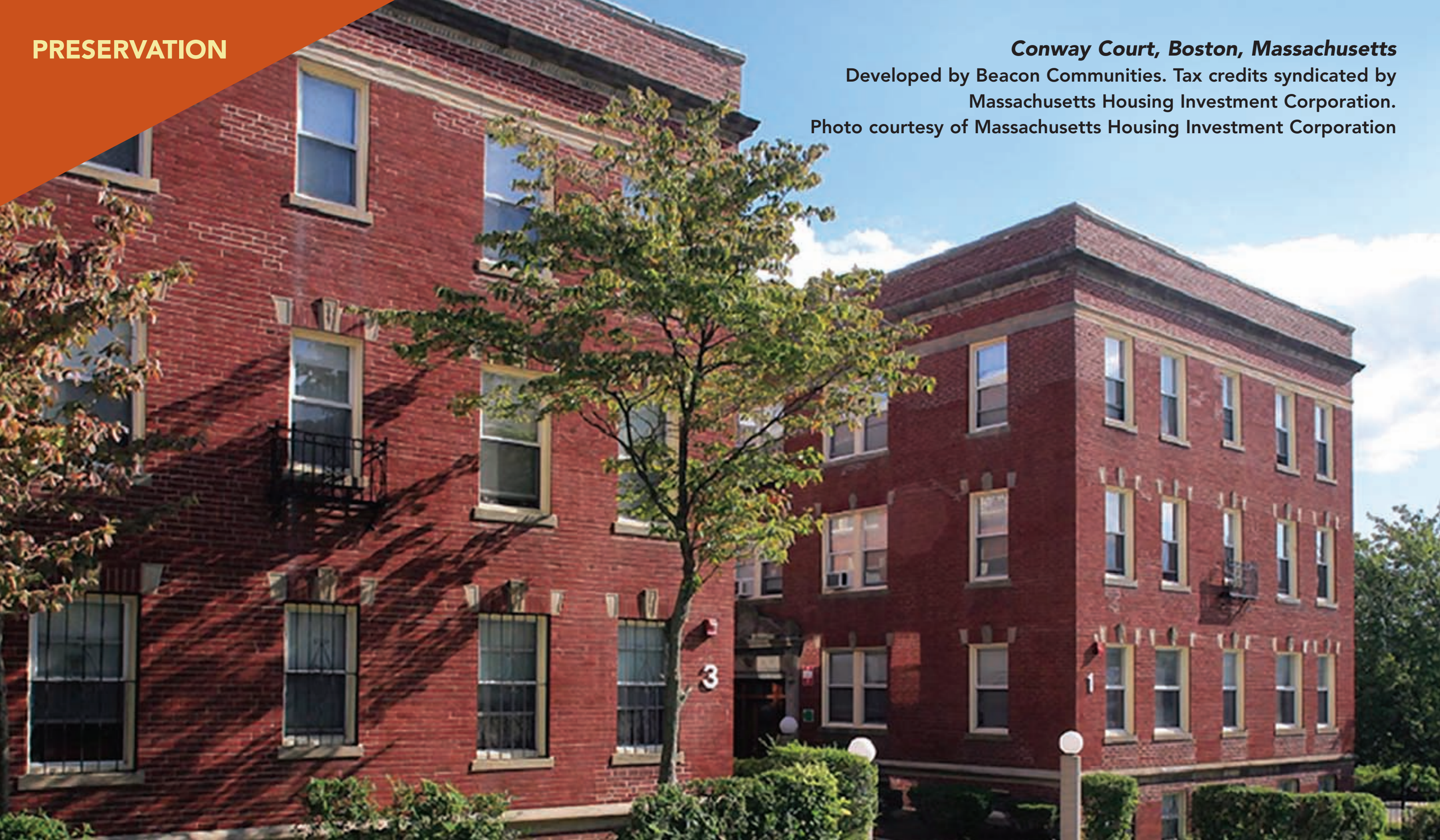

Conway Court, Boston, Massachusetts
Developed by Beacon Communities. Tax credits syndicated by Massachusetts Housing Investment Corporation. Photo courtesy of Massachusetts Housing Investment Corporation

Preserving Affordability

Acquisition/Rehab Transactions That Work

Developers continue preserving affordable rental housing by acquiring and rehabilitating existing multifamily properties in a variety of transactions.

The federal low-income housing tax credit (LIHTC), often paired with tax-exempt financing, is a popular funding source for many preservation deals. But other subsidies and favorable governmental policies are often part of the mix as well.

Various studies point to a shrinking supply of affordable apartments nationwide but a growing demand. An improving economy has triggered higher conventional rents in many markets, more and more non-traditional cash buyers are chasing after affordable properties when they come up for sale, and there is a dwindling amount of federal, state, and local gap funds and subsidies needed to make preservation deals pencil out.

States Recognize Preservation

Tracy Kaufman, director of the National Preservation Initiative at the National Housing Trust (NHT), says state housing finance agencies recognize the importance of preservation projects in their 9% LIHTC programs.

"Preservation transactions continue to be a really important consideration for most states," she says. "At this point 46 states incentivize preservation, either through set-asides or specific points or basis boost."

For example, in Texas' 2014 LIHTC program, at least 15% of the state's annual 9% housing credits are set aside for projects to preserve "at risk" properties in danger of leaving the affordable housing stock. Tennessee, meanwhile, has a 2014 preservation set-aside of up to 25% of its tax credits.

Kaufman says there have been some new trends in states' LIHTC qualified allocation plans when it comes to preservation.

"We've seen in the last couple of years that while some states have shied away from a specific [preservation] set-aside, states that had a set-aside in the past, they are finding other ways to incentivize preservation outside of a set-aside, such as weighting preservation in the [application] points or providing a basis boost." She said the result is a continuing significant volume of credit awards for preservation projects, with many states pro-

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viding well over half their 9% credits for such transactions.

Kaufman said some states have also begun to establish "green" criteria or requirements for acquisition/rehab projects that are different than those for new construction projects.

She said one promising new gap financing source for preservation transactions are utility-sponsored multifamily energy-efficiency programs. Under these, some electric and gas utilities offer funding or other support for energy efficiency improvements made to affordable multifamily rental housing properties. NHT and four other partners are trying to get utilities in nine targeted states to create or expand such programs.

Separately, NHT will soon roll out a new tool called PrezCat, an online catalogue and searchable database of information on state and local affordable housing preservation policies.

A Variety of Transactions

At Nixon Peabody LLP, partners Monica Sussman and Stephen Wallace have their hands full.

Photo by Nixon Peabody LLP

Stephen Wallace

"Most of what we're doing these days in our group is really preservation transactions," says Sussman. "But it's not really one category."

The pair indicated that their group has closed numerous transactions involving the conver-

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The Affordable Inventory

The opportunities for preservation transactions are enormous, based on the numbers of federally or state assisted, subsidized, or financed rental properties in the affordable housing inventory. According to the National Housing Trust (NHT), this includes:

- 5 million HUD-assisted units
- 1.2 million project-based Section 8 units
- 121,000 HUD Section 236 units
- 2 million LIHTC units
- 400,000 Rural Housing Service Section 515 units

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sion and preservation of federally assisted Rent Supp and Rental Assistance Program properties under HUD's Rental Assistance Demonstration (RAD) program, and is beginning to work on RAD transactions for public housing and Section 8 Mod Rehab properties.

Other preservation deals include Mark-Up-to-Market transactions, repositioning LIHPRHA properties, prepayment of Section 202 mortgages, and even "re-decouplings." In the latter, owners who previously decoupled the Interest Rate Payment (IRP) subsidy stream from a property's original Section 236 mortgage and attached it to a new loan are taking advantage of today's low interest rates by refinancing again, removing the IRP stream from the existing loan, and attaching it to the new debt.

Sussman and Wallace praised the current leadership and staff at the U.S. Department and Housing and Urban Development for being "much more preservation-oriented," taking steps and actions and promulgating policies making it easier to get deals done. One example is a HUD policy change that permits early terminations of Housing Assistance Payments contracts to do a preservation transaction with a

Photo by Nixon Peabody LLP

Monica Sussman

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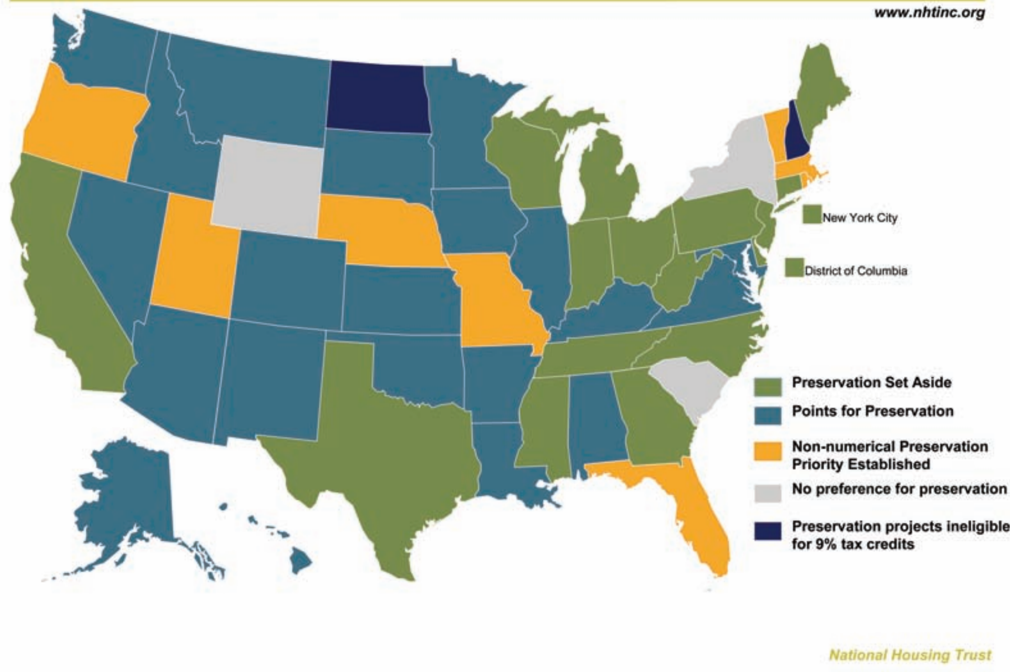
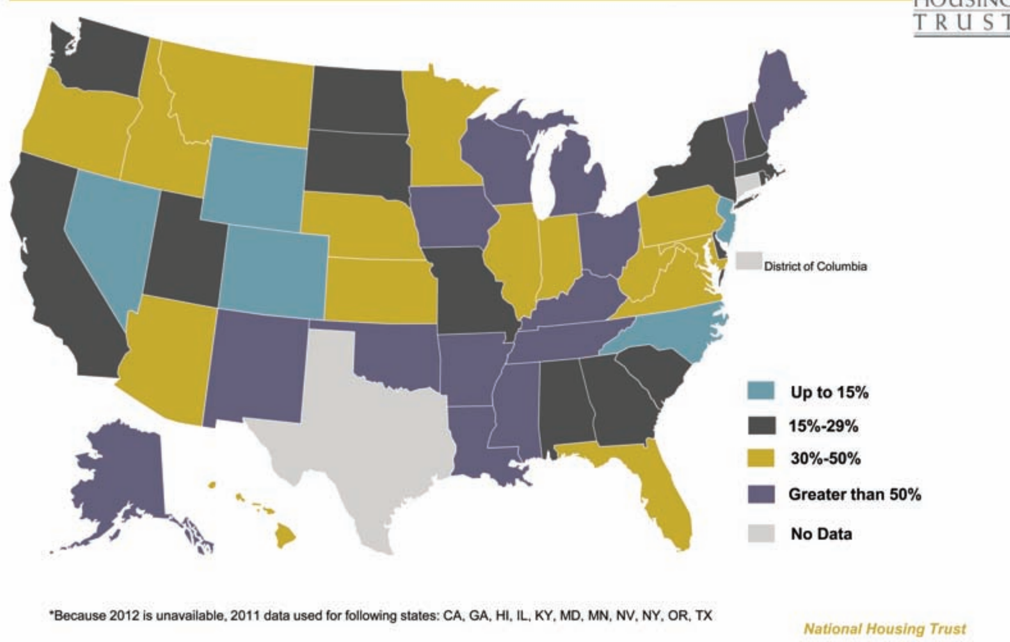
State QAP Incentives for Preservation in 2013

www.nhtinc.org



Charts courtesy of National Housing Trust, Washington, D.C.

Funding for Preservation:
LIHTC Allocations 2012*: % of Units Preserved using LIHTC



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long-term renewal of the Section 8 contract.

Moving Forward on RAD

HUD's RAD program is becoming a powerful engine for new preservation transactions, particularly for public housing projects. Under one component, local housing authorities can apply to HUD to convert the current subsidies for their existing public housing properties to project-based vouchers or rental assistance under new long-term Section 8 contracts. As a result, they can access housing credits and other capital sources to recapitalize and renovate these assets and preserve them as long-term affordable rental housing.

Current law limits HUD approval under RAD to 60,000 units. As of December 31, 2013, HUD had received applications for about 180,000 units.

In California, the Fresno Housing Authority (FHA) has closed three RAD projects so far and expects to close a fourth before April. "The first three are under construction and the fourth will start construction in March," says Preston Prince, CEO/executive director of FHA. Construction on all is expected to be completed by year end. FHA's jurisdiction includes the city of Fresno and Fresno County.

Photo: Bruce Weinstein with Creative Eye Photography

Preston Prince

Prince said the initial four RAD projects are being financed with equity generated by 9% federal tax credits (PNC and R4 Capital syndicated the credits), federal HOME dollars from the city and county, housing authority monies, reserves, and a small mortgage. All four projects have 20-year contracts providing Section 8 project-based rental assistance for all units.

Acting as its own developer, FHA is spending about $85,000 per unit on construction. The work includes upgrading kitchens and bathrooms; adding a second bathroom where there isn't one to three- and four-bedroom apartments; installing new heating and air conditioning systems, low-flow water fixtures, irrigation systems, and community facilities; and other improvements.

The four RAD projects include 10 different public housing developments, or about 25% of FHA's entire public housing portfolio. "Our goal is to eventually take all of our properties through a repositioning process," says Prince.

Northern Virginia Activity

In Arlington County, a high-cost Northern Virginia suburb across the Potomac River from Washington, D.C., the demand for affordable rental housing is "huge," according to Nina Janopaul, president/CEO of Arlington Partnership for Affordable Housing (APAH), a local nonprofit developer/owner.

In late February, the first families moved into Arlington Mill Residences, a new LIHTC community built by APAH. "When we opened our waiting list for the property last fall," says Janopaul, "3,000 families applied for 122 units."

"It's a real tragedy," she says. "In the year 2000 more than half of the Arlington County [market-rate] multifamily housing stock was affordable to households earning less than 60% of area median income. Today it's down to less than 30%." During this period, this inventory of affordable conventional apartments has dropped from approximately 17,000 to 5,000 units, she said. Fortunately, the number of "committed" affordable rental units (e.g., LIHTC, HUD-assisted, etc.) has risen from about 3,000 to 6,500 units. "We've been doing a pretty good job of capturing existing affordable properties and keeping them affordable, extending them, preserving them," says Janopaul.

One example is Arna Valley View Apartments, a 13-year-old garden-style apartment complex. APAH purchased the property in February from AvalonBay Communities and will preserve it as affordable rental housing for at least another 60 years. The LIHTC property, in Year 13 of its initial 15-year-compliance period, was one of a few, if not the only, 100% housing credit properties owned by Arlington-based AvalonBay, a major real estate investment trust.

APAH is maintaining the same income restrictions: one-third of the units are affordable to households at or below 45% of the area median income (AMI); one-third at or below 50% of AMI; and one-third at or below 60% of AMI. APAH indemnified the investor, Bank of America, for any tax credit recapture through Year 15.

The transaction originated when APAH approached AvalonBay and made an unsolicited offer for the property. The nonprofit had a connection – several AvalonBay executives have donated to APAH's annual fundraising event.

AvalonBay agreed to sell the property for $14,039,000 ($139,000 per unit).

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"We probably would have had to pay closer to $200,000 to $250,000 per unit if it had been unrestricted market property," says Janopaul.

APAH financed the purchase with $8.3 million in new hard and soft loans from three separate Arlington County programs and $8.4 million in 30-year taxable bond financing (blended rate 4.868%) from the Virginia Housing Development Authority.

The nonprofit has budgeted about $500,000 for physical improvements over the next three years; a reserve will pay for scheduled replacements over a longer period. Janopaul indicated the combination of favorable new debt and reserves enabled APAH to avoid seeking new housing credits.

Photo courtesy of Preservation of Affordable Housing

Hillside Village, Providence, Rhode Island
Developed by Preservation of Affordable Housing.

APAH used a similar financing package in 2011 to purchase Marbella Apartments, a 134-unit garden apartment complex built in 1947, from a for-profit owner.

The nonprofit has utilized housing tax credits for other new construction and acquisition/rehab projects.

APAH has used some creative techniques to be able to move quickly to acquire existing properties when the opportunity arises. For instance, it convinced a local community bank to approve lines of credit on three of its existing non-LIHTC properties that had appreciated in value, creating a ready source of immediate cash. The bank approved a new line of credit behind its existing mortgage at one property and agreed to convert its existing 10-year mortgage to a line of credit at the other two.

APAH's portfolio includes 14 affordable rental properties serving 1,218 households.

In nearby Fairfax County, one of the wealthiest areas in the U.S., the Fairfax County Redevelopment and Housing Authority (FCRHA) is constantly challenged as it tries to find ways to facilitate the production and preservation of affordable multifamily rental housing. FCRHA administers Housing Choice Vouchers, owns and manages public housing units, issues tax-exempt housing bonds, and has a construction and development division. Under a "housing blueprint" adopted by county officials in 2010, Fairfax County through various means tries to support the creation and preservation of housing affordable to households ranging from those at less than 20% of AMI up to those earning 120% of AMI. The county has done so by contributing county- or authority-owned land for new affordable housing projects, providing deferred payment loans to developers, awarding local rent subsidies, and other actions.

Before the recession, the county had a dedicated revenue source for affordable housing that generated some $22-23 million a year. However, the local housing downturn and erosion of the real estate tax base ended those days. Today the county has $5 million a year available in local housing blueprint funds, generated from debt service savings on one housing project.

Aseem Nigam

"Since the 9% credits are very competitive, our preference is to make things happen with bonds and 4% credits if possible," says Aseem Nigam, director of real estate finance and grants management. The county also receives federal HOME and CDBG dollars.

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Fairfax County also has an Affordable Dwelling Unit program that requires developers to provide a certain percentage of affordable units in new for-sale or rental single-family or non-elevator multifamily housing projects.

Eagle Point Companies

In Grand Rapids, Mich., Eagle Point Development is preserving and extending the restricted use of Stuyvesant Apartments, a historic building it acquired in October 2013 and is rehabilitating with residents in place. "We're doing about $61,000 per unit in renovation," says Laura Burns, partner and CEO of The Eagle Companies.

The South Portland, Me.-based company learned of the availability of the property from a broker, according to Burns, and had to structure a complicated deal.

"The property not only couldn't support any new debt beyond the existing first mortgage, but was really struggling and falling into disrepair," says Burns.

The property had been taken through HUD's Mark-to-Market process previously, at which point the existing debt was restructured into a smaller new first mortgage and HUD-held second and third mortgages.

According to Burns, Eagle Point structured a transaction to benefit from clearer HUD guidance issued in 2012 that allows the seller of a Mark-to-Market property to receive some of the sales proceeds and for some of the proceeds to be used to reduce the size of the second mortgage.

"We were able to get the seller some proceeds," says Burns. "And we were able to pay off the first mortgage with new conventional debt and then HUD subordinated the second and third mortgages. A portion of that second mortgage was paid down with the proceeds we were able to generate from the tax credits and the new financing."

Keeping the low-interest second and third mortgages reduced monthly debt service payments while boosting the amount of basis for housing tax credit purposes.

Eagle Point obtained an allocation of 9% federal housing credits from the Michigan State Housing Development Authority. These, together will federal historic tax credits, generated equity to complete the financing package.

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Eagle Point expects to reap significant energy cost savings as well from the energy efficiency renovations being made to the building.

Eagle Point is renovating the apartments and common areas a stack at a time, temporarily relocating residents in stages to vacant units. The first set of renovated apartments were turned back to residents at the end of February.

The development has a Section 8 contract and a PILOT agreement reducing local property tax payments.

Eagle Point is also starting to generate new preservation transactions from another source: acquired general partner (GP) interests in existing LIHTC projects. Eagle Point has used capital raised from private investors – and placed in investment funds – to acquire GP interests in existing LIHTC properties not yet in the final year of their initial 15-year tax credit compliance period. Often these properties – 18 so far – had not yet reached Year 10 when the GP interest was acquired. The first portfolio of GP interests was acquired in 2007.

When a project reaches the end of Year 15, Eagle Point will buy out the limited partner investor and decide what to do with the property to fulfill its fiduciary duty to its investors to sell each asset for the highest price. In some instances, Burns said, this may mean selling the property to a new partnership in which Eagle Point is the GP for a new acquisition/rehab transaction using fresh housing tax credits.

According to Burns, Eagle Point recently received approval to pursue this route for its first "recycle" deal, involving a Virginia property for which the plan is to utilize 4% housing credits and bonds.

Burns indicated that Eagle Point is particularly interested in existing affordable properties not being chased by conventional market-rate cash buyers, such as Mark-to-Market properties that still have long remaining restricted use periods.

Photo courtesy of Massachusetts Housing Investment Corporation

Jaclen Tower Apartments, Beverly, Massachusetts
Developed by Beacon Communities. Tax credits syndicated by Massachusetts Housing Investment Corporation.

Finding the Sweet Spot

Preservation of Affordable Housing (POAH), a Boston-based nonprofit with a portfolio of more than 70 properties in nine states and Washington, D.C., has engineered preservation transactions from different kinds of properties. However, they have primarily been acquisition/rehabs of properties with project-based Section 8 contracts and the financing has typically been 4% housing tax credits and tax-exempt bonds, says Rodger Brown, managing director of real estate development.

Photo by Preservation of Affordable Housing

Rodger Brown

"The sweet spot is 100% Section 8," he said. "To the extent there's less than 100% Section 8 we'll look at it."

When a project will require more extensive rehabilitation, POAH, in addition to 4% credits and bonds, will look for gap funds. For instance, these may be federal HOME dollars or soft state funds. "States like Massachusetts and Connecticut have subordinate debt, contingent financing that they'll provide for certain preservation transactions, and we tend to do that

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route," says Brown.

He said POAH tends not to seek 9% federal housing credits for preservation transactions "because the competition is fairly tough for those resources and the timing is rather unpredictable, which makes it difficult for our sellers. We are typically looking for a fast execution. That being said, there are exceptions where the purchase price is extremely attractive or where we have a special relationship with the seller. In some situations we will do an interim financing to bridge us over to the ultimate execution."

Like many other nonprofit sponsors, Brown said POAH often has a tough time competing for properties in strong markets and against non-traditional cash buyers. "For us it's really a relationship-driven business," he says. "We have a very hard time competing solely on price." However, he says POAH can sometimes succeed with for-profit sellers that are aware of POAH's reputation and want to make sure of the proper recapitalization and management of their asset by a buyer. He also said some for-profit sellers have desired to do follow-up transactions with POAH.

Two recent transactions illustrate preservation transactions by POAH with nonprofit sellers. In Providence, R.I., POAH acquired a HUD Section 202 property from a local church and is renovating it using housing credits to preserve the building as long-term affordable rental housing for seniors *(see story on p. 4)*. Separately, POAH recently closed on the purchase of Trinity Tower Apartments, a 510-unit, Section 8 affordable housing complex for seniors in Melbourne, Fla. The property was purchased from three nonprofits associated with a local church.

Brown indicated that preservation deals are fulfilling but often not easy to do.

"It's getting harder," he says. "There are a lot more players in the field. But the need has never been greater. So that's the challenge." TCA

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