Part 4: City Revenue Sources for Combating Displacement in Gentrifying Neighborhoods

Key City Revenue Sources

1. General obligation bonds
2. Tax increment financing
3. Homestead Preservation Reinvestment Zones
4. Type B sales tax
5. General revenue
6. Fees in lieu of density bonus

Limited funds for affordable housing can be one of the biggest barriers cities face when seeking to increase housing stability in gentrifying neighborhoods. While a majority of funding for preserving and creating affordable housing has historically come from federal sources, these funds are inadequate to support local housing needs. As a result, many Texas cities have been relying increasingly on local revenue sources to improve housing stability–although the range of local revenue sources available to cities here is very limited due to state legislative limits.

Six important local revenue sources and financing programs that are currently being used in Texas cities to fund affordable housing and other housing stability projects are outlined here, along with the opportunities and challenges of using these tools.

General Obligation Bonds

Highlights:

- Can generate large levels of funding over multiple years that are dedicated to affordable housing
- Subject to public vote: Affordable housing may not be a priority to all taxpayers
- Bond proceeds may fund only capital costs and not operational costs or support services

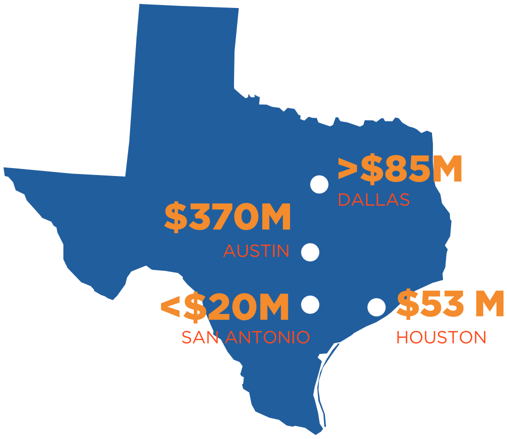
Texas cities have the authority to issue General Obligation (GO) bonds after receiving voter approval in a citywide election. The bonds must be used in advancement of a public purpose. The preservation and development of affordable housing (both rental and homeownership) for low-income households are examples of public purposes that qualify for GO bonds. GO bonds are spent over several years (four to seven years is typical) and are repaid by the city using general revenue, such as property and sales taxes. Approving GO bonds for affordable housing effectively locks in spending on affordable housing for several years and shields the funding from competing spending priorities during the term of the bonds.

Proceeds from GO bonds can be used only for capital costs, such as land acquisition, housing construction, and infrastructure related to an affordable housing development. The proceeds cannot be used to fund on-going operational costs or direct financial assistance to households, such as rental assistance.

Examples:

- **Austin:** In 2018, Austin voters overwhelmingly approved a $250 million bond in support of affordable housing. Out of the $250 million, $100 million of the bond will support land acquisition for affordable housing development, $98 million will support rental housing development assistance, $28 million will support homeownership, and $28 million will support home repairs and rehabilitation. The most recent GO bonds fund rental housing serving households at or below 30%, 40%, and 50% MFI, while the homeownership units serve households at or below 80% MFI. In 2013, Austin voters approved a $65 million bond for affordable housing and, in 2006, approved a $55 million bond.
- **Houston:** Houston voters have approved a total of $53 million in general obligation bonds for affordable housing over the course of three bond referendums from 2001 to 2012.
- **San Antonio:** In 2017, San Antonio voters approved $20 million for neighborhood improvements. The bond funds, which are not targeted towards housing stability, are focused on eliminating blight and the preparation of sites for construction of workforce housing development. Half the residential units in a bond-funded project can be market rate.
- **Dallas:** From 2003 to 2017, Dallas voters approved more than $85 million in general obligation bonds for affordable housing, including homeless assistance facilities, through bond referendums in 2003, 2005, 2006, 2012, and 2017.

General Obligation Bonds for Affordable Housing 2001-2018



Tax Increment Financing Targeted for Affordable Housing

Highlights:

- Transforms a funding mechanism with the potential to fuel gentrification into one that helps reduce the displacement of low-income residents
- Locks in ongoing contributions of city tax dollars towards affordable housing for many years
- Places the burden of financing affordable housing on future development rather than the current tax base

Tax Increment Financing (TIF) is used widely by Texas cities to capture the expected growth in property tax revenues to fund projects within a precisely-defined TIF zone for a long period of time–typically thirty years. When a TIF zone is formed, the amount of existing tax collections originating from inside the zone's boundary is set as the baseline. As tax revenues in the zone increase in future years (whether from redevelopment, inflation, or otherwise) the amount that exceeds the baseline is redirected out of the city's general fund and reserved for expenditure on designated projects that benefit the zone.

Under Chapter 311 of the Texas Tax Code, Texas cities have the authority to dedicate all or a portion of TIF funds towards affordable housing, such as land assembly, construction, and infrastructure for an affordable housing development, as well as affordable housing programs. Affordable housing receiving TIF funding can be located inside or outside of the TIF zone.

There are two primary ways to create affordable housing through TIF funding: (1) by requiring market-rate developments receiving TIF funds or abatements to set aside a certain percentage of units in the development as affordable housing; and (2) by redirecting a percentage of the TIF funds into a special fund used to subsidize affordable housing developments and affordable housing programs. The targeting for affordable housing can be required only for specific TIFs when they are created by the City Council, or via a city ordinance that applies to all future TIFs.

If TIF funds are used to incentivize the inclusion of affordable housing in a market-rate development, consideration should be given to the rents and sales prices of the affordable housing units, as well as the number of bedrooms required, to ensure that neighborhood residents who are at risk of displacement can access those units. Other best practices to consider include: (1) requiring properties receiving TIF funds to accept a percentage of renters with housing vouchers; (2) affirmative marketing requirements to reach area residents; and (3) requiring the developments to provide enhanced tenant rights such as right to cure provisions.

Examples:

- **Dallas:** All residential developments receiving TIF subsidies must set aside 20% of units for families earning at or below 50% to 80% AMFI, with the exact income targeting determined by the area where the TIF district is located. As of 2016, Dallas's TIF policy had yielded 2,320 affordable housing units.
- **Fort Worth:** Any residential projects receiving TIF support must set aside a minimum of 20% of units as affordable (half at 60% AMFI and half at 80%).
- **Houston:** Thirty percent of all funds from "petition" TIFs (those created by petition of landowners) are dedicated to affordable housing, pursuant to a requirement under state law that applies only to Houston. In 2015 and 2016, TIFs in Houston contributed a total of $41 million to the city's affordable housing fund, along with several additional TIFs that spent TIF funds directly on affordable housing within the respective TIF district. A 2018 City of Houston audit found major flaws in the city's administration of the TIF funds for affordable housing, including a finding that a majority of those funds were spent on city administrative costs and only 43% on affordable housing projects and programs.
- **San Antonio:** The City of San Antonio has created at least two TIFs dedicated solely towards the creation of affordable housing. For example, the Tarasco Gardens TIF is a petition-created TIRZ that will provide 60 affordable homes for low- and moderate-income families.
- **Portland, Oregon:** In each of the city's TIF districts, 25% of TIF funds must be set aside for affordable housing. Advocates were successful in getting the city to redirect an even higher amount of TIF funds in the North/Northeast Portland area towards affordable housing. Over a six-year period, $100 million in TIF funds will be dedicated towards affordable housing and mitigating displacement in that area of the city.

Homestead Preservation Reinvestment Zones

Highlights:

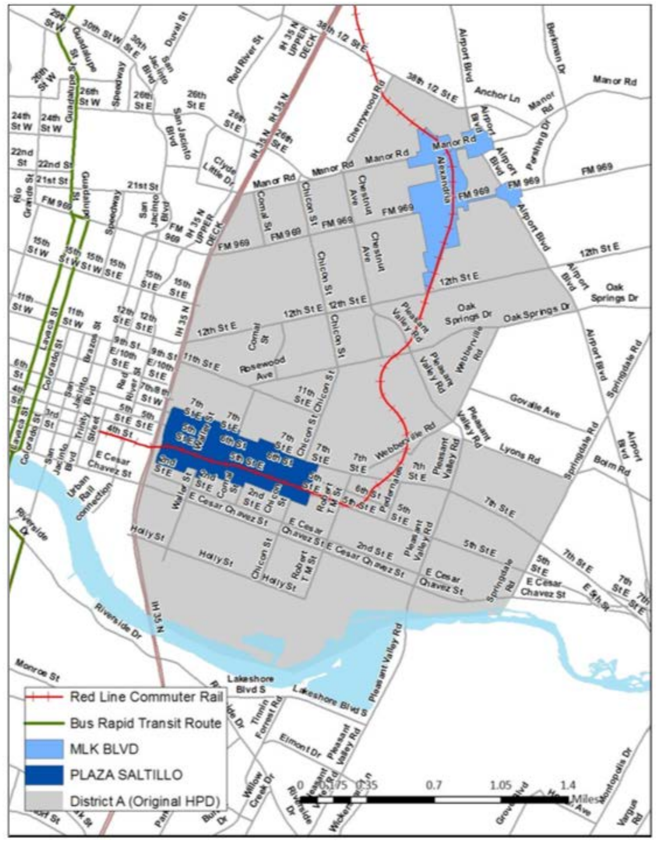
- Special TIF model that restricts TIF funds for the development, construction, and preservation of affordable housing with deep income targeting
- HPRZs can currently be created only in the cities of Austin and Dallas, and in these two cities, the tool is available only on a very limited basis. Legislative changes are needed to expand use of this tool statewide.

Homestead Preservation Reinvestment Zones (HPRZs) were created by the Texas Legislature in 2005 as a special form of tax increment financing to mitigate residential displacement in gentrifying neighborhoods. All of the tax increment funds in an HPRZ must be used for the development, construction, and preservation of affordable housing. HPRZs are authorized by Chapter 373A of the Local Government Code, which contains specific income targeting caps to ensure that most of the funding is used to assist the families most likely to be impacted by displacement. No more than ten percent of the HPRZ funds can be used on administrative costs.

HRPZs offer a great opportunity for Texas cities to create dedicated funding streams towards creating housing stability in gentrifying neighborhoods, but additional legislative changes are needed to make the HPRZ funding tool viable for cities. An HPRZ can be created only in an area that a city has designated as a Homestead Preservation District under the Local Government Code. Currently, only the cities of Dallas and Austin have authority under state law to create Homestead Preservation Districts. Prior legislative attempts to extend this authority to other cities has failed. The City of Austin has successfully created one HPRZ, but is currently ineligible to create any additional Homestead Preservation Districts because of an issue with the state statute's bracketing language. And in Dallas, the fastest gentrifying areas do not qualify as Homestead Preservation Districts under the restrictive language in the state statute, and, thus, do not qualify for the HPRZ funding tool.

Example:
In 2015, the City of Austin created its first HPRZ, which is located within seven census tracts of Central East Austin and dedicates 20% of the tax increment in the zone towards affordable housing. The HPRZ has a ten-year term that can be extended by the City Council.

City of Austin Homestead Preservation District A



Source: City of Austin

Type B Sales Tax

Highlights:

- Can be used to generate a dedicated source of revenue for certain types of affordable housing expenses, such as land acquisition, construction, and infrastructure
- Many Texas cities have already adopted a Type B sales tax, but very few are currently using the revenue for affordable housing.
- Cities are ineligible to adopt a Type B sales tax if their local sales tax revenue exceeds two percent, which is the case for Dallas, Austin, and Houston, unless the local general sales tax rate is reduced.

Under the Texas Development Corporation Act, Texas cities may adopt a Type B sales tax with voter approval to fund economic development activities through a city-created economic development corporation, as long as the total local sales tax rate (including any local transit authority's rate) does not exceed two percent. Affordable housing, including land acquisition and construction, is eligible as an economic development activity that can be funded with the Type B sales tax. Many cities, such as Dallas, Houston, and Austin, have already reached the two percent cap for local sales tax rates and so would have to decrease their general sales tax rate before adopting a Type B sales tax.

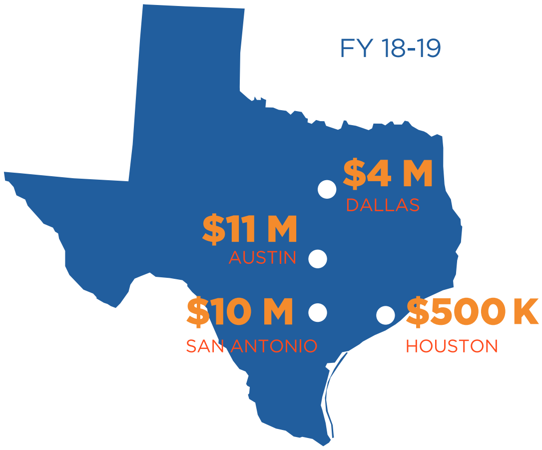
As of Fiscal Year 2016-17, 361 Texas cities have adopted a Type B sales tax, with 8 cities using part of the sales tax revenue towards affordable housing, according to the Texas Comptroller's annual report on economic development corporation expenditures.

Examples:
Texas cities that dedicate part of their Type B sales tax revenue for affordable housing include Corpus Christi ($500,000), San Angelo ($460,000), McAllen ($550,000), and McKinney ($200,000).

General Revenue

Highlights:
- Not very reliable as a long-term source of financing; subject to annual political battles and competing priorities
- Subject to the state's annual revenue caps on cities

As part of its annual budgeting process, a Texas city can dedicate general fund dollars in the city budget for that fiscal year towards affordable housing and other tools for creating housing stability. This method of funding is the most simple, straightforward, and transparent. However, relying on the general fund for affordable housing is not very reliable and subject to fluctuations in revenue. Budgeting processes are highly politicized and contested, with different constituencies jostling for their varying priorities to receive funding. Affordable housing can seem like a lesser priority compared to traditional bread and butter items such as public safety and street maintenance.



Texas cities have historically relied largely on federal funding instead of general revenue to fund local housing initiatives. The Texas cities that have dedicated general revenue towards affordable housing have done so in only small amounts in proportion to their overall general revenue budget.

Examples:
Austin ($11 million, FY 18-19); San Antonio ($10 million, FY 18-19); Dallas ($4 million, FY 18-19); Houston ($500,000, FY 18-19)

Fees in Lieu of Density Bonuses

Highlights:
- Fees in lieu are paid for by the developer of a project instead of taxpayers
- An inconsistent and unpredictable stream of revenue for affordable housing that relies on a strong real estate market and demand for denser development.

Through density bonus programs, cities provide developers with the option of obtaining the right to build a taller or more dense building (or obtain other increases in development entitlements) in exchange for providing community benefits such as affordable housing. Instead of requiring the affordable housing units to be built onsite of the development, Texas cities can give the developer the option of paying a fee to the city to fund the city's affordable housing programs. These fees are commonly referred to as "fees in lieu." If a fee in lieu is allowed, it should be calibrated to the price of what it would cost to build a unit of affordable housing offsite.

Some cities and housing advocates prefer the fee approach over requiring the affordable housing units to be built on site through the density bonus program. One reason for this preference is that the fee can be used more nimbly to address the most pressing housing needs in a community. The City of Austin's most active density bonus programs require the affordable housing units to be built onsite unless special circumstances exist. For example, the City's Downtown Density Bonus Program allows for a fee in lieu given the cost of high-rise construction and the sense that the city can get a "bigger bang for its buck" in funding the creation of affordable units offsite where land and construction costs are a lot lower.

Examples:
City of Austin's Downtown Density Bonus Program, along with several other density bonus programs. These programs generated $1.2 million in fees to fund affordable housing for fiscal year 2018-19.