Sacramento Housing & Redevelopment Agency

REPORT TO HOUSING AUTHORITY
City of Sacramento
915 I Street, Sacramento, CA 95814-2671
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STAFF REPORT
August 21, 2007

Honorable Chair and Members of the Housing Authority

Title: Housing Authority Asset Repositioning Study

Location/Council District: Citywide

Recommendation: Adopt a **Housing Authority Resolution** approving the Housing Authority Guiding Principles to address reposition of its public housing asset.

Contact: La Shelle Dozier, Director, Housing Authority, 440-1335, Nick Chhotu, Assistant Director, Public Housing, 440-1334

Presenters: La Shelle Dozier, Director, Housing Authority, 440-1335, John Hamilton and Nicole Graham CSG Advisors, Jonathan Zimmerman, Housing Policy Analyst, National Association of Housing and Redevelopment Officials (NAHRO)

Department: Sacramento Housing and Redevelopment Agency

Description/Analysis:

Issue: The issues confronting our public housing portfolio are significant. The housing stock is rapidly aging, the federal government has not adequately funded public housing programs for the past seven years, and the local demand for affordable housing continues to increase. Many Housing Authorities across the nation are facing similar challenges maintaining their public housing inventory. To meet these challenges, the Sacramento Housing Authority must take new innovative approaches to preserve and maintain its very valuable real estate portfolio.

The Housing Authority is currently challenged to leverage very limited resources to operate public housing units in the City and County of Sacramento. In June 2006, staff recommended developing a comprehensive approach to become fiscally self sufficient through the development of a real estate reinvestment and disposition strategy. CSG Advisors (CSG) was selected to analyze the Housing Authority portfolio and prepare recommendations on the best approach to address our current and long term needs. The purpose of the Asset Repositioning Study (Study) was to establish the framework for a proactive strategy to align Housing Authority operations to the realities of the Housing and Urban Development (HUD) funding environment while simultaneously eliminating ongoing operating and capital deficits.

CSG has been a leading housing financial advisor in California since 1983. CSG has extensive experience working with housing authorities nationally such as Tacoma, Phoenix, New Orleans, Houston, and New York City. More importantly CSG has a strong commitment to housing authorities in California, with clients in San Francisco, Monterey, Oakland, Los Angeles, Fresno, and Alameda County. These housing authorities have already implemented their asset repositioning strategies and have successfully completed public housing mixed finance development projects. Where appropriate, CSG can directly apply the lessons from these housing authorities to Sacramento's public housing portfolio.

The Study (Attachment 2) evaluated the immediate and long-term financial viability of our public housing portfolio, reviewed all public housing properties (except scattered sites with one to seven units), and identified initial properties that were strong candidates for in-depth repositioning analysis. The first priority properties or "Action Developments" are as follows: Central City Elderly High rises and all three large public housing developments (River Oaks, New Helvetia, and Dos Rios). In addition, the study provides alternative funding recommendations to implement future strategies. Staff will return with the first recommendations for the Central City Elderly High rise developments in the first quarter of 2008.

Guiding Principles (Exhibit A) were developed to frame the Study. These important principles will also shape and guide future strategic long term decisions by the Housing Authority. They support the mission of the Housing Authority, and they are the cornerstone of our long term vision: a self-sustaining real estate portfolio to serve extremely low income residents in the City and County of Sacramento.

A critical component to implement the recommendations contained in the Study is to obtain funding for predevelopment costs. The predevelopment period can take from 12-18 months or longer depending on the complexity of the project. Many tasks and activities occur during the predevelopment phase which require funding. Staff recommends use of Low Mod Tax Increment funds to help support this initiative and will return with specific recommendations during the annual budget process. Staff will also pursue predevelopment loans and grants available through other sources to help augment funding for these activities.

Policy Considerations: This report is consistent with the 2007 Public Housing Authority (PHA) Plan, and the Housing Authority's plan to transition to the asset management model in compliance with federal regulations.

Environmental Considerations: The proposed action is a planning activity for a possible future project. As such, it is exempt from further environmental review at this time pursuant to California Environmental Quality Act (CEQA) per Guidelines Section 15262. Full environmental review shall be conducted before the Agency is committed to a definite course of action or approval of a specific project for any Housing Authority development site. The National Environmental Policy Act (NEPA) does not apply.

Commission Action: At its meeting of August 1, 2007, the Sacramento Housing and Redevelopment Commission reviewed this item. The votes were as follows:

AYES: Chan, Coriano, Fowler, Gore, Hoag, Piatkowski, Shah, Stivers

NOES: None

ABSENT: Burns, Burruss

NOT AVAILABLE TO VOTE: Dean

Rational for Recommendation: Due to a reduction in federal funds for operating public housing units in the City, the Housing Authority developed a comprehensive plan with guiding principles to help diversify their existing portfolio and develop alternative funding strategies. Implementation of this plan will require establishment of a predevelopment fund for the normal and customary costs associated with repositioning of assets. Developing such a long term strategy and fund is crucial to the preservation of the Housing Authority assets.

August 21, 2007

Housing Authority Asset Repositioning Study

Financial Considerations: Staff recommends using Low Mod Tax Increment funds to establish a predevelopment fund for initial implementation of the Asset Repositioning Study. Staff will return with specific recommendations during the annual budget process.

M/WBE Considerations: M/WBE considerations shall be applied to the extent necessary required by federal funding involved.

Respectfully submitted,

ANNE M. MOORE
Executive Director

Recommendation Approved:

Cassandra H.B. Jennings
for RAY KERRIDGE
City Manager

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Attachment 1

BACKGROUND

The Housing Authorities of the City and County of Sacramento own and operate 3,167 public housing units, all of which are affordable to extremely low income families, seniors, or disabled persons. Approximately 7,000 extremely low income people live in these units. The Housing Authority's public housing portfolio has a value in excess of a half billion dollars.

Of the total public housing units 65 percent are located in the City of Sacramento, and 35 percent are in the County (including 93 units in Citrus Heights, 88 units in Rancho Cordova, and 46 units in Elk Grove). Listed below is a breakdown of the Housing Authority's housing stock characteristics.

Complex Size/Characteristics	# of Units	Percentage of Total Housing Stock
Mid Size Developments (8-200 units)	1,457	46%
Large Developments (200+ units)	904	28.54%
Senior/Disabled High Rise (24-150 units)	564	17.8%
Single Family/Duplexes (3, 4 and 5 Bedrooms)	242	7.66%

Impetus for Change - HUD Mandated Conversion to Asset Management

In September 2005, the Department of Housing and Urban Development (HUD) published the final rule on the project-based operating fund program which radically changes the way public housing authorities conduct business. The final rule contains two main provisions: 1) a new formula for determining operating subsidy and 2) a new business model called asset management.

In the past, HUD provided housing authorities operating funds to allocate across their entire portfolio of housing units. Under the new asset management system, funding is provided to individual "groupings" of properties. The new system required the Housing Authority to reorganize its 3,000 plus units into 16 "groupings" and decentralize the majority of our staff in new offices within these groupings. These changes have required significant modifications in how we do business since each property grouping must have its own budget, accounting records, funding, and assigned staff.

Under HUD's new model, the Housing Authority prepared a long term capital needs assessment for each property. The assessment has determined that the Housing Authority must invest from $130-$150 million dollars over the next ten years to maintain its current housing inventory. These estimates include both routine capital needs like periodic replacements of roofs and kitchen appliances, as well as extraordinary needs such as security surveillance and underground infrastructure utility replacement.

Stable and adequate capital funding is required for the Housing Authority to carry out activities such as these in a timely manner. Addressing capital issues when the need arises is less costly than undertaking extensive renovations after need accrues for several years. However, based on federal appropriations for capital improvements from FY1996 - FY2006, the cumulative shortfall in funding to Housing Authorities across the country is more than $20 billion.

Funding History:

Dollars in millions	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Actual Need	4,500	4,500	4,500	4,500	4,500	4,500	4,500	4,500	4,500	4,500	4,500
Appropriation	2,500	2,500	2,500	3,000	2,900	3,000	2,843	2,712	2,641	2,600	2,300
Cumulative Shortfall	2,000	4,000	6,000	7,500	9,100	10,600	12,257	14,045	15,904	17,804	20,004

Housing Authority officials agree that an annual funding level of about $4.5 billion annually is needed in order to bring the public housing stock up to standard within a decade. However, over the last five years, modernization funding has averaged only about $2.8 billion annually. This level of funding barely meets the ongoing maintenance needs of public housing and, as a result, the backlog of modernization needs in public housing is not being effectively reduced.

Housing Authority Transition to Asset Management

The Housing Authority has successfully implemented key requirements of HUD's new mandate for asset management including:

- Placement of individual developments into 16 new HUD approved project groupings (communities)
- Decentralization of staff to offices established in our new communities
- Conversion to project-based accounting and management practices
- Completion of an assessment to establish HUD authorized property management fees
- Development of a management performance system
- Development of a long term capital plan
- Completion of an assessment of risks and implementation of strategies to address findings
- Reorganization of substantially reduced centralized services

Need for Asset Repositioning Strategy

In June 2006, the Housing Authority presented the Council and Board of Supervisors with several strategies to address the current and future budget shortfalls. Staff estimated an annual operational shortfall of $3.5 million. One key initiative to address the operating and capital deficits was the development of a strategy to reposition the Housing Authority's real estate assets. The Housing Authority contracted with CSG consulting firm to develop a long term plan to assess our current properties and determine a priority for units that we should maintain, develop, renovate, sell or otherwise reposition for long term financial sustainability.

The key theme from the CSG Study and from other successful Housing Authorities is the ability to use innovative techniques to leverage limited existing resources. To be financially sustainable and to continue to serve our residents effectively, the Housing authority must identify opportunities to:

- Extend the useful life of aging property (current housing stock ranges in age from 11 to 56 years);
- Alter or retrofit facilities to consolidate space or accommodate new functions and technologies for more effective and efficient operations;
- Meeting evolving residential property based standards for safety and security, environmental quality and accessibility; and
- Dispose of obsolete or nonviable properties and develop replacement units which are also affordable to extremely low income households.

Long Term Asset Repositioning Results and Priorities

The attached report prepared by CSG Consulting firm (Attachment 2) evaluates the Housing Authority's portfolio to assess which property or grouping of properties are the best candidates for in-depth repositioning analysis based on strategic criteria such as high capital needs, operating deficits, risk of mandatory conversion from HUD, revitalization potential, resident retention and small scattered sites.

The results of the study conclude that the Housing Authority should focus their in-depth repositioning analysis on the following developments:

<u>Priority Action Developments</u>

- Central City Elderly/Disabled High rises (564 units)
- Large Family Developments: New Helvetia, River Oaks, Dos Rios (1,025 units)
- Small/Scattered Sites (300 units)

The first two "Action Developments" represent 50 percent of the Housing Authority portfolio. Since these developments scored relatively high according the aforementioned criteria and represent a significant portion of the portfolio, prioritizing repositioning of these developments first will provide the greatest potential beneficial impact to the Housing Authority.

Small/Scattered Sites also represent a significant part of the portfolio; however, they were not specifically analyzed as part of the Study. Therefore, they will be closely monitored with the new asset management accounting systems to track their revenues and expenditures. This data will allow us to make future repositioning decisions for our small/scattered site developments.

Redevelopment Collaboration Opportunities

Unlike the majority of Housing Authorities across the country, the Sacramento Housing Authority is in a unique position as a joint Housing and Redevelopment Agency, which we can capitalize on for future development opportunities. As a Housing and Redevelopment Agency, we have staff with expertise in both the financing and management of affordable housing developments as well as neighborhood revitalization.

In redevelopment areas that contain public housing developments, we will have the opportunity to evaluate the role of Housing Authority owned units and/or land in the context of the larger neighborhood revitalization/redevelopment strategy. When the opportunity arises to reposition Housing Authority owned units consistent with our guiding principles, we will be able to take advantage of those opportunities and collaborate with efforts to revitalize existing neighborhoods. A successful collaborative approach will provide mutual benefit for the community and our residents, who are an integral component in the neighborhoods within the redevelopment areas. Our initial review of possible opportunities includes Housing Authority owned units in the Oak Park, Stockton Blvd., Downtown, and Richards redevelopment areas.

Immediate Short term Strategies

In addition to proceeding aggressively with the aforementioned long term strategies outlined in the Study, the Housing Authority will also evaluate and implement immediate short term strategies to address specific small problem properties, single family homes, vacant lot sales and non-residential assets.

Of particular concern in the immediate strategies are specific smaller properties, which sometimes can be very inefficient to manage and require a disproportionate share of limited staff resources per unit. Because many are located in low income neighborhoods, they may provide opportunities to enhance SHRA's Community

Development initiatives. The following are possible immediate short term strategies which we will be considering:

Property Characteristics	Strategy
Single Family Homes (130 units)	Analyze opportunities to sell to first time home owners
Vacant lot sales	Market rate sale
Non-Residential property at Commerce Circle	Market rate sale or lease

Timeline for Implementation

A comprehensive asset repositioning strategy is a long term strategy which requires a significant investment of time and resources. Based on information from other Housing Authorities that have embarked on such initiatives, it is typical that implementation can take 5 – 10 years. However, the result is a sustainable real estate portfolio capable of providing affordable housing for low income people for many years. Our projected timeline for completion of the priorities outlined in this report are reflected in the timeline below.

Asset Repositioning Time Lines

- Short Term: Immediate Strategies — 1 – 2 years
- Long Term: Central City Elderly/Disabled High rises — 1 – 4 years
- Long Term: Large Developments — 3 – 6 years
- Long Term: Scattered Sites — 5 – 7 years

Staff will report back to the Council with a specific action timeline for each Action Development in our Asset Repositioning timeline listed above. Staff anticipates that the first Action Development for Central City Elderly High rises will come back for review and approval by the first quarter of 2008. In addition, we will update the Council on an annual basis of our overall progress on asset repositioning as a part of the annual budget process.

Attachment 2

Asset Repositioning Study

Submitted to the

Sacramento Housing and Redevelopment Agency

Prepared by CSG Advisors and Abt. Associates

July 27, 2007

CSG | advisors

Abt

Abt Associates Inc.

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1. Executive Summary

The Sacramento Housing and Redevelopment Agency (SHRA) operates more than 3,100 public housing units through its control and operation of the Housing Authority of the City of Sacramento and the Housing Authority of the County of Sacramento. SHRA operates these units in a climate of uncertain and, generally, declining operating and capital subsidies from the U.S. Department of Housing and Urban Development (HUD). SHRA has done well to maintain the integrity of its operations in spite of the recent difficulties with HUD funding, but the decline in operating and capital subsidies has nonetheless resulted in operating and capital shortfalls for SHRA with respect to its public housing units.

SHRA commissioned this Asset Repositioning Study (the "Study") as part of a proactive strategy to align SHRA operations to the realities of the HUD funding environment while adhering to SHRA's "guiding principles" and continuing to address the ongoing needs of SHRA's traditional constituents. Such alignment includes restructuring – or "repositioning" – specific SHRA public housing assets in order to reduce dependence on HUD funding and eliminate ongoing operating and capital deficits. SHRA can reposition its assets by leveraging HUD sources with private funding (debt and equity) and other subsidy sources (HOME, MHP, etc) to yield self-sustaining developments. Repositioning specific assets in this manner also helps SHRA achieve its broader goal of reducing its reliance on HUD funding sources.

This Study, using available SHRA data, identifies repositioning candidates, and describes potential repositioning strategies.

a. Capital and Operating Shortfalls

SHRA's traditional public housing relies on capital funding and operating subsidies from HUD. Capital funds are used for capital repairs (roof replacement, etc.) while operating subsidies offset operating shortfalls. SHRA currently has a projected 5-year capital need of approximately $78M while currently receiving $5M in annual capital funds – a $53M capital shortfall for the 5-year period. Operating subsidies also fall short of funding need: SHRA is currently experiencing annual operating shortfalls of approximately $3.5M.

b. Portfolio Review and Identification of "Action Developments"

The Study evaluates SHRA's public housing portfolio according to six strategic criteria:

- Risk of Mandatory Conversion;
- High Capital Needs;
- High Operating Deficit;
- Revitalization Potential;
- Poor Resident Retention; and
- Small Scattered Sites.

Based on the evaluation, the following four developments ("Action Developments") appear to be strong candidates for in-depth repositioning analysis:

- New Helvetia;
- River Oaks;
- Dos Rios; and
- Downtown Elderly High Rises (Riverview, in particular).

Among SHRA's portfolio, these developments exhibit concerning aspects of two or more of the six evaluation criteria. Because of their size and/or known negative economic impact, appropriate repositioning of the properties will likely provide the greatest potential beneficial impact to SHRA.

SHRA's public housing portfolio also includes a significant number of small properties (i.e., developments containing 8-50 units) and small, scattered-site properties (i.e., developments containing 1-7 units). The scattered site properties are not specifically analyzed as part of the Study. The small and scattered site properties, however, may together represent a significant opportunity for SHRA to improve upon the disproportionately high management and operating costs that are typically associated with scattered sites. However, the Study is unable to provide meaningful conclusions as to the current burden represented by these properties due to insufficient current data. SHRA should closely monitor these developments and analyze project specific data collected in order to determine if SHRA could significantly benefit from repositioning any portion of these assets.

c. Potential Strategies, Authority-Wide Implications

Each potential candidate for repositioning requires in-depth, project-specific analyses that are not within the scope of the Study. The project-specific analysis would quantify the potential benefit, if any, of repositioning, and recommend a specific repositioning strategy using all available and applicable sources. Sample strategies could prescribe full or partial demolition with new construction; substantial rehabilitation of existing developments; new construction of units on vacant/under utilized land; or strategic disposition of developments and/or land. The "program" of an existing development could entail replacing all or a portion of public housing units with other types of affordable units (i.e., non-public housing tax credit units), or market (or tax credit) units with attached project-based Section-8 vouchers.

Financing sources typical to these leveraging-type transactions include low income housing tax credits (4% and 9%), capital fund bonds, private-activity tax-exempt bonds, private mortgage debt, HOPE VI funding from HUD, and numerous other local and state funding sources, including MHP (and other HDC programs), HOME, CDBG, tax-increment, etc.

To effectively implement any repositioning strategy, SHRA must understand the potential authority-wide impacts of such strategies and develop policy to address or anticipate them. For instance, SHRA must consider its policies on replacement housing; the manner in which it would participate in development (e.g., as developer, developer partner, non-developer sponsor, etc); resident involvement; staff resources and capacity; and funding for predevelopment activities. Key among these considerations might be allocation of (or hiring new) staff dedicated to the repositioning initiatives.

d. *Next Steps*

Key next steps for SHRA include the following:

- Prioritize Action Developments based on need, potential benefit, and initial financial analysis;
- Review small/scattered developments and other assets (e.g., vacant land) to understand current benefit/costs of, particularly, the small/scattered developments considered as a group;
- Develop detailed financial analysis/repositioning strategy for prioritized developments;
- Build capacity to undertake repositioning initiatives, including allocating and/or hiring the necessary dedicated staff;
- Continue and further refine data collection at a project-level to refine and assist in future decision making; and
- Procure necessary legal counsel (particularly HUD counsel) that can assist SHRA in navigating HUD regulatory issues. Additionally, SHRA will likely require counsel with transaction-specific expertise, such as bond counsel, tax counsel, local real estate counsel. SHRA in-house counsel may possess some or all the required expertise.

2. Introduction

SHRA commissioned this Asset Repositioning Study (the "Study") to evaluate the immediate and long-term financial feasibility of its public housing portfolio. The Study focuses on SHRA's real property rather than agency cost centers or overall operations. The Study aimed to review all of SHRA's public housing properties (except the scattered site properties between one and seven units), identify those showing the greatest need for – or potential benefit from – repositioning, and suggest preliminary repositioning strategies for those properties.

Although the Study's central analysis in this study reflects a snapshot that will change with time, it also provides some general guidelines that should remain valid over the long term (for example, general criteria that should guide SHRA's ongoing evaluations of its portfolio as well as specific repositioning initiatives). Section 6, describes implications of development activity for SHRA now and in the future, e.g., staffing and funding for repositioning initiatives. Section 7 provides recommendations for next steps and offers suggestions for future data collection and monitoring to inform future portfolio review.

a. Overview of SHRA's Public Housing Portfolio

SHRA controls and manages the Housing Authority of the City of Sacramento (City) and the Housing Authority of the County of Sacramento (County). Through the two public housing authorities (PHAs), SHRA owns and manages over 3,169 public housing units. This total includes 1807 units in 37 developments owned by the City, 962 units in 49 developments owned by the County, and approximately 400 scattered site units.

Physical characteristics

SHRA's public housing portfolio includes many different sizes and types of developments, ranging from scattered site single family housing to 100+ unit high rise developments for the elderly to 400+ unit developments for families.

The City's portfolio includes two very large developments (River Oaks at 460 units and New Helvetia at 347 units), five elderly high rise buildings ranging from 76 to 108 units, and a wide range of other developments ranging from 1 to 80 units.

In contrast, the County's portfolio is dominated by smaller developments, with the exception of Dos Rios (218 units). The next largest County development is 36 units (El Paraiso), followed by a 30-unit property (Southwest/Dewey), after which all other developments in this portfolio are 24 units or smaller

SHRA's public housing stock ranges in age from 11 to 56 years, with an average age of 35 years. The County units tend to be newer compared to City units. The average age of the County units is 21 years (and would be 18 years if Dos Rios were excluded from the calculation). The average age of the City units is 32 years.

Present conditions and capital needs

The Agency has maintained its portfolio well given the limited, decreasing funding that Congress and HUD have provided for public housing.

In recent years, SHRA has completed major capital improvements at several developments. Complete modernization improvements were made at 2970 2nd Avenue, 3937-39 & 4037-39 Renick Way, 3725-35 Haywood Avenue, and Alkali Flat. Additional modernization improvements were made at 6054 Shupe Avenue and 3725 Cypress, while structural foundations were replaced at three New Helvetia buildings. Additional improvements were made to the River Oaks Complex, 1107 23rd, 2845 37th St, 1820 Capital, 3725 Cypress, 1318 E St, 2516 H St, 1725 K St, 2526 L St, 480 Redwood, and 626 I St. Finally, single family homes were replaced at 237 Haggin Avenue and 7717 Bellini Way.

Pursuant to HUD requirements, the Agency prepares long-term capital needs assessments for each property. These assessments, last prepared in July 2006 by SHRA staff, suggested total capital needs of $78 million over the next five years for the entire public housing portfolio, including $52 million for City-owned properties and $26 million for County-owned ones. Looking ahead over longer time horizons, staff estimated capital needs of $136 million over the next ten years and $185 million over the next fifteen years (in each case the figures include the projected need over the first five years). These estimates include both costs related to routine capital improvements like periodic replacement of roofs and kitchen appliances as well as costs related to certain known extraordinary needs: security surveillance systems or underground infrastructure utility replacement.

HUD's Real Estate Assessment Center (REAC) evaluates public housing properties on several factors including the physical well-being of the properties, the financial condition of properties, resident satisfaction, and the effectiveness of PHA management. Though not without limitation, the REAC scores is an indicator of a development's physical and financial health: the higher the score, the "healthier" the development. REAC scores are provided on a scale of 1 to 100, with scores above 60 considered passing. In 2005, the County properties received an average REAC score of 67, while the average score for City properties was 81. The 2006 REAC inspections for both the City and County are currently underway and should be completed towards the end of May.

Resident incomes and rents

SHRA's public housing serves some of the poorest residents in Sacramento County, with average median income of approximately $12,686 (5% of the area median income of $67,200 for a four-person household). On average, SHRA's public housing residents can afford to pay $296 in rent under HUD's regulations restricting tenant-paid rents to 30% of gross income. City- and County-owned properties are similar in this respect, with the City average at $283 and the County average at $309. Note that under HUD funding procedures, increases in tenant-paid rents do not necessarily result in better financial performance for a property, because the HUD operating subsidy is designed to offset tenant-paid rental income.

b. Funding Context

SHRA should understand the universe of available funding sources in order to most effectively evaluate repositioning options for certain developments. The available funding sources fall into two general categories: funding for ongoing operations and capital needs, and funding for extraordinary activities such as asset repositioning.

Operating and Capital Subsidies

Over the past few years SHRA and all PHAs nationally have experienced significant reductions in HUD funding for public housing. Despite steady inflation in operating and maintenance costs, operating subsidies have not been fully funded since 2002 and capital fund allocations have dropped each of the past five years. For instance, in 2006 HUD funded operating subsidy at approximately 85% of actual need as measured by HUD (this percentage is also known as the "proration factor"), and capital fund allocations nationally shrank 11% -- from $2.6 billion to $2.3 billion between 2005 and 2006. The total count of SHRA's public housing units and levels of tenant-paid rents have not changed materially during this time period, so virtually all the reductions shown in the graph represent HUD funding cutbacks (the picture would look even worse if the figures were adjusted for inflation).

These reductions in Public Housing operating subsidies and capital improvement funding have caused SHRA to rely on reserves, inter-fund transfers, and asset sales for continued operations. For 2006, the housing authority received only 82% of the annual funding formula HUD used for the past twenty-five years. This is the lowest percentage in the history of the Public Housing program and translates to a loss of over one million dollars for 2005 out of a $10 million budget.

While it is impossible to predict future HUD funding levels, it seems unlikely that HUD will fully fund operating subsidy in the near future. This has significant implications for the long-term sustainability of the public housing portfolio. Note especially that the current annual capital fund allocation of approximately $5 million falls far short of the projected five-year capital need of $52 million for City properties and $26 million for County properties.

Switch to Asset Management

To successfully function under HUD's new operating rule, SHRA, on November 1, 2006, implemented the asset and portfolio management practices used by private and institutional real estate investors while continuing to adhere to the agency mission of serving low-income households. SHRA must become an active manager of its assets – including actively assessing the viability of individual SHRA-owner properties – in order to implement the transition to full asset management. The SHRA established an Executive Team to implement conversion of the existing revenue model to a private sector based asset management model. Some of the key transitions include:

- Placement of individual developments into new project groupings;
- Project based accounting conversion;
- Project based management conversion;
- Property management fee assessment;
- Determining centralized services;
- Development of a management performance system;
- Develop a long term capital plan; and
- Risk assessment.

SHRA will suffer from additional losses in funding related to HUD's new "asset management" procedures. Under the new operating subsidy formulas established by HUD, SHRA is predicted to receive approximately 8% less operating subsidy for the properties owned by the City and approximately 2% less operating subsidy for the County properties. Although there is a multi-year phase-in period for these reductions, the loss in operating subsidy eligibility will eventually reach approximately $486,550 for the City and County compared to current eligibility.

In addition to reductions in property-specific operating subsidy levels, HUD's "asset management" procedures limit funding for the central office cost center. SHRA has already taken actions to prepare for this change, and continues to explore ways to reallocate costs, restructure staffing, and/or find additional resources to allow the central office to properly manage and maintain the public housing portfolio. These reductions also affect the Agency's capacity to fund new initiatives such as the asset repositioning strategies described in this study.

New Tools for Asset Repositioning

Over the past decade, PHAs have gained access to many previously unavailable financing tools. HOPE VI grants have been a key resource. However, with reductions in program funding and only just $99 million expected to fund 4-5 grants in 2007, PHAs cannot count on receiving a HOPE VI grant no matter how worthy the application.

Fortunately, the HOPE VI program has changed the industry in ways that will continue regardless of the future of HOPE VI grants, including the ability to use low-income housing tax credits on public housing units under HUD's "Mixed Finance" regulations and the ability to transfer ownership of public housing properties to other entities such as tax credit partnerships that may be controlled by PHAs. The advent of the Capital Fund Financing Program allows PHAs to borrow against future HUD capital grants to accelerate rehabilitation and modernization. The many successful transactions that have been done under these programs over the past decade have helped many lenders, tax credit investors, developers, and others gain experience and comfort working with public housing.

Collectively, these changes in federal regulations and the growing base of experience in the financing and development communities provide PHAs with many new options for repositioning assets. Combining these options with state and local funding sources greatly expands the possibilities for SHRA's portfolio. The Appendix offers an overview of many of the funding sources with particular relevance to SHRA.

c. *SHRA Guiding Principles and Unique Strengths*

SHRA's evaluation of its public housing portfolio and opportunities to reposition assets should be informed by its guiding principles as listed below. SHRA should also recognize and attempt to best leverage its unique strengths concerning real estate development and management.

1. Sustain our commitment to house extremely low income households by adopting a "no net loss policy", requiring the development of at least an equivalent number of replacement units when units are removed from our baseline inventory.

2. Decrease reliance on federal funding sources by leveraging the use of existing sources with private funding (debt and equity) and other sources (grants and local subsidies).

3. Preserve and enhance existing physical housing stock; upgrading stock whenever possible to a 30 year useful life.

4. Locate new units into sustainable and livable communities that meet the specific needs of residents.

5. Incorporate smart growth principles (i.e. energy efficiency, safety/security, quality of life) into project design to the maximum extent possible.

6. Diversify real estate portfolio in creative ways to support extremely low income units.

7. Maximize utilization of existing resources (i.e. vouchers, local funds, the value of HA real estate assets, etc.) to implement development strategies.

8. Reinvest proceeds from the sale of Housing Authority properties in the replacement of units.

9. Promote and support resident self sufficiency.

10. Seek creative partnerships with other agencies, non-profits, community groups, resident advisory boards, and private sector sponsors.

Many of these have direct implications for how SHRA should conduct any asset repositioning. For example, the principle of 1:1 housing replacement suggests that disposition of public housing units may not be an option unless affordable replacement units can be identified. The guiding principles suggest that maintaining the "status quo" is not an option for SHRA. Given the pattern of increasing costs and decreasing HUD funding described previously, SHRA must work proactively to preserve both its housing stock and its ability to serve extremely low-income people.

Unique Strengths

Compared to many housing authorities around the country, SHRA enjoys some important and relatively unusual advantages. First, the experience of SHRA and its nonprofit affiliates in developing affordable housing outside of HUD programs is valuable in pursuing new initiatives and can help the Agency compete effectively for scarce funding resources and attract lenders and tax credit investors.

Second, the SHRA's dual functions as a public housing authority and a redevelopment agency provides SHRA knowledge, expertise, and resources unavailable to many housing authorities. It also allows SHRA to potentially focus both public housing repositioning efforts and other redevelopment activities within a certain area (or multiple areas) to maximize SHRA's overall impact on a given neighborhood.

Finally, SHRA's size and location in the state's capitol (location of state funding sources and allocating agencies) give SHRA a strong base from which to pursue asset repositioning.

d. Criteria for Portfolio Review and Asset Repositioning

Portfolio Review Criteria

As further described in Section 3, data limitations present an obstacle to deriving firm conclusions about any one property For example, multiyear, property specific revenue and expensed data are not currently available: the data does not yet exist given previous HUD accounting procedures. We can identify, however, general criteria for evaluating properties regarding asset repositioning regardless of the available data (for example, significant and sustained operating deficits, etc.). One goal of this study is to identify a master list of criteria for SHRA to use both now and regularly in the future as it monitors its portfolio and considers opportunities to reposition assets. By focusing attention on these criteria, and systematically collecting information on them over time, SHRA can best focus its efforts.

As will be described further in Sections 3, 4 and 5, we suggest six core criteria for identifying properties that lend themselves to asset repositioning. These criteria highlight properties that exhibit one or more of the following characteristics:

- Identified by HUD as a possible mandatory conversion property in the past 12 months;
- Near-term capital needs that greatly exceed anticipated capital funding;
- Significant and sustained operating deficits;
- Property characteristics well-suited to repositioning (e.g. opportunity to add units on a site that has low density compared to surrounding uses, opportunity to combine repositioning activities with other properties that lead to overall cost savings or efficiencies, opportunity to draw on unique funding sources, opportunity to coordinate with new development activities on an adjacent parcel, etc.);
- Significant ongoing problems attracting and retaining residents;
- Additional management challenges exacerbated by small size and distance from other properties in the portfolio;

Suggested Criteria for Next Steps of Asset Repositioning

Although the asset repositioning ideas presented in Section 5 are only preliminary, we recommend that SHRA start thinking about criteria by which it will judge specific repositioning initiatives when they are presented for approvals. These should echo the eleven guiding principles of SHRA described previously. In addition, we would suggest adding the following two criteria to guide SHRA's asset repositioning strategy:

- Capitalize on SHRA's unique strengths and abilities, such as leveraging outside funding and coordinating with other redevelopment activities to stimulate broader impact in the community; and
- Generate developer fees, sales proceeds, or other revenues to SHRA that at least cover its associated costs.

Any single asset repositioning initiative likely will not satisfy all of these criteria simultaneously. But by systematically evaluating each proposed initiative against these criteria, SHRA will be better able to identify the projects that are most consistent with its mission and principles and are most likely to lead to success for SHRA, its residents, and the broader community.

3. Information Collected on the Portfolio

The goal of this Study is to provide insight into the long-term financial feasibility of SHRA's public housing portfolio. To do this, we sought to distinguish successful and viable properties from those that represent a significant drain on SHRA resources or are otherwise infeasible to maintain and operate. Our focus was on data that could help differentiate properties by illuminating strengths and weaknesses of individual developments. This section describes the main types of information we collected – that concerning operations, physical needs, site context and special characteristics, and community considerations – and the limitations in the amount and quality of data currently available.

a. Operations

HUD has historically required PHAs to report information about project operations on a portfolio-wide basis rather than on an individual project level. Consistent with HUD's reporting requirements, PHAs often collected data on the broader portfolio level, making it difficult to identify operating distinctions between high performing developments and low performing ones. For example, it was common for PHAs to report electric usage at dozens of public housing sites, which obscured the need for conservation improvements and other interventions at the least efficient developments.

More recently, HUD has required PHAs to transition from the previous portfolio-wide accounting methodology to project-level accounting. SHRA completed this transition in January of this year, and has been collecting operations data for individual developments within its portfolio since November 2006. Although this shift will make it much easier for SHRA to track the operational viability of individual developments over time, sufficient historical data does not currently exist at the project level.

Due to the limited operational data available, we relied on a combination of data from the expertise of SHRA staff members most familiar with the portfolio to provide contextual knowledge, limited financial data and , supplemental information about the relative strengths and weaknesses of each property. Specifically, staff drew on their own experiences with individual properties to provide input on utility costs, unit maintenance and site maintenance costs, central office oversight, resident service costs, unit turnover, and the ability to lease-up units. Limited data on occupancy rates and utility costs was also considered along with the HUD Project Expense Levels (PEL), which determine available subsidy levels for clusters of properties. Appendix A contains summaries of the data we collected and used in evaluating each development.

b. Physical Needs

SHRA has two key data sources that shed light on the structural well-being of its properties: a capital needs assessment prepared by 3D-I in March 2005, and recent assessment scores prepared by HUD's Real Estate Assessment Center (REAC). The capital needs assessment provides cost estimates for improvements that each property is expected to require over a 5-, 10-, and 15-year timeframe. The REAC scores are provided for each property (or in a few cases for clusters of small properties), and are based on several factors including the physical well being of the properties, the financial condition of properties, resident satisfaction, and the effectiveness of PHA management.

Both the capital needs assessment and the REAC scoring system have limitations. For example, the findings of the capital needs assessment appear inconsistent for certain properties, with higher needs identified for certain newer properties, and lower needs identified for some properties that appear to require major system overhauls. Meanwhile, because the REAC scores are also based on several factors not directly related to the physical well being of the properties, low scores do not necessarily indicate high capital needs. We also found that in some cases where REAC scores are prepared for clusters of small properties, individual properties within the same group are given identical scores even where significant differences exist between properties in the cluster. Given the limitations of these data sources, we also relied on input from staff to evaluate the physical needs of individual developments.

c. Site Context and Special Characteristics

SHRA provided additional information on the development context of each property, including zoning designation, location in relation to redevelopment areas, and estimated acreage. In addition, SHRA advised our team of each property's location in relation to other development efforts, perceived market potential, synergy with existing land uses, and potential for improved financial performance through rehabilitation, redevelopment, or other intervention.

d. Community Considerations

Several community attributes were also considered. SHRA staff provided input on the proximity of individual properties to public transit, public schools, employment opportunities, medical services, shopping, and public services, as well as the perception of crime at each location and the level of involvement from resident, community, and political stakeholders.

4. Data and Portfolio Analysis

Based on the information gathered for each property, we worked with SHRA staff to determine which properties may warrant some level of intervention based on the six criteria for reviewing the portfolio, which were identified in Section 2. Properties believed to meet these criteria were grouped into one or more of the following categories:

- **Risk of Mandatory Conversion.** This group includes SHRA developments that have appeared on HUD's listing of possible mandatory conversion properties;
- **High Capital Needs.** Properties in this group appear to require significant near-term physical improvements that substantially exceed available funding.
- **High Operating Deficit.** Properties in which operating costs are believed to far exceed the level of operating subsidy available through HUD were included in this group.
- **Revitalization Potential.** Properties in this group were identified as having strong potential to be reused or revitalized.
- **Poor Resident Retention.** Several properties that exhibit chronic problems retaining residents were included in this theme.
- **Small/Scattered Sites.** This theme includes a number of small properties (8-50 units) that face significant management challenges. All of SHRA's scattered site properties (1-7 units) were also included.

This section explains which properties fall into each of the six groupings and also identifies several Action Developments that may warrant more immediate action.

a. Property Groupings by Criteria

Risk of Mandatory Conversion

PHAs are required to review their properties on an annual basis to determine whether units should be removed from the public housing inventory. This review is designed to identify the following: 1) properties for which the cost of modernizing and operating units as public housing exceeds the cost of providing tenant-based assistance to residents; and 2) properties that will not be viable over the long term. Properties that fit this definition are subject to mandatory conversion requirements by HUD.

To identify developments potentially subject to mandatory conversion, HUD periodically posts a "Cluster List" on its website showing all properties of 250 units or more in which vacancy rates exceed an average of 15% over three years. Two properties in the City portfolio were identified as distressed on HUD's website in December 2006 – New Helvetia (360 units) and River Oaks (400 units). Although these properties have not appeared on subsequent lists to date, the

December report serves as an early warning that these properties may eventually fall into the category of required conversion.

Both properties should continue to be monitored to determine if they meet HUD's definition of mandatory conversion. If either property appears on HUD's listing two months prior to SHRA's next Annual Plan submission, then they must be addressed in that Annual Plan. Options for addressing the property include:

1) Explain to HUD why the property should not be on the Cluster List;

2) Certify that the PHA has completed HUD's Cost Comparison Spreadsheet and determined that it is more cost effective to continue operating the development as public housing; or

3) Submit a Conversion Plan because the Cost Comparison shows that the development is not cost effective to maintain when compared to the cost of Section 8 vouchers. This option would trigger a request to replace the public housing units with vouchers.

High Capital Needs

HUD provides capital funds to PHAs annually for modernization purposes. In most cases, HUD funding barely covers accrual and is far short of covering the backlog of improvements necessary for long-term sustainability. For instance, as noted in Section 2, for FY 2006 SHRA will receive a total of $5,556,244 in capital funds ($3,621,239 for the City and $1,935,005 for the County) while its 5-year portfolio-wide capital need is estimated to total $78 million. The disparity between capital needs and available funding is exacerbated by some properties that require an inordinate modernization investment to maintain viability, and thereby drain the capital funds available for improvements at other properties.

To identify properties that exhibit high capital needs, we reviewed SHRA's 5-, 10- and 15-year capital needs projections for each property, as well as REAC scores for each group of properties. The team, along with SHRA, looked specifically for properties that had an exceptional 5-year need and relatively low REAC scores, indicating that the property may be past its useful life. These properties generally had a Capital Need in the range of $25,000 to $40,000 per unit and REAC scores of between 68 and 84.

Ten City properties fit into the High Capital Needs group, including New Helvetia, River Oaks, Connie Drive, Sherman Oaks, Capitol Terrace, Comstock, Washington Plaza, Sierra View, Sutterview, and Riverview. Seven County properties were also characterized as requiring high capital needs, including Dos Rios, Evelyn Lane, Wallerga, Sunset Avenue, Cassandra, Tiara and Mariposa. However, the Tiara and Mariposa are currently undergoing modernization, so these properties will no longer fit into the High Capital Needs group.

High Operating Deficit

HUD provides PHAs with Operating Funds to operate and manage public housing. This funding is now provided at the project level (vs centralized), consistent with HUD's move to project-based "Asset Management" described previously. Each development must stand on its own financially and SHRA will be limited in its ability to cross-subsidize properties that run an operating deficit with those that maintain an operating surplus. The transition in funding and shift to project-based operations forces PHAs to carefully review each property to determine if they can break even, and if not, to develop a strategy for addressing the operating shortfall.

Several factors drive operating costs upward, even beyond standard management and maintenance. Certain neighborhood, site, and property characteristics can contribute to low resident retention, high utility costs per unit, and greater demands on central office staff. Prevailing wage requirements associated with construction and other contractors can also drive operating costs higher. With this in mind, we reviewed each property with SHRA staff to understand relative operating costs (utilities, unit and site maintenance, security and management) at each property, as well as the potential need for subsidy. The purpose was to identify properties that may not be able to support themselves over the long-term due to limited tenant income and HUD operating subsidy as sources to pay for site-based management and maintenance operations.

Nine properties fit the High Operating Deficit theme, including five City properties (New Helvetia, River Oaks, Riverview, Coral Gables, and Gibson Oaks) and four County properties (Dos Rios, Wallerga, Northcrest Circle and Southwest/Dewey).

Revitalization Potential

With changing national priorities and declining resources at the local, state and federal levels, PHAs are challenged to be creative in how they use limited resources to maximize change in their communities. While overall resources from the public, private, non-profit and philanthropic sectors flowing into depressed neighborhoods are limited, these resources (which include funding, programs, and talent) can be strategically leveraged to create the critical mass necessary to transform targeted areas into healthy, safe and economically viable communities.

As noted in Section 2, SHRA is in a unique position to leverage funding and other resources because it serves as a redevelopment agency as well as a public housing authority. There are a number of public housing developments located in active redevelopment areas in Sacramento and throughout the county. Several other properties are located in areas with significant development planned nearby, while others appear to underutilize their development potential in light of current zoning and adjacent uses.

These sites present an opportunity to combine federal funds with private resources (such as those generated by current development activity and Redevelopment Plans) by partnering with other public and private entities to maximize their impact. This can be accomplished by providing a housing (family, senior, special needs, homeless, etc.) through a variety of means, including traditional development, disposition and acquisition in targeted neighborhoods, the addition of public housing units to third party developments, or utilization of project-based Section 8. These techniques can be used to deconcentrate poverty by integrating subsidized housing with market rate housing or commercial development in areas of demand, and by stimulating neighborhood revitalization through the initial investment.

Based on our discussions with SHRA about Redevelopment Areas, planned development, and other neighborhood development initiatives (public and private), six properties were identified as having revitalization potential, either as housing or other uses, due to activities occurring in the neighborhoods around them. Among these are five City properties (River Oaks, Riverview, Fairgrounds, Comstock, and New Helvetia) and one County property (Dos Rios).

Poor Resident Retention

Public housing residents are generally limited in where they can live. They apply for housing, are placed on a waiting list, and are assigned to the first unit that becomes available and meets their household needs. Public housing properties that are difficult to lease-up and/or have high rates of turnover present a drain on limited management resources, and often suffer larger problems at the property that are manifest in poor resident retention. These factors also have a negative impact on the performance status of the PHA in HUD's eyes. Sixteen properties meet the criteria for this group because they exhibit below average occupancy, difficulty in leasing when units become available and frequent turn-over compared to other SHRA properties, including eight City properties (Washington Plaza, Lincoln Manor, Gibson Oaks, West Silver Eagle, Sherman Oaks, Western Avenue, Coral Gables, and Connie Drive) and six County properties (Dos Rios, Northcrest Circle, Cassandra, Southwest/Dewey, Walnut Grove and Young).

Small/Scattered Site

Smaller properties, especially scattered site properties, can be particularly difficult to manage because they are spread out geographically, making them less efficient to manage and requiring a disproportionate share of limited staff resources. Our team worked with SHRA staff to identify properties that present significant management challenges for SHRA due to their small size and their isolated or otherwise difficult location. Five City properties were placed in this group (Coral Gables, Western Avenue, Connie Drive, 24th Street, and West Silver Eagle), along with six County properties (Northcrest Circle, Cassandra, 48th Avenue, Southwest Dewey, Walnut Grove, and Young). All single-family homes and properties of between 2-7 units were also added to this group, though they were not individually evaluated.

The table on the following page summarizes the properties identified under the various evaluation criteria. Note that only properties that were placed in one or more groupings appear on this listing; all other properties were omitted.

b. Action Developments

Based on the criteria described above, we have identified three large properties that warrant near-term asset repositioning as Action Developments, including the City properties of New Helvetia and River Oaks, and the County property of Dos Rios. The Riverview elderly high rise, which includes SHRA's offices, was also identified as an Action Development, and was grouped with five other elderly high rise properties located in Downtown Sacramento (Capitol Terrace, Comstock, Sierra View, Sutterview and Washington Plaza). The following paragraphs describe the considerations that led us to identify these properties as Action Developments.

City Properties	Risk of Mandatory Conversion	High Capital Needs	High Operating Deficit	Revitalization Potential	Poor Resident Retention	Small/Scattered Site
24th Street						✓
Capitol Terrace**		✓				
Comstock**		✓		✓		
Connie Drive		✓			✓	✓
Coral Gables			✓		✓	✓
Fairgrounds				✓		
Gibson Oaks			✓		✓	
Lincoln Manor					✓	
New Helvetia*	✓	✓	✓	✓		
River Oaks*	✓	✓	✓	✓		
Riverview*		✓	✓	✓		
Sherman Oaks		✓			✓	
Sierra View**		✓				
Sutterview**		✓				
Washington Plaza**		✓			✓	
West Silver Eagle					✓	✓
Western Avenue Scattered Site					✓	✓
County Properties						
48^{th} Avenue						✓
Cassandra					✓	✓
Dos Rios*	✓	✓	✓	✓	✓	
Evelyn Lane						
Northcrest Circle			✓		✓	✓
Southwest/Dewey			✓		✓	✓
Wallerga			✓			
Walnut Grove					✓	✓
Young					✓	✓

* Designated "Action Development"
** Elderly High Rise to be considered Action Development with Riverview.

New Helvetia and River Oaks

The December 2006 HUD Cluster Listing of New Helvetia and River Oaks is significant. Chronic vacancy issues are often a symptom of multiple overlapping problems at a property. These two properties are likely to appear again on the Cluster List, which may require them to be addressed and evaluated for Mandatory Conversion to Section 8 vouchers. Together, these properties represent roughly 25% of SHRA's public housing portfolio. Because high capital needs and high operating deficits are expected at these properties, both New Helvetia and River Oaks drain a disproportionate share of SHRA resources. River Oaks and New Helvetia also have strong revitalization potential due to the significant developments planned nearby and their location in highly valued neighborhoods. For these reasons, both River Oaks and New Helvetia have been identified as Action Developments.

Dos Rios

Similar to New Helvetia and River Oaks, Dos Rios has a chronic vacancy problem. While the property isn't subject to HUD Mandatory Conversion (because it has fewer than 250 units), it shares many of the same characteristics as New Helvetia and River Oaks, including high capital needs, high operating deficit, poor resident retention and revitalization potential. Therefore, Dos Rios should be examined in the short term as an Action Development.

Downtown Elderly/High Rise

The elderly high rise buildings (Riverview, Comstock, Washington Plaza, Capitol Terrace, Sutterview and Sierra View) all require significant improvements over the short-term to preserve their ability to serve seniors. Riverview is unique in this list as it also is projected to run a high operating deficit and has strong revitalization potential due to its central location downtown. These buildings represent a significant percentage of SHRA's portfolio and, similar to New Helvetia, River Oaks and Dos Rios, will require a significant share of SHRA capital fund resources if modernized in the traditional fashion. Due to their similar design, age, systems and population served, we have grouped them together as one Action Development for efficiency purposes. Because of these similarities, comparable modernization techniques can be used for them all. In addition, grouping these buildings provides opportunities for increased leverage by pooling the buildings and their improvements into a larger funding package, which itself brings efficiencies in soft costs.

5. Potential Repositioning Initiatives

a. Action Developments

The following proposed initiatives are based on consideration of the general characteristics of the Action Developments, e.g., overall size, strength of local market, magnitude of operational difficulties, etc., and not detailed financial/operational/development analyses. Using the proposed initiatives as a guide, we expect that SHRA will subsequently undertake detailed, project-specific analyses.

In general, the initiatives below reflect approaches that do not rely exclusively on financing traditionally available through HUD (i.e., capital fund, operating subsidy, etc.), but attempt to leverage HUD resources with third-party capital resources such as low-income housing tax credit equity, tax-exempt bond financing, private mortgage debt and available grants and subsidies, as well as non -HUD income sources such as income from non-public housing (tax credit, or perhaps, market rate) tenants.

New Helvetia

New Helvetia is a large site (29.4 acres) with a significant number of units (390), and is surrounded by a strong, active real estate market with significant residential, commercial, and new development activity. New Helvetia's combination of size, location, and surrounding economic activity may be leveraged to benefit redevelopment of the site.

The proximity of a strong, active real estate market presents the opportunity to pursue mixed-income (mixed-finance) development where either: 1) affordable (i.e., tax credit eligible) and market rate units are added to the existing site, resulting in an increase in net units; or 2) the number of public housing units is reduced with a corresponding addition of non-public housing affordable and/or market rate units. In addition to establishing a programmatic mix of incomes that may provide social benefits to low-income residents, mixed-income developments also are generally structured to provide a cross-subsidization of cash flow from the tax-credit or market units to the public housing units in order to cover shortfalls in operating subsidy.

In a mixed income development, sponsors take great care to achieve a mix of incomes that, while achieving the goal of providing affordable units for public housing residents, also remains attractive to potential residents (market and tax-credit) that can also choose to live at other competing (non-affordable) developments.

River Oaks

River Oaks is situated in close proximity to New Helvetia and benefits from the same location advantages, i.e., strong local real estate market, strong economic activity, etc., in combination with a similarly large site (37.3 acres) and large number of units. River Oaks has the additional advantage of being the locus of encroaching development and is adjacent to a site where the current owner is actively pursuing redevelopment activity. Representatives of the owner have already inquired about SHRA's potential redevelopment of River Oaks. Such interest provides specific possibilities for the site's redevelopment.

<u>Combined Activities with Adjacent Owner</u>
SHRA could combine efforts with the adjacent owner as follows:

- The developer of the adjacent site could develop the River Oak site on a "turn-key" basis on behalf of SHRA;
- In exchange for a land lease of the River Oaks site (and operating subsidy), the developer of the adjacent site could master develop both sites and agree to a certain number of public housing units to be dispersed throughout the development;
- SHRA and the owner of the adjacent site could jointly redevelop River Oaks;

- The developer of the adjacent site could pay SHRA for the right to build units, etc. on a portion of the River Oaks site, including distributing market rate units on site or among public housing units; and

- SHRA and the developer of the adjacent property could share economies of scale for infrastructure or other costs.

Redevelopment Timeframe

Encroaching development and the development activities of the adjacent landowner enhances the value of – and expands SHRA options for – River Oaks. The activity of the local market, including encroaching development, will likely continue to add value to the River Oaks site with the passing of time, providing timing flexibility (from a financial equity perspective) to SHRA. A potential increase in financial equity will have to be balanced against increases in construction/development costs to assess potential net gain over time. The local activity also provides leverage against surrounding landowners, who may be motivated to "assist" (financially, or otherwise) in SHRA's redevelopment efforts if doing so elevates the marketability and value of their own adjacent or neighboring sites and/or developments.

Dos Rios

The land uses surrounding Dos Rios and the Richards Boulevard redevelopment activity guide the analysis of potential site redevelopment. Dos Rios is largely surrounded by light industrial/office uses that are generally incompatible with residential development. The 2005 Richards Boulevard Redevelopment Strategy details the redevelopment objectives of the Richards Boulevard redevelopment project area, and specifies support for "pioneering" residential development initiatives. However, the Strategy anticipates that such residential developments would be sited along the American River, which the Dos Rios development is not. SHRA must consider the most appropriate land use for Dos Rios in light of surrounding non-residential land uses and the availability of appropriate services.

Downtown Elderly High Rises

SHRA's high rise elderly developments present specific redevelopment issues and constraints. Elderly tenants tend to be highly immobile, so temporary relocation would be both difficult and costly: rehabilitation may have to be accomplished with tenants "in-place." The high-rise nature of the developments and age of construction could require overhauls of entire systems (i.e., electrical, mechanical, etc.) that may substantially increase the rehabilitation costs and make rehabilitation with in-place tenants problematic. In any event, one can expect rehabilitation costs to be relatively high given the high-rise nature of the buildings and current construction costs in California.

We expect that SHRA will want to maintain the low-income, elderly nature of the tenancy, and not attempt to alter the affordability of the developments. Altering the current income mix by adding market rate units or converting some units to tax-credit (with or without Section-8 certificates) might yield units that are not competitive in the open market (in the case of market rate senior units) or raise strong objections from in-place elderly residents who view other forms of subsidy as less secure than public housing.

<u>Group Approach</u>
The redevelopment of the Elderly High Rise buildings can be considered as a "group" with each building financed individually but with a similar rehab/finance strategy. Alternately, the buildings can be groupings of two or more buildings redeveloped under a common plan of finance and rehabilitation (e.g., multiple properties would be owned by the same tax credit partnership, and work would be performed by a common contactor).

<u>Riverview</u>
Of the Elderly High Rise developments, Riverview represents a special case in view of its current use (i.e., office space for SHRA alongside elderly residential units), high estimated rehabilitation costs, high vacancy levels achieved through attrition, and market proximity.

SHRA may commission a "highest and best use" analysis to determine if the building or site would be most economically developed as office space or residential. Assuming market viability, either option is reasonable as the development both sits next to an existing tax-credit residential development, but also is part of a neighborhood with a mix of office, retail, residential, and institutional uses. In the case of non-residential development, and given that the building physical state has required that SHRA engineer a relatively high level of vacancies through attrition, the building could be disposed of for office or retail purposes. Such a treatment would require the permanent relocation of existing residents, the expense of which might be by relocating existing tenants to suitable replacement units within SHRA's existing portfolio.

As a stand-alone residential development, SHRA must address the difficulty of obtaining sufficient sources to cover high rehabilitation costs (that reflect the age and extensive deterioration of the building's major systems). A likely financial structure would involve low-income housing tax credits. However, the efficiency of the credits is limited by the combination of high rehabilitation costs and the threshold basis limits imposed by the California Tax Credit Allocation Committee (CTCAC). Preliminary estimates of rehabilitation costs provided by SHRA already exceed the threshold basis limits. As a result, no benefit can currently be gained by attributing value to the building that is then purchased by the partnership (through seller take-back financing), which means that additional tax credits could not be generated from the acquisition price of the building. SHRA could strategically address this limitation in two ways:

1. Combine the redevelopment of Riverview and one or more additional developments within a single tax credit partnership where the other developments have low acquisition value (or, at least, where there may not be a significant advantage or need to attribute significant value to the buildings), a significant number of units in order to raise the aggregate threshold basis limit, and do not require significant rehabilitation.

2. Lobby CTCAC to allow, for public housing redevelopment activities, an exception to the threshold basis limits with respect to acquisition basis.

It may be difficult to identify Elderly High Rise developments that meet the criteria of the first option given the expected value and rehabilitation costs associated with those developments. The second option should prove a reasonable option, but would require a coordinated lobbying effort on the part of SHRA and other PHAs to effect the change.

The Appendix provides detailed descriptions of several financing tools and strategies with applicability to the redevelopment of the Action Developments, including the following:

- Low Income Housing Tax Credits ("4%" or "9%"), generated on "eligible basis" costs (including building acquisition costs) attributable to qualified, affordable units;

- Tax-exempt bonds, issued in a sufficient amount (i.e., 50% of "aggregate land and building basis") to obtain the 4% tax credits outside of credit allocation caps;

- Capital funds or capital fund bonds, to pay for a portion of development costs attributable to public housing units;

- State, local, and redevelopment funding, including the Multifamily Housing Program (MHP), HOME, CDBG, etc.; and

- Hope VI grants, which are extremely competitive but could provide significant development funding.

In addition to the financing tools described above, SHRA could also employ:

- Rent subsidies, such as project-based Section 8, that allow for rental income in excess of tax-credit rents on tax credit units for specific periods of time. The additional income can be used to achieve breakeven operations for otherwise infeasible developments, and/or support higher long-term debt.

- Disposition to SHRA controlled entities, non-profit organizations, or independent third parties.

- Additional funding, competitively awarded, to offset predevelopment and other soft costs.

b. Strategy for Small Properties and Scattered Sites

Asset repositioning may also be warranted at several of SHRA's small properties and scattered sites, based on the property groupings described in Section 4.

Small Properties (8 to 50 units)
The Action Developments identified above were selected as the first priority for SHRA both because they fall into multiple intervention themes, and because intervention at these properties would have the greatest impact to the SHRA portfolio since the properties represent more than 1,500 public housing units in total. Of the estimated 58 SHRA properties with between 8 and 50 units, 14 were identified in one or more of the property groupings described in Section 4.

We recommend that SHRA closely monitor its small properties over the next year, with particularly attention to those developments identified in Section 4. As additional data become available, we can provide more focused recommendations tailored to the specific challenges facing each property. In the case of properties identified under just one theme, for example, a simpler intervention may be sufficient to improve the feasibility of that property. The Sunset property, for example, is identified under the "High Capital Needs" theme only. The best approach for this property may be to move forward with the required improvements because the property appears to be performing well otherwise. On the other hand, it may be best to dispose of an isolated property that is difficult to manage because it drains valuable staff resources the rest of the SHRA portfolio.

Scattered Site Properties (1 to 7 units)

SHRA owns an estimated 300 public housing scattered site properties with fewer than 8 units that were not specifically addressed in this Study. As noted in the discussion of small properties above, scattered site properties can be particularly difficult to manage because they are spread out geographically, making them less efficient to manage and requiring a disproportionate share of limited staff resources. However, there are several approaches that SHRA can employ to concentrate its assets in a way that limits inefficiencies, as described further below.

Property Inventory. SHRA may conduct an inventory of its scattered site properties to identify properties that 1) are located outside of a reasonable radius from other properties in the portfolio, or 2) require significant physical improvements. SHRA may decide to retain only those properties that can be efficiently managed and maintained.

Disposition of Units SHRA may elect to dispose of scattered site public housing units that can't be efficiently managed. For instance, SHRA already has an active program for selling single-family homes to its residents utilizing HUD's Section 32 and Section 5(h) homeownership programs. Alternately, SHRA could sell the properties at market values, and use the sales proceeds to fund replacement units as part of mixed-finance developments elsewhere in the City and County.

Tax Credit Development. Another option available to SHRA is to assemble a number of scattered site properties requiring moderate levels of rehab for inclusion in a single tax credit development. As described further in the Appendix, SHRA could combine acquisition credits with 4% tax credits to finance 50-75% of total improvement costs.

6. Authority-Wide Implications of Asset Repositioning

As SHRA reviews its portfolio and considers initiating asset repositioning strategies, a number of policy and budgeting issues will likely arise. The following section provides an overview of some of the key implications asset repositioning may have for SHRA.

a. Replacement Housing Policy

Current federal policy does not require nor fund one-for-one replacement of units lost due to demolition, disposition and/or revitalization. But providing for the replacement of public housing units is identified as one of SHRA's guiding principles, due in part to current and projected demand for affordable housing in the Sacramento region. To accomplish one-for-one replacement, SHRA must take advantage of HUD rules that allow both mixed-finance development (the ability to use private and/or public sources of funds for the purpose of developing public housing that may be owned by an entity other than SHRA) and mixed-income development (the inclusion of public housing units and non-public housing units, such as LIHTC, market rate and homeownership units) in the same development.

SHRA has established a preference for developing housing units over reliance on Section 8 assistance. However, the public housing program provides few capital resources for redevelopment and operating subsidy is designed at best to break even. These factors make it difficult for PHAs to commit to large rebuilding programs that achieve one-for-one replacement of "hard" public housing units without additional resources. As activities such as Mandatory Conversion (to Section 8 vouchers), resident relocation and need for leveraged financing rise to the forefront for each Action Development, the goal will be to provide replacement housing that maximizes choice and serves the demographic and services needs of public housing residents. This will be a multi-year effort requiring patience, trust, additional resources and partnerships.

b. Development Model

In today's political and economic environment, housing advocates must consider new entrepreneurial strategies for delivering and increasing the amount of affordable housing. Unlike the old days of developing public housing, PHAs are now allowed by HUD to enter into partnerships with third parties to provide for the mixed-finance development of public housing units. As a result, PHAs now have many options in the development and ownership of public housing.

- **For-Profit or Non-Profit Developer.** PHA procures third party developer who is responsible for all development activities including financing, design, construction, lease-up and operations. The developer typically owns the improvements (housing units) and may lease the land from the PHA. The PHA has the least responsibility and exposure to risk in this model.

- **Fee-Based Developer.** Same as For-Profit or Non-Profit Developer during development. After stabilized occupancy, ownership of the improvements and on-going operations responsibilities is transferred to the PHA.

- **PHA Partners with Third Party Developer.** PHA procures third party developer who is responsible for working with the PHA to help build its capacity on all development activities including financing, design, construction, lease-up and operations. In essence, the developer is the teacher and the PHA is the student. This requires mutual understanding of roles and a positive working relationship between the parties. Ownership can be a combination of the two entities.

- **PHA as Developer.** PHA or its affiliate serves as developer responsible for all development activities including financing, design, construction, lease-up and operations. The PHA owns the improvements and typically the land. The PHA has the most responsibility and exposure to risk in this model.

We recommend that SHRA enter the development arena slowly and methodically. The long-term goal is to develop in-house capacity to self-develop. But in the shorter term, SHRA may want to partner with a third party developer, either non-profit or for-profit, to learn from while revitalizing its properties. PHAs such as Tacoma, WA, Phoenix, AZ, and Beaumont, TX are approaching mixed-finance development in this way with the expectation that they will gradually take on more responsibility and risk from the developer in later phases of development, and as a result will earn larger fees and exert more control over the development process.

c. *Resident Involvement and Relocation*

Because each of the Action Developments is currently occupied, it is critically important to provide residents with assurances that they will continue to be housed and that there is no immediate need to move. A key component of any process seeking to address the revitalization of distressed property is resident involvement. During the revitalization planning process, residents should be asked about their preference for future housing – whether they wish to return to the site after redevelopment, move to other public housing, purchase a home under one of the programs offered by SHRA, or take a Section 8 voucher and move to the private sector. Regardless of their choice, public housing residents are protected under the federal Uniform Relocation Act (URA) when an agency such as SHRA takes any action that requires the household to be displaced. The URA requires SHRA to provide comparable housing for the household and also addresses relocation costs and rehousing payments.

In addition, without access to additional vouchers, which are currently difficult to obtain from HUD unless under Mandatory Conversion or HOPE VI, any large-scale relocation effort will have a tremendous impact on PHA operations. For instance, SHRA may need to stop issuing Section 8 vouchers to households on its waiting list to create a stockpile of vouchers that can be used for relocation purposes. Or, SHRA may elect to stop leasing public housing units as they come available so that these units can be used as a relocation resource. This will limit the number of new households that SHRA can house as it addresses vacating properties for revitalization purposes.

d. *Staff Resources and Capacity (dedicated staff)*

For some PHAs, mixed-finance development is a unique, one-time undertaking that threatens to divert staff resources from other urgent priorities. In other instances, the PHA may view the mixed-finance transaction as an opportunity to build in-house capacity for an expanded development and management role at other properties. For SHRA, the goal should be to build capacity over time to self-develop, or at least to minimize reliance on third party developers. This will require staff at a senior level within SHRA since the removal and redevelopment of an asset will have dramatic impacts on the entire agency. As units come off-line, there is a reduced need for management and maintenance personnel. Contracting with a third party developer will require assistance from the procurement staff and legal counsel. Finance staff will need to help track SHRA's funding commitments during predevelopment and construction, and someone will be needed to work with the community and press. Decisions about management (whether third party or provided by SHRA) will also need to be made. This level of activity requires staff members that can access all departments of SHRA and obtain resources to get the work done.

Many PHAs that head down this path create a Development Department with a Director who reports directly to the Housing Authority Director. Since the department is "deal" oriented, staffing levels can go up and down depending on the number of revitalization efforts under way. We recommend that SHRA consider creating a Development Department and hire a Director with development experience. This position requires a set of skills not typically found among PHA staff, so the desired individual may come from either the private or public sector. In addition, at least one Project Manager should be hired initially to help the Director address the next steps for the Action Developments identified in this Study.

e. Funding for Predevelopment Costs

The predevelopment period of any development activity can take from 12 – 18 months or even longer. During this time, many tasks have to be completed, including meeting with the residents, establishing a planning process, developing a project concept and schedule, procuring a developer and any advisors, negotiating contracts, preparing a relocation plan, obtaining financing, designing the project, preparing an environmental remediation and demolition plan, obtaining permits, finalizing construction pricing and general contractor contract, developing the management plan, and documenting the transaction.

Each of these activities requires time and money, most of which falls on the PHA to provide. It is not unusual for a PHA to expend $1 million or more during predevelopment for a major revitalization effort (some or all of which may be reimbursable expenses attributable to the eventual project). Therefore, SHRA should consider establishing a fund (grant or loan) to cover Development Department staffing costs for a period of two years as well as predevelopment funding sized against the number of revitalization projects it anticipates undertaking in the next two years. SHRA should also pursue predevelopment loans and grants available through other sources.

7. Next Steps

The authority-wide implications of asset repositioning described in the previous section suggest a number of issues that SHRA will want to consider as it moves forward with its asset repositioning.

a. Prioritize Action Developments

The Action Developments identified in Section 4 warrant short-term intervention because they exhibit several characteristics that need to be addressed, and because they represent a significant portion of the larger SHRA portfolio. Among the Action Developments, however, some may require attention sooner than others. SHRA should prioritize the Action Developments in light of 1) the relative urgency of challenges facing each development, 2) internal considerations such as funding availability and staff capacity, and 3) external forces such as development activity nearby and market considerations.

b. Initiate Review of Small Properties

As described earlier in this report, SHRA owns an estimated 300 units in small properties throughout the City and County. These properties represent nearly 10% of SHRA's total public housing portfolio and should be an early component of SHRA's repositioning strategy. SHRA should inventory these properties to determine those best suited for asset repositioning, as described in Section 5. Additionally, SHRA should evaluate its scattered-site properties and other assets, such as vacant land.

c. Prepare Detailed Financial Strategy for Action Developments

SHRA should identify two or three development scenarios that may be appropriate for each of the Action Developments, and cause the preparation of a financial analysis of each scenario. Input from SHRA and the findings of any refinements to these scenarios would then be used in preparation of a detailed financial analysis reflecting the recommended strategy for each Action Development.

d. Build Capacity to Finance and Manage Multiple Projects Simultaneously

As described in Section 6, we recommend that SHRA allocate knowledgeable, experienced staff (and resources) to undertake the recommended repositioning strategies. Such allocation could include the creation of a Development Department, with a Director and a Project Manager. Once created, the new Department will need to assess SHRA's capacity to move forward with several Action Developments simultaneously in view of financial and staff constraints. SHRA will also need to understand the entire array of potential funding sources, including internal sources such as public housing and redevelopment funds as well as external sources that may be available to fund predevelopment costs.

e. Continued Data Collection to Guide Future Decision-Making

As SHRA moves forward with the Action Developments, SHRA can also progress on the remaining sites in SHRA's portfolio by continuing project-specific data gathering. SHRA already collects much of the data that will assist in future decision-making. For example, operating expenses, tenant-paid rent, and occupancy figures at each property have been tracked since November 2006. Although it is difficult to draw strong conclusions from a single year or even two years of property data, this information can help confirm observed trends and refine conclusions as appropriate for each property.

f. Secure Legal Counsel

Embarking on a development program like the one contemplated by SHRA will require input from real estate and transaction attorneys familiar with HUD processes related to the repositioning of public housing assets. PHA's require a variety of competent legal counsel – HUD counsel, bond counsel, real estate counsel – to successfully address the complex legal and regulatory issues as they attempt to effect repositioning. We recommend that SHRA begin the process of securing, especially, a HUD counsel expert in the HUD rules, especially as they relate to mixed-finance development. To the extent that expertise the necessary areas are not provided by in-house counsel, the SHRA will have to secure the services of third-parties..

Appendix

This appendix presents an overview of commonly used funding sources for development and rehabilitation of affordable multifamily housing in California, exluding those administered by SHRA such as CDBG funds and tax increment. These include:

1. Low-Income Housing Tax Credits
2. Tax-Exempt Multifamily Housing Bonds
3. Capital Fund Financing Program
4. California Multifamily Housing Program
5. California Housing Finance Agency
6. California Community Reinvestment Corporation
7. HOPE VI Funds
8. Federal Home Loan Bank Affordable Housing Program
9. Fannie Mae
10. Federal Housing Administration 221(d)(3) and (d)(4)
11. Federal Housing Administration 223(f)

1. Low-Income Housing Tax Credits

The Low-Income Housing Tax Credit (LIHTC) program is a federal program that provides tax credits to subsidize acquisition, rehabilitation, and construction of affordable rental housing. The credits provide dollar-for-dollar reductions in federal tax liabilities over a ten-year period, subject to federal and state compliance requirements. To monetize the credits, developers typically enter into partnerships with investors to jointly own affordable housing properties. The investors provide upfront cash to the partnership in exchange for the tax credits and other benefits.

a. Illustrative Examples

There are three types of LIHTCs – "9% credits," "4% credits," and "4% acquisition credits." Examples of each type of credits are provided below:

- The Houston Housing Authority (HHA) used 9% credits as its primary funding source to finance construction of 250 new public housing units as part of its Oxford Place development. The 9% credits generated $12.1 million in equity, or nearly 60% of the $21 million in demolition, relocation, construction, and other development costs. The balance of funds was provided through a capital fund loan (see description of HUD's Capital Fund Financing Program under item 3 below) and deferred developer fee. Because HHA served as developer of Oxford Place, it earned about $750,000 in fees that could be used to address future affordable housing needs.

- The Housing Authority of the County of Monterey (HACM) is using 4% credits to develop 73 farm worker housing units in the City of Soledad, CA. The tax credits will generate roughly $7 million in equity, or more than 35% of the $19.3 million in estimated acquisition, relocation, construction, and other development costs. Other funding sources will include a USDA loan of $4.2 million, a HOME loan of $3.8 million, $3 million in debt secured with rental income from tax credit rents and USDA operating subsidy, $500,000 in funds from the redevelopment agency, $470,000 in deferred developer fee, and $300,000 in other sources. HACM is developing the Benito Farm Labor Center, and will earn over $750,000 in net fees.

- The King County Housing Authority (KCHA) in Washington State used 4% acquisition credits to help finance roughly $38 million in net project costs at eight existing elderly/disabled public housing developments. KCHA generated about $25 million in tax credit equity for this transaction, including roughly $11.5 million from the acquisition value of the eight developments and $13.5 million from eligible rehab costs. The $25 million in tax credit equity was combined with about $12.6 million in KCHA funds (including $9.2 million that was obtained through HUD's Capital Fund Financing Program) and $300,000 in other funds. As developer for this transaction, KCHA will earn over $7 million in fees that can be used to repay a portion of its funding commitment. The rehabilitation work, which is being performed without displacing residents, is currently underway and the first buildings are scheduled for completion by the end of 2007.

California also offers state tax credits that are coupled with the federal credits as a supplemental funding resource. Investors receive the state credits over a four-year period in contrast to the ten-year period for federal credits.

b. Project Eligibility Requirements

Tax credits are only available for units that are both income- and rent-restricted to households earning up to 60% of area median income (AMI). In many cases developers will need to restrict units to even lower AMI levels to compete successfully for the more-valuable 9% credit allocations.

Three types of affordable housing development activity are eligible for tax credits: 1) new construction or substantial rehabilitation without federal subsidies (9% credits); 2) new construction or substantial rehabilitation with federal subsidies (4% credits); and 3) acquisition of an existing building that will be substantially rehabilitated (4% acquisition credits).

As implied in the descriptions in the preceding paragraph, federal subsidies affect eligibility. When other federal subsidies are involved, a project is generally only eligible for 4% credits rather than 9% credits. There are sometimes ways to structure other federal subsidies to avoid these restrictions.

Using private activity bond proceeds on qualified project costs can often trigger 4% credit eligibility. Ordinarily, only the bond-funded costs would be eligible for tax credits. But under a special provision, 100% of the qualified costs are eligible for tax credits if the bonds fund more than 50% of the aggregate basis of the building and land. This is often referred to as the "50% test."

To be eligible for 4% acquisition credits, three important tests must be met. First, at least ten years must pass between when the prior owner placed the building in service and when the new owner acquires the building. This is often referred to as the "10 year rule." Second, at least ten years must pass between any "substantial improvement" of the building and when the new owner acquires the building. For this purpose, "substantial improvement" is defined as that within a 24-month period equal to at least 25% of the adjusted basis of the building before improvement, subject to certain depreciation elections. Third, the new owner must "substantially rehabilitate" the building, which is defined as spending the greater of $3,000 per low income unit or 10% of the depreciable basis of the building on rehabilitation expenditures (which costs can be funded, in whole or part, by 4% tax credit equity).

California's state tax credits have very similar eligibility requirements to 9% federal credits, and in very limited cases can also be used for acquisition costs.

c. Subsidy Amounts and Types

The original Congressional intent was for the present value of the stream of tax credits over their ten-year lifespan to equal either 30% (4% credits) or 70% (9% credits) of most costs of developing the affordable housing units. The value of the credits is determined by negotiations between the developer and tax credit investor to determine pricing for the credits, which depends on the value of the credits to the investor, the value of other tax benefits from the investment such as losses from depreciation, and many other factors.

Eligible development activity within a HUD-designated Difficult Development Area (DDA) or Qualified Census Tract (QCT) enjoys a 30% "basis boost" provision. This effectively increases the amount of tax credits a project can receive. Basis boost is not available for acquisition costs or in certain cases where HOME funds are involved.

California's state credits are designed to equal 13% of the project's eligible basis for 4% transactions and 30% of the project's eligible basis for 9% transactions.

d. Availability

The California Tax Credit Allocation Committee (TCAC) allocates LIHTCs. The California Debt Limit Allocation Committee (CDLAC) allocates private activity bond volume cap that triggers eligibility for 4% credits.

<u>9% Credits</u>
TCAC expects to allocate approximately $74 million of annual 9% credits in 2007. No more than $2 million will be allocated to any one project in a particular funding round (or $2.5 million if a waiver is received), and no more than 15% of the total available credits will be allocated to a single development entity.

4% Credits
Four percent credit availability is generally unlimited. Note however that private activity bond allocation that triggers 4% credit eligibility is limited. In 2007 the state has targeted approximately $1.7 billion of its $3.1 billion of total cap to multifamily housing, as described more fully in the next section on multifamily bonds.

State Credits
In 2007 California expects to allocate $80 million of state tax credits.

e. Allocation/Application Process

Allocations of 9% credits are determined based on a highly competitive application process with multiple scoring criteria. 92 applications were submitted in the first funding round of 2007, with credit requests totaling $103 million, or 2.8 times the $37 million available. Thirty-one applications received reservations.

TCAC typically allocates 9% credits in a two annual funding rounds. In 2007 application deadlines were schedule for March and July, with awards in June and September, respectively. For 4% credits, applicants need to apply for both private activity bond volume cap and the credits themselves. In 2007 CDLAC has an "open window" application process, with allocation decisions scheduled for each of CDLAC's five different meetings throughout the year. Developers typically submit the tax credit application to CTAC shortly after the submittal to CDLAC.

California prioritizes state tax credit allocations to projects not located in a Difficult to Develop Area or Qualified Census Tract and those using HOME funds to finance eligible costs. California allocates 85% of its state credits to 9% transactions with the remaining 15% reserved for 4% transactions.

f. Additional Information

For additional information, see the TCAC website at www.treasurer.ca.gov/ctcac/ and the CLDAC website at www.treasurer.ca.gov/cdlac/.

2. Tax-Exempt Multifamily Housing Bonds

Tax-exempt multifamily housing bonds provide financing at below market interest rates for the development of rental housing, a portion of which is affordable to very low- or low-income households. Bonds are sold for a specific project for which the developer has site control; they cannot be sold and "banked" until a project comes along.

Bonds do not substitute for deep subsidies, nor do they work for group homes, SROs and homeless shelters since projects must have net operating income and evidence of the ability to repay debt. Bonds do not provide credit that a project cannot otherwise obtain.

One reason for using bond financing, however, is that it can bring additional resources to the project from 4% tax credits (9% credits are not permitted with tax-exempt financing). In fact, both of the 4% tax credit examples provided under Item 1 above included tax-exempt multifamily housing bonds. Projects in which at least 50% of the aggregate tax credit basis (eligible development costs) is financed by tax-exempt bonds are eligible to receive 4% tax credits. Unlike 9% credits, the 4% credits are allocated by TCAC without a competitive process, making the combination of bond financing and 4% credits an attractive alternative to 9% credits for many projects.

The tax code regulates the issuance of bonds on the federal level. Individual states also have laws that authorize cities, counties, housing authorities, and redevelopment agencies to issue bonds. A bond issue must meet both the federal and state requirements.

There are three basic types of financings: (1) Private activity bonds, where the project is owned by a partnership or other profit motivated sponsor; (2) 501(c)(3) bonds, where the project is owned solely by a nonprofit corporation which has received a 501(c)(3) determination letter from the IRS; and (3) Essential function bonds, where the project is owned by a public body such as a housing authority or redevelopment agency.

All three types of bonds can be sold either through a public sale process (through underwriters who resell the bonds to institutions and, rarely, individuals) or through a private placement with a single large investor (bank, Fannie Mae, or other investor). The primary advantage of private placements is that issuance costs are usually lower, making bond issuance feasible for smaller projects.

a. Project Eligibility Requirements

Bond proceeds can be used for both construction and permanent, or just permanent, financing. They may also be used to purchase and rehabilitate an existing rental property. In addition, no more than two percent of the bond proceeds may be used to pay the costs of issuance, including underwriters, attorneys fees, rating agency fees, issuer fees, and credit enhancement fees.

Targeted Groups—Essential function bonds do not carry any affordability restrictions. In California, state law applies the same affordability requirements to 501(c)(3) bonds as it does to private activity bonds. These are:

- At least 20 percent of the units must be rented to households earning no more than 50 percent of the area median income, adjusted for household size, or 40 percent rented to households at 60 percent of the area median income. Income eligibility must be recertified annually and if a tenant is no longer eligible, the next available unit must be rented to an income-eligible household;
- Rents are calculated at 30 percent of 50 percent (or 60 percent if applicable) of the area median income, assuming certain household size in a unit and not subtracting out a utility allowance; and

- Affordability requirements are contained in a regulatory agreement that is recorded against the property and remains in place for 15 years or as long as bonds are outstanding, whichever is longer. The requirements are lifted in the event of foreclosure and the redemption of the bonds.

Other rules for private activity bonds include the following:

- Dwelling units must have complete bathing and cooking facilities; and
- If bonds are used for purchase of an existing building, 15 percent of the bond amount not used for land acquisition or costs of issuance must be used for rehabilitation of the units.

If private activity or 501(c)(3) bonds are used for building purchase, all affordable units must be in place at the time of bond closing; there is no phase-in period.

New 501(c)(3) organizations whose mission is affordable housing must meet the safe harbor guidelines established by the IRS. The most rigorous of these is that at least 75 percent of the units must be rented to households earning no more than 80 percent of area median income and 20 percent are rented to 50 percent of median income households.

b. Availability

In California, the California Debt Limit Allocation Committee (CDLAC) is charged with allocating bond authority. CDLAC has developed a procedures manual and application process to award bond volume. If the bonds are to be credit enhanced, evidence of a credit enhancement commitment must be submitted with, or soon after, the application. In addition, a refundable deposit equal to one-half percent of the bond authority requested must be posted. This deposit may be forfeited if an allocation is granted, and bonds are never sold. To discourage projects that are really not ready to proceed, CDLAC requires that once an allocation is granted bonds be sold and the bond issue closed within 90 days. Therefore, it is important that the issuer and developer have their primary transaction terms agreed upon and the credit enhancer has underwritten and sized the bond loan before a CDLAC allocation is requested.

The tax code imposes an annual private activity bond volume ceiling for each state (501[c[3] bonds are not subject to the volume ceiling). In California, this volume ceiling is divided among single family, multifamily, student loan, industrial development, and exempt facilities bonds. In 2007, of the total state volume ceiling of approximately $3.1 billion, $1.7 billion or 56% was set aside for multifamily private activity bonds.

The demand for private activity bond authority has varied over time, depending on the overall level of interest rates and other factors.

In 2007 CDLAC has an "open window" application process, with allocation decisions scheduled for five different meetings throughout the year.

c. *Additional Information*

See the following website for more information on multifamily private activity bonds: www.treasurer.ca.gov/cdlac

3. Capital Fund Financing Program

HUD's Capital Fund Financing Program (CFFP) permits PHAs to pledge a portion of future capital funds (including Capital Fund Program and Replacement Housing Factor funds) to secure conventional debt for improvements to, or new construction of, public housing units. Generally, a PHA may pledge no more than one-third of its projected capital funds over a maximum term of 20 years to secure debt under the CFFP program.

a. *Illustrative Examples*

Several housing authorities have used the CFFP program to develop new or rehabilitated public housing units:

- The Seattle Housing Authority (SHA) is using the CFFP program to help finance improvements to nearly half of its public housing portfolio. This broad effort is being completed in three phases, and SHA has already closed the financing on the first two of these phases representing 1,394 units and roughly $55 million in rehab and related costs. In the first two phases, SHA leveraged $28 million in capital fund bonds with more than $25 million in tax credit equity generated from both the rehab costs and the acquisition value of the sites, and $2 million in interest earnings and other sources.

- The Housing Authority of New Orleans (HANO) used the CFFP program to develop 353 new affordable housing units at three of its large public housing sites. These three sites had failed the HUD test for viability and faced mandatory demolition and conversion to Section 8 Housing Choice Vouchers. The CFFP program allowed HANO to secure $49.25 million in tax-exempt private activity bonds, which was further leveraged with approximately $21 million in 4% tax credit equity and more than $20 million in other funding sources, including the Federal Home Loan Bank's Affordable Housing Program (AHP) described under Item 8 below. Two of the three sites have been completed and are nearly occupied; the third was irreparably damaged by Hurricane Katrina and will not be completed.

b. *Project Eligibility Requirements*

All PHAs are eligible to participate in the CFFP program subject to the application process described below. Smaller PHAs typically participate in pooled transactions with other small and medium sized PHAs to minimize the financing costs that each PHA must absorb. SHRA's current capital fund allocation of +/- $5 million is large enough to support a CFFP transaction on its own, and could potentially generate between $15 and $20 million in funding.

Because capital funds are used to secure the CFFP debt, the proceeds of the financing are considered capital funds and must be expended according to applicable HUD requirements. For example, these funds can only be expended on public housing units subject to HUD Total Development Cost (TDC) and Housing Construction Cost (HCC) limits. Projects that incorporate CFFP funds must also meet HUD safe harbor requirements related to developer fees, contractor overhead and profit, property management fees, etc.

c. *Application Process*

CFFP applications are typically reviewed within 180 days, and must include the following: 1) a cover letter from the PHA; 2) a CFFP term sheet; 3) a debt service schedule; 4) a portfolio schedule showing anticipated changes to the number and nature of public housing units; 5) excerpts from the PHA Plan; 6) a Board Resolution authorizing the CFFP transaction; 7) a sources and uses schedule showing costs of issuance, etc., 8) a schedule of the effective cost of financing; 9) a fairness opinion from an independent financial advisor; 10) a management assessment from an independent third party; 11) a contact list for all participating parties; 12) all bond or loan documents; 13) a draft PHA counsel's opinion; 14) declarations of trust; 15) a depository agreement for all accounts into which CFFP proceeds will be deposited; and 16) a physical needs assessment (PNA) for the entire portfolio.

d. *Additional Information*

For additional information, visit www.hud.gov/offices/pih/programs/ph/capfund/cffp.cfm or contract Kevin Gallagher (Kevin_J._Gallagher@hud.gov) at HUD's CFFP office.

4. California Multifamily Housing Program

The Mulifamily Housing Program (MHP) of the California Department of Housing and Community Development has become a major source of funding for low-income multifamily development in California. When an MHP loan is combined with 4% tax credits, the total subsidy can approach that delivered by 9% credits. MHP funds can be used for new construction, preservation and acquisition/rehabilitation of multifamily housing. Within MHP, funds are set aside for supportive housing and for student housing.

a. *Illustrative Example*

The MHP program helped the Housing Authority of the City of Los Angeles (HACLA) and its developer partners (Mercy Housing and the Los Angeles Community Design Center) finance $41.5 million in development costs associated with the construction of 116 new affordable townhome units at Phase II of HACLA's New Dana Strand site. In addition to an $8.5 million MHP loan, other major funding sources included $20.6 million in 4% tax credit equity, HACLA loans totaling $7.2 million, $2.1 million in HOME funds, an $850,000 AHP grant, $770,000 in funding from the City of Los Angeles Housing Department, and roughly $220,000 in deferred developer fee. CalHFA, described further under Item 5 below, also provided permanent loans totaling $2.5 million and $27 million in below-market construction financing.

b. Project Eligibility Requirements

MHP will fund new construction, rehabilitation, or acquisition and rehabilitation of permanent or transitional rental housing, and the conversion of nonresidential structures to rental housing. Eligible costs include the cost of child care, after-school care and social service facilities integrally linked to the assisted housing units; real property acquisition; refinancing to retain affordable rents; necessary onsite and offsite improvements; reasonable fees and consulting costs; and capitalized reserves.

Projects are not eligible if construction has commenced as of the application date, or if they are receiving 9% federal low income housing tax credits. MHP will not finance construction costs; funds will be provided for post-construction permanent financing only.

Targeted Groups—Housing developed with MHP funds must be rented to households with incomes not greater than 60% of median income. However, the scoring system for awards and the loan amount policies strongly encourage serving residents at lower income levels, down to 25% of median income.

c. Subsidy Amounts and Types

MHP subsidies are structured as a 55-year loan bearing simple interest at a 3% interest rate. For the first 30 years of the loan, annual interest payments are required in the amount of .42% of the outstanding principal balance of the loan. Additional payments must be made with a portion of any surplus cash flow. MHP funds are provided as permanent financing only.

The maximum loan per project is $10 million. Loan size is also limited based on a sliding scale of loan limits per unit, where the limits are set based on unit size, county, and affordability level.

d. Availability

HCD allocates MHP funds through a NOFA process, issuing separate NOFAs for the general program, supportive housing and homeless youth components. The general program typically has two allocation rounds per year, with applications due in March and October. In 2007, the first general funding round offered $70 million in loans.

e. Additional Information

For more information see www.hcd.ca.gov/ca/mhp/

5. California Housing Finance Agency

The California Housing Finance Agency (CalHFA) provides below market interest rate financing for the development or acquisition/rehabilitation of affordable multifamily rental housing. CalHFA raises its funds for mortgage financing in the capital markets through the sale of tax-exempt revenue bonds. Rental housing developments are financed with direct capital to eligible developers (nonprofit, for-profit and public agencies).

CalHFA also offers unsecured lines of credit to local governmental entities for affordable housing development. This program, HELP (Housing Enabled by Local Partnerships), can be very useful as predevelopment funding and in bridging temporary financing gaps. It is structured as a 10-year loan to the public agency, with a 3.5% interest rate.

a. Illustrative Example

The Oakland Housing Authority (OHA), working with its developer partner BRIDGE Housing, used CalHFA financing for Mandela Gateway, a 168 unit affordable housing development. Development costs for Mandela Gateway totaled $51.5 million, and CalHFA provided a total of $4.8 million in below market permanent financing. Other sources included roughly $30 million in 9% tax credit equity, $10 million in HOPE VI Revitalization grant funds, $2.3 million in OHA funds, $2.5 million in Oakland Redevelopment Agency funds, $1 million in HOME funds, and a $1 million AHP grant provided through the Federal Home Loan Bank.

b. Typical Underwriting Standards

The maximum loan amount is the lesser of 90 percent of the approved total development cost or 80 percent of the economic value. The interest rate and loan fee vary according to the market at the time which CalHFA sells bonds. The interest rate commitment occurs at the time of final CalHFA commitment.

A nonprofit borrower is required to have five percent equity in the project and a for-profit must have 10 percent, of which five percent must be cash. Required debt service coverage is 1.10. Loans are fixed rate and amortize over 30-40 years. Prepayment is generally not permitted.

All loans are secured by a first mortgage; if the property is subject to a ground lease, that lease must be subordinated to the first mortgage. Subordinate mortgages, payable out of surplus cash flow, are permitted with CalHFA's prior approval.

CalHFA requires that a marketing account, rent-up account, operating expense reserve, replacement reserve, and construction defects agreement be established and administered by them.

c. *Project Eligibility Requirements*

CalHFA provides both permanent financing and construction financing for multifamily projects.

Targeted Groups—Households with incomes of 50 percent or less of the area median income, adjusted for household size, must occupy at least 20 percent of the units. For loans in excess of $10 million, additional levels of affordability are required. A regulatory agreement that contains the affordability restrictions will be recorded against the property.

d. *Availability*

Interested agencies should contact CalHFA. Applications to CalHFA may be made on an open window basis. The HELP program has semi-annual funding rounds, typically in February and August.

e. *Additional Information*

See www.calhfa.ca.gov/multifamily/financing/index.htm for more information.

6. California Community Reinvestment Corporation

The California Community Reinvestment Corp. (CCRC) is a nonprofit consortium of over 40 California banks that make mortgages for affordable rental housing projects. Every member participates in each CCRC loan in a share amount approximately equal to the bank's size in relation to the aggregate assets of all participating banks. The size of CCRC's revolving blind loan pool at this time is about $200 million. Both nonprofit and for profit developers can obtain a CCRC loan

a. *Illustrative Example*

CCRC financing helped the Housing Authority of the City of Los Angeles (HACLA), through its developer partners Mercy Housing and the Los Angeles Community Design Center, finance construction of 120 new garden units at Phase I of HACLA's New Dana Strand site. A permanent loan of $2.4 million from CCRC was combined with $21.1 million in 9% tax credit equity and $5.6 million in HACLA funds to finance total development costs of $29.1 million. The 120 family units are completed and occupied.

b. *Typical Underwriting Standards*

The minimum loan amount is $250,000; total outstanding loans per borrower cannot exceed $15 million.

Projects are underwritten at a cumulative loan-to-value ratio of up to 90 percent on a restricted basis. Subordinate notes are not included in the loan-to-value ratio if they are structured as residual receipt loans with a provision for forgiveness.

Interest rates are based on the rate of U.S treasury bonds with maturities matched to the number of years for which the CCRC rate will initially be fixed. There are two basic rate structures: "30/10-10" where the loan is recast at the prevailing CCRC rate in years 11 and 21 and the "30/15-15" where the rate is reset in year 16. Loans fully amortize over 25 or 30 years. Either in years 11 and 21, or just in year 16, a borrower may either prepay or accept a rate adjustment. Prepayment carries a penalty.

Commitments are made on either an immediate delivery (i.e., loans closing with 45 days of commitment) or forward basis. Forward commitments are available for up to 24 months, with a lock-in provision any time up to the 45-day pre-closing period.

c. Project Eligibility Requirements

CCRC provides first position permanent financing for the development or acquisition of family or senior rental housing projects of five or more units. SROs and special needs housing can be considered on a limited basis. Construction loans are available for acquisition/rehabilitation projects. Predevelopment loans are currently offered through a joint program with LIIF, for up to $100,000. Refinancing of permanent loans is permitted where the new loan will significantly enhance affordability. Affordability restrictions from other funding sources must be subordinated to the CCRC first mortgage. Loans are non-assumable.

Targeted Groups—The number of affordable units must meet one of three tests: (1) Fifty-one percent of the units are affordable to households earning 80 percent or less of the median income; (2) Forty percent of the units are affordable to households earning 60 percent or less of the median income; or (3) Twenty percent of the units are affordable to households earning 50 percent or less of the median income. Rents are calculated at 30 percent of the income appropriate to the targeted group and must be sufficiently below area market rents. Affordability provisions remain in effect for the life of the loan.

d. Availability

Interested agencies should contact the CCRC office in Glendale. Applications are accepted on an open window basis. CCRC's loan committee generally meets once per month to grant loan commitments. CCRC can perform a preliminary feasibility analysis to ensure the project is eligible for CCRC financing.

If CCRC resources are limited, it gives priority to projects with greater, deeper, or longer affordability; projects in areas with a shortage of affordable housing or served by CCRC member banks; and to projects where the sponsors use an affirmative marketing plan or have local government financial participation.

e. *Additional Information*

For more information, see the following website: www.c-ccrc.org

7. HOPE VI Revitalization Grants

The HOPE VI program is designed to help PHAs dramatically improve severely distressed public housing developments by changing their physical shape, establishing positive incentives for resident self-sufficiency, reducing concentrations of poverty by providing mixed-income communities, and leveraging resources with other governmental, private, and non-profit sources.

a. *Illustrative Examples*

Several housing authorities have been successful in securing HOPE VI Revitalization grants, including the Tacoma Housing Authority (THA) and the Dallas Housing Authority (DHA).

- THA received a $35 million HOPE VI Revitalization grant in 2000 to redevelop the Salishan public housing site, and has successfully completed the first three development phases. Upon completion of all phases, the 188-acre development is expected to include at least 650 affordable rental units, 224 market rate for-sale homes, and 96 affordable for-sale homes. The $35 million in HOPE VI funds is being leveraged with roughly $130 million in other funding sources, including about $70 million in 9% tax credit equity, $15 million in THA Capital Funds, $9 million in funds from the Washington State Housing Trust Fund, $9 million in land sales, $6 million in reinvested developer fees, $6 million in conventional permanent financing, $6 million in CDBG funds, $4 million in AHP funds, and $5 million in additional funding sources. Salishan won a housing award from the American Institute of Architects and a neighborhood design award from the Congress for the New Urbanism.

- In 2002, DHA received a $20 million HOPE VI Revitalization grant to redevelop its Frazier Courts public housing community. The master plan for Frazier Courts calls for demolition of 550 public housing units, and construction of 234 public housing apartment units, 76 public housing townhouses, 53 for-sale single-family homes, and an 18,000 square foot Head Start facility. The Frazier redevelopment will include 5 development phases, the first of which was completed in early 2007. Total development costs are estimated at more than $60 million, and funding sources will include 4% and 9% tax credit equity, home sale proceeds, AHP funds, DHA Capital Funds and Replacement Housing Factor funds, and several other funding sources

b. *Project Eligibility Requirements*

Any PHA that has severely distressed public housing units in its inventory is eligible to apply for HOPE VI. Program funds can be used to fund capital costs of major rehabilitation, new construction and other physical improvements, demolition of severely distressed public housing, acquisition of sites for off-site construction, and community and supportive service programs for residents.

c. Subsidy Amounts and Availability

Total HOPE VI funding has declined dramatically since the program's inception – from more than $500 million in Revitalization grant funds in 93/94 to less than $72 million in 2006. The funding available to individual projects has also declined over this time period from a maximum of $50 million in 93/94 to no more than $20 million in 2006. Allocation/Application Process

d. Application Process

Of the 26 HOPE VI Revitalization Grant applications submitted last year, funds totaling $71.9 million were awarded to four PHAs across the country. The NOFA for 2007, which will describe the application process, selection criteria, and timeline for funding awards, has not yet been issued.

e. Additional Information

For additional information, please see www.hud.gov/hopevi.

8. Federal Home Loan Bank Affordable Housing Program

The Affordable Housing Program (AHP) is a private subsidy program run by each of the nation's twelve regional Federal Home Loan Banks (FHLB). These banks, which are government-sponsored private corporations, invest at least 10% of their annual net income in the AHP program to subsidize the development of affordable housing for low- and moderate-income households.

a. Illustrative Example

AHP grants typically represent a small proportion of total project costs and are most helpful in closing or narrowing funding gaps for affordable housing developments. AHP grants were used by several of the public housing authorities described above to bridge funding gaps for affordable housing developments in New Orleans, Los Angeles, Oakland, Tacoma, and Dallas.

b. Project Eligibility Requirements

To be eligible for AHP subsidies, projects must involve the purchase, construction, or rehabilitation of owner-occupied or rental housing (transitional housing and overnight shelter projects are also eligible). Rental projects must serve households earning 80% of AMI or below, and 20% or units must be affordable to households earning 50% of AMI or below.

Homeownership projects must serve households earning 80 percent or less of area median income, adjusted for family size.

AHP funds may be used directly for rehabilitation or new construction, or can be used to reduce mortgage principal, to cover down payment and closing costs, or to lower the interest rate on a loan.

Applicants must also have some ownership in the property once a project is completed. Sponsors of homeownership projects are not required to maintain an ownership interest, but must be integrally involved in the project's development.

c. *Subsidy Amounts and Types*

The San Francisco FHLB does not limit the amount of funds that any single developer may request, though awards in 2006 averaged roughly $7,000 per unit. The maximum subsidy that can be requested for any one project is $5 million at the San Francisco FHLB in 2007.

While applications to the local FHLB make up the vast majority of AHP awards, projects can also apply to one of the other eleven FHLBs across the nation if they can find an appropriate sponsor bank. Each has different policies and funding availability.

d. *Availability*

The San Francisco FHLB made 132 AHP awards in 2006 with a total subsidy amount of $55 million. Funding amounts vary from year to year depending on the profitability of each FHLB in the prior year.

e. *Application Process*

Allocations of AHP are made based on a competitive application process. The San Francisco FHLB holds two funding rounds each year in April and October. The Bank awarded $34.7 million in Round A of 2007, and these funds will support 4,413 affordable housing units in 80 developments located in Arizona, California, Florida, Illinois, Nevada, and Texas. In 2006, the Bank awarded a total of more than $55 million. Each FHLB district sets its own application process, so applications to FHLB districts other than San Francisco will likely differ.

Applicants must partner with a member institution to submit an AHP application, which generally means that the applicant will obtain construction and/or permanent financing through the member Bank. The member bank must underwrite the development proposed in the AHP application and review the project's schedule to reasonably assure that it will be ready to draw funds within one year of application approval.

f. Additional Information

For additional information, see the San Francisco FHLB website www.fhlbsf.com and/or speak with an affiliated bank.

9. Fannie Mae

Fannie Mae has created a number of programs to support the development of multifamily housing. Some of these programs are described below.

- Delegated Underwriting and Servicing (DUS)—DUS is Fannie Mae's key product line for the purchase of individual multifamily mortgages on rental properties. Fannie Mae purchases first-lien mortgages for the acquisition or refinance of existing or recently completed multifamily properties, or properties needing moderate rehabilitation. Under DUS, specially approved lenders, operating within guidelines established by Fannie Mae, are able to underwrite, close, and sell mortgages to Fannie Mae without prior review. In turn, DUS lenders share in any losses with Fannie Mae should there be a default.
- Tax-Exempt Multifamily Bonds—Fannie Mae also supports the efforts of state and local bond issuers through the provision of credit enhancement for tax-exempt bonds. Working through a Fannie Mae-approved lender, credit enhancement can be provided for both fixed-rate and variable-rate bonds. Fannie Mae's AAA rating results in a favorable interest rate on the bonds at the time of sale.

a. Typical Underwriting Standards

Maximum LTV is:

- For fixed-rate, tax-exempt bonds, the maximum LTV is generally the greater of 90% of market value or 80% of adjusted value.
- For variable-rate, tax-exempt bonds, the maximum LTV is generally the greater of 85% of market value or 80% of adjusted value.

Minimum DSCR is:

- For fixed-rate, tax-exempt bonds, the minimum DSCR is generally 1.15x.
- For variable-rate, tax-exempt bonds, the minimum DSCR is generally 1.20x.

The mortgage loan term may be a minimum of 10 years (15 years for Multifamily Affordable Housing) and a maximum of 30 years. The mortgage and the bonds must have the same maturity date. There is full amortization on a schedule of up to 30 years. Interest-only is available in some cases.

b. Eligible and Ineligible Activities

Fannie Mae provides credit enhancement for tax-exempt bonds issued to finance the acquisition, new construction, refinancing, or moderate or substantial rehabilitation of multifamily housing.

Tax-exempt bonds backed by Fannie Mae credit enhancement carry the same requirements as all tax-exempt private activity bonds.

c. *Availability*

Prospective borrowers must work through a Fannie Mae approved lender to access the Fannie Mae programs described above. Interested agencies should contact the Fannie Mae office in Pasadena for a list of such lenders.

d. *Additional Information*

See the following website for more information on Fannie Mae multifamily programs: www.fanniemae.com/multifamily/index.jhtml.

10. Federal Housing Administration 221(d)(3) and (d)(4)

Under the Section 221(d)(3) and (d)(4) programs, FHA provides mortgage insurance to insure FHA-approved lenders against loss on rental projects. A HUD field office designated to process FHA insurance handles the paperwork for the insurance. The loan made by the lender or mortgagee may either be taxable or use tax-exempt bonds issued by a local or state issuer. The FHA mortgage is fully amortized over 40 years.

FHA charges an annual mortgage insurance premium equal to one-half percent of the mortgage amount. In addition, there is an application processing fee, and an inspection fee. Annual financial statements must be submitted to HUD each year.

a. *Illustrative Example*

The City of Phoenix and its developer partner McCormack Baron Salazar used the FHA 221(d)(4) program to help finance 136 new units at the third phase of Matthew Henson Homes, a 2001 HOPE VI Revitalization grant recipient. The FHA-insured loan of $2.9 million was combined with $19 million in other funding sources, including $11.7 million in 9% tax credit equity, $6.4 million in HOPE VI funds, and a $900,000 loan from the Phoenix Housing Finance Corporation.

b. *Typical Underwriting Standards*

There are three types of limits on the maximum loan amount: A percentage of the replacement cost, the amount obtained using the debt coverage ratio and the statutory limit which varies according to the size of the unit, type of structure, and location of the project.

Using the replacement cost limit, the maximum amount of the loan is equal to 90 percent of the replacement cost for all users of the 221(d)(4) program. For-profit borrowers using the 221(d)(3) program are limited to mortgages equal to 90 percent of the estimated replacement cost; nonprofits may obtain loans up to 100 percent of the replacement costs. The debt coverage is 1.11:1.0.

c. *Project Eligibility Requirements*

Insured mortgages may be used to finance new construction or rehabilitation of rental housing containing five or more units.

Targeted Groups—There are no income limits for the tenants. HUD does have restrictions which control reporting, reserve deposits, management, etc. which will be contained in a regulatory agreement that is recorded against the property. If tax-exempt bonds are used, the regulatory agreement required by the tax code is subordinated to the FHA regulatory agreement.

d. *Availability*

This program is available to borrowers through qualified FHA-approved lenders. Interested agencies should contact the San Francisco or Los Angeles offices of HUD for a list of such lenders. There are several steps in the FHA approval process. HUD considers the project's financial feasibility, market need, zoning, architectural merits, sponsor capacity, etc. in granting its approval. HUD will issue its commitment to the FHA lender. The commitment is usually valid for 60 days, and this timeframe may be extended under specific circumstances. Total processing time usually takes from nine to 12 months.

e. *Additional Information*

For more information, see the following website:
www.hud.gov/offices/hsg/mfh/progdesc/progdesc.cfm.

11. Federal Housing Administration 223(f)

Under the Section 223(f) Program, HUD provides mortgage insurance to insure FHA-approved lenders against loss on rental projects, just as in the 221(d) programs described earlier. The difference is that 223(f) is used for refinance, acquisition or moderate rehabilitation of existing apartments.

The mortgage term is not less than 10 years, nor more than the lesser of 35 years or 75 percent of the remaining economic life of the improvements. There is full amortization. FHA charges a mortgage insurance premium equal to one percent of the mortgage amount for the first year. Thereafter, the premium is equal to one-half percent of the mortgage amount.

a. Illustrative Example

The Bremerton Housing Authority (BHA) used an FHA 223(f) insured loan with a GNMA-backed 35 year bond to help finance the acquisition and rehabilitation of 148 units at Erlands Point. Because of the longer amortization term and debt service coverage requirement described further below, BHA was able to secure more debt using the FHA 223(f) program than would be possible using other competitive loan products.

b. Typical Underwriting Standards

There are three types of limits on the maximum loan amount: (1) A percentage of the value; (2) The amount obtained using the debt coverage ratio; and (3) The statutory limit. The statutory limit varies according to the size of the unit, type of structure, and location of the project.

Using the value limitation, the maximum loan cannot exceed 85 percent of the value determined by HUD. The debt coverage is 1.17:1.0.

c. Project Eligibility Requirements

Purchase, moderate rehabilitation, and refinancing of projects of five or more units are permitted. Projects requiring substantial rehabilitation are not eligible. In addition, at least three years must have elapsed from the later of the date of completion of the project or beginning of occupancy to the date of application, and the remaining economic life must be long enough to permit at least a 10-year mortgage.

The estimated cost of required repairs may not exceed the greater of 15 percent of the estimated value after repairs or $6,500 per unit, adjusted by a high cost factor. It may not involve the replacement of more than one major system.

Targeted Groups—Like the 221(d) programs there are no income limits for the tenants. HUD does have restrictions which control reporting, reserve deposits, management, etc. which will be contained in a regulatory agreement that is recorded against the property. If tax-exempt bonds are used, the regulatory agreement required by the tax code is subordinated to the FHA regulatory agreement.

d. Availability

This program is available to borrowers through qualified FHA-approved lenders. Interested agencies should contact the San Francisco or Los Angeles offices of HUD for a list of such lenders. The formal mortgage insurance application for either conditional or firm commitment is submitted through an FHA-approved mortgagee. HUD will issue its commitment to the FHA lender. The length of the commitment is established on a case-by-case basis. Total processing time usually takes from six to nine months.

e. Additional Information

For more information, see the following website:
www.hud.gov/offices/hsg/mfh/progdesc/progdesc.cfm.

RESOLUTION NO. 2007 - ___

Adopted by the Housing Authority of the City of Sacramento

ON DATE OF

ADOPTION OF GUIDING PRINCIPLES FOR THE HOUSING AUTHORITY OF THE CITY OF SACRAMENTO TO ADDRESS REPOSITIONING OF ITS PUBLIC HOUSING ASSETS

BACKGROUND

A. Adoption of the Guiding Principles developed by the Housing Authority of the City of Sacramento to frame its Asset Repositioning Study. These important Guiding Principles will shape and guide future strategic long term decisions by the Housing Authority. The Guiding Principles support the mission of the Housing Authority and are the cornerstone of our long term vision; a self-sustaining real estate portfolio to serve extremely low income residents in the City and County of Sacramento.

BASED ON THE FACTS SET FORTH IN THE BACKGROUND, THE HOUSING AUTHORITY OF THE CITY OF SACRAMENTO RESOLVES AS FOLLOWS:

Section 1. The Repositioning Strategy Guiding Principles for the Housing Authority of the City of Sacramento (Exhibit A) are hereby adopted.

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Exhibit A

Sacramento Housing Authority
Guiding Principles

➢ ***The mission of the Sacramento Housing Authority is to provide decent, safe, and sanitary housing to low income residents in the City and County of Sacramento. As such, the following guiding principles will be used to judge specific repositioning initiatives when presented for approval.***

1. Sustain our commitment to house extremely low income households by adopting a "no net loss policy" requiring the development of at least an equivalent number of replacement units when units are removed from our baseline inventory.

2. Decrease reliance on federal funding sources by leveraging the use of existing sources with private funding (debt and equity) and other sources (grants and local subsidies).

3. Preserve and enhance existing physical housing stock; upgrading stock whenever possible to a 30 year useful life.

4. Locate new units into sustainable and livable communities that meet the specific needs of residents.

5. Incorporate smart growth principles (i.e. energy efficiency, safety/security, quality of life) into project design to the maximum extent possible.

6. Diversify real estate portfolio in creative ways to support extremely low income units.

7. Maximize utilization of existing resources (i.e. vouchers, local funds, the value of Housing Authority real estate assets, etc) to implement development strategies.

8. Reinvest proceeds from the sale of Housing Authority properties in the replacement of units.

9. Promote and support resident self sufficiency.

10. Seek creative partnerships with other agencies, non-profits, community groups, resident advisory boards, and private sector sponsors.