Unlocking Integrated, Efficient Land Use and Transportation Through Innovative Financing of Transit-Oriented Development

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Good afternoon, members of the committee, and thank you for the opportunity to offer testimony as you explore the potential of applying innovative financing tools administered by the Department of Transportation's Build America Bureau to produce desperately needed affordable housing in ideal locations: near transit service.

My name is Tracy Hadden Loh, and I am a fellow with the Bass Center for Transformative Placemaking at Brookings Metro. Transformative placemaking is an integrated practice that breaks down the siloes between professional disciplines—including real estate and transportation planning—to advance local growth and development through holistic, interconnected strategies. I'm here today to share insights gleaned from our work at the Center to create new knowledge, policies, investment strategies, practices, and tools to build more great places that work for more people.

According to the Census Bureau's 2021 Rental Housing Finance Survey, the three most common sources of mortgage loans for multifamily housing are commercial banks, mortgage banks, and credit unions.[1] In that survey, these sources provided capital to an estimated 4,569 properties, while alternative sources of financing (including public options) serviced only 137 properties—a trickle next to a stream. This could be interpreted as an indication that conventional lenders

[1] U.S. Census Bureau. (2021) Rental Housing Finance Survey (RHFS). https://www.census.gov/data-tools/demo/rhfs/#/?s_tableName=TABLE5&s_moe=showmoe

have the multifamily market covered, and are multifamily builders' preferred source of capital. Is a public option needed?

The answer to this question depends on the goal that policymakers are trying to achieve. It is clear that in good times, traditional finance has learned how to invest in multifamily construction, and builders work with these capital sources. The caveat is that right now these are not the best of times. Additionally, we are not necessarily getting the most needed housing in the most needed locations. Multifamily housing production is facing challenges, and there is an opportunity to respond.

The remainder of this testimony will outline the three-part case for why the public sector should consider creating new tools for multifamily lending, especially for transit-oriented development. I will then specifically address the potential of the Build America Bureau's lending tools and how they are—and are not—suited to this use case.

The three-part case for more tools for public sector multifamily finance

First, as my colleagues at Brookings and elsewhere have recently noted, "Making apartments more affordable starts with understanding the costs of building them."[2] Recent research on the inputs to production of multifamily housing notes that while the majority (50% to 70%) of project costs are "hard costs" related to labor and materials, the 20% to 30% of a typical project's "soft costs" related to permitting and financing are of particular public sector interest because these costs are directly shaped by public policy and regulation, and "affordable housing projects often have higher soft costs due to the complexity of financing."[3] Any intervention that reduces the cost of financing for affordable housing projects can directly improve their feasibility and affordability.

Second, real estate is a cyclical industry because of its reliance on finance and, therefore, economic cycles. As shown in Figure 1, multifamily housing production has fluctuated dramatically over time—much more so than natural demand (i.e., population), with downturns in production typically coinciding with recessions.[4] However, most recently, new multifamily starts have collapsed even without a recession, due to higher interest rates and lower property

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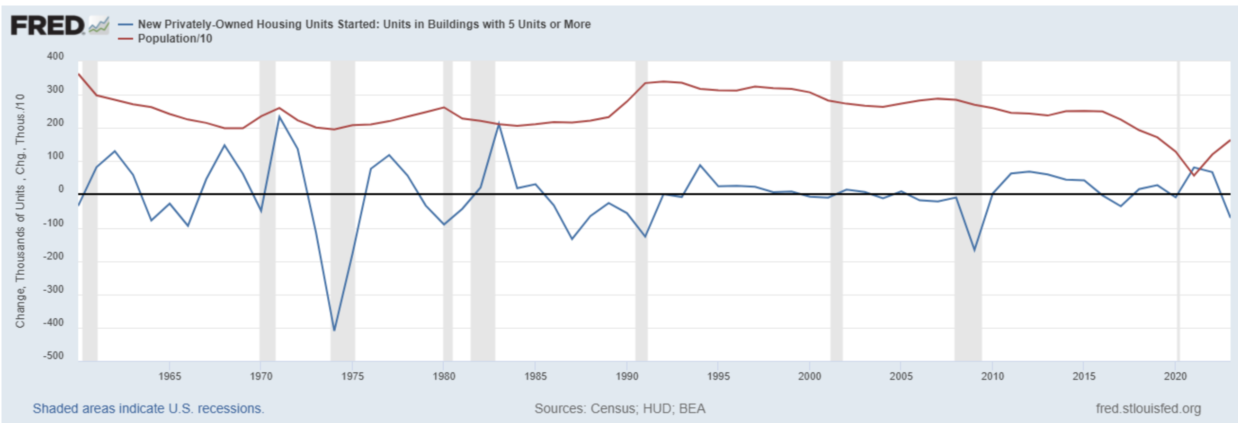
[2] Hoyt, H. & Schuetz, J. (2020, May 5) Making apartments more affordable starts with understanding the costs of building them. *Brookings Institution*. https://www.brookings.edu/articles/making-apartments-more-affordable-starts-with-understanding-the-costs-of-building-them/

[3] Hoyt, H. & Schuetz, J. (2020, May 19) Flexible zoning and streamlined procedures can make housing more affordable. *Brookings Institution*. https://www.brookings.edu/articles/flexible-zoning-and-streamlined-procedures-can-make-housing-more-affordable/

[4] Figure 1 can also be accessed online at https://fred.stlouisfed.org/graph/?g=1ohWg.

values that are a factor of rising operating costs (e.g., insurance) reducing net income.[5] A major lesson learned from the Great Recession was that there are better economic outcomes during and after economic downturns, when government backing is available to help move capital counter-cyclically.[6] While the Federal Housing Administration does this through mortgage insurance, it is also hypothetically possible for the federal government to do this through direct finance. However, any potential change to the federal role in multifamily finance should be carefully considered to avoid exposing the public to unbearable costs and/or risk.[7]

Figure 1. US multifamily housing production and population trends



Third, the case of transit-oriented development is a unique use case for a federal role in multifamily finance that directly addresses the need to balance risk and reward in the public interest in multifamily lending. As the literal book on transit-oriented development notes, a "strong real-estate market 'floats all boats, but when the tide goes out it is the boats in the best position relative to transit that continue to float.'"[8] This assertion, reported to researchers in a qualitative interview, is consistent with the findings of studies testing relationships between

[5] Goodman, L., et al. (2023, November 30). *Housing Finance: At a Glance Monthly Chartbook, November 2023.* Urban Institute. https://www.urban.org/research/publication/housing-finance-glance-monthly-chartbook-november-2023

[6] Passmore, W., & Sherlund, S. M. (2018). The FHA and the GSEs as Countercyclical Tools in the Mortgage Markets. *Federal Reserve Bank of New York Economic Policy Review*, 24(3) https://www.newyorkfed.org/medialibrary/media/research/epr/2018/EPR_2018_fha-and-gses_passmore.pdf?sc_lang=en ; Young, S.D., Browne, E.K. & Moroz, P.C. (2021). The Countercyclical Nature of the Federal Housing Administration in Multifamily Finance. *Cityscape: A Journal of Policy Development and Research*, 23(1), 319-338. https://www.huduser.gov/portal/periodicals/cityscpe/vol23num1/ch15.pdf

[7] Congressional Budget Office. (2015). *The Federal Role in the Financing of Multifamily Rental Properties*. https://www.cbo.gov/publication/51006

[8] Cervero, R., et al. (2004). *Transit-Oriented Development in the United States: Experiences, Challenges, and Prospects.* Transit Cooperative Research Program. https://nap.nationalacademies.org/catalog/23360/transit-oriented-development-in-the-united-states-experiences-challenges-and-prospects

location affordability (i.e., lower transportation costs from transit access) and foreclosure outcomes after the Great Recession, for both single-family and multifamily properties.[9] While the evidence indicates transit-oriented development has lower foreclosure risks, some transit-oriented development projects also have higher risks related to the complexity of executing mixed-use projects or those that involve joint development with a transit authority and higher hard costs related to infrastructure that make them unattractive to conventional lenders and in need of alternative financing.[10]

Over the past three decades, the federal government has spent an average of about $14 billion each year on transit.[11] Mass transit and rail are both cumulatively and currently the third-largest category of public spending on infrastructure, after highways and water.[12] Given the magnitude of this investment, there is a clear public interest in maximizing the utility and performance of the resulting assets, and land use is key factor in transit ridership trends.[13] Locations proximate to transit are also ideal for lower-income households who need affordable housing, because these locations also reduce their transportation cost burden.[14]

The current applicability and challenges of Build America Bureau lending tools

The U.S. Department of Transportation (DOT) has over $100 billion ready for deployment at very low interest rates through the Transportation Infrastructure Finance and Innovation Act (TIFIA) and the Railroad Rehabilitation and Improvement Financing (RRIF) program.[15] These programs have traditionally helped finance major transportation projects, such as constructing roads, bridges, and tracks. Both the 2015 Fixing America's Surface Transportation (FAST) Act

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[9] Wang, K. & Immergluck, D. (2019). Neighborhood Affordability and Housing Market Resilience. *Journal of the American Planning Association*. 18(5). https://doi.org/10.1080/01944363.2019.1647793
[10] Venner, M. & Ecola, L. (2007). Financing Transit-Oriented Development: Understanding and Overcoming Obstacles. *National Academies of Science: Transportation Research Board.* 1996(1). https://doi.org/10.3141/1996-03
[11] Congressional Budget Office. (2022, March 22). *Federal Financial Support for Public Transportation*. https://www.cbo.gov/publication/57636
[12] Congressional Budget Office. (2018, October 15). *Public Spending on Transportation and Water Infrastructure, 1956 to 2017*. https://www.cbo.gov/publication/54539
[13] Watkins, K., et al. (2022). *Recent Decline in Public Transportation Ridership: Analysis, Causes, and Responses*. Transit Cooperative Research Program. https://nap.nationalacademies.org/catalog/26320/recent-decline-in-public-transportation-ridership-analysis-causes-and-responses
[14] Renne, J.L, et al. (2016). The Cost and Affordability Paradox of Transit-Oriented Development: A Comparison of Housing and Transportation Costs Across Transit-Oriented Development, Hybrid and Transit-Adjacent Development Station Typologies. *Housing Policy Debate*, 26(4-5), 819-834. https://doi.org/10.1080/10511482.2016.1193038
[15] Build American Bureau. (n.d) Transit Oriented Development Financing Overview. [PowerPoint Slides]. U.S. Department of Transportation. https://www.transportation.gov/sites/buildamerica.dot.gov/files/2024-01/2024_FinancingTOD.pdf

and the 2021 Infrastructure Investment and Jobs Act contained reforms intended to make it easier for transit-oriented development to leverage TIFIA and RRIF. Since 2021, the DOT has also made administrative changes to the program to facilitate deployment.

The first real estate project to close on a TIFIA loan happened last month (May 2024).[16] This is because the Biden administration has prioritized figuring out administrative issues with the programs and providing technical assistance to potential users. However, additional statutory and regulatory changes and clarifications are needed to make this resource more accessible:

- Because TIFIA and RRIF were originally intended for transit, rail, and roadway projects, there remains a requirement that projects undergo a review for environmental impact. That doesn't make sense for infill real estate development. Projects are likely eligible for a categorical exclusion under the National Environmental Policy Act (NEPA), but it's a time-consuming, bureaucratic headache for public-private investments that succeed or fail based on the time it takes for a project to go from conception to occupancy and stabilization. Other agencies—such as the Department of Housing and Urban Development, Department of Agriculture, and Economic Development Administration—have NEPA processes that are much more efficient. There is a need for resources to support either an interagency collaboration or a new process within the DOT.

- Similarly, "Buy America" requirements that are impactful and make sense for billion- or trillion-dollar infrastructure projects are unnecessary deal-killers on smaller-scale real estate projects. An administrative waiver to speed up the more pressing policy priority of building housing near transit makes sense.

- Congress should consider increasing the maximum loan-to-cost (L2C) threshold for TIFIA from 49% to match the RRIF program, which allows loans up to 75% L2C for transit-oriented development and 100% L2C for public infrastructure. This would reduce the burden on project sponsors to find gap financing from other sources, which for some projects will make the difference between feasibility and impossibility. It is also more consistent with typical real estate practice, in which most real estate developments borrow 60% to 70% of their project costs from commercial lenders and secure the remaining 30% to 40% from private equity (at a much higher cost).

- TIFIA borrowers are required to have an investment grade rating in order to receive a loan. That's unrealistic for a tool intended to encourage transit-oriented real estate

[16] McAdams, B. & Loh, T.H. (2024, May 30). How local governments can put their assets to work. *Brookings Institution*. https://www.brookings.edu/articles/how-local-governments-can-put-their-assets-to-work/

development. Rating agencies don't typically even rate the debt for these types of projects. Applicants have found some workarounds, but it's another instance in which the tool needs an update to work better for this new use.

- While RRIF does not technically require an investment grade rating, the publication of guidelines for setting the RRIF credit-risk premium rate (based on a project's credit rating, collateral ratio, pre-lease or pre-sale rates, etc.) so developers can have some early expectation of the outcome of this critical step in the underwriting process could make or break the value and feasibility of RRIF as a debt source.

- The development of model documents—including a pro forma financial model—for transit-oriented development projects could provide more clarity than any number of webinars, workshops, or pages of guidance. This should be an immediate priority for the Build America Bureau.

- There are questions about whether the definitions in Chapter 53 of Title 49, which covers public transportation, authorize the Federal Transit Administration to oversee transit-oriented development projects. This could be clarified in the statute, or the Build America Bureau could be given project oversight authority for transit-oriented development.

Conclusion

Transit-oriented development is a logical and elegant solution to multiple problems. However, that does not mean it is easy. The barriers to using TIFIA and RIFF financing for real estate are significant, but there is new motivation to justify addressing them for several key reasons:

- Any counter-cyclical housing lending is helpful, and affordable housing near transit achieves many broadly shared policy goals (such as production, improving the efficiency of existing federal transportation investments, and climate).

- Some projects will never be strong candidates for conventional debt, but provide significant public benefits and merit a lender of last resort. The first TIFIA real estate project—in Mount Vernon, Wash., located next to an Amtrak station in the county seat of a rural county that also contains three Native American reservations—is an example of this.

- Commercial real estate as a sector will likely see a medium-term lack of liquidity because of a confluence of factors, especially rising defaults in both office and multifamily and persistently higher interest rates. However, the broader economic and social need for capital to flow in order to adapt the built environment to new realities is urgent. Available facilities should be deployed, not idled on the sidelines.

We are in a time where there is a broad need for government to do more with the same level of resources and deliver positive economic, social, and environmental returns. Transit-oriented development is an opportunity to do so, which merits this committee's scrutiny. I thank you for the opportunity to inform your considerations on this topic.