Federal Barrier to Affordable Housing Supply: State Volume Cap on Private Activity Bonds

POLICY BRIEF

NEW YORK HOUSING CONFERENCE

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While tax-exempt Private Activity Bonds (PABs) are one of New York State's primary financial tools to build and preserve affordable housing, a federal limit on those bonds is also a significant barrier to expanding its overall affordable housing supply. By reforming the system to exempt affordable housing from the volume cap, New York, as well as other states, could build more affordable housing at the local level and access new resources to preserve HUD-assisted housing including public housing, senior housing, and other programs with significant capital needs. This fix is simple – and there are precedents for federal lawmakers to follow (Table 1).

New York's Housing Shortage

New York is facing a severe housing affordability crisis due to a long-term shortage in housing supply that has only been exacerbated by the pandemic. Lack of supply places pressure on households across the housing market, but disproportionately impacts low-income households. Analysis by the National Low-Income Housing Coalition found that the state lacks almost 650,000 units of housing affordable to very low-income households, contributing to soaring rents and a homelessness emergency.[1] A New Yorker earning minimum wage would need to work 94 hours per week to afford a one bedroom apartment at fair market rent as determined by the Department of Housing and Urban Development (HUD) and 109 hours for a two bedroom apartment[2].

State, local and federal policy contribute to creating & perpetuating the housing shortage in a variety of ways:

- Zoning laws limit the size, use and location of residential housing
- Building codes restrict materials used in construction and design
- **Federal limits on state private activity bond (PAB) volume cap limit affordable housing financing**

In New York City, the crisis is particularly acute. While rents were temporarily lowered early in the pandemic, those deals have since disappeared and rents have since soared past pre-pandemic levels.[3] Further, over two million New Yorkers who live in rent stabilized apartments are anticipating rent increases of two to six percent after eight years of minor increases or complete rent freezes[4] Rapidly rising inflation stresses the tight housing market even further. Housing costs have seen their largest 12 month increase since 1991 and in March accounted for *almost two-thirds* of the jump in core inflation, which excludes food and energy, making it "by far the biggest factor in the increase," according to the Bureau of Labor Statistics[5].

The national housing supply deficit is 3.8 million homes according to Freddie Mac[6]. As a nation, we are not building enough housing. In New York, the production of new housing per capita has lagged other major U.S.

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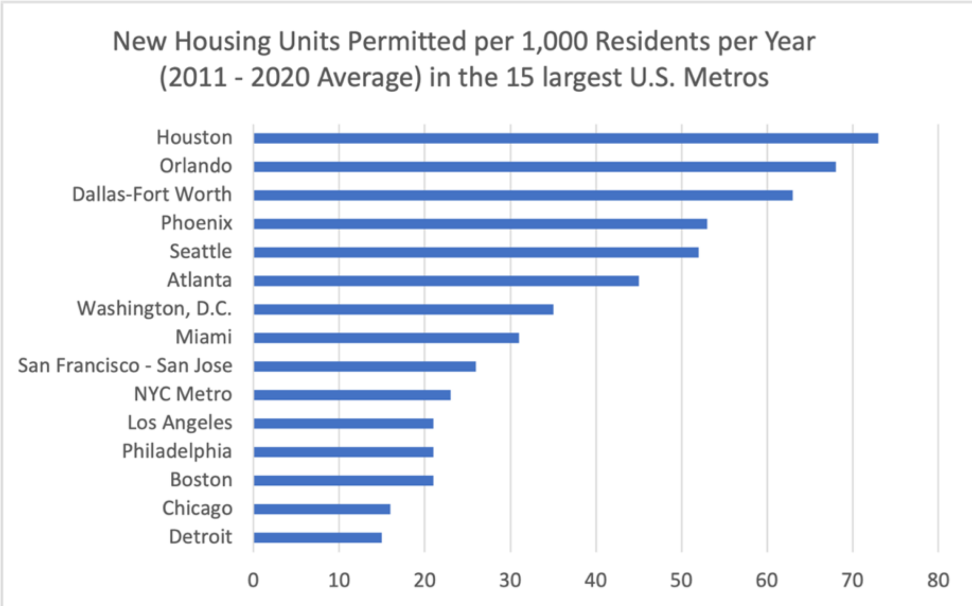
[1] "The Gap: A Shortage of Affordable Homes," *NLIHC* March 2021.
[2] "Out of Reach: The High Cost of Housing", *NLIHC.* 2021. https://nlihc.org/sites/default/files/oor/2021/Out-of-Reach_2021.pdf
[3] Zaveri, Mihir. "Rents Are Roaring Back in New York City" *NYTimes*. March 7, 2022. [Rents Surge in New York City at Double the National Rate - The New York Times (nytimes.com)]
[4] Zaveri, Mihir, "Panel Backs Rent Increases for More Than 2 Million New Yorkers," *NYTimes*. May 5, 2022.
[5] Bureau of Labor Statistics, "Consumer Price Index Summary" https://www.bls.gov/news.release/cpi.nr0.htm
[6] Housing Supply: A Growing Deficit, *Freddie Mac*. https://www.freddiemac.com/research/insight/20210507-housing-supply

metros over the past decade. The New York City metro area created only 23 new housing units per every 1,000 residents annually over the last decade, far behind the national average and other similar metros.[7]



Source: NYC Department of City Planning, "NYC Thinking Regionally"

Further, in New York City, housing supply has lagged significantly behind population growth across the city in the past decade:

Borough	Units Permitted from 2010-2020	Population Growth from 2010-2020
Bronx	40,200	87,546
Brooklyn	86,800	231,374
Manhattan	52,500	108,378
Queens	54,700	174,742
Staten Island	7,274	27,017

Source: NYC Department of City Planning

The preservation of public housing is also critical to NY's housing supply. The New York City Housing Authority (NYCHA), which serves over 350,000 New Yorkers is the largest source of housing affordable in NYC to those with the lowest incomes, accounting for almost 60 percent of all units affordable to extremely low-income (ELI) households and 30 percent of all units affordable to very low-income households[8]. And by law it is permanently affordable housing. However, NYCHA residents are currently living under deteriorating conditions, including mold, lead paint, and inconsistent heat and hot water. These units are at risk of becoming uninhabitable, with $40 billion in unfunded capital needs, a price tag which only continues to grow.

Tax-Exempt Private Activity Bonds Fuel Affordable Housing Production

PABs are a vital financing tool for expanding the supply of affordable housing. At marginal expense to the federal government, PABs create a huge multiplier effect that bolsters our country's rental and owner-occupied housing stock, while also producing jobs and beneficial long lasting economic effects.. Private activity bonds for affordable housing come with as-of-right Low Income Housing Tax Credits (LIHTC), which provide equity, at no expense to the project, for the development and preservation of affordable housing for low-income

[7] "NYC Metro Housing Production," *Department of City Planning.* November 2021. [NYC Thinking Regionally (November 2021) - Housing Production (mailchi.mp) (Do you mean Department of City Planning?)]

[8] NYU Furman Center, "NYCHA's Outsized Role In Housing New York's Poorest Households." December 2018. https://furmancenter.org/files/NYCHA_Brief_12-17-18.pdf

households. However, these bonds are a finite resource, limited by the Federal "volume cap," which caps the volume of tax-exempt private activity bonds each state can issue. Newly received volume cap that is not used by the end of the year may be carried forward for use in one of the next three years. Left unused after three years, the authority to issue these bonds expires.

Every year, new cap is allocated to each state based on a formula set by the U.S. Congress. In 2020 the PAB volume cap was $105 per capita, making New York's cap $2,042,623,905[9]. Volume cap per capita has only increased about 16 percent over the past decade, making it a largely static resource that hasn't kept pace with rising housing costs or the demand for affordable housing.

Volume Cap Is a Financing Barrier to Expanding Affordable Housing Supply

While PABs have several uses, 88 percent of issuances in 2020 went to multi- and single-family housing, continuing an upward trend of almost a decade, most of which is attributed to the increased demand for affordable rental housing and attendant increases in multifamily development. Additionally, some states came to recognize that prioritizing the use of volume cap for rental housing was the most efficient use of this resource because the bonds came with tax credits, which are not available for other uses of the bonds (e.g., economic development projects.) Nationally, the total amount of multifamily bonds issuances have nearly *doubled* in only a few years from $7.2 billion in 2017 to over $13 billion in 2020. The number of apartments expected to be built from PABs increased by almost 20 percent in just one year from 2019 to 2020.

New York uses virtually all of its cap on affordable housing, financing the creation or preservation of about 10,000 units of affordable housing annually through the City and State affordable housing plans. Demand for additional volume cap is great, with demand outstripping supply. As a result, some "shovel ready" projects must sometimes wait several years before receiving financing.

As communities face housing supply shortages across the country, more states are reaching their maximum allowable PAB issuance like New York. Many states issued record levels of PABs in 2019 and 2020 while eight states – California, the District of Columbia, Massachusetts, Minnesota, New Mexico, Rhode Island, Utah and Washington – issued more PABs than their annual cap in 2020[10]. States have also been carrying forward less unused cap over the past several years, reducing their overall capacity. This prevents states from fully addressing supply and preservation needs. Further, the Infrastructure Investment and Jobs Act (IIJA) created two additional uses for PABs – broadband projects and carbon capture facilities – that could potentially compete with housing for usage.

Volume Cap Exemptions Help Achieve the Public Good

There have been exceptions made to state volume cap for 17 activities – 14 of which have been completely exempt from the cap – that contribute to the public good ranging from transportation infrastructure to schools to green buildings as seen in Table 1. These exceptions have allowed localities to build critical infrastructure without taking away tax exempt bonds for other purposes and preserving state resources to address other needs. Congress has addressed these exceptions in multiple ways. For example:

1. Large scale infrastructure such as airports, docks and wharves that are government owned and for public use are exempt from volume cap[11].
2. To address mounting capital needs for school construction and repair, Congress established a separate cap for financing public educational facilities equal to the greater of $10 times the state population or $5 million[12].

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[9] New York State Division of Budget, "2020 IDB Cap Final Allocation Report"

[10] Novogradac, "Despite Pandemic Concerns, Multifamily Private Activity Bond Issuance Reaches New Record of $17.2 Billion in 2020," November 5, 2021. https://www.novoco.com/notes-from-novogradac/despite-pandemic-concerns-multifamily-private-activity-bond-issuance-reaches-new-record-172-billion

[11] "Private Activity Bonds: An Introduction," *Congressional Research Service*. January 31, 2022.

[12] Stan Provus, "Volume Cap Overview," *CDFA.* https://www.cdfa.net/cdfa/cdfaweb.nsf/ord/dec2007spot.html

3. Provisions in the 2004 American Jobs Creation Act authorized $2 billion in tax exempt bonds not subject to volume cap for qualified innovative green projects with language specific enough to restrict it to four projects.
4. Similarly, Congress authorized $15 billion in tax exempt bonds not subject to volume cap for highway and surface freight transfer facilities to address the challenges in our transportation systems[13].
5. For three uses, only 25 percent of bonds contribute to the cap. This includes private projects to expand broadband access to underserved areas and facilities that capture carbon dioxide from the air, both of which were included in the IIJA passed just last year.

The affordable housing crisis is an emergency affecting the lives of millions of Americans and the stability of our communities. Adding affordable housing projects to this list of exceptions would allow localities to build and preserve more desperately needed affordable housing.

Table 1: Qualified Private Activities

Qualified Private Activities			
Internal Revenue Code Section	**Type of Private Activity** (Italicized activities must be owned by the issuing government to qualify)	**Subject to Volume Cap**	**Year Established**
§142(n)	Qualified broadband projects (government)	No	2021
§1400U-3	Recovery zone facility bonds	No	2009
§142(l)	Qualified green building and sustainable design projects	No	2005
§142(m)	Qualified highway and surface freight transfer facilities	No	2005
§142(k)	Qualified public educational facilities	No	2001
§1394	New empowerment zone facilities	No	1994
§142(j)	*Environmental enhancements of hydroelectric generating facilities*	No	1992
§142(i)	High-speed intercity rail facilities (government)	No	1988
§142(c)	*Airports*	No	1968
§142(c)	*Docks and wharves*	No	1968
§142(a)(6)	Solid waste disposal facilities (government owned)	No	1968
§143(b)	Qualified veterans' mortgage bond	No	1968
§145	Qualified 501(c)(3) bond	No	1968
§150	Current refunding bonds not exceeding outstanding amount of refunding bonds	No (2)	1968
§142(h)	Qualified hazardous waste facilities	Yes	1986
§142(g)	Local district heating and cooling facilities	Yes	1982
§142(c)	*Mass commuting facilities*	Yes	1981
§144(b)	Qualified student loan bond	Yes	1976
§142(e)	Water furnishing facilities	Yes	1968
§142(a)(5)	Sewage facilities	Yes	1968
§142(a)(6)	Solid waste disposal facilities (private owned)	Yes	1968
§142(d)	Qualified residential rental projects	Yes	1968
§142(f)	Local electric energy or gas furnishing facility	Yes	1968
§143(a)	Qualified mortgage bond	Yes	1968
§144(a)	Qualified small issue bond	Yes	1968
§144(c)	Qualified redevelopment bond	Yes	1968

[13] US Dept of Treasury, "Acting Deputy Assistant Secretary For Tax Policy Eric Solomon Testimony" https://home.treasury.gov/news/press-releases/js4121

§150	Current refunding bonds exceeding outstanding amount of refunding bonds	Yes	1968
§142(n)	Qualified broadband projects (private)	Yes(1)	2021
§142(o)	Qualified carbon capture facilities	Yes(1)	2021
§142(i)	High-speed intercity rail facilities (private)	Yes(1)	1988
(1)25% of the bond issue is included in the cap. (2)Maturity limitations apply for refundings of qualified mortgage revenue bonds and qualified student loan bonds.			
Source: Congressional Research Service: Private Activity Bonds: An Introduction			

Affordable Housing Stimulates the Economy

Increasing supply will not just provide families with safe, affordable housing but it will also help stimulate the economy and generate jobs. New York's pandemic economic recovery is behind other states and experts project it will take years before the state gets back to its pre-pandemic economic level. At the same time, affordable housing investment is a countercyclical tool that has a positive multiplier effect, creating thousands of jobs, generating new tax revenue and billions in economic spending – in the process, shortening the economic crisis and reducing its severity. Every 100 units of affordable housing creates 120 construction jobs, 135 indirect and induced jobs, and $43.5 million in direct, indirect, and induced economic spending. Over the long-term, after construction is completed, those units generate 4 permanent on-site jobs, 32 ongoing direct, indirect, and induced jobs, and $8 million in sustained economic activity per year.[14]

LIHTC generated by PABs helps finance the overwhelming majority of new low-income housing and is critical to meeting our housing supply needs. Leveraging private equity at no cost to the projects, the program produces affordable housing that serves incomes from 30 to 80 percent of AMI, with all LIHTC units in a development averaging at 60 percent AMI. Since its creation in 1986, the program overall has developed or preserved over 240,000 homes in New York, generated $15 billion in tax revenue and over $43 billion in wages and business income[15].

The Solution for This Political and Economic Moment

With rents and home prices soaring across the U.S. and rising inflation and interest rates, every state and every community is feeling the impact. There is political will to address the supply shortage. We are grateful for recent increases in the HUD budget, but a significant HUD expansion to address our supply shortage will likely not gain support in the immediate future. However, a tax-side solution is possible.

There are several tax side proposals to allow more efficient uses of PABs that would produce meaningful increases in supply. Lowering the "50 percent test"[16] to 25% would double housing production in NY over the next decade[17]. The SAVE Act would create an exception to volume cap for the preservation, improvement, or replacement of federally-assisted buildings to aid public and other HUD-assisted housing. Expanding eligible uses of recycled bonds would free up to $200 million annually in NY.[18]*However, exempting the cap for*

[14] Economic Impacts of Affordable Housing on New York State's Economy. By HR&A Advisors, for NYSAFAH. Feb. 10, 2017. https://www.nysafah.org/cmsBuilder/uploads/nysafah-economic-impact-of-affordable-housing-2017-update-(2011-2015)-final_001.pdf

[15] "New York Housing Credit State Fact Sheet," *The ACTION Campaign*. https://rentalhousingaction.org/new-york/

[16] Affordable multifamily rental projects are typically offered low-interest financing and automatically generate as of right 4% Low Income Housing Tax Credits, if they meet the "50 percent test," which requires that 50 percent of a development's qualified development be financed by PABs. To meet this requirement for affordable housing projects, more bonds must be allocated during the construction period than are needed to finance the project over the long-term.

[18] In 2008 Congress authorized the "recycling" of tax-exempt multifamily Housing Bonds so that states could use the proceeds from the repayments of those bonds to finance more affordable multifamily bond-financed housing. Recycled bonds currently may only be used to finance multifamily housing. Broadening eligible use to include single family housing as proposed in the AHCIA would

multifamily housing would address the underlying issue and have the greatest impact in this housing emergency.

Proposal	Impact
1. Exempt all affordable housing from volume cap	Unlock New York's full capacity to address supply at scale
2. Lower the "50 percent test" as proposed in the Affordable Housing Credit Improvement Act (AHCIA)	Double housing production in the state over ten years
3. Exempt HUD-assisted housing from volume cap (SAVE Federally Assisted Housing Act)	Allow more resources to be directed to preserving HUD assisted housing
4. Expand use of recycled bonds to single family housing (AHCIA)	Preserve \$100M-\$200M in new volume cap to generate \$80M-\$160M per year in additional 4% Housing Credit

Exempting affordable housing from volume cap can aid and preserve existing HUD-assisted housing, including public housing, in buildings requiring major capital improvements. It will also spur the preservation and new construction of affordable housing at the scale necessary to seriously start tackling this crisis and in New York State and across the United States.

allow for more efficient allocation of limited resources by States. If States can dedicate recycled bonds to uses that do not utilize Low Income Tax Credits, they can free up non-recycled private activity bonds, which generate as-of-right 4% Low Income Tax Credits, for multifamily housing.