Executive Summary

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

A boon for affordable housing or windfall for apartment developers?

This research report examines a recently adopted property tax exemption for private apartment developers available under Section 303.042(f) of the Texas Local Government Code. While the amendment received little notice when it was adopted, the use of this exemption is rapidly growing and delivering property tax breaks to apartment developers of close to $1 million a year per property on average—or an average of $7,400 a year per income-restricted unit. New construction projects are also eligible for a 100% sales tax exemption on construction materials, resulting in an additional, one-time exemption of $1.3 million on average per new apartment development. The costs of the tax breaks are large, and, on scrutiny, the public benefits are comparatively few.

FIG. 1

Tax-Exempt Apartments Sponsored by PFCs under Section 303.042(f)

(acquired, completed, or under development 2016-2020)

To receive the exemption, a private apartment developer transfers land to a public facility corporation (PFC) set up by a local government entity—such as a public housing authority, county, or city—which then leases the land and any buildings on the land (including those built in the future) back to a limited partnership controlled by the developer. The local government entity gets paid to participate in the venture.

Other local government entities—such as school districts—have no say over these property tax breaks to for-profit apartment developers, even though the tax breaks directly impact these other entities' property tax base and bottom line. In contrast, the state's other property tax break programs supporting economic development by for-profit entities provide taxing units with the option to participate in the tax break. The ability of public housing authorities to approve exempt projects under Section 303.042(f) is particularly troubling since the housing authorities are not impacted by any of the lost property tax revenue and their boards consist entirely of unelected officials who lack any political accountability to taxpayers.

Section 303.042(f) also lacks the protections provided in the state's property tax exemption statutes for nonprofit-owned affordable housing developments—such as reporting requirements, rent restrictions, and other protections meant to ensure transparency, accountability, and delivery of strong public benefits. The Section 303.042(f) exemption comes with no restrictions other than a requirement that at least 50% of the units in projects sponsored by public housing authorities' public facility corporations be reserved for occupancy by households earning less than 80% of the area median family income.

The report's specific findings include:

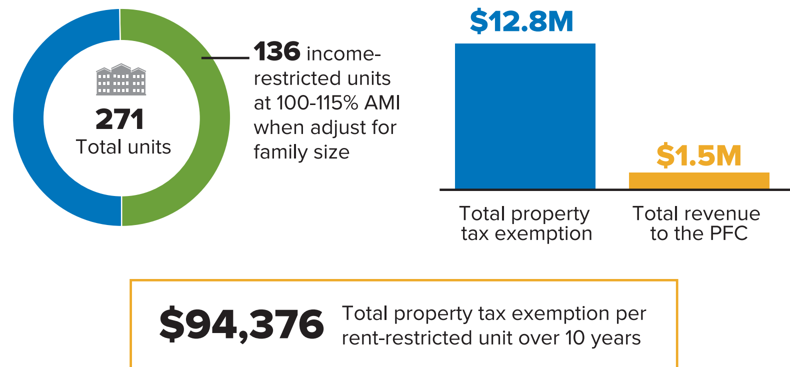
- **Texas has seen a rapid growth in Section 303.042(f) exempt projects.** Since 2016, at least **30 apartment** complexes in Texas have been acquired, developed, or are in active development under this tax-exempt structure, with **17 of these deals approved in 2019**. Housing authorities, cities, and counties report an

on-going onslaught of proposals by apartments developers to convert existing apartment complexes as well as develop new apartment complexes under this structure in order to obtain the Section 303.042(f) exemption. To date, these projects have been concentrated in the state's largest cities (especially San Antonio and Houston) but are spreading into suburban areas and smaller cities. See Appendix 2 of the report for an inventory of exempt projects.

- **The Section 303.042(f) exemption's marginal financial returns to PFCs are outstripped by the property tax losses.** In exchange for entering into a leasehold interest structure with a private apartment developer, public facility corporations receive some form of revenue from the project. However, in the projects approved to date, the amount of revenue flowing to PFCs from these deals pales in comparison to the value of the property tax exemption. See, for example, Figure 31. If recent trends continue, the Section 303.042(f) exemption could remove more than **$12 billion** in property values off the tax rolls by 2026, resulting in a loss of approximately **$326 million a year** in revenue to local taxing districts and the state public education budget. See Figure 12 in the report. Despite the mismatch in financial returns and tax revenue losses, public housing authorities—which are struggling financially to maintain their properties—have a perverse incentive to approve these exempt projects since they are not impacted by the loss of property tax revenue.

FIG. 31

The Baldwin: Revenue to the City of San Antonio vs Property Tax Exemptions 2019-2029



$94,376 Total property tax exemption per rent-restricted unit over 10 years

- **The Section 303.042(f) exemption fails to serve the state's affordable housing needs**. A core public policy rationale for the Section 303.042(f) exemption is that it generates affordable housing. But because Section 303.042(f)'s income restrictions do not require adjustments in household size, the income restrictions utilized at the exempt properties **end up largely targeting middle-income renters making 100-115% of the area median income (AMI)**—a group of renters adequately served by the market. Figure 22 shows the actual income targeting of PFC projects approved to date once household size is taken into account (which is the standard in affordable housing programs). **Only 2% of the units in Section 303.042(f) exempt properties are restricted to serving renters making less than 60% AMI**—renters whose housing needs are largely not served by the market. Close to half of renters making up to 60% AMI in the state's five largest metro areas pay more than half their income on rent, meaning they are severely cost burdened under federal guidelines.

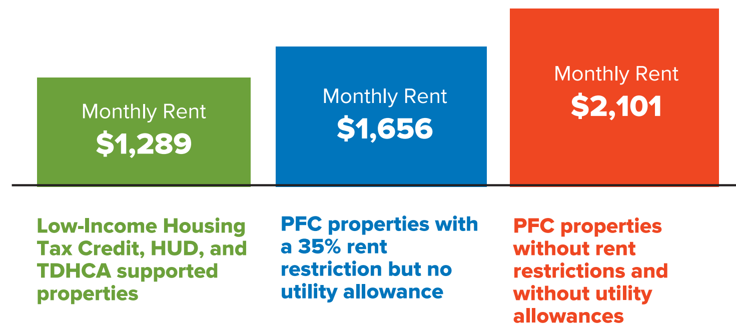
- **Texas' middle-income renters do not need deeply subsidized rental housing.** For-profit apartment developers tout the Section 303.032(f) exemption as a tool to promote middle-income rental housing (controversially termed "workforce housing"). However, the subsidy provided through the exemption is very large—**an average of $7,400 a unit a year, or $148,000 per unit over 20 years**—which is on par with the rental subsidy for tenants with Housing Choice vouchers, whose average income is below the poverty line. But, unlike renters living in poverty, the middle-income renters served by properties with a Section 303.042(f) exemption do not need deep subsidies for their housing. Texas actually has a surplus of units that are available and affordable to households making up to 80% and 100% of the Area Median Income. Even in the state's most populated counties, there is a surplus of units for middle-income renters, and only a very small fraction of these renters are extremely cost burdened.

- **Many Section 303.042(f) exempt properties lack rent restrictions.** In contrast to most other affordable housing subsidy programs, Section 303.042(f) does not require any rent restrictions on the income-restricted units. As a result, **close to 48% of properties with a Section 303.042(f) exemption have no rent restrictions**, and there is thus no guarantee that the rents will be affordable to low-income renters. Of the 12 exempt properties with rent restrictions, none require a utility allowance to be deducted from the maximum rent and five impose rent restrictions at 35% of the applicable AMI restriction level, rather than the affordable housing program standard of 30%, making it more difficult for renters to cover other essential living expenses.

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)



- **PFC projects discriminate against tenants with vouchers.** Very few properties with a Section 303.042(f) exemption accept tenants with rental vouchers from their local housing authority. For example, none of the PFC-sponsored properties in San Antonio with a Section 303.042(f) exemption accept tenants with vouchers. In contrast, other major affordable housing subsidy programs—such as the Low Income Housing Tax Credit program—prohibit apartment complexes from discriminating against voucher holders. The failure to accept voucher holders is troubling, especially given that housing authorities are sponsoring most of these projects. Housing authorities' largest group of clients are voucher holders, who are predominantly African-American and Hispanic. Many of these renters face enormous challenges securing a unit with their vouchers, especially in high opportunity neighborhoods with access to strong schools, transit, and jobs.

Recommendations

The findings in our report raise important questions about the 100% property tax exemption under Section 303.042(f) and whether it should continue. And even if local governmental entities should have the authority to exempt their own tax base to subsidize apartment developments, should they have the authority to exempt the tax base of other taxing authorities? These are important questions that deserve further public scrutiny. Assuming that the Section 303.042(f) exemption does continue, we make the following recommendations on ways to strengthen the exemption.

TRANSPARENCY AND ACCOUNTABILITY

1. **Require annual reports.** At a minimum, state law should require local governments to submit annual reports to the Texas Comptroller and local taxing entities regarding all apartment complexes receiving an exemption under Section 303.042(f).

2. **Require compliance reviews including an annual audit.** PFCs should engage in regular compliance monitoring of the conventionally-financed properties they are sponsoring under Section 303.042(f). And private developers receiving a property tax exemption under Section 303.042(f) should be required to obtain an annual audit regarding the property's compliance with all the affordability restrictions imposed on the property

3. **Require an RFP process.** Developers partnering with local governments on PFC projects under Section 303.042 should have to go through a competitive request for proposal process. Proposals should be

submitted via an application process and scored according to specific criteria based on goals adopted by the local government's governing body, to ensure that partnerships via Section 303.042 are awarded to projects best qualified to meet the community's needs. The application should be reviewed by an independent real estate finance expert to evaluate the project's finances and weigh the cost-benefits of awarding a 100% exemption on the property.

AFFORDABILITY MEASURES

4. **Require alignment of rent and income restriction policies with affordable housing industry standards.** All properties receiving an exemption under Section 303.042(f) should be required to follow affordable housing industry standards by adjusting their AMI targeting levels for family size and adopting rent restrictions based on 30% of the applicable AMI restricted levels as established by HUD. The rent restrictions should also incorporate a utility allowance. Finally, the income screening should consider the income of everyone living in the unit and not just the person listed on the lease.

5. **Require deeper income targeting.** In order for a property to qualify for Section 303.042(f) exemption, a good portion of the property's rents must be restricted at significantly lower rates than market rents for the area. Ideally at least 25-50% of the units at the property would be restricted at affordable rates for households making less than 60% of the Area Median Income with the affordable units spread across the bedroom sizes and a small percentage of the units restricted to renters with vouchers from the local housing authority to result in truly mixed-income housing.

6. **Ban source of income discrimination.** Property developers receiving a Section 303.042(f) exemption should be barred from discriminating against tenants with a housing voucher that covers part of their rent. This means that properties also need to be barred from applying minimum income policies to exclude voucher holders—the minimum income policy should only be applied to the tenant's portion of the rent. Public entities should also consider requiring the exempt properties in high opportunity neighborhoods to dedicate up to ten percent of the units for tenants with vouchers.

7. **Engage in affirmative marketing.** Housing authorities should actively market the 303.042(f) exempt properties to their voucher clients, including listing these properties on their websites. Cities and counties should also actively market all of their exempt properties. Property managers of PFC-sponsored properties should be required to market the affordable units on the property's website and include references about the availability of affordable units at the property in all public marketing materials. The property managers should also be required to notify the housing authority's Housing Choice Voucher program when vacancies arise in the income-restricted units.

8. **Adopt enhanced protections for renters.** In order for a property to qualify for the 100% property tax exemption under Section 303.042(f), the property should be required to include enhanced protections for tenants for the life of the property. These protections should include a right to cure any lease deficiencies, a right to organize, and a ban on lease non-renewals without cause. The City of Austin requires similar protections in all apartment developments it funds as well as private activity bond projects it approves.

9. **Serve families with children.** The affordable units in a property receiving an exemption under Section 303.042(f) should be distributed proportionately across bedroom/bathroom categories and not concentrated in the smaller units. PFCs should also require that the affordable units in the larger bedroom sizes be marketed to families with children.

10. **Impose limits on acquisition projects.** If a PFC is taking an existing apartment complex off the tax rolls, the property should have to meet criteria similar to the requirements in Section 11.825 of the Tax Code to justify the removal of the property off the tax rolls. Under Section 11.825, rehabilitation projects are eligible for the exemption only if (1) the original construction was completed at least 10 years prior to rehabilitation, (2) the prior owner owned the property for at least five years, and (3) the organization spent at least $5,000 per unit on rehabilitation costs, or an amount required by the lender, if greater. If a PFC partners on an acquisition project it should be required to pay for tenant relocation costs at a standard equivalent to the federal Uniform Relocation Act for any tenants displaced as a result of the acquisition.