NOVOGRADAC
Journal of Tax Credits™

Insights On Affordable Housing, Community Development, Historic Preservation, Renewable Energy and Opportunity Zones
February 2021 ◆ Volume XII ◆ Issue II
Published by Novogradac

HISTORIC TAX CREDIT TOOL BOX

The Intersection of Workforce Housing and Historic Tax Credits

CINDY HAMILTON, HERITAGE CONSULTING GROUP

At the turn of the 21st century, growing disparity among socioeconomic classes increasingly impacted the affordability of housing in cities across the United States. At that time, wage growth was stagnant, while the cost of housing rose. As a result, many middle-class individuals were forced to either relocate or devote significant portions of their income to their housing expenses. Although traditional affordable housing for low-income citizens remained a primary concern for government at federal, state and local levels, it became apparent that affordable housing for middle-income working-class citizens was a growing need for many cities across the country. In an effort to combat this, many developers have focused their attention on workforce housing.

According to the Urban Land Institute, workforce housing is generally defined as housing that is financially affordable to households earning between 60% and 120% of the area median income (AMI). Workforce housing was largely created as market-rate housing when it was built in the 1960s through perhaps as late as 2000. Today that housing is sometimes known as naturally occurring affordable housing, or NOAH, due to the fact that the rent for this housing, unlike new construction, is often affordable to people and families earning between 60% and 100% AMI. Today this housing is often occupied by members of the local workforce, such as service and manufacturing industry employees, teachers, police officers and firefighters, enabling them to live in affordable housing in close approximation to their work. This housing option, however, has expanded to include the larger middle, or working, class. Further differentiating itself from more traditional low-income housing (generally affordable to people earning less than 60% of AMI), workforce housing receives little to no incentives from the government.

To developers across the country, the housing market remains a significant and ever fluctuating component of the construction industry. Developers and policymakers nationwide understand the importance of workforce housing affordable for those earning between 60% to 120% of AMI. They also recognize that in most communities it is impossible to build such housing and achieve any reasonable rate of return due to the ever-increasing cost of new construction and land, as well as increasing municipal charges. With this growing demand for cost-effective housing solutions, there are opportunities to create workforce housing in historic buildings. The economic infeasibility of solely using the federal historic tax credit (HTC) program to rehabilitate historic buildings for workforce housing can be a challenge due to increased costs to meet HTC requirements. For developers to see the potential for workforce housing in historic structures, state HTCs may be the solution to bridging the financing gap.

Although relatively modern in terminology, the concept of providing housing for the working class is not new within the history of community planning and development in the United States. Looking back to both the 19th and 20th centuries, housing solutions for workers and the middle-class existed in the form of company towns and planned communities.

Historical Precedents of Workforce Housing

As the Industrial Revolution announced America's entry onto the global stage during the mid- to late-19th century, company towns were developed to provide the three basic human needs–clothing, food and shelter–for employees of each respective company, though these were not without controversy. As the name suggests, company towns were devised by a singular company to provide housing, groceries, retail stores and community buildings to its employees. Many company towns were designed as planned communities that largely consisted of housing clusters dependent upon a single store for their residents' remaining basic needs.

Company towns grew in prominence throughout the 19th and early-20th centuries, with thousands of examples existing across the country. Examples include: Pullman, Illinois, home to the Pullman Palace Car Company; McDonald, Ohio, adjacent to the Carnegie Steel Company in Youngstown, Ohio; and, Hershey, Pennsylvania, home to the Hershey Chocolate Company. Among the numerous company towns nationwide, many have been highlighted for their historic significance and are listed in the National Register of Historic Places.

Similar to company towns, 20th-century planned communities in the United States sought to tackle the growing trend of suburbanization within a growing middle-class, particularly in the post-World War II period. Although planned communities significantly predate World War II, the modern planned community was developed by urban planners such as Clarence Stein as an outgrowth of the earlier European Garden City movement. In the 1920s and 1930s, Stein and his peers began developing housing clusters outside traditional city centers in areas primarily used for farming. In that period, planned communities such as Radburn, New Jersey, and Greenbelt, Maryland, both designed by Stein, foreshadowed suburbanization and the need for housing within the middle class. Following World War II, suburbanization forever altered the American landscape. As the middle class continued to grow in the 1950s and 1960s, additional planned communities, such as the three Levittowns in Long Island, New Jersey and Pennsylvania, were developed to accommodate the desire to own property in a peaceful setting outside city centers. Even as people are returning to city centers in the 21st century, suburban homes remain a significant component to the American housing market.

Although it might not be readily noticeable, company towns and planned communities serve as precursors to modern-day workforce housing. The ultimate goal of both was to provide affordable housing to the growing labor force. On a much smaller and often isolated scale, workforce housing seeks to accomplish that same goal. The history of company towns and planned communities, therefore, provide important insight into the historical precedents of workforce housing, whose growing importance has impacted the modern-day built environment, similar to its historical counterparts.

Continued Need Today: A Developers Perspective on Workforce Housing

Various economic and societal issues, including the wage gap, rising property values and the ongoing economic crisis and Covid-19 pandemic, have highlighted the demand for workforce housing. In order to accommodate that demand, developers such as Mark Edlen, co-founder of real estate development company Gerding Edlen and more recently of Edlen & Company, have increasingly looked to provide workforce housing in real estate markets ranging from big to small. As Edlen noted, a great deal of workforce housing is being built outside the larger markets of Chicago, Philadelphia and New York, to name a few, and in "smaller cities … such as Spokane, Washington and Boise, Idaho." Edlen continued to explain that in these smaller cities property values are lower, which allows for greater margins in overall rental costs. No matter where workforce housing is being built, Edlen pointed out that "proximity to transportation and employment is definitely a big deal for both developers and tenants."

Qualifying for workforce housing is defined by the AMI of a given municipality. As a result, there is a wide array of individuals from numerous occupations that use it. Edlen described the types of tenants within the workforce housing that his company has acquired and renovated or developed.

"The demographic can vary greatly from place to place depending on the local average wage and real estate prices. In general, the lower end of the AMI [60-80%] is typically hourly workers, people who work in retail and shipping services," Edlen said. "On the upper end of the AMI (100-120%) you tend to find more young teachers, technicians and medical personnel."

Developers recognize the variety of tenants when designing the physical layout and form of workforce housing.

Like any multifamily housing complex, workforce housing is not confined to a specific building type, shape or form. The standard layouts within, therefore, parallel other apartment complexes with studio, one-, and two-bedroom units. Edlen explained, however, that the mix and number of units is important for any developer to consider when factoring in the financials per unit. In addition to unit size and layout, developers have to balance the desire to offer amenities with the need to keep the properties affordable. According to Edlen, many workforce housing complexes include ample parking, laundry facilities and in the case of some older complexes, pools or other recreational amenities. The flexibility of workforce housing to accommodate various building types and unit layouts allows for developers to utilize existing building stock.

Unlike developing affordable housing with low-income housing tax credits, workforce housing generally offers more flexibility to a developer with less prescribed restrictions. For any developer, however, filling the capital stack is necessary for project viability. Rehabilitation of the existing building stock for workforce housing may provide an opportunity for developers to use HTCs in the project financing.

Potential to Use Historic Tax Credits in Workforce Housing Development

Like many developers, Edlen understands the value of historic buildings within the built environment. Additionally, he acknowledges that rehabilitation of historic buildings is an important component of his firm's portfolio. As he noted, "As a whole, we have seen an increase in the buying and redeveloping of historic properties in recent years."

During his time at Gerding Edlen, Edlen typically completed at least one rehabilitation project every other year. Those projects, however, were not for workforce housing. Edlen explained that using HTCs may result in increased construction costs to meet the historic requirements, which could require rents above the 60%-120% AMI. Edlen confirmed that in planning for the HTC he would be forced to either raise rents outside affordable ranges or pair the HTCs with LIHTC in order to ensure a profitable outcome.

Additionally, Edlen also pointed out the additional challenges with HTC rehabilitations, stating "It is important to do your due diligence when in the market for purchasing older properties because there are likely unforeseen conditions that could require additional capital expenditure. It's a difficult task and you don't know what's behind that wall until you rip it apart."

Despite challenges in rehabilitations, Edlen noted the primary benefit to undertaking an adaptive reuse project. "It makes for a richer neighborhood from a design perspective," he said. The ability to utilize HTCs in developing workforce housing, can result in significant positives for each respective market.

One opportunity to close the financing gap and maintain rent requirements for workforce housing exists in pairing state HTCs with federal HTCs. In states that do not offer state HTCs, using only the federal HTC is not always economically feasible. Incorporating the state HTC serves as a possible avenue to offset the increased construction costs and offer a competitive rent that individuals in the AMI range can afford.

The Future of Workforce Housing

As the 21st century inches closer to its second quarter, the need for workforce housing is only growing. Just as company towns and planned communities in the 19th and 20th centuries focused on providing affordable housing options for the working class, the modern concept of workforce housing maintains that historic goal, which is often overlooked as cities experience pronounced increases in property values.

Developers have already begun to understand the importance of and economic benefits to supplying workforce housing to the 60% through 120% AMI range. The concept, therefore, does not appear to be a mere fad in the housing industry. Instead, it is something that will continue to grow and be an important factor. Although the potential to use HTCs in workforce housing development has inherent challenges, combining state and federal HTCs in markets that accommodate both can be a differentiator. Edlen, again, provides keen insight from the developer's perspective, noting, "This workforce housing market is huge and here to stay."

The opportunity to plug holes in financing gaps with HTCs provides a necessity within the housing industry and preserves our historic landscape, ensuring a bright future for this real estate sector.

Cindy Hamilton is president of Heritage Consulting Group.

in the article are not intended to be construed as tax advice or to create an accountant-client relationship between the reader and Novogradac & Company LLP and/or the author(s) of the article, and should not be relied upon by readers since tax results depend on the particular circumstances of each taxpayer. Readers should consult a competent tax advisor before pursuing any tax savings strategies. Any opinions or conclusions expressed by the author(s) should not be construed as opinions or conclusions of Novogradac & Company LLP.

This editorial material is for informational purposes only and should not be construed otherwise. Advice and interpretation regarding property compliance or any other material covered in this article can only be obtained from your tax advisor. For further information visit www.novoco.com.

NOVOGRADAC™

CONTACT

CORRESPONDENCE AND EDITORIAL SUBMISSIONS
Alex Ruiz
alex.ruiz@novoco.com
925.949.4243

ADVERTISING INQUIRIES
Christianna Cohen
christianna.cohen@novoco.com
925.949.4216

ISSN 2152-646X