Preservation of At-Risk Units

August 8, 2008

The California Housing Partnership Corporation has produced a report for San Mateo County that includes:

1. A description of State housing element requirements related to at-risk units
2. Financing and subsidy resources for preserving affordable units
3. Best practices,
4. Sample language for housing elements, and
5. A list of at risk units by jurisdiction (in the appendix)

Preservation of At-Risk Units
Prepared by the California Housing Partnership Corporation

I. Housing Element Requirements Related to At-Risk Units

The preservation section of the housing element should include an analysis of existing assisted housing developments (as defined below) that are at-risk of converting to market rate uses during the next ten years due to termination of subsidy contracts, mortgage prepayment, or expiration of use restrictions.

“Assisted housing development" means a multifamily rental housing development that receives governmental assistance under any of the following programs:

(A) New construction, substantial rehabilitation, moderate rehabilitation, property disposition, and loan management set-aside programs, or any other program providing project-based assistance, under Section 8 of the United States Housing Act of 1937, as amended (42 U.S.C. Sec. 1437f).

(B) The following federal programs:

(i) The Below-Market-Interest-Rate Program under Section 221(d)(3) of the National Housing Act (12 U.S.C. Sec. 1715l(d)(3) and (5)).
(ii) Section 236 of the National Housing Act (12 U.S.C. Sec. 1715z-1).
(iii) Section 202 of the Housing Act of 1959 (12 U.S.C. Sec. 1701q).

(C) Programs for rent supplement assistance under Section 101 of the Housing and Urban Development Act of 1965, as amended (12 U.S.C. Sec. 1701s).

(D) Programs under Sections 514, 515, 516, 533, and 538 of the Housing Act of 1949, as amended (42 U.S.C. Sec. 1485).

(E) Section 42 of the Internal Revenue Code.

(F) Section 142(d) of the Internal Revenue Code (tax-exempt private activity mortgage revenue bonds).

(G) Section 147 of the Internal Revenue Code (Section 501(c)(3) bonds).

(H) Title I of the Housing and Community Development Act of 1974, as amended (Community Development Block Grant program).

(I) Title II of the Cranston-Gonzales National Affordable Housing Act of 1990, as amended (HOME Investment Partnership Program).

(J) Titles IV and V of the McKinney-Vento Homeless Assistance Act of 1987, as amended, including the Department of Housing and Urban Development's Supportive Housing Program, Shelter Plus Care program, and surplus federal property disposition program.

(K) Grants and loans made by the Department of Housing and Community Development, including the Rental Housing Construction Program, CHRP-R, and other rental housing finance programs.

(L) Chapter 1138 of the Statutes of 1987.

(M) The following assistance provided by counties or cities in exchange for restrictions on the maximum rents that may be charged for units within a multifamily rental housing development and on the maximum tenant income as a condition of eligibility for occupancy of the unit subject to the rent restriction, as reflected by a recorded agreement with a county or city:

- (i) Loans or grants provided using tax increment financing pursuant to the Community Redevelopment Law (Part 1 (commencing with Section 33000) of Division 24 of the Health and Safety Code).
- (ii) Local housing trust funds, as referred to in paragraph (3) of subdivision (a) of Section 50843 of the Health and Safety Code.
- (iii) The sale or lease of public property at or below market rates.
- (vii) The granting of density bonuses, or concessions or incentives, including fee waivers, parking variances, or amendments to general plans, zoning, or redevelopment project area plans, pursuant to Chapter 4.3 (commencing with Section 65915).

The analysis should include (1) inventory of at-risk units; (2) analysis of at-risk units; (3) an estimate and analysis of the costs of replacement versus preservation of at-risk units; (4) list of qualified entities that would be interested in preserving at-risk projects; (5) list of financing and subsidy sources to preserve at-risk units; and (6) a program for preserving at-risk units.

1. Inventory of At-Risk Units

If there are no units at-risk of conversion in the jurisdiction during the ten-year period, the housing element must include a description of how the jurisdiction determined and verified that there are no federal, state or locally funded units at-risk of conversion.

If the jurisdiction has determined there are at-risk units, the housing element must include a detailed inventory and analysis. The inventory must list:

- each development by project name and address;
- type of governmental assistance received;
- earliest possible date of conversion; and
- the total number of elderly and non-elderly units that could be lost from the jurisidiction's low-income housing stock.

2. Analysis of At-Risk Units

The housing element should include an analysis of the risk of conversion for each project that is identified as at-risk. The risk of conversion varies from project to project depending on market (areas with high housing costs and/or low vacancy rates), intent of ownership to convert, and project-based factors (size of units, location, condition of property, etc.).

3. Estimate and Analyze the Costs of Replacement Versus Preservation for Units At-Risk in the Current Five-Year Planning Period

Determine whether replacement or preservation will be the most economical approach to preserving at-risk units. The housing element should estimate the costs of producing new rental housing (comparable in size and rent levels to existing at-risk units) to replace the units that could convert to market rate. Use current land costs and either current construction costs (square footage rates for multifamily development) or the actual cost of recently completed units.

Estimate the cost of preserving the identified assisted housing developments including acquisition and rehabilitation costs long-term affordability controls and project-based rent subsidies.

A project-by-project cost estimate is not required (Government Code Section 65583(a)(8)(B)).

4. Identify Entities Qualified to Preserve At-Risk Units

Identify qualified entities (local public agencies, nonprofit organizations, and for-profit organizations) with the capacity to acquire and manage at-risk projects and commitment to maintain the long-term affordability of the projects.

5. Identify Financing and Subsidy Resources

Identify and consider the use of all federal, State, and local financing and subsidy programs as preservation resources. Indicate which available federal, State, and local financing and subsidy programs, will be targeted for specific preservation program actions (e.g., replacement, preservation through acquisition, extended affordability controls, regulatory actions, direct rental subsidies, rehabilitation, tenant and sponsor technical assistance, etc.)

6. Program for Preserving At-Risk Units

The housing element must include a description of the program a jurisdiction will implement to preserve at-risk units. Programs are the specific action steps the jusrisdiction will take to implement its policies and achieve goals and objectives, including: (a) actions to monitor; (b) actions to finance and provide technical and regulatory assistance; and (c) actions to assist tenants. Programs must include a specific time frame for implementation, identify the agencies or officials responsible for implementation and describe the jurisdiction's specific role in implementation.

II. Federal, State and Local Financing and Subsidy Resources for Preservation

A. Federal Housing Funds

1. Community Development Block Grants (CDBG)

   - Federal funds for loans or grants benefiting lower income households
   - Flexible use for housing or economic development, with some limits on new construction uses
   - Administered locally and by state, depending on size of jurisdiction
   - Federal regulatory compliance requirements:
     - Davis-Bacon prevailing wage rules may apply
     - National Environmental Protection Act clearance needed

2. HOME

   - Federal housing block grant funds
   - Loans or grants benefiting lower income households
   - Administered locally and by state depending on size of jurisdiction
   - Federal regulatory compliance requirements:
     - Davis-Bacon prevailing wage rules may apply
     - National Environmental Protection Act clearance needed
   - Other rules
     - Loan limits
     - Affordability requirements

3. Low Income Housing Tax Credits (4% and 9%)

   - Administered by California Tax Credit Allocation Committee
   - 9% tax credits very competitive, can only be combined with taxable debt
   - Projects with tax-exempt bonds eligible for automatic 4% tax credits
     - Must compete for tax-exempt bond allocation or can be receive over the counter if not too much demand
     - Eligible for MHP funds from the State

4. Tax-Exempt Bonds

   - Private activity mortgage revenue bonds: local government or joint powers issuer must apply for allocation to the California Debt Limit Allocation Committee; can be combined with LIHTC.
   - 501(c)(3) bonds (nonprofit organizations have authority to issue directly); cannot be combined with LIHTC.

5. McKinney Homeless Assistance Programs

   - Provides capital grants, rental subsidies and services for housing serving the homeless. There are currently three major McKinney multifamily programs:
     - Supportive Housing Program (SHP)
     - Shelter + Care (S+C)
     - SRO Moderate Rehabilitation (SRO ModRehab)

6. Housing Opportunities for Persons with AIDS (HOPWA)

   - Can use as capital grants and operating or subsidies
   - Federal program administered locally

7. Federal Home Loan Bank Affordable Housing Program (AHP)

   - Grant or soft loan
   - Member bank "sponsors" AHP application
   - Sponsor applies for a specific project or program
   - Semi-annual RFP – application deadlines April 1 and October 1

B. State and Local Housing Funds

1. Redevelopment Agencies

   - Generate tax increment funds
   - Set aside minimum 20% for low and moderate income housing
   - Administered locally
   - Projects must be in or linked to redevelopment area

2. Housing Trust Funds

   - Created locally and funded through a variety of sources including local taxes, in lieu fees, assessments and charitable contributions.
   - The state has bond funds that it also makes available to eligible housing trust funds on a competitive basis.

3. Multifamily Housing Program (MHP)

   - New construction/rehab multifamily and supportive housing
   - 3% loans, mandatory interest payment
   - Prevailing wage required
   - Funds at permanent closing
   - No 9% tax credit projects (except for SHP)
   - Very competitive, two rounds per year

4. Mental Health Services Act (MHSA)

- Administered by CalHFA (over the counter)
- Must apply through local County Mental Health Dept.
- New construction/rehab multifamily and shared housing for seriously mentally ill homeless and at risk of homelessness
- 0.42%-3% loans, mandatory interest payment
- Capitalized operating subsidy available
- Funds at construction or permanent closing
- Can be used with 9% or 4% tax credit projects
- Targeting to less than 50% AMI

5. Infill Infrastructure Grant Program

- Promotes infill housing development.
- Grants are available as gap funding for infrastructure improvements necessary for specific residential or mixed-use infill development projects.
- Funds allocated through a competitive process. Approximately $240 million is available for allocation during FY 2007-08.

6. TOD Housing Program

- Provides financial assistance for the development of housing and related infrastructure near public transit stations.
- Low-interest loans are available as gap financing for rental housing developments that include affordable units.
- A total of $285 million available over three years.

III. Best Practices in Local Preservation Strategies

There are several strategies jurisdictions can pursue to ensure their stock of affordable housing is preserved for the longest period possible. Local preservation strategies are just that, they are local, which means every jurisdiction will have their own strategies that are suitable to their particular communities.

Staff activities

1. Analyze inventory

   Staff can review the inventory of federally assisted units by utilizing the Risk Assessment report published by the California Housing Partnership Corporation (CHPC). Projects designated "At-Risk" are within five years of the end date of the most valuable subsidy or rent restriction. For example, a property with a Section 8 contract that expires four years from the current date is considered "At-Risk". CHPC also has additional information about individual projects, which is available upon request. For more information contact CHPC at (415) 433-6804.

2. Establish communications with local HUD office

   Regular contact with the local HUD office can provide early warning about the status of opt-outs and prepayments. Notices of intent to opt-out and prepay are sent to the HUD offices. The HUD staff often has additional information regarding owners who are interested in selling. Contact with HUD also reinforces their focus on preservation.

3. Ensure Owners are Complying with the State Notice Law

   Pursuant to the State Preservation Notice Law (California Government Code Section 65863.11), owners of government-assisted projects must provide 12 months notice to affected public entities of their intention to terminate subsidy contracts, prepay a federally-assisted mortgage, or discontinue use restrictions. In addition, owners must provide Qualified Entities with a Notice of Opportunity to Submit an Offer to Purchase. Owners proposing to sell or otherwise dispose of a property at any time during the five years prior to the expiration of restrictions must provide this Notice at least 12 months in advance unless such sale or disposition would result in preserving the restrictions. Qualified Entities are nonprofit or for profit organizations or individuals that agree to maintain the long-term affordability of projects. See HCD's current list of Qualified Entities http://www.hcd.ca.gov/hpd/hrc/tech/presrv/

4. Contact owners regarding Section 8 renewal plans or mortgage prepayments

In some jurisdictions, local staff has been able to obtain information from owners regarding their plans more readily than tenants or nonprofit organizations. In some cases, these contacts have led to discussions about potential sales, if the owners want to explore that option. This action is primarily applicable to projects owned by profit-motivated owners.

5. Assist in tenant education

   The Federal regulations concerning Section 8 renewals and prepayments are complicated. Regardless of the level of risk, there is a desire among many tenants to acquire more understanding of the law and policy issues involved. Local jurisdictions can hire tenant liaisons to organize or attend meetings with residents of assisted developments. Jurisdictions may also consider providing Resident Capacity Grants and Predevelopment Grants to tenant organizations to explore options and make informed choices about how they may want to deal with this transitional time. Most resident organizations look at ways to link with an existing nonprofit organization to assist in keeping the development affordable.

6. Identify potential buyers and potential acquisition funds

   Local jurisdictions can take an active role to identify potential purchasers who will preserve the housing at affordable rents for an extended period of time. After contacting owners, staff can help match interested sellers with potential buyers. In addition, staff can identify local funds to make the acquisition possible. Several cities have provided gap funding for nonprofit acquisition of at-risk developments.

7. Establish a preservation coordinator

   Some cities designate a staff person to coordinate all of the preservation activities within the jurisdiction. A coordinator can make sure that all of the jurisdiction's efforts work together. Having a coordinator is also a way of publicly recognizing the importance of the local jurisdiction's preservation efforts.

Regulatory actions

1. Require owners who want to opt-out or prepay to provide notice

   Federal and state law requires that notice be provided to tenants of an owner's desire to opt-out or prepay. Federal law requires that notice be provided from 5-9 months for prepayments and 12 months for opt-outs. State law requires 12 months notice for all situations. This notice must be provided to tenants, local jurisdictions, HCD, and HUD. Some cities have passed their own notice requirements that have extended this time period even further and also require a public hearing about the impact on the tenants.

2. Require a Right of First Refusal from owners who sell assisted projects

   A Right of First Refusal provides an opportunity for the local jurisdiction or a qualified entity (typically a nonprofit organization) to purchase the assisted property. The City of San Francisco requires a six-month period after giving notice in which owners must negotiate with the City or a qualified entity for a "fair return" price. The City of Portland, Oregon, provides a 90-day period in which the City can make an offer based on an appraisal.

3. Require owners to provide moving assistance for tenants

   Some cities have enacted ordinances requiring assistance to tenants who are displaced due to a prepayment or opt-out. The City of San Francisco requires a payment for the difference between a tenant's new rent and the tenant-paid portion of the old rent, up to $5,250. The City of Portland requires that $1,000 for the first member of each household and $200 for each subsequent member be paid into a relocation fund, matched 50% by the City.

4. Prohibit discrimination against voucher holders

   Owners opting out or prepaying have sometimes refused to accept voucher holders or otherwise discriminating against the source of income of a tenant. While this is becoming clarified in federal and state law, some cities have enacted local ordinances prohibiting such discrimination.

Financial assistance

1. Provide funding for preservation purchases

   A key way to assist in preserving at-risk properties is to make local funds available for the purchase of these developments by a buyer who will preserve the housing at affordable rents for an extended period of time. Many cities have set-aside a portion of their HOME, CDBG or local Housing Trust Fund dollars for preservation, or established a priority for preservation in the allocation of such funds.

2. Require restrictions in return for financial assistance

   When allocating funds to the purchase of an at-risk project, a local jurisdiction should require restrictions in return to insure that the project is truly "preserved". These restrictions should include the following:

a. *Require that the purchaser accept all renewals of any project-based subsidy.*
b. *Require that the purchaser accept tenants who receive vouchers.*
c. *Require that the period of affordability be extended for an additional 55 years.*
d. *Require that the purchaser set up a reserve to subsidize tenant payments if Congress stops renewing Section 8 or stops appropriating funds for vouchers. A reserve of 2-3 years of operating expenses is a reasonable size.*
e. *Require that rents paid by tenants, particularly in Section 236 projects without Section 8, not increase as a result of the acquisition.*
f. *Require that a majority (50-80%) of the cash flow be used to repay the local loan. The purchaser may be receiving substantially higher rents than the pro forma indicates if they continue to receive Section 8 payments. This is because the pro forma shows the "underwriting rents", i.e. what will be restricted locally or by TCAC or CDLAC. As Section 8 rents are often substantially higher, the actual cash flow may be very large. The local jurisdiction should share in that cash flow if it is providing funds to the project*.

4. <u>Provide guarantees against the Section 8 payments</u>

   In the face of annual renewals by HUD, an effective local strategy to increase project feasibility without increasing the cost is to provide a guarantee against Section 8 payments for a long period of time (10-15 years or more). With such a guarantee, lenders will be willing to fund a loan based on the difference between the "underwriting" rents (generally 50%-60% of AMI) and the Section 8 rent. This enables the project to leverage substantially more debt and therefore reduces the project's shortfall – and, in turn, reduces the need for more local subsidy. A guarantee does not require any out-of- pocket cash.

IV. Preservation Program Sample/Template

Preservation Program Format

Description of Specific Actions Steps, Jurisdiction's Specific Role in Implementation and Demonstration of Commitment to Implement

Timeframe:
Responsible Agency:
Objectives (quantified, where possible):
Funding Sources (where appropriate):

Sample Preservation Program

The City of ________ has a total of ___ units in ___ (*insert type of subsidized properties; i.e. HUD subsidized, other federal subsidy program, state, local*) that are at-risk of conversion to market rate prior to ________. The City will continue or undertake the following programs and activities during the period of the housing element to ensure these at-risk units are preserved as affordable to low-income households. ___________ *(insert name of department responsible for implementation)* will implement these efforts, except where another division or agency of the City is identified. Funding sources to support the implementation of these efforts is specified where appropriate. These local efforts utilize existing City and local resources. They include efforts to secure additional resources from the public and private sector should they become available. The City's program includes the following activities:

a. ***Monitor Units At-Risk*** – Monitor owners of at-risk projects on an ongoing basis, at least every three months, in coordination with other public and private entities to determine their interest in selling, prepaying, terminating or continuing participation in a subsidy program. Maintain and annually update an inventory of "at-risk" projects through the use of existing databases (e.g., HUD, State HCD and California Tax Credit Allocation Committee).

b. ***Work with Potential Purchasers*** - Establish contact with non-profit agencies interested in purchasing and/or managing units at-risk to inform them of the status of such projects. Where feasible, provide technical assistance and support to these organizations with respect to financing. The City should actively pursue affordable housing opportunities and maintain a list of interested and qualified affordable housing developers. The City will update this list annually.

c. ***Tenant Education*** - The City will work with tenants of at-risk units and provide them with education regarding tenant rights and conversion procedures. The City will also provide tenants in at-risk projects information regarding Section 8 rent subsidies through the Housing Authority, and other affordable housing opportunities in the City.

d. ***Assist Tenants of Existing Rent Restricted Units to Obtain Priority Status on Section 8 Waiting List*** - HUD has set aside special Section 8 vouchers for existing tenants in Section 8 projects that are opting out of low-income use. Upon conversion, the units will stay affordable to the existing tenants as long as they stay. Once a unit is vacated and new tenants move in, the unit will convert to market-rate housing.