ITEM #_24_

Staff Report

OPTIONS FOR INCENTIVES TO CONVERT RENTAL HOUSING TO HOME OWNERSHIP

October 22, 2019

BACKGROUND:

City Council directed staff as part of the Planning Division work plan to research options for incentives directed towards the conversion of single-family dwellings from rental properties to home ownership. While most cities do not address this issue, there are examples of different programs from across the country. Staff reviewed examples from Iowa City, IA; Carbondale, IL; Madison, WI; St. Cloud, MN; and others (Memo Attachment). These examples range from a city directly purchasing homes, rehabilitating them, and reselling the houses; to a city providing rehabilitation grants to property owners. **Some programs are designed to advance affordable housing goals, while others prioritize improvements in housing stock regardless of income levels. Financial incentives vary greatly in both the amount and funding source.**

Staff has divided the topic into four issues to focus the discussion on defining goals for an incentive program. These include issues of rehabilitation vs. purchase, funding as grants vs. loans, funding sources, and affordability levels. The length of time the home is required to be owner-occupied varies considerably as well, with duration between 5 to 30 years.

ISSUE #1 - REHABILITATION, PURCHASE, OR COMBINATION:

Due to the higher value of rental properties, it may be financially infeasible to buy a rental home at market levels and then rehabilitate it into an owner-occupied home. Therefore, rental properties tend to be perpetually used as rental properties.

One of the issues intended to be addressed by incentivizing conversion of properties is the condition of the home and its desirability as an owner-occupied home as opposed to a rental home. Rental properties may have been modified to increase bedrooms or create different entrances. These modifications affect the flow and layout of a floor plan and do not work well for other household types. Rental properties also have a higher intensity of use, which may result in the property becoming more run-down in appearance when compared to an owner-occupied home.

If City Council pursued a program to rehabilitate former rental properties, the program could take one of three potential forms:

1. **Provide reimbursement for rehabilitation work, up to an established incentive limit**. This could be matching funds or a straight incentive with no match requirement. The City would not be involved in acquisition or completing the work for improving the home. This approach of supporting rehabilitation is likely viable

for small to moderate scaled projects to incent the conversion of homes. This model is similar to existing City programs, such as the façade grant program. *Examples include: Elgin, IL; Green Bay WI; Madison, WI; Hagerstown, MD.*

2. **Support the acquisition of former rental properties**. This could include providing down payment and closing cost assistance for buying the property. The City has experience with these types of programs for first time homebuyers. Once the property has been purchased, the homeowner would then be free to make improvements as they determine necessary with their own financing.

   This type of program would require review of applications and preparation of agreements to coincide with purchase of the property. The City would likely need to consistently operate the existing first time home buyer program and include marketing to attract interest in the program. *Examples Include: Carbondale, IL; Mt. Pleasant, MI; St. Cloud, MN; Madison, WI, Green Bay, WI; Hagerstown, MD.*

3. **Purchase former rentals directly, then sell them to new owners**. In this hybrid approach, a city would purchase a rental property and make renovations prior to reselling the property. The City of Ames has used this approach with CDBG funds in the past to create affordable housing opportunities for non-rental properties. Iowa City, for example, operates an acquisition and rehabilitation program called "UniverCity" for targeted neighborhoods. The City acquires a former rental property directly with a loan from a bank, invests in moderate rehabilitations (targeted at $50,000 of less), and then resells the home to a qualified buyer for the initial purchase price and carrying costs, but not the renovation costs.

   This type of program is more risky and time intensive for staff to identify and purchase properties, coordinate their improvements, and then market them for sale compared to the other options, but simplifies everything for the buyer of the home. The intent is to sell homes for under $235,000. There are household income limits of up to 140% of average median income (AMI).

ISSUE #2 - GRANTS VS. LOANS:

Whether used for acquisition or rehabilitation, the incentive can be offered as a grant or a loan. In either case, continued funding by the City is required to support a program long-term if no revenue is generated from prior investments.

> **Loans** - If the incentive takes the form of a loan, the interest rate would likely be below market rates to incentivize conversion. The City would also need to take 2nd position to the primary mortgage on the property. Typically, a City loan would be used to help fund the down payment or remove private mortgage insurance requirements to make the home more affordable. **This type of assistance is commonly provided as a forgivable loan based upon the length of occupancy by the beneficiary.** *Examples Include: Iowa City, IA; St. Cloud, Green Bay, WI; Hagerstown, MD.*

<u>Grants</u> - An advantage to using grants is that they do not require ongoing monitoring. However, the City must consider whether matching funds must be contributed by the buyer, and if so, what amount the match must be. **If the grants are utilized for rehabilitation rather than homebuyer assistance, then creating priorities for physical improvements to the property would be recommended with the program.** *Examples Include: Carbondale, IL; Mt. Pleasant, MI; Elgin, IL.*

<u>ISSUE #3 - INCENTIVE SOURCES:</u>

There are three primary options for financial incentives for a rental conversion program:

1. **Property Tax Abatement.** One option is to provide a Property Tax Abatement for improvements made to a property within an Urban Revitalization Area. This option requires no upfront costs by the City and would instead provide for an abatement of property taxes on the increment of value created by improving the home. This option would not apply to acquisition. This incentive only works with physical improvement to a property that increase value. The option would not provide much incentive for low value or small projects, but could be valuable for more substantial renovation projects.

2. **HOME/CDBG Funding**. The City previously has relied upon state grants or direct federal housing money from the CDBG program to fund acquisition, first time homebuyer, and rehabilitation projects. Such funds could be directed to this type of program. However, the use of federal funding would add additional requirements to the process related to environmental review, income limits, relocation costs, and timing. Funding can be in the form of loans or grants, or direct use by the City for acquisition and rehabilitation. **One of the more significant issues with the use of federal funds is the acquisition of currently rented property results in the City's obligation to identify replacement housing and provide for relocation costs.** The City currently has $400,000 set aside in the Annual Action Plan for property acquisition with CDBG funds. **Importantly, if there is use of federal funds, the beneficiary can only be a low and moderate income household (<80% of AMI).**

3. **City Funding.** A third option is to identify city funding for the program. Under this option, the City would need to appropriate funds form the General Fund, Local Option Sales Tax Fund, or other appropriate fund balances. City funding would be the least restrictive option to finance a program. The City Council would be free to use the funds for any purpose that meets the allowable uses under state law.

<u>ISSUE #4 - HOUSEHOLD ELIGIBILITY:</u>

As described earlier, understanding the primary purpose of the program for rehabilitation or acquisition and the funding source will help identify the intended beneficiary for incentives. The use of federal funds will limit benefits to low and moderate income (LMI) households. This would require a qualified household to earn less than 80% of the median household income. If the goal is to address housing conditions overall and not focus on LMI households, the City will need to rely upon a local incentive structure of either tax abatement or use of local funds.

STAFF COMMENTS:

To move forward with creating an incentive based housing conversion program, City Council would, at a minimum, need to 1) identify the goal(s) for the incentive program (providing affordable housing opportunities and/or increasing the owner-occupied housing stock) and 2) provide direction regarding the four the issues listed above.

If there is an interest in pursuing a specific type of program, staff will prepare program requirements, program operational costs, and program funding sources for Council review based on the direction provided.

City staff believes funding assistance of $25,000 to $50,000 per property may be necessary to overcome buyer disinterest in rehabilitation projects and market demand for rental properties. In addition to a direct cash subsidy per property, the City Council might want to consider using Tax Abatement for incremental improvements to owner occupied homes as an incentive for both existing and new owners to consider upgrades to their property and increase their value overall, possibly deterring market interest in the property for a rental property. **A program focused on assisting with the purchase of properties by others (down payment and closing costs) would be the most efficient use of the City resources by not assuming the risk of City ownership and resale.**

City Council initiated this referral at the time of discussion of changes in occupancy limits and rental concentration concerns. **Staff believes that if this program were to move forward it should be targeted to areas where there is an imbalance in ownership vs. rental properties.** A general program for city-wide conversion of rental properties to homeownership would not appear to be necessary as many neighborhoods have a healthy mix of housing types and having diverse housing options on a community level is important. Targeting resources to specific areas would likely make the most appreciable difference in housing conditions compared to a distributed citywide program.

MEMO

Item No. 24

To: Steve Schainker, City Manager
From: Tasheik Kerr, Management Analyst
Date: 10/22/2019
Subject: Rental Conversion Programs

Listed below is a brief summary of programs used by other communities to incentivize conversion of rental property to single-family homeownership. Each program awards either a grant or a loan for individuals who meet the program's requirements. The awards are financed through general funds, tax increment financing, state grants, developer fees, or by lines of credit from local banks. Absent from the list are those programs that utilize CDBG funding.

Iowa City, IA

UniverCity Neighborhood Partnership Program

The City purchases rental homes that are adjacent to the downtown and to the University of Iowa campus, renovates them (target of $50,000 of renovation per home), and offers them for sale as affordable housing. The program is financed by general funds and lines of credit through local banks (e.g., UICCU, Hills, and US Bank). In FY18, $250,000 was budgeted for five homes. For FY19, $180,000 ($60,000 per home) was budgeted for three homes. To date, 65 homes have been renovated and sold as owner-occupied housing. It was noted that it is getting costlier to buy remaining homes in this district due to homes needing more repairs and that many homes have been converted. Lines of credit were secured with four residential lenders to acquire the homes. When the homes are sold, the City repays the lender with interest. The City has borrowed over $11.7 million through local lenders.

Rental Properties Converted to Single Family Homes by Year:

Year	# of Conversions
FY 2013	8
FY 2014	8
FY 2015	7
FY 2016	10
FY 2017	3
FY 2018	5

Eligible Single Family Residential Structure:

Homes must be located within the designated UniverCity neighborhoods, have a current rental permit, be in a condition that may be addressed with the rehab budget; and sell for less than $235,000.

Eligible Recipient:

For homes renovated with general funds, the purchaser of the property can exceed an income limit of 140% of AMI. The cost of renovations will not be passed on to homebuyers so long as the homebuyer retains ownership of the property as their primary residence for five years. Homes must be maintained as owner-occupied housing and affordable housing for 30 years.

Carbondale, IL

Single Family Housing Conversion Program

The City provides a $5,000 grant to approved homebuyers of a single-family house. The program is funded through the use of general funds. For FY19/20, $25,000 has been set aside for city-funded housing programs. The program awards an average of two grants per year. Permit fees for improvements made to the residential structure are also waived.

Rental Properties Converted to Single Family Homes by Year:

Year	# of Conversions
FY 2013	1
FY 2014	-
FY 2015	3
FY 2016	2
FY 2017	2
FY 2018	3

Eligible Single Family Residential Structure:

An existing housing structure located within any residential zoned area in the corporate limits of Carbondale, Illinois that has been duly registered as a rental-housing unit with the City of Carbondale's Building & Neighborhood Services. The structure must have been a single-family rental house the previous two (2) years from date of application being submitted under the Single Family Housing Conversion Program.

Eligible Recipient:

A person, persons and/or entity that intends to purchase an existing single-family residential property and will convert the unit from rental to an owner occupied residence for a time frame of no less than five (5) consecutive years. If occupied for less than five years, the grant payment to the owner is prorated.

<u>Mt. Pleasant, MI</u>

Owner Occupied Residential Incentive Program

The City grants 5% of the purchase price up to $10,000 per applicant for the purchase of a licensed “family” rental and 8% of the purchase price up to $16,000 per applicant for the purchase of a licensed “rooming and boarding” rental. Applicants will be accepted on a first come, first served basis until the allocated $100,000 for the program has been exhausted.

In 2005, the City allocated $100,000 from its HODAG (Housing Development Grant Program funds) toward this initiative. Through 2015, the City awarded 16 grants totaling over $70,000. The program was suspended in 2016 until the City Commission can review the program and determine whether and in what capacity to continue it.

Eligible Single Family Residential Structure:

Must be an existing rental property for sale in the target area. Existing duplexes may qualify, provided at least 50% of the property is converted to owner-occupied.

Eligible Recipient:

Must have pre-qualified for a home loan prior to making application and must own and occupy the property for at least 5 years, or sell to another owner-occupant.

<u>St. Cloud, MN</u>

Homestead Incentive Program

Qualified buyers are provided with a deferred loan of $3,000 for the purchase and homestead of a St. Cloud Core Neighborhood Property (includes those neighborhoods in proximity to St. Cloud State University campus).

The Homestead Incentive Program has been financed through various ways over the past 30 years. In its first two years, the program was funded with $30,000/year from the City’s General Fund. Over the years, large banks have provided down payment assistance to qualified individuals of the program. When the City did an affordable housing development, it used the fees earned to put back into the program. The City also received state grant money to fund the program.

Eligible Single Family Residential Structure:

Property must be located in targeted Core Neighborhood, be a homestead and a single-family residence.

Eligible Recipient:

Homebuyer must meet income guidelines (1-2 persons $80,400, 3+ persons $92,400) and must use traditional financing (no Contract for Deed or ARM financing)

Elgin, IL

Residential Conversion Grant

Provides funding for converting non-conforming multiple unit residences back to their original use and for the loss of rental income following the conversion. Both non–owner-occupied and owner-occupied properties are eligible for funding. Participating property owners are provided with $25,000 for converting a two-unit building and $30,000 per unit removed for buildings with three or more units. An additional $3,000 per unit removed is available for buildings located within certain census tracts.

The Residential Conversion Grant is currently funded through TIF revenues. Prior to 2018, the City funded the program through its Riverboat Funds, which are special revenue funds established to collect gaming tax revenues. Though the City budgeted $100,000 for the program, there is no guarantee that the program will be funded from year to year.

Eligible Single Family Residential Structure:

Properties that contain lawful, but non-conforming multiple-family residential units; properties located within the Central Area TIF District; rental properties currently licensed by the City of Elgin; properties that will be converted to their original, conforming residential use; properties outside the floodplain.

Eligible Recipient:

Eligible program participants include owners of record, mortgagees, or owners with a beneficial interest in a trust.

Green Bay, WI

Conversion Grant Program

Grants an owner up to $10,000 to restore a multi-family property to its original single-family use. The program also encourages homeownership by offering an extra $5,000 deferred payment loan to those individuals that are owner occupants. A grant of 25% of the conversion and rehabilitation cost, up to $10,000, is also available for qualifying projects.

Eligible Single Family Residential Structure:

The structure must have originally been constructed as a single-family home and must require improvements in order to convert the property from a multi-family to a single-family.

Eligible Recipient:

Applicant must provide, at a minimum, 75 percent private rehabilitation investment for each 25 percent of conversion grant, with a maximum grant of $10,000 and has not received a housing-related citation in the one-year prior to the City receiving his/her application.

<u>Madison, WI</u>

Small-Cap TIF Program

Provides forgivable loans to individuals who purchase and/or renovate a current rental property in a defined TIF district and convert the property to owner-occupied. The City funds the cost of renovation plus up to 10% of purchase price, not to exceed $80,000 for a single unit property, $90,000 for a two-unit property, and $100,000 for a three-unit property. Different versions of the program allow for either existing property owners or new purchasers to take advantage of the program. Note these programs no longer are in operations.

Budgeted Amount per Calendar Year for Each TIF District:

TIF #32: Mansion Hill-James Madison Park Neighborhood		
CY	**Budget**	**Spent**
2015	$520,000	$160,000
2016	$540,000	$0
2017	$440,000	$440,000
TIF #42: Greenbush Housing Renovation Program		
CY	**Budget**	**Spent**
2015	$300,000	$180,000
2016	$360,000	$260,000*
2017	$850,000	$410,000

Eligible Single Family Residential Structure:

Must be located in the Renovation Program expenditure area, will have no more than three dwelling units after renovation, and at least one unit will be used as Borrower’s principal residence within 12 months from program loan closing or the subject property will be sold to owner occupant buyer within 12 months from program loan closing.

Eligible Recipient:

No borrower income limits, borrower must demonstrate credit- worthiness in the form of a bank commitment or other documentation acceptable to staff, and must invest a minimum down payment of 3% of the purchase price if they do not already own the property.

Hagerstown, MD

The City-Wide Down Payment and Rehabilitation Program

Provides down payment/rehab loan grant of $7,500 citywide to individuals who convert a rental of two or more units to a single unit, owner-occupied home. The program is financed through the City's Economic Redevelopment Fund. Revenues in this fund consist of periodic transfers from other funds, State Grant funds (when available), and a transfer from the General Fund to continue carrying out strategic revitalization efforts as part of the Invest Hagerstown Programs. $110,000 has been budgeted for FY20, a $35,000 increase from FY19. Eligibility for rental conversion is a new component to the homebuyer assistance program.

Eligible Residential Structure:

Structure must be located within the Corporate Limits of Hagerstown. The applicant must purchase a rental dwelling consisting of two or more units that upon purchase will be converted to a single family, owner-occupied dwelling unit within 6 months of the date of settlement.

Eligible Recipient:

No income restrictions; loan to be secured by a mortgage. The homebuyer will be required to maintain the structure as their primary residence for five (5) years in order for the loan to be forgiven.