Public Facility Corporations and the Section 303.042(f) Tax Break for Apartment Developments

A boon for affordable housing or windfall for apartment developers?

October 6, 2020 Webinar

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Background
Key Findings
Recommendations
Q&A

Full report is available at https://law.utexas.edu/clinics/2020/09/14/pfc-apartment-tax-breaks
LOCAL GOVERNMENT CODE

TITLE 9. PUBLIC BUILDINGS AND GROUNDS

SUBTITLE C. PUBLIC BUILDING PROVISIONS APPLYING TO MORE THAN ONE TYPE OF LOCAL GOVERNMENT

CHAPTER 303. PUBLIC FACILITY CORPORATIONS

SUBCHAPTER A. GENERAL PROVISIONS

Sec. 303.001. SHORT TITLE. This chapter may be cited as the Public Facility Corporation Act.

Added by Acts 1999, 76th Leg., ch. 227, Sec. 11, eff. Sept. 1, 1999.

Sec. 303.002. PURPOSE; CONSTRUCTION. (a) The purpose of this chapter is to authorize the creation and use of public facility corporations with the broadest possible powers to finance or to provide for the acquisition, construction, rehabilitation, renovation, repair, equipping, furnishing, and placement in service of public facilities in an orderly, planned manner and at the lowest possible borrowing costs.

(b) The legislature intends that a corporation created under this chapter be a public corporation, constituted authority, and instrumentality authorized to issue bonds on behalf of its sponsor for the purposes of Section 103, Internal Revenue Code of 1986 (26 U.S.C. Section 103). This chapter and the rules and rulings issued under this chapter shall be construed according to this intent.

Added by Acts 1999, 76th Leg., ch. 227, Sec. 11, eff. Sept. 1, 1999.
FIG. 3
Typical Entity Structure for a Rental Housing Development with a Public-Private Partnership and Low Income Housing Tax Credits
(from Hunter Plaza Apartments, Fort Worth Housing Authority)

FW Hunter Plaza, LP
Texas Limited Partnership
Owner of Improvements and recipient of a 4% LIHTC (EIN: 46-0610392)

FW Hunter Plaza, LLC
General Partner (EIN: 30-0743861)

Fort Worth Affordability, Inc.
Sole Member of General Partner

Fort Worth Housing Authority
Owns the land and provides a ground lease to the partnership

Carleton-Hunter, LLC
Class A Limited Partner

PNC Bank National Assn.
Limited Partner & Tax Credit Investor

Columbia Housing SLP Corp.
Special Limited Partner

Hunter Plaza Investor, LLC
Special Investor Limited Partner
SECTION 5. Section 303.042, Local Government Code, is amended by adding Subsection (f) to read as follows:

(f) Notwithstanding Subsections (a) and (b), during the period of time that a corporation owns a particular public facility, a leasehold or other possessory interest in the real property of the public facility granted by the corporation shall be treated in the same manner as a leasehold or other possessory interest in real property granted by an authority under Section 379B.011(b).
Senator Seliger: “Senator Estes, my understanding is that these are public facility corporations, but can they transfer these tax exemptions from leasehold agreements to non-governmental entities, and thereby pass on a tax exemption that they get to a private entity that has not applied for a tax exemption and would not otherwise be getting one?”

Senator Estes: “Senator, only if they continue in that non-profit status.”

Senator Seliger: “I’m sorry I didn’t hear you.”

Senator Estes: “Only if they continue in that non-profit status.”

Senator Seliger: “And so what you are saying is that the non-government entities would be non-profits, not for profits?”

Senator Estes: “That’s correct. Yep, that’s correct.”
FIG. 5
How a PFC Partnership Works for New Construction Projects with a Section 303.042(f) Exemption

1. **Developer** acquires control of land

2. Land ownership transferred to **Public Facility Corporation (PFC)**

3. **PFC** leases land and to-be-built apartment complex to a newly-formed **Development Partnership** for 75-99 years.

4. **Development Partnership** builds and rents apartments on the land. The partnership is exempt from paying property taxes on the land and apartments.

**Development Partnership**
- **Developer**
- **Investors**
- **PFC** (special limited partner, .01% interest)
Average property tax savings: $1 million/year
$7,400/year per income-restricted unit

Averages sales tax exemption savings: $1.3 million
FIG. 6
PFC Approval of Apartment Projects Under Section 303.042(f): 2016-2019

- New PFC Projects Approved
- Anticipated Growth in PFC Deals
FIG. 9
Public Entities Utilizing the PFC Tax-Exempt Leasehold Interest Structure under Section 303.042(f): 2016-July 2020

Exempt properties including those under development

<table>
<thead>
<tr>
<th>Entity</th>
<th>Exempt Properties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Houston Housing Authority</td>
<td>11</td>
</tr>
<tr>
<td>City of San Antonio Housing Trust</td>
<td>9</td>
</tr>
<tr>
<td>Fort Worth Housing Authority</td>
<td>4</td>
</tr>
<tr>
<td>San Antonio Housing Authority</td>
<td>2</td>
</tr>
<tr>
<td>City of San Antonio Hemisfair Park PFC</td>
<td>1</td>
</tr>
<tr>
<td>Austin Housing Authority</td>
<td>1</td>
</tr>
<tr>
<td>City of Cibolo</td>
<td>1</td>
</tr>
<tr>
<td>Denton Housing Authority</td>
<td>1</td>
</tr>
</tbody>
</table>

Additional Entities with Section 303.042(f) Exempt Projects in Negotiation
Huntsville Housing Authority  | San Marcos Housing Authority | City of Boerne
FIG. 7
PFC Deals: Acquisition vs New Construction Projects, as of July 2020

Acquisition 27%
New Construction 73%

FIG. 8
Private Developer Beneficiaries of the Section 303.042(f) Property Tax Exemption

NRP Group 30%
Ojala Holdings 17%
Other 53%
Finding #1: The 303.042(f) exemption lacks important safeguards
<table>
<thead>
<tr>
<th></th>
<th>Qualified Nonprofit Organizations: Section 11.1825, Texas Tax Code</th>
<th>Private-controlled leasehold interests under Section 303.042(f)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Amount of property tax exemption</strong></td>
<td>50%</td>
<td>100%</td>
</tr>
<tr>
<td><strong>Rent restrictions</strong></td>
<td>30% of income</td>
<td>None</td>
</tr>
<tr>
<td><strong>Income restrictions</strong></td>
<td>50% units at or below 60% AMI, adjusted for family size</td>
<td>50% units at or below 80% AMI, not adjusted for family size (applies only for public housing)</td>
</tr>
<tr>
<td><strong>Accountability and monitoring</strong></td>
<td>Annual audit submitted to TDHCA and chief appraiser; annual exemption required</td>
<td>None</td>
</tr>
</tbody>
</table>
FIG. 17

Maximum Rents Allowed at Apartment Complexes for 2-Bedroom Units Restricted to Renters Making up to 80% AMI (2020)

(= based on 4-person household making up to $63,040 in the Houston metro area)

- **Low-Income Housing Tax Credit, HUD, and TDHCA supported properties**
  - Utilize rent restrictions: 30% of the applicable income limit
  - Include a utility allowance

- **PFC properties with a 35% rent restriction but no utility allowance**

- **PFC properties without rent restrictions and without utility allowances**
  - Based on properties' internal 2.5 income-rent screening restrictions.

<table>
<thead>
<tr>
<th>Monthly Rent</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1,289</td>
</tr>
<tr>
<td>$1,656</td>
</tr>
<tr>
<td>$2,101</td>
</tr>
</tbody>
</table>
FIG. 21

Comparison of 80% AMI Rent Caps: Affordable Housing Industry Standards vs PFC Projects in San Antonio Metro Area

- Standard rent caps in affordable housing programs
- PFC rent caps with no adjustment for family size and 35% monthly income to rent restrictions
<table>
<thead>
<tr>
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<tr>
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<td>None</td>
</tr>
</tbody>
</table>
**FIG. 18**

Comparison of Income Restrictions Based on Adjustment for Family Size in the Houston Metro Area

<table>
<thead>
<tr>
<th>Household size</th>
<th>80% AMI</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-person household</td>
<td>$44,150</td>
</tr>
<tr>
<td>2-person household</td>
<td>$50,450</td>
</tr>
<tr>
<td>3-person household</td>
<td>$56,750</td>
</tr>
<tr>
<td>4-person household</td>
<td>$63,050</td>
</tr>
</tbody>
</table>
### FIG. 18
Comparison of Income Restrictions Based on Adjustment for Family Size in the Houston Metro Area

Income restriction at a PFC-sponsored apartment complex with 80% AMI restrictions not adjusted for family size: **$63,040**

**VS**

Income restrictions adjusted for family size

<table>
<thead>
<tr>
<th>Household size</th>
<th>80% AMI</th>
<th>100% AMI</th>
<th>115% AMI</th>
<th>120% AMI</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-person household</td>
<td>$44,150</td>
<td>$55,188;</td>
<td><strong>$63,465</strong></td>
<td>$66,200</td>
</tr>
<tr>
<td>2-person household</td>
<td>$50,450</td>
<td><strong>$63,063</strong></td>
<td>$72,522</td>
<td>75,600</td>
</tr>
<tr>
<td>3-person household</td>
<td>$56,750</td>
<td>$70,938</td>
<td>$81,578</td>
<td>$85,100</td>
</tr>
<tr>
<td>4-person household</td>
<td><strong>$63,050</strong></td>
<td>$78,813</td>
<td>$90,634</td>
<td>$94,550</td>
</tr>
</tbody>
</table>

HUD, FY2020 MFI, Houston-Woodlands-Sugarland, TX, HUD Metro Area
FIG. 19
80% AMI Adjusted for Family Size in San Antonio

Income restriction used by PFCs for all units when family size not adjusted.
FIG. 22
Income Targeting Levels for 8,906 Apartment Units at Properties with the Section 303.042(f) Exemption When Adjusted for Family Size*

- no income restrictions
- 100-115%AMI
- 80%AMI
- 0-65%AMI

*Assuming that the four PFC properties with unknown AMI policies actually do adjust the AMI for family size
San Antonio: 12 PFC Projects with Section 303.042(f) Exemption Approved as of June 2020

- Total units: 3,406
- Market units: 1,679
- Income-restricted units: 1,727

Income restrictions when AMI adjusted for family size:
- 1,423 units: 100-115% AMI
- 235 units: 80% AMI
- 69 units: 50-65% AMI
FIG. 24
Houston: 11 PFC Projects with Section 303.042(f) Exemption
Approved as of June 2020

- 3,152 total units
- 1,501 market units
- 1,651 income-restricted units

Income restrictions when AMI adjusted for family size:
- 815 units: 100-115% AMI
- 621 units: 80% AMI
- 215 units: 30-65% AMI
Finding #2: Renters targeted by the 303.042(f) exemption don’t need the exemption’s deep housing subsidy (avg. $7,400/yr)
FIG. 26

Percent of Renter Households with Severe Cost Burden
(Paying More than 50% of Income on Rent)

<table>
<thead>
<tr>
<th>County</th>
<th>At or less than 30% AMI</th>
<th>31% AMI to 60% AMI</th>
<th>61% AMI to 80% AMI</th>
<th>81% TO 100% AMI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bexar County</td>
<td>68.3%</td>
<td>33.4%</td>
<td>2.3%</td>
<td>0.3%</td>
</tr>
<tr>
<td>Harris County</td>
<td>79.8%</td>
<td>27.0%</td>
<td>2.3%</td>
<td>0.8%</td>
</tr>
<tr>
<td>Tarrant County</td>
<td>78.7%</td>
<td>21.1%</td>
<td>3.0%</td>
<td>0.6%</td>
</tr>
<tr>
<td>Travis County</td>
<td>86.6%</td>
<td>24.4%</td>
<td>4.6%</td>
<td>0.3%</td>
</tr>
</tbody>
</table>

Source: National Low-Income Housing Coalition tabulations of 2018 ACS PUMS
FIG. 2
Renter Households and Affordable & Available Rental Homes, Texas, 2018
(In 1,000s)

- Incremental Increase in Households
- Incremental Increase in Affordable & Available Rental Homes

Source: NLIHC Tabulation of 2018 ACS PUMS data
FIG. 27
Comparison of 80% AMI Rents and Market Rents at New Non-Subsidized Apartments

- **80% AMI affordable rent** for an efficiency and one-bedroom, AMI adjusted for family size
  - Efficiency: $1,008
  - 1 bedroom: $1,152

- **Average market rent** for new efficiencies and one-bedroom units (built within prior 10 years)
  - Efficiency: $1,368
  - 1 bedroom: $1,563

*San Antonio Metro Area*

*Austin Metro Area*
FIG. 29

San Antonio Metro Area
Gaps Between Market and Affordable Rents
Based on Number of Bedrooms

- Affordable rent for 80% AMI household
- Avg. market rent at new apartments
- Difference

<table>
<thead>
<tr>
<th>Housing Type</th>
<th>Affordable Rent</th>
<th>Avg. Market Rent</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Efficiency Unit</td>
<td>$1,008</td>
<td>$980</td>
<td></td>
</tr>
<tr>
<td>One-bedroom Unit</td>
<td>$1,152</td>
<td>$1,062</td>
<td>-$106 = GAP</td>
</tr>
<tr>
<td>Two-bedroom Unit</td>
<td>$1,296</td>
<td>$1,402</td>
<td>-$243 = GAP</td>
</tr>
<tr>
<td>Three-bedroom Unit</td>
<td>$1,498</td>
<td>$1,741</td>
<td></td>
</tr>
</tbody>
</table>
### Comparison of 80% AMI Affordable Rents and Median Rents at PFC Comp Properties for 1-Bedroom Units

- **Culebra**  
  (SA Housing Authority)  
  - 80% AMI “affordable” rent for 2-person household with 30% rent restriction, no utility allowance  
  - Median 1-bedroom unit rent at comp properties within a 3-mile radius built within last 10 years  
  - Gap between affordable rent and comp rents  
  
- **SOCO II**  
  (Austin Housing Authority)  
  
- **Holston**  
  (FW Housing Authority)  
  
- **Standard River District**  
  (FW Housing Authority)  
  
- **Standard Heights**  
  (Houston Housing Authority)  
  
<table>
<thead>
<tr>
<th>Property</th>
<th>80% AMI Affordable</th>
<th>Median Comp Rents</th>
<th>Gap</th>
</tr>
</thead>
<tbody>
<tr>
<td>Culebra</td>
<td>$1,152</td>
<td>$958</td>
<td>$194</td>
</tr>
<tr>
<td>SOCO II</td>
<td>$1,563</td>
<td>$1,194</td>
<td>$369</td>
</tr>
<tr>
<td>Holston</td>
<td>$1,305</td>
<td>$1,220</td>
<td>$85</td>
</tr>
<tr>
<td>Standard River</td>
<td>$1,306</td>
<td>$1,305</td>
<td>0</td>
</tr>
<tr>
<td>Standard Heights</td>
<td>$1,261</td>
<td>$1,642</td>
<td>$381</td>
</tr>
</tbody>
</table>
Finding #3: The exemption needs more robust compliance monitoring
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</tr>
<tr>
<td>Accountability and monitoring</td>
<td>Annual audit submitted to TDHCA and chief appraiser; annual exemption required</td>
<td>None</td>
</tr>
</tbody>
</table>
Finding #4: Properties with a 303.042(f) exemption are allowed to discriminate against voucher holders.
The Location of Housing Choice Vouchers, PFC Properties, and Percent of White, Non-Hispanic Residents by Census Tract in Houston, TX

Legend

<table>
<thead>
<tr>
<th>PFC Site</th>
<th>White, Non-Hispanic</th>
</tr>
</thead>
<tbody>
<tr>
<td>Development Stage</td>
<td>Greater than 50%</td>
</tr>
<tr>
<td>Completed</td>
<td></td>
</tr>
<tr>
<td>Development</td>
<td>30% - 50%</td>
</tr>
<tr>
<td>Negotiation</td>
<td>10% - 30%</td>
</tr>
<tr>
<td>Acquisition</td>
<td>Less than 10%</td>
</tr>
</tbody>
</table>

Source: Housing Housing Authority (Jan. 2020). 2018 ACS (5-year estimates), Table B03002.
Finding #5: The financial returns to PFCs in Section 303.042(f) deals are outweighed by significant property tax losses.
### TABLE 3
The Baldwin at St. Paul Square (opened for leasing in May 2018)

<table>
<thead>
<tr>
<th>Revenue</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Application fee (one-time, up-front fee)</td>
<td>$3,000</td>
</tr>
<tr>
<td>Origination fee (one-time, up-front fee)</td>
<td>$250,000</td>
</tr>
<tr>
<td>Cumulative asset management fees (25,000 annual fee once project is leased)</td>
<td>$16,666</td>
</tr>
<tr>
<td>Cumulative share of rental revenue (annual fee)</td>
<td>$11,656</td>
</tr>
<tr>
<td><strong>Total revenue to the PFC, as of June 2020</strong></td>
<td><strong>$281,322</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Tax Savings</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Property tax exemption</td>
<td>Total: $2.1 million</td>
</tr>
<tr>
<td>2020 (pro rata): $532,128</td>
<td>2019: $1,042,726</td>
</tr>
<tr>
<td>2018: $371,624</td>
<td>2017: $133,165</td>
</tr>
<tr>
<td>Estimated sales tax exemption (one-time)</td>
<td>$1.1 million</td>
</tr>
<tr>
<td><strong>Total tax savings, as of June 2020</strong></td>
<td><strong>$3.8 million</strong></td>
</tr>
</tbody>
</table>
FIG. 31
The Baldwin: Revenue to the City of San Antonio vs Property Tax Exemptions 2019-2029

- **271** Total units
- **136** income-restricted units at 100-115% AMI when adjust for family size

- **$12.8M** Total property tax exemption
- **$1.5M** Total revenue to the PFC

**$94,376** Total property tax exemption per rent-restricted unit over 10 years
FIG. 30
Smart Living at Telephone Road:
Revenue to the Houston Housing Authority vs Property Tax Exemptions
2019-2029

- 120 market units
- 96 income- and rent-restricted units at 80% AMI
- 24 at 50% AMI

240 Total units

$9.5M
Total property tax exemption

$460,000
Total revenue to the PFC

$78,927 Total property tax exemption per rent-restricted unit over 10 years
Recommendations: Transparency and Accountability

• **Require annual reports.** To local taxing entities and Texas Comptroller.

• **Require compliance reviews including an annual audit.**

• **Require an RFP process.** Create competitive process; independent screening by outside finance expert and housing investment committee with community representation.
Recommendations: Affordability Measures

• Require alignment of rent and income restriction policies with affordable housing industry: 30% rent restrictions with utility allowances, adjustments for family size, income of entire household counted

• Require deeper income targeting.

• Ban source of income discrimination. Ideally: require dedication of 10% of units for voucher holders

• Engage in affirmative marketing
Recommendations: Affordability Measures

• **Adopt enhanced protections for renters.**

• **Serve families with children.** Distribute affordable units across bed/bath sizes

• **Impose limits on acquisition projects:** built at least 10 years ago; prior owner—5 years; minimum $5k/unit rehab investment