A Viable Solution for Affordable and Workforce Housing in Baltimore

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Introduction

The Problem – New workforce and affordable housing in Baltimore City has been challenged for over 40 years. As home values declined and construction costs increased, the market value of homes was lower than the cost to renovate. The "Appraisal Gap" is the single largest issue effecting redevelopment in Baltimore neighborhoods with high vacancy rates. How is it possible to sell a home for $225,000 when it costs $285,000 to redevelop? The answer is without significant financial assistance, redevelopment is impossible.

A Solution - One solution uses a form of financing that is already permitted "by right" under Baltimore City's regulations and laws. [1] The proposed financing is defined as non-contiguous Tax Increment Financing ("TIF"). The proposed form of financing would **exclude** all existing homes that are currently paying taxes to the City of Baltimore. It eliminates the main objection to TIF's, which is the city is deprived of increased tax revenue from its existing base of taxpaying residents.

By using non-contiguous TIF bonds ("NCTB's"), the costs of reimaging a neighborhood falls to those homeowners who buy homes that were funded using NCTB's. While this may sound regressive it is not. The owner of a new home benefits from reimbursement to the developer of roughly $60,000 (the appraisal gap) in construction costs through the issuance of NCTB's. Asking the homeowner to pay the standard city tax rate seems a reasonable proposition. Any home in the TIF would not be eligible for ANY tax benefits or tax reduction programs currently offered by the City.

Neighborhood TIF's that have been used nationally, are fraught with logistical hurdles. This type of "area" TIF requires the "consent" of 51% of the **property owners**. The owners of all vacant homes and or lots, must be contacted, and their votes recorded. Logistically, it could be difficult if not impossible to create an area TIF for this reason. By using a non-contiguous TIF, the city needs no consent, and only needs to own one home in the proposed neighborhood redevelopment. What will make a

[1] Board of Finance of Baltimore City "Tax Increment Financing Policy and Project Submission Requirements dated January 23,2012."

non-contiguous TIF successful is the comprehensive assistance to be provided by the City or other agency. This will include help with planning, construction financing and serving as a conduit for local, state, and federal permanent financing programs.

Who is eligible – The most important aspect of NCTB financing, is that all purchasers or renters in homes built with NCTB's will be income restricted. Article II, Section 62 (b)(4) of the City Charter states: "***"Affordable housing" means housing that is affordable to households with incomes up to 115% of the regional median income***." The Baltimore – Columbia – Towson SMSA is used for this purpose. The income of a single person is $70,409, and household income is $105,100 in 2021. [2]

How it is funded - The funding source for rehabilitation of Baltimore's neighborhoods will come primarily from taxes on newly renovated vacant homes. Each renovated home should generate $5,058 of new taxes per year. [3] Because new City tax revenue will be generated from the renovation and sale of vacant homes, the City must be involved in the structure, execution and solution of this affordable housing problem.

Who administers the Plan - The plan involves creating a new entity for affordable housing. By offering the lowest cost of funds for both construction AND permanent financing, the City assures that redevelopment is economically feasible. All developers (non-profit and for profit) meeting the requirements for redevelopment will be able to access the lowest cost of construction and permanent financing. Whether this agency is created in city government, or as a stand-alone entity (such as the Stadium Authority) will be a policy decision made in the near future.

The plan also seeks to strengthen those City agencies that need more funding to oversee the planning and reimaging of the city's neighborhoods.

[2] St. Louis Fed FRED Economic data St. Louis FED Baltimore - Towson - Columbia per capita income , St. Louis FED Baltimore - Towson - Columbia household income

[3] The city tax rate for 2021 is 2.248 per $100 of home value. A home that sells for $225,000 will generate $5,058 in tax revenue.

History of Redlining and Disinvestment in Baltimore

The history of redlining in Baltimore is well known. In 1937, the Home Owner Loan Corporation (HOLC) drew maps of cities throughout the U.S. The areas that were coded red were considered areas that were riskier investments. In Baltimore, the east, west and southwest portions of Baltimore were outlined in red, which played a role in creating Baltimore's Black Butterfly. Homewood, Guilford and other suburban destinations were coded green. Since the mid-40's, Baltimore has made few substantial investments in areas of the City that were redlined relative to the scale of the problem.

The culprit to disinvestment has always been seen as the HOLC. However, the truth is far worse. The agency that effected the way houses were financed was the Federal Housing Agency ("FHA"). The FHA's discriminatory practices were wide spread in the 40's, 50's and 60's. The FHA denied federal mortgage insurance to those areas that were red-lined under the map that was created in 1937. *"But new research shows that the maps very probably did not guide private lenders or the Federal Housing Administration (FHA), which clearly engaged in racist lending practices all on their own. The HOLC, however, loaned widely in Black neighborhoods and other red-shaded areas."* [4]

Impact on Urban Areas - In Baltimore, the effects of redlining are easy to spot. The neighborhoods of Sandtown-Winchester, Southwest Baltimore, Upton/Druid Heights, Clifton-Berea have vacant property rates that exceed 25% of the housing in the neighborhood.[5] The lack of investment over decades has impacted these areas considerably. When properties are vacant, crime increases, drug dealing becomes more prevalent, and trash becomes a major issue. School occupancies drop as the neighborhoods go further into decline. It is a vicious cycle that continues to this day.

Vacancy rates – As mentioned earlier, vacancy rates dramatically impact housing values. For example, in Sandtown /Winchester the average sales price of a home is $55,000 where vacancy rates approach 25%. The average sales price in South Baltimore is $295,000 where vacancy rates are low.[6] In neighborhoods where vacancy rates have

[4] An article from the publication Governing titled "Redlining Didn't Happen Quite the Way We Thought It Did" dated September 21, 2021. https://www.governing.com/context/redlining-didnt-happen-quite-the-way-we-thought-it-did

[5] Information from 2019 BNIA median price of homes sold. https://bniajfi.org/indicator/Housing%20and%20Community%20Development/

[6] Information from 2019 BNIA median price of homes sold. https://bniajfi.org/indicator/Housing%20and%20Community%20Development/

decreased significantly, home values have increased dramatically. For example, the home at 412 E Lanvale Street sold for $9,000 on August 7, 2013. The seller was the Mayor and the City Council. [7] The same home sold for $292,000 in October 2021.[8] **<u>An increase of 3,200%.</u>**

<u>The Appraisal Gap</u> - Prices in some neighborhoods have decreased so dramatically that the costs of renovation substantially exceed current market prices. This gap can be as much as 25%-30% of construction costs. A renovated home in one of these neighborhoods, could cost roughly $200,000 to renovate. With high vacancy rates, starting prices for new homes could be in the $150,000 range.

Example:

New construction costs	$285,000
Home sells for	225,000
Appraisal Gap	$ 60,000

The "Appraisal Gap" is the single largest issue effecting redevelopment in neighborhoods with high vacancy rates. How is it possible to sell a home for $225,000 when it costs $285,000 to redevelop? The answer is without financial assistance, redevelopment is impossible. For this report, a worst-case analysis is used. Many homes are vacant, not abandoned. The cost to renovate most vacant homes should be lower, and the sales prices higher.

<u>Neighborhoods with high vacancy rates</u> - As the appraisal gap is widest in neighborhoods with high vacancies, redevelopment cannot take place without financial assistance. This assistance comes in the form of tax credits (from local, state, and federal sources) and/or other large private equity investments. The problem with tax credits is they are in extremely short supply and are not a dependable <u>permanent</u> source of financing. Redevelopment in the most challenging parts of city is difficult, if not impossible to achieve without significant financial subsidies. To succeed at changing the trajectory of our City's most challenged neighborhoods will require consistent, affordable redevelopment for 10-15 years. *Given the city's inability to fund this type of work from a general obligation bond, an alternative form of financing is imperative to turn the most challenging neighborhoods back to vibrancy.*

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[7] Deed FMC/15503/0108 record at Maryland State Department of Taxation.

[8] In Greenmount West, vacant homes were worth less than $10,000. Today, homes in Station North sell for well over $250,000. https://www.zillow.com/homedetails/412-E-Lanvale-St-Baltimore-MD-21202/122476575_zpid/

Cost of Maintaining vacant and abandoned property – The answer to this will shock some and not surprise others. It is an issue that has been looking for an answer for decades. In September 2022, 21st Century City Initiatives of John Hopkins issued a report "The Cost of Baltimore's Vacant Housing" that answered this question.[9] The city of Baltimore currently spends over $100 million a year on vacant and abandoned properties.[10] The report goes on to say the true costs are higher when crime, blight, dis-investment and neighborhood decline are included.

The simple math is that the rehabilitation of vacant homes will pay for itself in increased taxes and lower expenses to the city. The benefits include lower crime, schools reopening, and broader dynamic tax bases that will create a city of vibrant neighborhoods. In summation, the city is losing roughly ***$200 million per year in direct expenses and negative financial impacts.***

Neighborhood Planning and Redevelopment – The essential element of successful neighborhood redevelopment requires thoughtful community-based planning. The planning process can take up to eighteen months to complete. The planning involves listening to all the constituencies in a neighborhood. Whether businesses, residents, church groups or other stakeholders, their voices and opinions matter. This gold standard of re-imagining neighborhoods takes time and work. Each neighborhood has its own character, and its unique needs. By engaging in a methodical neighborhood planning process, the resulting plan will meet the needs of the neighborhood, while still being overseen by the Department of Planning and DHCD. ***This is a vital process that should be completed before any major redevelopment occurs in a target neighborhood***.

A professionally administered neighborhood planning effort can cost as much as $200,000. The City should establish a planning fund of $1.5 million. This would allow for the planning in six to seven strategic neighborhoods that have high vacancy rates. Given the volume of planning to be done, the City might consider hiring outside community planning firms to undertake the work at the direction of the City.

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[9] "The Cost of Baltimore's Vacant Housing"- 21st Century City Initiatives September 2022 https://21cc.jhu.edu/wp-content/uploads/2022/09/the-costs-of-baltimores-vacant-housing-1.pdf

[10] "The Cost of Baltimore's Vacant Housing"- 21st Century City Initiatives September 2022 https://21cc.jhu.edu/wp-content/uploads/2022/09/the-costs-of-baltimores-vacant-housing-1.pdf

Tax Increment Financing (TIF) – This form of financing depends on new or incremental property tax revenue. Normally TIF's are criticized because they take away future tax revenue from cities that could be used for education, healthcare, etc. This type of TIF is called a contiguous TIF. As an example, take Harlem Park. If the base tax revenues from a Harlem Park TIF district are $500,000, all tax increases over $500,000 would go to pay debt service for the TIF. Over a 10–15 year period, as home values increase and taxes go up, the increase in taxes for the entire neighborhood goes to pay off the TIF, and, are unavailable to the City. The deprivation of additional tax revenue to the City is often cited as the main objection to TIFs. What if there was a different model that could solve the appraisal GAP? Could a TIF be created that does not deprive the City of incremental tax revenue? The answer is yes, and it allows the City to participate in increased home values and tax revenue as neighborhoods recover.

Use of Non-Contiguous TIF Bonds – Non-contiguous TIF's solve many of the objection's cities have towards TIFs. If a non-contiguous TIF were created for Harlem Park, any home currently paying city taxes would be excluded from the TIF. The only homes that would be eligible for inclusion in the TIF are those homes that are currently "vacant", "distressed" or "abandoned." The City is not deprived of any existing tax revenue as all occupied tax paying homes are EXCLUDED from the TIF. As the neighborhood improves and vacancies go down, home prices will go up. Assuming the TIF was available to 20% of the homes in a neighborhood, the other 80% of homes will see increases in their home value as the neighborhood stabilizes and grows. *The City will capture 100% of the additional tax revenue* generated by the increases in home values of the 80% of homes that are not in TIF.

A non-contiguous TIF currently has the legal authority required by the City (by right).[11] There have been material conversations with the bond counsel of McKinnon and Shelton, a firm that has previously served as bond counsel to Baltimore City. Attorney Elizabeth McKinnon has reviewed the various City laws and regulations, and has confirmed there are no impediments to the creation of a non-contiguous TIF for Baltimore City.

Non-Contiguous TIF Bonds and City Financial Impacts – Almost every form of City financing impacts the City's borrowing capacity, bond rating and creates a liability on the City's balance sheet. Often mentioned as a funding solution for affordable housing is a general obligation bond. While simplistic as a solution, general

[11] Baltimore City Charter Art II, § 62 page dated 12/08/22

obligation bonds have all of the negative impacts discussed above for the City and its financial condition.

A tax exempt, unrated non-contiguous TIF bond (NCTB) for affordable housing would have the following benefits:

1. **No financial liability to the city**
2. **No impact on the city's credit rating**
3. **No impact on the city's borrowing capacity**
4. **No special taxing districts need to be created**

A non-contiguous TIF will add tax revenue to the City and keep the current real estate tax base intact. While increasing tax revenue, there are no negative consequences to the City in the form of increased balance sheet liabilities, impacts on borrowing capacity or credit rating. [12]

TIF's and the Appraisal GAP – The reason a TIF solves the appraisal gap is that the cost of borrowing of a TIF is lower than the tax revenue generated by a new home that sells for $150,000.

Example:
A new home valued at $225,000 (that costs $285,000) generates $5,058/year in taxes.[13]
The Appraisal Gap is $50,000. The cost of financing for $50,000 is $2,250.[14]

Taxes	$3,372
Cost of funding	(2,250)
Excess revenue	$1,122

The example demonstrates that a non-contiguous TIF can pay for itself. The City will also benefit from substantial tax revenue increases in the 80% of properties that will not be in the non-contiguous TIF as the neighborhood improves.

Administration – To administer a broad reaching renovation of Baltimore will require expertise and staffing that no city agency currently has. ANY proposal using TIF funds will require that each finance application must show how the funds are used, and how it is repaid using new residential tax revenue. Every developer submitting an application will have to demonstrate the financial and construction capacity, and,

[12] Confirmed in discussions with TIF expert Keenan Rice – principal of Muni-Cap and advisor and TIF servicer to the City of Baltimore

[13] Baltimore City tax rate of $2.248/$100 of value. $225,000 x $2.248 = $5,048in taxes.

[14] $60,000 appraisal gap calculated in hypothetical TIF borrowing at a 4.5% constant or $4,363.

expertise to do the proposed work. In essence, the city is creating a construction lender that will distribute TIF construction funds. This will require the creation of a new entity such as the Affordable Housing Finance Agency of Baltimore (AHFAB). Its role would be overseeing the construction funding and permanent financing of hundreds of homes a year. Finance agencies play a key role in helping low income families achieve home ownership. In a report dated March 2021 by National Council of State Housing Agencies the median income of an SHFA borrower was $50,770, while all homebuyers were $93,200.[15]

Affordable Financing – For ANY affordable housing program to be successful will require the lowest cost of funds possible for both construction and permanent financing. AHFAB would be responsible for the distribution of NCTB funds as well as a conduit for affordable permanent financing available for the settlement of affordable homes to buyers.

All homes benefiting from the NCTB must be sold to residents making no more than 115% of the regional median income.[16] This assures that all development is affordable and accessible to most of the city's residents. The Baltimore – Columbia - Towson SMSA (as defined by the St. Louis Fed) indicates a single person has median income of $70,409 (maximum income of $80,970). For a family, the median income is $105,100 (maximum $120,865).

AHFAB would also partner with the myriad of local non-profits that are providing housing counseling, credit rehabilitation etc.

Abandoned and Vacant Homes – One consistent complaint has been the inability of the city to rapidly gain control of vacant and/or distressed homes. A major contributor has been city tax liens and the system of property disposition. Without going into detail, this has been one of the most vexing issues for Baltimore redevelopment. In order to get control of these homes the city must go through a tax lien and sale process. This often benefitted speculators who could pay off the lien and take possession of the property. The drawback is that the community cannot control the outcome of the property. Often communities and the CDCs they work with cannot bid high enough - particularly in this market - to obtain properties for their community development and affordable housing goals.

[15] State Housing Finance Agencies: The Center of the Affordable Housing System March 2021 by the National Council of State Housing Agencies https://www.ncsha.org/wp-content/uploads/2018/09/State-HFAs-at-the-Center-Current.pdf

[16] Baltimore City Charter Art II, § 62 (2) (b) (4) page 60 dated 05/26/17

Judicial In Rem – A dramatic new law was recently enacted. It will change the future of redevelopment of abandoned and vacant homes. This is a legal process by which the City can circumvent the tax lien sales process. Judicial In Rem Foreclosure allows the Baltimore City Department of Housing & Community Development (DHCD) to foreclose on the liens on a vacant lot or building where the value of the liens and fines exceeds the assessed value of the property, and thereby take title to the property. (liens are unpaid property taxes, environmental citations, water bills, etc.) This allows DHCD to acquire abandoned properties in a block by block manner and work with communities on the outcomes for these properties. This should improve the pace at which the City can address properties that have a blighting influence on our neighborhoods."[17] It is an ingenious way for the city to convert non-cash fines and unpaid taxes to acquiring a property for "free" that will be redeveloped in the future.

Conclusion

By using a non-contiguous TIF and the creation of a new finance agency, both DHCD and the Department of Planning can play central roles in the planning of each neighborhood's redevelopment. The reasoning behind a non-contiguous TIF is that each home's tax revenue pays for the redevelopment of that home. The new residential tax revenue from the TIF must be separated from other streams of residential tax revenue. This can only be accomplished by using a non-contiguous TIF. This design comes after spending numerous hours with many different individuals, non-profits, representatives of the city, and experts in the field of affordable housing and finance. Further, this group has a depth of understanding of Baltimore City, its challenges and potential. DHCD and the Department of Planning will be deeply involved in the planning and strategic vision for the city's neighborhoods.

With a source of dependable construction funds, the future of the "black butterfly" neighborhoods of Baltimore can be reimagined. The City can take a long-term sustainable vision for the recreation of Baltimore's distressed neighborhoods. After fifty years of disinvestment in Baltimore's most distressed neighborhoods, there is a viable solution.

To the knowledge of the author, there is no other form of financing that has the city legislative requirements needed, and, is a dependable, sustainable and scalable form of financing. The city is spending too much money maintaining vacant properties. NCTB's are a solution the city could implement now.

[17] DHCD Judicial In Rem - DHCD In Rem Fact Sheet

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