<td></td>
<td>2</td>
<td>1</td>
<td>$900</td>
</tr>
<tr>
<td>4935 Edgemere Ave</td>
<td></td>
<td>4</td>
<td>2</td>
<td>$1,400</td>
</tr>
</tbody>
</table>

**Sources and Uses**

This project will be financed through a combination of private debt, the Baltimore City HOME Funds, and the previously discussed tax credit equity.
The amount of equity raised through the tax credits is calculated off of the hard and eligible soft costs of the project. Hard costs and some soft costs (this analysis assumes 80%) combine to arrive at the eligible basis for calculation of the equity injection. The eligible basis is multiplied by the percent of affordable units in the development to arrive at the qualified basis. This project calls for 100% of units to be below 50% of MFI. Because these properties are located in a Qualified Census Tract (QCT), there is a 30% “bump” applied to the qualified basis. The qualified basis is then multiplied by the credit percentage established by the IRS that applies to low-income housing tax credit buildings that are placed in service that month. There are two separate rates, 90% present value credit (PVC) and 30% present value credit. The maximum 90% rate is available for low-income new construction and substantial rehabilitation expenditures that aren't otherwise federally subsidized (e.g.; funded with tax-exempt bond proceeds or with below market federal loans) (Housingonline.com). The value is then calculated for the term of the credit (10 years) and applied to the current trading rate ($0.72) to arrive at the level of equity infusion.

The first mortgage on the properties will be sought through a traditional lender offering favorable rates of 7.5% on a 30-year loan for $1,303,351. This represents an 32% loan-to-cost ratio. The assumption is that a community development lender would be interested in underwriting this deal based on the low LTC, a commitment to community investment, as well as the need to allocate Community Reinvestment Act (CRA) dollars.
As an additional source of funds, the project will utilize Baltimore City HOME Funds in the amount of $380,000. This number is calculated as $20,000 per housing unit, requires no debt service, and is forgiven after 10 years.

**Ownership Transfer**

The ultimate goal of a lease-purchase program is to transfer ownership of the properties into the hands of prepared and willing purchasers. Few lease-purchase programs in the U.S. have reached the point of ownership transfer, but developers of such projects are confident that the incentives are such that turnover will be minimal and tenants will opt to purchase at the end of the tax credit period (Ebner, 2010). At the start of year 15, the tenant will seek private financing for the balance of the loan. For this project, in year 15, that balance will be $51,585. If the property has appreciated even 5% over the 15 year period to $101,356, this represents nearly $50,000 in equity that the tenant will benefit from at the time of purchase. This represents a tremendous incentive for the tenant to purchase. At a 70% loan-to-value, the tenant can secure a loan for $36,109. Assuming the tenant plans to maintain the same level of monthly payments as during the rental period (approx 1,000/month) at a 7.5% interest rate, the tenant could have full ownership in the property after 5 years. With the addition of operating expenses now the responsibility of the new home-owner, the monthly payment remains in line with previous rental payments.

<table>
<thead>
<tr>
<th>Owner's Budget</th>
<th>Mortgage</th>
<th>Taxes</th>
<th>Insurance</th>
<th>Repairs/Maintenance</th>
<th>monthly</th>
<th>annual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner's Budget</td>
<td>$723.57</td>
<td>$191.56</td>
<td>$84.46</td>
<td>$166.67</td>
<td>$1,166.26</td>
<td>$13,995.13</td>
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</tbody>
</table>

**Lease Up**
A 2% vacancy/collections expenses is assumed in the analysis. The program calls for 19 affordable units at 50% of MFI. Affordable rates are calculated utilizing 2009 Baltimore-Towson, MSA maximum income limits. According to HUD, the three-bedroom monthly rental expense calculates to $1,026 at 50% of AMI. Utilizing a front-end back-end ratio, according to HUD underwriting standards, the ratio of principle, interest, taxes and insurance to monthly gross income must be no less than 31% and on the back end, payments on all installment debts must not exceed 51%. This translates to an income level of $39,716 annually with no more than $2,011 in monthly debt expenses. Average median income in Park Heights is $35,081. Because of the location of the units and the fact that they will be brand new rehab, this project appropriately targets the upper range of the area median income.

**Healthy Neighborhoods and the Viability of Redevelopment**

The true test of the success of the redevelopment will be determined by the properties’ ability to hold value (and ideally appreciate) and their ability to positively impact surrounding property values. The goal of all civic-minded development should be to create sustainable change with a ripple effect toward future success. From a neighborhood revitalization standpoint and from the standpoint of the individual future home buyer, the subsidy will be deemed successful when it contributes to creating a valued asset and catalyst for future growth. From the neighborhood perspective, that future growth will ideally manifest itself in a web of development.

Several ancillary factors will contribute to the success or failure of a neighborhood redevelopment effort of this kind. David Boehike’s Healthy Neighborhoods model describes several characteristics of healthy, sustainable redevelopment that go beyond the construction of physical structures. According to Boehike’s model, healthy neighborhood revitalization efforts
are characterized by a rise in property values, an emphasis on high standards of buildings and maintenance, consistent marketing efforts, involved residents, and the attraction of diverse income groups.

In order for a development to sustain itself, the cost to purchase and renovate to quality standards should not exceed comparable sales values in the neighborhood (Boehlke, 2001). The proposed project adheres to that rule provided it can bridge the gap to Cylburn. There is an inherent potential for market distortion when subsidized projects result in sales prices that are below the value of the property. If subsidies are needed to build value, it follows that the market will recognize that purchase is not a sound investment and current owners will not be motivated to improve their properties.

In order to emphasize high standards of building and maintenance, redevelopment budgets should reflect quality materials and construction, and surrounding property owners should be encouraged to take an investment interest in their own properties. The Park Heights Renaissance Home Improvement Loan program is an existing example of flexible financing options to promote increased investment by current homeowners and the established rehab budget accounts for quality materials and construction.

The Healthy Neighborhoods model recognizes that dwellers have many options in terms of where to live. Message management is a powerful force in terms of motivating individual’s buying decisions. Promotional campaigns, newspaper articles, and participation with local organizations whose mission it is to promote the City as a whole, can all be effective vehicles to communicating a neighborhood’s successes.
Another key element to successful residential redevelopment is for residents to become personally involved in the community. Volunteer programs, community gardens, neighborhood safety patrols, and social gatherings are all means to engage residents in their communities. Particularly for homeowners, residents become likely to participate in local voluntary and political activities because they have an economic investment in their homes and they see participation in voluntary and political organizations as a means of protecting that investment (Baum and Kingston 1984; Rohe and Stewart 1996). Homeowners may also be civicly active because of the transaction costs associated with moving. If deterioration in neighborhood conditions forces homeowners to move, it can result in significant expense to buy, sell, and relocate thus, there is an economic incentive for owners to join neighborhood or community associations that work to maintain physical and social conditions in their neighborhoods (Rohe, 2001).

Finally, attracting diverse income groups decentralizes poverty and creates opportunity for successful redevelopment. Boehike writes that rebuilding a neighborhood requires involving, not excluding, all stable households.
Conclusion

Maintaining consideration for the factors associated with viable redevelopment as defined by the Healthy Neighborhoods model will be a key contributor to the potential success of the project. Fred Keene, Healthy Neighborhoods coordinator for Cylburn will be fully engaged in the proposed development. Addressing the barrier of Pimlico Road is a significant challenge to the project. Eliminating the mental barrier between Cylburn and Central Park Heights through community engagement will be imperative to the success of the project. Tenant qualification will be an intensive process to identify the proper individuals interested in making a long term commitment to the property given the required 15-year rental period. Lease-Purchase properties that do not sell quickly become a management & maintenance burden, tenant turnovers (including damages & eviction expenses) may cause financial losses, and managing a rental portfolio long term may deplete un-replaceable financial reserves and require different staff skills (Albany Community Land Trust, 2010).

As another caveat, tax credit equity is competitive, especially given the current lending environment. In 2006, on average, one in five applications received a credit allocation (Jackson, 2006). This project is significantly smaller scale than most tax credit awardees. In 2008, the smallest number of units that received an allocation was 32. That project received $294,449 in tax credit equity and $1,600,000 in rental housing funds. It may be necessary to increase the scope of the project in order to attract attention from the Maryland Department of Housing and Community Development, however, this project will rank favorably because it does not utilize any other State funds to sustain itself. With the attraction of a qualified development team, this project scores well in the remaining criteria for tax credit award.

Provided the necessary equity can be attracted and favorable lending rates can be achieved, the proposed lease-purchase project provides a viable and valuable niche product. Properly prepared
buyers—low-income individuals among them—who select homeownership should be afforded the opportunity to do so at the lowest possible cost with the greatest chances of maximizing their risk-adjusted returns. By remaining flexible and identifying a tailored “build from strength” location such as this, the LIHTC lease-purchase program could be a key element in the long-term solution to the redevelopment of Park Heights.