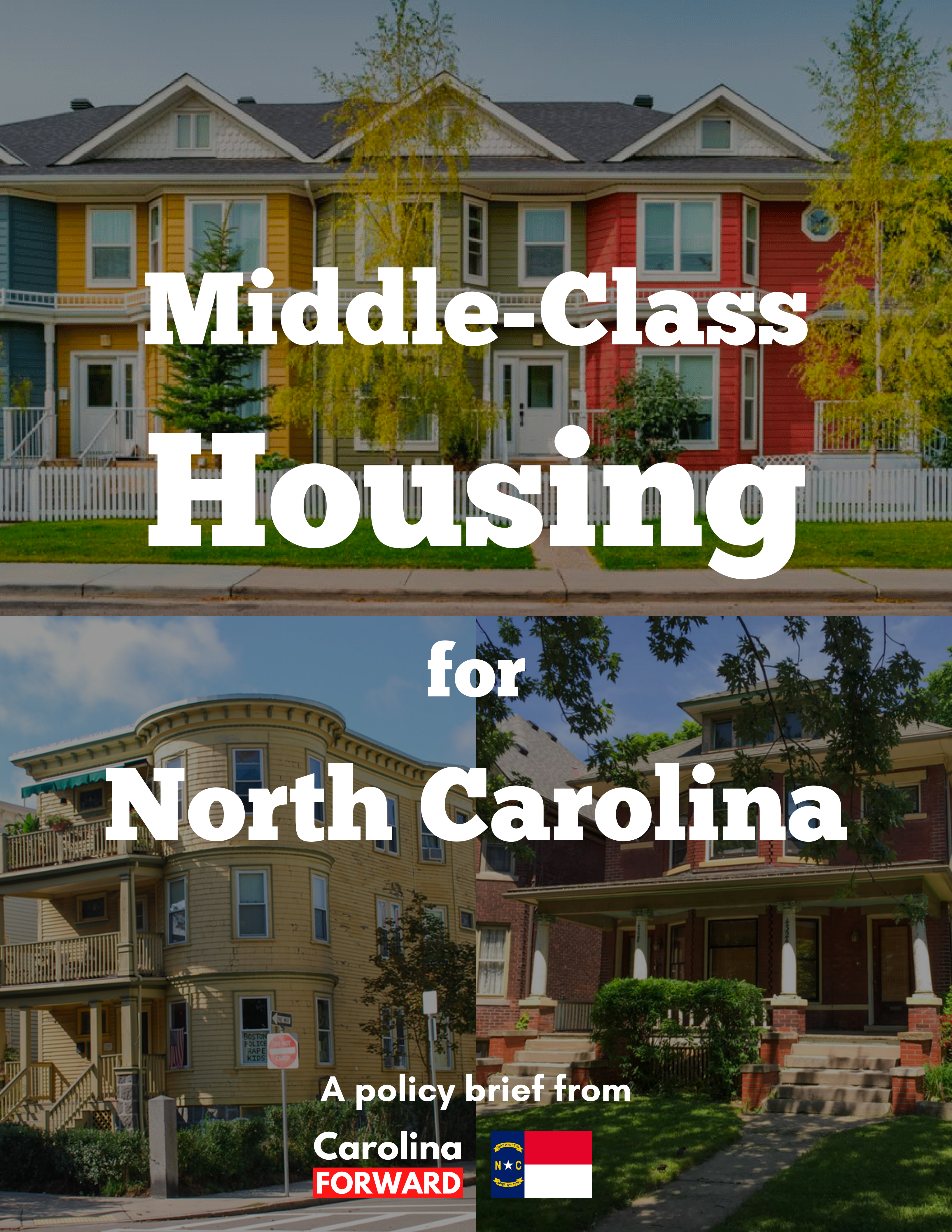


Middle-Class Housing for North Carolina

A policy brief from

Carolina FORWARD

North Carolina has a housing crisis.

Across our state, housing costs are rising.

Young and old. Families, singles, retirees. Big cities, rural communities and everything in between. Everywhere you look, the cost of housing is **by far** the biggest driver in our rising cost of living.

Renters and buyers alike face a similar problem: there is simply too little housing inventory available. When supply is low and demand is high, prices go up. With constant upward pressure on housing costs, middle-class North Carolinians get squeezed even more.

Our proposal:

The Middle Class Housing Plan

The Middle Class Housing Plan is based on a radical idea: safeguard a viable business model for the construction of more market-rate housing. Then, get out of the way.

Here's how it works.

The Problem

Two of the biggest barriers to constructing more, and lower-cost, housing today are local permitting restrictions and relatively high interest rates.

Housing is very expensive to construct, and typically just as difficult (and also expensive) to get permitted by local governments. High interest rates in particular, which raise the cost of borrowing, require higher consumer prices (in the form of rent or purchase prices) for projects to remain financially viable. This means developers have an obvious financial incentive to build only those housing formats which command the highest prices that the local market will bear.

One result is that “missing middle” housing (also known as “gentle density”) formats - townhouses, duplexes, quadplexes and so forth - are often the ***least*** financially viable projects to build, while giant apartment complexes and high-end “McMansion” style single-family homes are the most attractive.

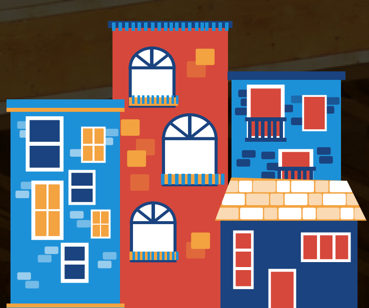
Another result is that, even when financing is available and not cost-prohibitive, building “gentle density” housing is simply illegal in many places. Vast swaths of most cities and towns are zoned by local governments for exclusively single-family housing, and higher-density formats are not allowed. Many jurisdictions have additional burdensome requirements and discretionary review processes that make it anyone’s guess whether even a qualifying project will be allowed at all.

The Solution: The Middle-Class Housing Plan

1 The State of North Carolina will guarantee below-market construction and permanent financing for qualifying housing projects

2 To access a Middle Class Housing concessional loan, a project must meet two criteria:

- a **minimum density requirement** of 10 dwelling units per acre
- target annual rent of finished units **may not exceed** Fair Market Rent (FMR) for that county, as published by HUD*
  - projects that achieve target rents of only 80% of FMR are eligible for an **additional** financing discount



3 Qualifying projects are eligible to **override** certain local permitting restrictions, assuming they are zoned appropriately and connected to utility services

* The U.S. Department of Housing and Urban Development's annual Fair Market Rent estimates are 40th percentile gross rents for standard quality housing units in a given county.

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How it works

The Middle Class Housing Plan lending program is modeled on the highly successful U.S. Small Business Administration 7(a) loan program. It targets the cost of capital (interest rates) and local restrictions as the primary pressure points to unlock greater housing development.

Under this plan, the State of North Carolina does not, itself, lend any money, let alone any taxpayer funds. It does not evaluate applicants, choose projects, or supervise them. Instead, the state *guarantees* up to 75% of a private lender's loans for a qualifying project. To qualify, those projects must deliver multifamily housing with target rents or purchase prices at or below market rates (FMR). Projects delivering particularly low target rents (80% of FMR) are eligible for even more attractive financing.

Qualifying projects will be eligible for a concessionary 4% interest rate on financing, as long as the prime rate remains above 5%.* Lenders shall charge a guarantee fee on the loan, which is used to finance potential defaults and administration of the program. They are also permitted to charge a loan packaging fee that is consistent with their market-rate loans, thus providing an incentive for lenders to participate.

This mechanism aligns incentives for all stakeholders. Lenders, working with their own private capital, have a reason to make loans to housing builders. Builders, with access to low-cost capital and easier permitting, have a business model to build dense, multi-family housing. Finally, home buyers and renters get access to more multifamily housing inventory, with built-in downward price pressure.

* Below 5%, the rate will remain 100 basis points below prime, with a rate floor of 2%.

But how much does it cost?

One of the most attractive aspects of the Middle-Class Housing Plan is that it is extremely taxpayer-friendly.

Under the Plan, the State of North Carolina does not lend any money directly. It only uses the state's financing guarantee to leverage and mobilize private capital. Because such a financing guarantee involves risk to the guarantor, there are several safeguards in place.

The first is lenders' own underwriting standards. Because the State of North Carolina only guarantees 75% of financing, lenders and builders themselves still have "skin in the game" to make sensible loans. This way, they are still exposed to downside default risk, and have a reason to maintain industry loan screening standards.

Secondly, just like the SBA 7(a) loan program, a mandatory "guarantee fee" charged on loans will be used to finance potential future defaults and program administration. As a point of comparison, the SBA's own "charge-off" rate (eg. loans deemed in default and unrecoverable) hovers between 1-2%, and frequently below the former. Thus, while some borrowers will inevitably default, the rate is likely to be low and predictable.

The Plan thus uses a relatively small amount of capital as leverage to unlock significantly larger private investments in below-market rate multifamily housing. Even in scenarios of much higher defaults than the SBA program (for example, 5%), the Plan would still result in a significant amount of new housing construction at very low overall cost. A $20 million pilot program would be sufficient to prove the viability of this model.

Legalize housing

Another major challenge to growing housing supply is that, in many jurisdictions, simply building it is illegal. Myriad opaque local restrictions and requirements block the construction of much new housing, particularly in formats any more dense than single family homes.

Qualifying projects under the Middle-Class Housing Plan will be eligible to override certain local permiting restrictions. As long as projects are located in areas generally zoned for residential or mixed residential-commercial use, and connected to utility services, local restrictions may not block new housing projects. In industry terms, projects may proceed **“by right.”** This means that they cannot be held up by local discretionary review processes, arbitrary height or density limits, parking minimums or design requirements.

By making the construction of specifically market-rate (and especially below-market rate) housing possible “by right,” this reform will unlock housing supply in exactly the segment of the market where it is most needed.

Carolina Forward is a think tank and policy organization dedicated to building a more just, democratic and prosperous North Carolina.

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