

Present Realities, Future  
Prospects: Chicago's Low Income  
Housing Tax Credit Portfolio  
Summary Report 2002



The findings of Present Realities and Future Prospects: Chicago's Low Income Housing Tax Credit Portfolio will be disseminated in three documents—a manual, a research analysis, and a summary report. Chicago Rehab Network thanks the Chicago Housing Partnership (CHP) for its generous support of the manual and the analysis. This third document, an essential companion to the longer treatments, is solely the work of CRN and does not represent the interests of CHP.

Chicago Rehab Network hopes this policy analysis will result in a healthier, sustainable LIHTC portfolio. CRN appreciates and thanks the network members who made initial contributions of time and money to the project. We also thank the John D. and Catherine T. MacArthur Foundation, Chicago Community Trust, Fannie Mae Foundation, Woods Fund of Chicago, Polk Bros. Foundation, and Wieboldt Foundation for making this study possible. Finally, special thanks to researcher, Ron Hesselgrave, for his diligence and expertise.

**Chicago Housing Partnership**

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Chicago Community Loan Fund

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## Present Realities, Future Prospects: Chicago's Low Income Housing Tax Credit Portfolio

A sound affordable housing stock is one of the city's most important investments: it is the base from which families and individuals hold jobs, attend school, raise families and realize their full potential as members of their communities and the city at large. The most significant tool we currently have for creating new affordable housing is the Low Income Housing Tax Credit (LIHTC). Roughly 16,000 units of affordable housing in Chicago depend on it.

In 2002, affordability agreements will begin to expire on the first of Chicago's Low Income Housing Tax Credit Projects. Recent studies show a tight regional rental market with a 4.2% vacancy rate, a deficit of over 182,000 affordable units for low-income families, and thousands of Section 8 units at risk of conversion to market rate housing. In this context, it is essential that we make preparations to preserve the LIHTC stock. This study data should serve as a guide.

Chicago Rehab Network and the Chicago Housing Partnership, an association of housing stakeholders involved with the development and preservation of the LIHTC portfolio, commissioned this analysis of 1998 LIHTC project audits. The study compiles information on operating expenses, incomes, cash flows, and reserves, and looks closely at trends that determine overall project performance. The findings will be released in three documents—a manual, a research analysis, and a summary report. This report is a summary of what we found in the first careful look at LIHTC properties.



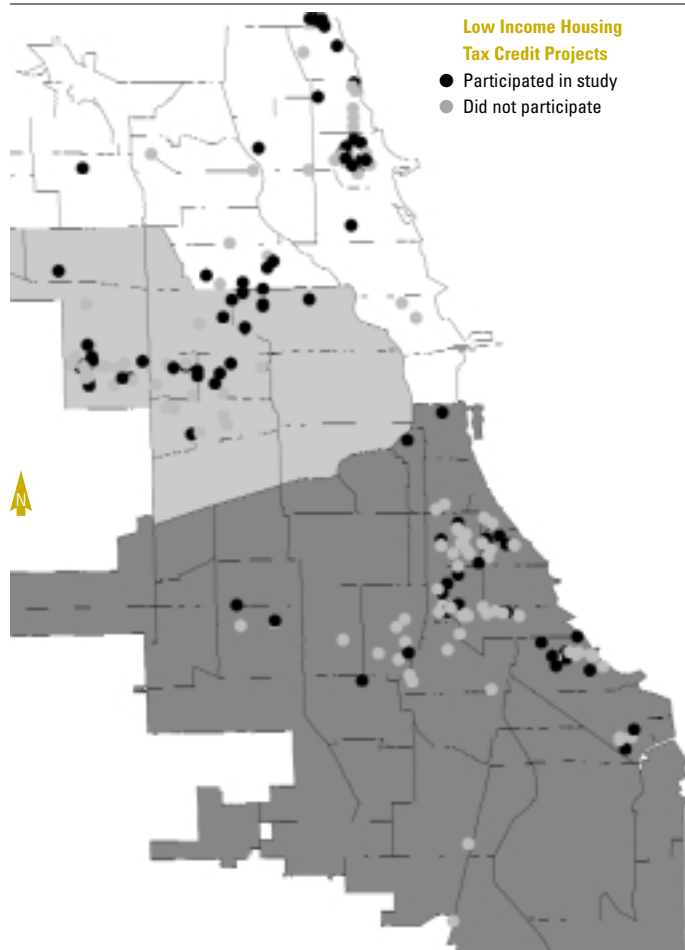
# Study Background

Congress created the federal Low Income Housing Tax Credit program in 1986 to funnel private investment into affordable housing development. Today, the program represents a \$4 billion annual investment, and leverages the creation of about 62,000 units of affordable housing every year. With the steady extinction of other federal housing programs, the Low Income Housing Tax Credit has become the most important federal program for creating new affordable housing.

Information about Chicago's estimated 16,000 LIHTC projects is scattered among developers, investors and state and city housing agencies; very little is understood about the existing stock. This first became apparent in the mid-1990s, when the failures of several large portfolios took Chicago by surprise. No one was sure what caused projects to succeed or fail, and the failures sent a wave of concern through Chicago's affordable housing networks.

Development practices were examined in many forums ranging from articles in *Crain's Chicago Business* to discussions sponsored by the LISC Futures Forum and the United Way.

Chicago Rehab Network's Property Management Task Force proposed to collect detailed information about real operating costs of existing projects, supplemented by information about income and vacancies, cash flow and reserves. And entities like the Chicago Housing Partnership realized that everyone could benefit by pooling what they knew about their individual portfolios to get a better understanding of the situation in Chicago as a whole. It was hoped the information in the study would prove an invaluable reference tool—a guide for developers and funders in underwriting new projects, and a reference for property managers monitoring the performance of existing ones.



**The Reality Challenge**  
*Present Realities, Future Prospects* is a snapshot of how things currently are, not necessarily how they ought to be. While the data should serve as a useful reference for practitioners, the numbers do not represent best practices, and therefore, should not be used as such.

The study reveals average LIHTC operating costs to be \$351 per unit per month (not including debt service) for family projects—a figure that is lower than the figure typically used in underwriting new projects. It is \$75 lower than comparable averages compiled by the Family Housing Fund in Minnesota/St. Paul for the same

year. The \$351 figure reflects budgets squeezed to fit within yesterday's optimistic projections: it's not an ideal per unit figure.

56% of the units in the sample are operating at a deficit, and an analysis of the close connections between costs, incomes and reserve accounts suggests that false projections can set whole budgets off track. For instance, underestimating operating costs can lead to deferred maintenance and low reserves, which will eventually contribute to high vacancies and make it difficult to realize project rent increases, which will only make it more difficult to meet operating costs in the future.

# Overview: LIHTC Projects In Chicago Today

The study draws from 1998 audits on 8,704 units, 60% of the city's LIHTC stock, and it presents a profile of projects as they are now.

## Location

LIHTC projects are widely distributed through Chicago's neighborhoods, but particularly in minority neighborhoods. Only 6.5% of the projects in the dataset are found in neighborhoods that are predominately white; nearly 60% are found in minority neighborhoods, and the remaining 35% fall in neighborhoods that are racially mixed. The vast majority are found in low-income neighborhoods, where median incomes fall between 40%-80% of the area median income, though 40% are in gentrifying neighborhoods where incomes rose between 1990 and 1998.

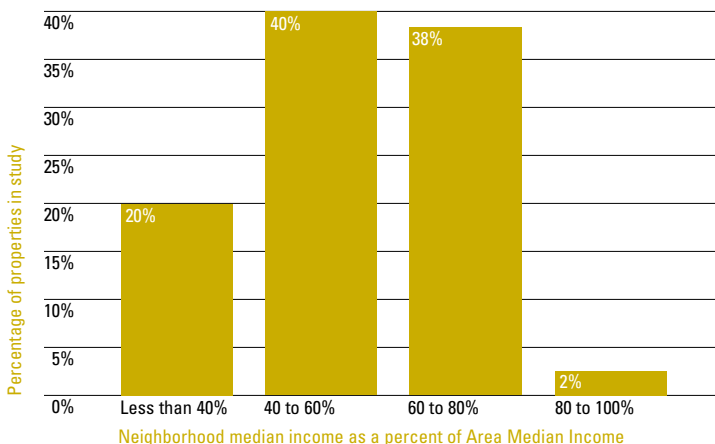
## Income

We broke the sample down by family, SRO and senior projects, and found that the average family project had billable rents of \$556 per unit (affordable to families earning \$22,245). A quarter of that billable rent comes from rental subsidies. Twelve percent of those rents are lost to vacancy and another five percent to bad debt, or unpaid rents, bringing the average effective gross income for family projects down to \$492 per unit.

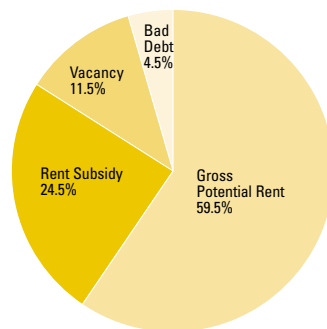
## Expenses and Debt Service

Average operating cost (not including debt service) is \$351 per unit —the largest share of which goes to maintenance costs (32%), administrative (25%), utilities (19%) and property tax (14%). The breakdown is different for senior and SRO projects, where administrative costs comprise 36% and 52% of total operating costs respectively. Family units have the largest debt service burdens, averaging 36% of effective gross income.

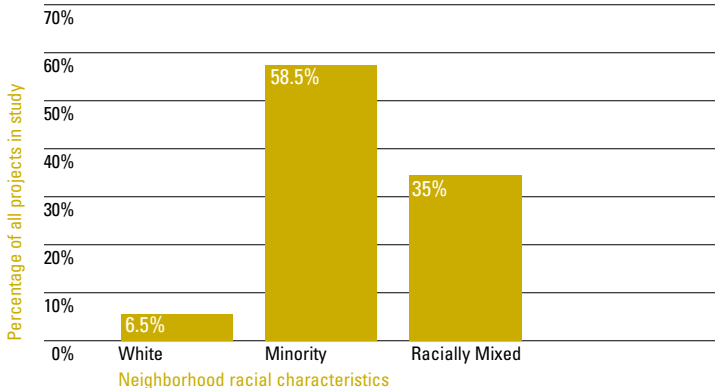
Location of LIHTC properties according to 1990 AMI



Profile of family projects by income



Location of LIHTC properties according to neighborhood racial composition



Project Type and Debt Service Burden as a Percentage of EGI

Project Type	Average Debt Service/ Unit/Mo	Average Effective Gross Income/Unit/Mo	Debt Service as % of EGI
Family	\$179	\$492	36%
Senior	\$160	\$464	34.5%
SRO	\$54	\$348	15.5%

Sources: 1990 Census and Chicago Department of Planning and Development, 1998

# Project Performance

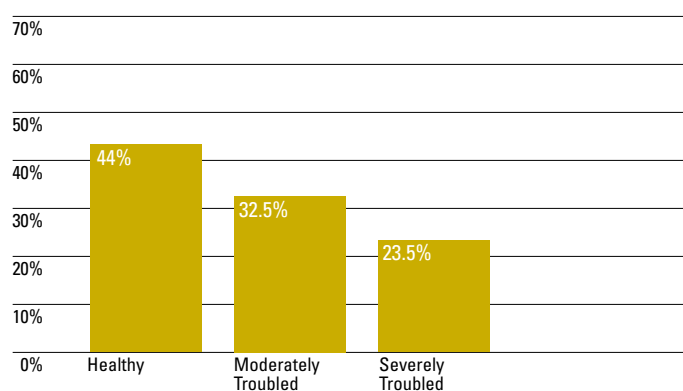
To gauge the overall condition of Chicago’s LIHTC portfolio we paid particular attention to cash flows, which indicate how a project is performing now, and reserves, which indicate how well a project is prepared for the future.

Most projects in the survey perform poorly when measured by their reserve accounts: 81% of family projects have no operating reserves, 47% have no replacement reserves. We found that properties with negative cash flow were often properties without

reserve accounts. In fact, projects with no replacement reserves have an operating ratio (which is the percent of effective gross income used to cover total operating expenses) 20% higher than projects with replacement reserve levels of \$300 or more—which appears to confirm the obvious—that projects straining to meet costs are also failing to make deposits in their reserve accounts, or are withdrawing from these accounts. More importantly, it seems to promise a future of deferred maintenance, rising vacancies and ever deepening budget shortfalls.

“Less than half of the projects, or 44%, report enough income to cover both expenses and debt service in 1998. About a third of the projects have moderate cash flow difficulties, while almost one fourth have severe difficulties, in which expenses and debt service amounted to 115% of effective gross income, or higher.”

Financial condition of projects



# Key Findings

## Finding 1

### Individual project costs vary by project type, size, and configuration, and by neighborhood.

Family units in the sample cost more overall to operate than SRO units, but SROs and senior units pay more for administrative costs.

Family units pay an average of 36% of their effective gross incomes to service their mortgages.

Projects in communities with lower property values pay more for property insurance; those in neighborhoods with higher unemployment rates pay more for security.

Both conditions are correlated with higher vacancy rates, which suggests the need for additional rental subsidies to allow for adequate and reliable rental incomes in an environment where tenant incomes are low and unreliable.

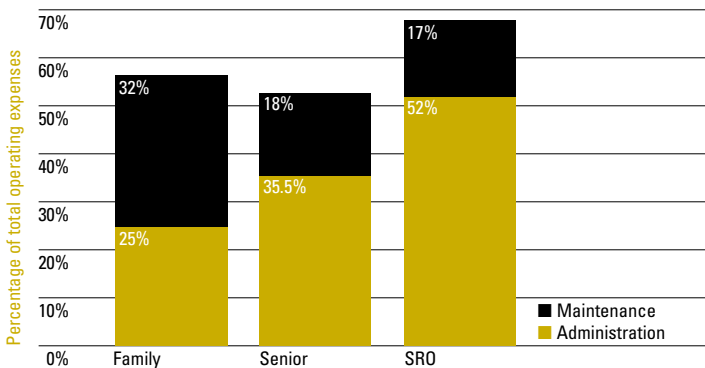
## Finding 2

### Nonprofit LIHTC developments cost more to run

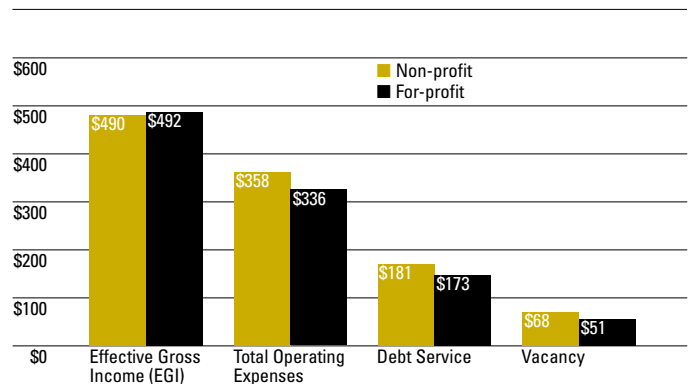
LIHTC projects are often located in more affluent neighborhoods; mission driven nonprofits build more often in low-income communities.

Nonprofits report much higher operating reserves than for-profits (\$484 per unit vs. \$87 per unit), potentially because they reinvest in the buildings.

**Finding 1 Comparison of project types and costs**



**Finding 2 Performance of for-profits and nonprofits**



“Single building projects with less than 40 units have an average maintenance cost per unit that is 39% higher than single building projects with 100 units or more.”

# Key Findings

## Finding 3

**Chicago LIHTC projects are serving households earning 39%-46% of AMI, but don't reach households earning less than 30% without additional rent subsidy.**

The LIHTC program requires that projects set aside either 20% or 40% of their units to be affordable to people with incomes under 50% or 60% of AMI. Properties in the data set are affordable to households earning 39-46% of the area median income, and though they fall within required limits, are clearly not affordable to the lowest income households.

Close to a third, 22%-32%, of households in the neighborhoods where LIHTC troubled properties are located have incomes less than 30% of AMI which may account for high vacancy rates among troubled projects.

Projects with low vacancy rates (under 8%) have higher rental subsidies than projects suffering high vacancy rates (\$156 per unit vs. \$72 per unit respectively). The difference is particularly acute among severely troubled projects, many of which don't have enough rental income to pay expenses even when fully occupied.

We estimate an “affordability gap” of approximately 62% in the north, 67% in the west, and 67% in the south.

Note: “affordability gap” is derived from the estimated percentage of eligible renter households that earn less than 30% of AMI.

## Finding 4

**Projects with high debt service are more likely to have high operating deficits.**

Specifically, projects with conventional debt at over 20% of their total debt operate at an average deficit of \$36 per unit; those with less average a \$5 surplus. They also have lower reserves, which makes them less prepared for trouble later on.

Family projects in the survey spend 36% of their effective gross income for debt service. The rates for senior projects are comparable, averaging 33%, while SROs average 13%.

Troubled projects have higher debt service burdens that consumed more of the project's gross income than healthy ones.

Projects with private first mortgages, i.e. expensive debt service are more likely to have negative cash flows than those with first mortgages from non-conventional lenders.

Almost twice as many of the first mortgages in the data set come from private lenders than in a nationwide survey (79% vs. 40% nationally).

Older projects (pre-1990) are more likely to have a private first mortgage, and one that covers a larger percent of long term debt, suggesting debt service will be an important consideration in the stabilization and refinance of expiring properties.

### Finding 4 Project Condition and Debt Service Burden as a Percentage of EGI

	Average Debt Service/ Unit/Mo	Average Effective Gross Income/Unit/Mo	Debt Service as % of EGI
Healthy	\$161	\$528	30.5%
Moderately Troubled	\$197	\$518	38%
Severely Troubled	\$181	\$399	45%

Note: SROs have been excluded



### Finding 5

**Low replacement reserves directly correlate to high vacancy rates and high maintenance costs, particularly in aging properties.**

44% of the projects in the data set have no replacement reserves and 73% have no operating reserves.

Properties with negative cash flows are even less likely to have reserves –which suggests the obvious, that budget deficits gets in the way of their ability to make deposits into their reserve accounts.

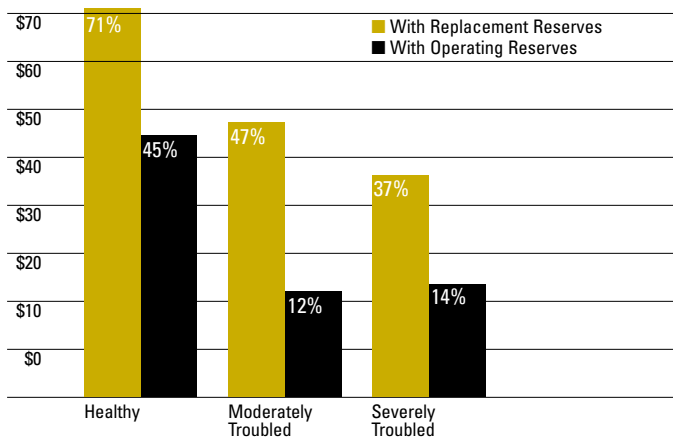
Troubled projects have operating reserves averaging 4% of total costs vs. 15% among healthy projects, and 88% of troubled projects have no operating reserves at all.

71% of healthy projects have replacement reserves (vs. 47% of moderately troubled projects and

37% of severely troubled projects) and 53% have at least \$300/unit.

Without reserves, buildings are more vulnerable to slip into a cycle of deferred maintenance, rising vacancy rates, and higher operating costs in the future. In fact, aging projects with severe cash flow problems and no replacement reserves also have vacancy rates of 25% and maintenance costs of \$190 per unit.

### Finding 5 Comparison of projects based on cash flow



### Finding 6

**Property taxes have a significant impact on project performance.**

Troubled projects spend more of their effective gross income on property taxes than those with positive cash flows.

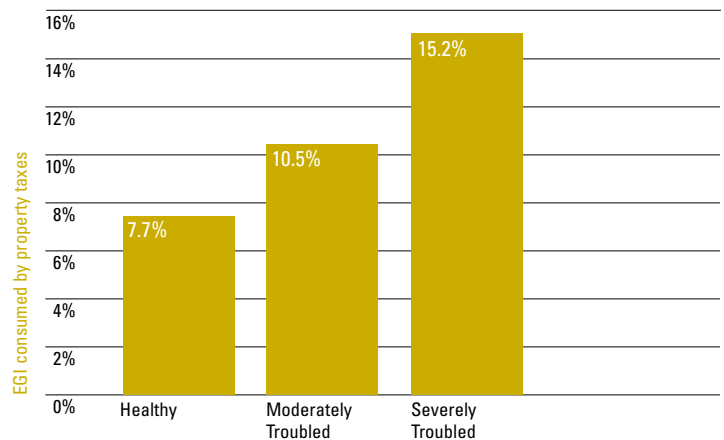
Among severely troubled projects, the percentage of effective gross income consumed by property taxes is double that of healthy projects.

Property tax is the third largest operating expense overall at 14%.

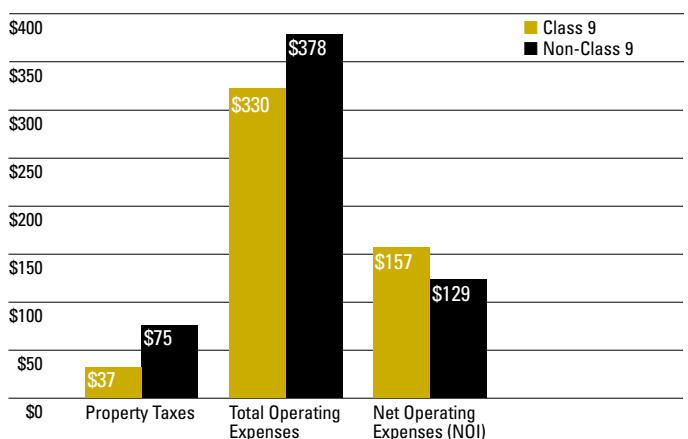
Class 9 status reduces property tax costs by over 50% and cuts operating costs by 12.6%.

Class 9 is associated with larger net operating incomes, over 21.4%.

### Finding 6 Property tax as percentage of effective gross income



### Finding 6 Class 9 and Project Performance



# What can go wrong?

Where do project budgets stray off course? Figures from one year can't tell us what goes wrong first, but they do allow us to compare troubled projects with healthy ones. Are incomes too small, or expense projections short, or both? In our snapshot, the answer varies with the size of the deficit.

Projects that perform poorly receive much lower income per unit on average than those that are successful, due largely to higher vacancy losses and unpaid rents. Projects with severe cash flow problems have effective gross incomes that average \$129 lower, including vacancy rates, and bad debt expenses that are almost three times higher than projects with positive cash flow. Severely troubled projects also have total per unit operating expenses that are more than 18% higher on average than those of financially healthy projects: particularly higher maintenance (50% higher), property tax (30% higher) and utility expenses (26% higher). They also have significantly lower per unit administrative and maintenance payroll expenses (46% lower), suggesting budgetary constraints force them to trim staff when they probably need staff most.

Moderately troubled projects present a slightly different picture. They appear to suffer more from higher operating expenses than income shortfalls; losses from residential vacancy are higher but effective gross income is virtually identical with

those of healthy buildings because billable rents are higher and fill in the difference. Moderately troubled projects have a per unit operating expense of \$361, which is about \$40 higher than that of healthy projects—the difference appears to come down to higher maintenance (20% higher) and utility (18% higher) costs and a higher property tax burden (25% higher).

Vacancy rates appear to be the most important determinant of project stability; under regression analysis, vacancy rates account for about 16% of the total variation in cash flows between projects in the data set and are the most important determinant we tested. Property taxes and debt service account for another 8 percent of total change in cash flow per unit. We also found that cash flows fall as the age of the project increases, but, interestingly, neighborhood conditions did not prove to be a significant predictor of whether a project would have positive or negative cash flow.

That projects with poor cash flows have higher operating costs and lower incomes is hardly surprising. The suspicion that problems with occupancy, deficits and deferred repairs feed each other over time is not news to Chicago's affordable housing community, and neither are warnings that bad projections at underwriting impact long-term project performance.

# Looking ahead

This first formal analysis of Chicago's Low Income Housing Tax Credit portfolio is timely as 15-year affordability agreements begin expiring in 2002. As the study shows, many of these projects may require substantial resources to be stabilized.

The LIHTC program is complex, difficult to use, but sharing information can help all parties make projects work better. Some of the conclusions from this first round of information sharing include:

- There is no blanket operating cost. Individual neighborhood characteristics and project types must be taken into account during underwriting.
- Nonprofits build LIHTC projects where community needs are the greatest. Limited LIHTC allocations should be prioritized towards nonprofit developers to maximize public resources and ensure long-term preservation of the stock.
- Debt service should not be allowed to jeopardize projects. Private debt should be minimized—

preferably kept under 20% of total debt—so that debt service plays a smaller part in project budgets over all. This should be a consideration both in underwriting new projects and in refinancing old ones. Additionally, statewide leadership should call for the passage of the National Affordable Housing Trust Fund to replace private debt and offer a source for gap financing.

- Operating and replacement reserves are worth extra investment. Public debt should amortize only after reserves are fully funded, and money to build up reserve accounts should be written into stabilization plans of existing projects.
- Property taxes are one of the largest single line items in project operating costs, and they grow for troubled properties. High tax burdens threaten the stability of a multi-million public investment and the health of our communities. Considerations must be made about the extent to which housing funded with public monies should be taxed.

Our goal in using the Low Income Housing Tax Credit is both to ensure sustainable housing, and create housing that expands housing choice and meets the needs of low and very low income Chicago residents. There is much work to do in the years ahead to preserve this important portfolio of properties—it will require strong leadership from the political, corporate, and philanthropic sectors.





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