COOK COUNTY ASSESSOR'S OFFICE

AFFORDABLE HOUSING

Issues Presented:
AFFORDABLE HOUSING

Policies Proposed:
THE ALTERNATIVE AFFORDABLE RELIEF MODEL
("AAR-M")

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November 15, 2013

AFFORDABLE HOUSING

and

THE ALTERNATIVE AFFORDABLE RELIEF MODEL

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SURVEY OF AFFORDABLE HOUSING ISSUES

The 10 and 25 Ordinance, Parity

Prior to the changeover to the 10 and 25 level of assessment ordinance ("10 and 25"), the Class 9 Affordable Housing (Class 9) Incentive program enjoyed a level of assessment benefit. Under the prior ordinance, Class 9 had the same level of assessment as residential classes (Class 2). Without the Class 9 an apartment type improvement would be classified as a Class 3. The difference between the Class 9 and Class 3 levels of assessment resulted in substantial property tax savings for Class 9 properties in comparison to equivalent apartment classes (i.e., Class 3).

Subsequent to 10 and 25, there has been much debate as to the continued viability of the Class 9 Incentive and the associated property tax advantage. The debate stems from the fact that Class 3 apartments now share the same level of assessment as residential improvements (Class 2): 10%. The result is an assumption that there is no longer a need for Class 9 incentives because the difference in the level in assessment no longer applies. The assumptions are essentially valid in relation to the diminished tax savings provided by the Class 9 incentives in relation to 10 and 25. However, Class 9s remains an important option as part of a larger bouquet of tools to provide and retain affordable housing for low income residents in Cook County. The purpose of this white paper is to justify the application of a factor that reduces the assessed value for properties that would currently qualify for the Class 9 Incentive. The factor is justified due to the special valuation nature of Class 9 affordable housing due to the current program's government restrictions and regulations imposed (which also includes repayment of savings during a term upon termination).

Need for Low Income Housing

The economic crisis of 2006 to 2008 resulted in approximately $7trillion in household wealth loss. See *The U.S. Housing Market: Current Conditions and Policy Considerations*, Federal Reserve 2012. More than half of the aggregated home equity that existed in early 2006 has been lost. Id., at 3. The decline in average home equity for middle income homeowners from 2007 to 2009 was approximately 66%. Id., at 4. In addition, the national vacancy rates on multifamily rental properties have dropped from its peak in 2009. Id., at 8. Pursuant to the Federal Reserve, the trend indicates an unwillingness or inability to purchase homes and are instead renting. Larges scale conversions of single family homes to rental have not occurred, in part due to the lack of proximity (unlike apartment type complexes). Id., at 9.

Pressures on Low Income Housing

According to *Rental Market Stresses: Impact of the Great Recession on Affordability and Multifamily Lending*, Harvard 2011, low income renters pay more than half of their incomes for rent and utilities. Those renters that fall below the federal poverty level paid 71% of their income for rent and utilities. Id., citation omitted. A quarter of all renters have household incomes below the full-time minimum-wage equivalent of $14,500. See *America's Rental Housing, Meeting Challenges, Building Opportunities*, Harvard 2011. Utilizing a 30% of income to rent standard, a minimum wage worker can afford only $377 a month in rent. Id.

Loss of Rental Stock and Competition for Dwindling Rental Units

Rental stock loss from 1999 to 2009 was 6.3% and equates to an annual loss of 240,000 for the decade. A major contributing factor for the loss of rental stock is age of the improvement, with a median age of 38 years. See *America's Rental Housing, Meeting Challenges, Building Opportunities*, Harvard 2011. In 2003, 16.3 million very low income renters competed for 12 million affordable housing rentals; by 2009 the number of low income renters rose to 18 million with supply dipping to 11.6 million. Id. Although the Great Recession has dampened rental demand by slowing the rate of young adults from forming independent households and reducing immigration, annual vacancies for rental units fell from 12.7% in 2009 to 9.4 by the end of 2010. Id.

Local Pressures on Affordable Housing

Pursuant to *The State of Rental Housing in Cook County*, DePaul 2011, the same affordable housing pressures have been noted on a local level. According to the DePaul study, Cook County's housing trend mirrors that of the nation. Id. The economically strong years of 2000 to 2007, saw conversions or demolition of 76,000 rental units. Id., at 6. The recession reversed the trend and saw owner occupied homes decrease by more than 63,000 and an increase of renters by 54,000. Id. In 2009 there was a shortage of 180,000 units, an increase of 9.1% since 2005. Id. The total rental units, according to DePaul, are concentrated in the City of Chicago which has 72.3% of all rental units within Cook County. The Woodstock Institute found that in 2010 there were 39,122 foreclosures in the six county Chicago Metropolitan area with 405,413 residential properties being "underwater" by the fourth quarter of 2011. *Struggling to Stay Afloat: Negative Equity in Communities of Color in the Chicago Six County Region*, K. Buitrago, Woodstock Institute 2012.

<u>Validation of Third Party White Papers via CCAO Data</u>

Findings in third party white papers referenced herein are confirmed by our own internal data studies. Our own view of the publicly available assessment data shows an increased demand for Class 3 based upon PIN counts and stagnation/shrinkage in Class 9s due to parity of the level of assessment for these classes. When accounting for issues with the data (for example the movement of certain Class 3s into – then new – Class 2 subclasses, i.e., 2-12s), the data strongly relates to the overall affordable housing picture as compared to the economic boom and subsequent decline.

The demand for Class 3s shows a marked decrease during the economic boom (or bubble, depending on your point of view) beginning in the year 2000. See Exhibit A, B and C, graph showing Class 3 PINs. This decline is strongly associated with condo conversions during this time frame. An increase in the numbers of Class 3 correlates very well with the economic decline and loss of homes during the mortgage foreclosure crises. At the same time that Class 3s are coming back into demand, the implementation of 10 and 25 has caused a "perfect storm" of stagnation in the growth of Class 9s at a time of greater need. See Exhibit A, B and C. The conclusion is obvious, but restated herein: Parity between Class 3 and Class 9 has been reached, with differences associated with opinions of value at this juncture.

Class 3 and Class 9, a Frank Discussion

The valuation of affordable housing raises a number of problems, for example rent restrictions and the impact of rent subsidies in determining market value. The issue with the opinion of values – on an investment side point of view – is the difficulty in determining tax savings. See valuation issues raised in *Valuing Affordable Housing: A New Challenge for Assessors* CCAO, 2007. Valuing subsidized housing is a complex process in which various negatives are offset by benefits to be considered. *Appraising Affordable Multifamily Housing, in Valuation of Subsidized Housing*, D. Nahas 192, 194-195, 198 IAAO 2003. Illinois is a benefits and burdens State, in which Federal subsidies must be taken into account as well as the impact of HUD rules, regulations and restrictions. The income approach is preferred as Illinois courts disfavor the cost approach and are wary of the sales comparison approach in this context. *Valuation of Federally Subsidized Housing: The Judicial Response [Revised], in Valuation of Subsidized Housing*, C. Byers and T. Jaconetty, 134, 137 IAAO 2003. For example, in Illinois, the rent subsidies cannot be ignored in determining value. See Kankakee Board of Review v. PTAB, 131 Ill.2d 1 (1989). The court in Kankakee, however, also held that that the negative aspects of subsidy agreements (between landlord and state) should not be ignored. Finally, per USPAP Advisory Opinion 14, a critical factor in all subsidized housing appraisals is whether or not the various subsidies, incentives, and restrictions remain with the real property following a sale or foreclosure and thus are marketable property rights to be included in the appraisal. See also *The Valuation of Federally Subsidized Housing: Ten Questions for the Property Tax*, Lincoln Institute of Land Policy, Youngman 2011, discussing struggle of valuing subsidized housing. See also *Low-Income Housing Valuation Guide*, DOR State of Washington 2008, discussing methods of value based on state case law in valuing low income housing.

Coming back to the preface of this paper, prior to 10 and 25, an investor could clearly estimate what the property tax savings would have been based on the known level of assessment changes. Because both Class 9 and Class 3 now share the same level of assessment, investors must rely upon appraisals and valuation appeals to realize any benefit; which may be an expensive expenditure in both time and money in relation to increased business risk. Because Class 9 properties are uniformly affected the same way (i.e., uniform requirements, rent restrictions, etc.,), a factored valuation approach can be realized to effect Class 9 affordable housing policy.

Alternative Affordable Relief Model ("AARM")

Design: AARM is designed at the outset as a State Law with the following basic premises: First, AARM would allow the continuation of existing local regulatory frame work. Utilizing existing regulatory framework provides for continuity of existing affordable housing programs, retains government employees and their knowledge thus reducing the tax burden of having to create new systems/frameworks from scratch. Secondly, the continuity of existing regulatory framework leverages existing community knowledge and more importantly leverages existing local knowledge and understanding of existing affordable housing programs (i.e., Class 9). Finally, an implementation of sliding scale ratio relief maximizes demand to create and reward the creation of affordable housing and also moves with the increase and decline of market values.

<u>Implementation</u>: The essence of AARM is to grant relief via an adjustment to the assessed value at a percentage rate of affordable housing. Therefore, AARM is designed to look like homeowner type exemption relief, not with a fixed EAV relief, but with a factor based upon the ratio of affordable housing provided. (AARM does not make an adjustment to the EAV side due to Constitutional considerations and is not a Homeowner Type Exemption). As previously stated, local government is already familiar with implementing relief for homeowner type exemptions (programmatically/software) and implementation can be done with existing affordable housing employees. The learning curve is also reduced as it leaves all regulations in place other than the calculation of relief that leverages local understanding of existing programs.

<u>Calculation:</u> To illustrate the calculation, prior to the 10 and 25 Ordinance, Class 9 property received relief typical of the below hypothetical calculation (assuming all qualifications are met):

		Class 3			Class 9
Mkt. Value		$1,000,000			$1,000,000
Lvl. of Assess.		33%			16%
AV		$330,000			$160,000
Multiplier		2.8			2.8
EAV		$924,000			$448,000
Tax Rate		8%			8%
Taxes		$73,920			$35,840

As the above hypothetical shows – upon meeting a baseline percentage of affordable housing units, the incentive is granted and full relief is granted. The relief shows a near 50% factor for meeting baseline affordable housing units. Following along the same lines in utilizing a base line to qualify for AARM, AARM is also designed to create an incentive in granting additional relief as more affordable housing units are added.

		Class 3	Number of AARM Units Increasing			
			35%	60%	80%	100%
AARM Relief Ratio			35%	38%	40%	50%
Mkt. Value		$1,000,000				
Lvl. of Assess.		33%				
AV		$330,000				
Multiplier		2.8				
EAV		$924,000	$600,600.0	$572,880.0	$554,400.0	$462,000.0
Tax Rate		8%	8%	8%	8%	8%
Taxes		$73,920	$48,048	$45,830	$44,352	$36,960

As a hypothetical exercise, looking at the up and down market, the following tables have been devised to show an increase in market value due to economic recovery and an example showing economic decline. Because AARM is designed as a percentage in each current year without any sort of complicated carry over, the relief self adjusts according to the market – unlike static relief (i.e., homeowner exemptions or complex calculations required under the now defunct alternative homeowner exemption). AARM would also take into consideration adjustments in HUD rental pricing.

Economic Recovery Example, Increase in Market Value						
		Class 3	Number of AARM Units Increasing			
			35%	60%	80%	100%
Mkt. Value		$1,500,000	$1,500,000	$1,500,000	$1,500,000	$1,500,000
Lvl. of Assess.		33%	33%	33%	33%	33%
AV		$495,000	$495,000	$495,000	$495,000	$495,000
AARM Savings		0%	35%	38%	40%	50%
AV AARM		$495,000	$321,750	$306,900	$297,000	$247,500
Multiplier		2.8	2.8	2.8	2.8	2.8
EAV		$1,386,000	$900,900	$859,320	$831,600	$693,000
Tax Rate		8%	8%	8%	8%	8%
Taxes		$110,880	$72,072	$68,746	$66,528	$55,440

Economic Decline Example, Reduction in Market Value						
		Class 3	Number of AARM Units Increasing			
			35%	60%	80%	100%
Mkt. Value		$500,000	$500,000	$500,000	$500,000	$500,000
Lvl. of Assess.		33%	33%	33%	33%	33%
AV		$165,000	$165,000	$165,000	$165,000	$165,000
AARM Savings		0%	35%	38%	40%	50%
AV AARM		$165,000	$107,250	$102,300	$99,000	$82,500
Multiplier		2.8	2.8	2.8	2.8	2.8
EAV		$462,000	$300,300	$286,440	$277,200	$231,000
Tax Rate		8%	8%	8%	8%	8%
Taxes		$36,960	$24,024	$22,915	$22,176	$18,480

Conclusion

Affordable Housing: The need for affordable housing varies according to market forces. A failure to institute a lasting affordable housing policy that allows self adjustments for market forces results in an eventual failure of the policy and the disintegration of affordable housing at the cost to those who are especially in need. As discussed in this white paper the original incentive, although well intentioned, was designed around a set of assumptions – unchanging levels of assessments. Based upon the experience of 10 and 25, we conclude that the market value of the affordable housing stock should be allowed to be in relative parity with non-affordable housing stock as the case is now. Adjustments should, therefore, be made as a factor of the Assessed Value in relation to a percentage ratio to the number of affordable housing units provided. The factor discussed herein is not a final recommendation and should be viewed as a framework for further refinement.

Ending Notes:

1. Note that the marked decline in Class3s in the year 2000 is likely the result of movement of certain Class 3s into Class 2 sub-classifications.
2. The average assessed values of the North Tri Towns show Class 9s and Class 3s reaching parity due to 10 and 25 – although the comparison is an "apples and oranges" situation due to population numbers of Class 9s and Class 3s, the comparison provides valid assumptions that both of these classes will roughly appear the same with differences associated with opinions of value.
3. The Class 9 incentive program is unique due to the fact that other incentives are designed to increase the tax base. Class 9, therefore, is unique in seeking to increase the affordable housing stock/base.
4. This white paper is not post-hoc criticism of 10 and 25, but speaks to its effects.

Model Statute

ALTERNATIVE AFFORDABLE RELIEF MODEL

Class 9 relief. All real estate otherwise entitled to an apartment classification, or scattered site housing as defined in this statute, provided that such real estate, consisting of land and existing buildings and structures is multifamily residential real estate; either has undergone major rehabilitation, or is new construction, or both; and is in substantial compliance with all applicable local building, safety and health requirements and codes.

Definitions.

Multifamily residential real estate shall mean an improvement with more than six residential units.

Scattered site housing shall mean a grouping of more than six single family residential real estate owned and operated by a single owner contained within a ______ mile area.

Affordable Housing Unit and/or Class 9 Unit shall mean a residential apartment unit, or scattered site house, designated to be occupied by low- and moderate-income persons or households.

A. Class 9 relief qualification, the applicant must:

1. File an eligibility application with the Assessor prior to commencement of rehabilitation and/or of new construction;

2. Either undertake and complete a major rehabilitation of the subject property, or undertake and complete construction of a new building;

3. Maintain the subject property, including any new construction, in substantial compliance with all local building, safety and health codes and requirements for the duration of the Class 9 relief period;

4. Lease, for the duration of the Class 9 relief period, at least 35 percent of the dwelling units of the subject property, including any new construction, to tenants at rents which will not exceed rents affordable to low- and moderate-income persons or households;

i. Low- or moderate-income person or household means a person or household occupying a single dwelling unit and whose combined annual income is equal to or less than the income limits for low-income families for the Chicago Metropolitan Statistical Area as determined by the Secretary of the United States Department of Housing and Urban Development pursuant to the United States Housing Act of 1937 (42 U.S.C. § 1437 et seq.). A household consists of all the occupants of a legal dwelling unit, related or unrelated;

ii. Rents affordable to low- and moderate-income persons and households means gross rents that do not exceed 30 percent of the adjusted income of a household whose income equals 55 percent of the median income for the Chicago Metropolitan Statistical Area, with adjustments for number of bedrooms in the units, as determined annually by the Secretary of the United States Department of Housing and Urban Development, or rents for units occupied by households receiving housing assistance under Section 8 of the United States Housing Act of 1937 (42 U.S.C. § 1437 et seq.). The term "gross rents" means the rental cost of the unit plus any allowances for tenant paid utilities (except telephone), services and appliances.

iii. Tenant Income Levels. Maximum household income of Class 9 tenants cannot exceed 80% of the areas median income. Owners must make a current listing of Class 9 tenants and their income available to the Assessor upon request. See the Class 9 Rent and Tenant Income Schedule attached to the end of this Bulletin for the current maximum income levels.

5. Agree to make a current listing of Class 9 tenants and their income available to the Assessor upon request;

6. Further agree to annually provide the tenants with a list of the permissible Class 9 rents;

7. Agree to notify tenants of the upcoming Class 9 expiration at least one year prior to the termination of the incentive treatment; and

8. File annually with the Assessor, on or before a date determined by the Assessor, for the duration of the Class 9 relief period, a sworn statement verifying continuous compliance with the Class 9 provisions of this law.

9. Agree to payback any and all relief within a term where the applicant seeks to terminate or is terminated from the Class 9 relief.

10. Must submit an affidavit as to the designation of the Affordable Housing Unit(s) ("Designation Affidavit"), the designation specifically assigned Affordable Housing Unit(s) may not be changed, switched or substituted without consent of the Assessor.

11. Must submit an affidavit ("Year End Affidavit") at the end of each tax year in which the incentive was granted, the affidavit shall report the percentage of occupancy for the affordable housing units for the tax year in question. Failure to maintain a _____percentage occupancy rate for the affordable housing units shall require the applicant to repay the incentives savings for the reported tax year.

B. No Discrimination Clause: No applicant shall discriminate on the basis of race, color, sex, marital status, religion, national origin or ancestry, or on any other basis prohibited under Federal, State or local law.

C. Application process: Upon completion of the major rehabilitation, the applicant must supplement the application by submitting evidence showing that major rehabilitation did, in fact, occur, the date that the major rehabilitation was completed and that the real estate complies with all applicable local building, safety and health requirements and codes. Upon completion of the new construction, the applicant must supplement the application by submitting an occupancy permit showing the date that the new construction was completed and ready for occupancy, and evidence that the real estate complies with all applicable local building, safety and health requirements and codes.

D. Class 9 Relief Duration: The Class 9 relief shall have an initial duration of ten years from the date that the major rehabilitation was completed. That period may be extended for additional ten-year periods if:

1. An application is filed with the Assessor at least 12 months before the expiration of the incentive period;

2. The applicant presents evidence that the real estate currently complies with all applicable local building, safety and health requirements and codes; and

3. The Assessor determines that all application qualifications, except the major rehabilitation or new construction requirement, were maintained during the incentive period.

E. Expiration or Termination: When the Class 9 relief is due to expire or is terminated by action of the owner or the Assessor, the property owner shall, in a manner and form determined by the Assessor, notify all Class 9 tenants of the date of the termination of Class relief. Once the Class 9 relief is terminated, the real estate shall revert to the applicable classification.

F. Existing Class 9 Ordinance Incentives: An existing Class 9 Incentive property, as created by operation of county ordinance, shall be allowed to opt into this statutory Class 9 relief program by application to the Assessor and where the applicant has been found by the Assessor to have fully qualified via continued compliance under the county's Class 9 incentive program.

G. Rules and Regulations: The Assessor may promulgate rules and regulations for the purposes of administering the Class 9 Relief program herein.

H. Calculation:

AARM Units	AARM Relief Ratio
35%	AV 35% minus AV = taxable AV
60%	AV 38% minus AV = taxable AV
80%	AV 40% minus AV = taxable AV
100%	AV 50% minus AV = taxable AV