

Making History

*Developer Preserves Two California Properties
Using First FHA Pilot Program Mortgages*



Villa Vasona Apartments, Los Gatos, California

“Historically folks have thought of HUD as, ‘Man, those loans take a long time to do,’” says developer Bill Price, CEO of Arcadia, Calif.-based Highland Property Development LLC (HPD). But Rice obtained two Section 223(f) mortgages in just 110 days under HUD’s FHA pilot program for two new housing projects in California.

The mortgages were the first closed under the U.S. Department of Housing and Urban Development’s pilot program, which is designed to drastically reduce the time it takes HUD to process applications for FHA insurance for new Section 223(f) mortgages for projects utilizing federal low-income housing tax credits.

The HUD mortgages, LIHTC equity, and deferred developer fees are the sole funding sources for HPD’s acquisition and substantial rehabilitation of Villa Vasona Apartments and Twin Oaks Apartments.

“I can’t say enough good things about the HUD San Francisco office,” says Rice. “Paul Carney is really moving that office. He and the team he has in place there really understand tax credit deals.”

Advantages of Section 223(f) mortgages are that they are non-recourse, provide construction and permanent financing, and offer a long term and low borrowing rate. Rice obtained two 35-year mortgages, each with an all-in rate of 3.05% including the mortgage insurance premium.

Besides faster processing, the FHA LIHTC pilot program permits more rehabilitation work than usual to be funded by a Section 223(f) mortgage – up to \$40,000 per unit, which Rice is spending at both California properties.

The two Section 223(f) mortgages were originated by CBRE HMF, Inc. The mortgage amount was \$13,250,000 for Villa Vasona Apartments and \$4,231,900 for Twin Oaks Apartments.

HPD acquired and is renovating the two properties in a joint venture with Mission Housing Development Corporation, a nonprofit whose participation qualifies the developments for property tax relief.

Twin Oaks Apartments, located in Vacaville, about midway between San Francisco and Sacramento, consists of 12 two-story garden and townhome-style build-

ings with 46 one-, two-, and three-bedroom apartments for families. Villa Vasona Apartments, located in Los Gatos, near San Jose, has 7 three- and one-story buildings containing 107 studio and one-bedroom apartments for seniors.

Constructed in the 1980s, both developments were in relatively good physical condition though dated when Rice began exploring the purchase of them. In addition, Twin Oaks Apartments was at risk of loss from the affordable housing stock. Its existing state agency bond-financed mortgage – imposing rent restrictions – was set to mature within a few years.

HPD found Twin Oaks Apartments through a broker and had previously done business with the owner of Villa Vasona Apartments.

Rice’s company negotiated purchase prices for the two properties. It also applied for and received allocations of 9% federal housing tax credits in 2012 from the California Tax Credit Allocation Committee: \$1,038,417 for Villa Vasona and \$364,747 for Twin Oaks.

As it happened, HUD was gearing up the new FHA LIHTC pilot program in 2012. “CBRE,” says Rice, “had pitched us on the

concept that, ‘Look, the San Francisco HUD office would really like to do the 223(f) pilot. These two projects are perfect for the program because they’re both preservation – one family and one senior.’”

According to Rice, HUD’s turnaround time of 110 days for the two deals included approvals for both Section 223(f) mortgages, multiple waivers, and new 20-year project-based Section 8 contracts for both properties covering 100% of the units.

One waiver was needed to accommodate a new ground lease for Villa Vasona Apartments. The property had been subject to a ground lease that had 43 years left on it. The new ground lease, Rice said, enabled the town of Los Gatos “to get their land rights back at closing instead of waiting for 43 years, and extended the regulatory period for another 55 years.” The ground lease payment is \$10,000 per year.

Construction Underway

Rehabilitation work began in January and should be

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completed by year-end.

Improvements include replacing the siding at one property; replacing roofs; adding resident amenities (e.g., broadband Internet); installing new energy-efficient windows and appliances; and replacing apartment kitchens and bathrooms. Highland Property Construction is the general contractor.

The renovations are being done without displacing residents. Highland is coordinating subcontractors so that they can replace an entire kitchen or bathroom in one day. This means, for example, repainting a kitchen and installing new cabinets, Corian countertops, and appliances within the span of hours, not days. "We deliver the kitchen before 5 p.m. for the resident to cook dinner that night," says Rice. "We do about four kitchens and bathrooms a day."

Doing renovations with tenants in place maximizes

rental income during construction and facilitates earlier delivery of housing credits to the investor. As of early April, occupancy was 99.1% at Villa Vasona Apartments and 97.8% at Twin Oaks Apartments.

Range of Resident Incomes, Rent Levels

Each development has a mix of tenant income restrictions. Ten percent of the units are designated for renter households earning 30% or less of the area median income (AMI); 25% for renters at or below 45% of AMI; 40% for renters at or below 50% of AMI; and 25% for renters at or below 60% of AMI.

For new projects, HUD's current annual income limits for a four-person household at 60% of AMI are \$47,280 for Vacaville (Solano County) and \$60,780 for Los Gatos (Santa Clara County).

All of the rental apartments at both properties are LIHTC units.

Post-rehab monthly rents at Twin Oaks Apartments will range from \$465 (one-bedroom, 30% of AMI) up to \$1,168 (three-bedroom, 60% of AMI). At Villa Vasona Apartments, the range will be from \$551 (studio, 30% of AMI) up to \$1,181 (one-bedroom, 60% of AMI).

Tax Credit Equity

RBC Capital Markets Tax Credit Equity Group syndicated the housing tax credits for both projects and is providing \$13,801,547 in total equity. The credits were syndicated for 98 and 98.5 cents per dollar of credit, respectively, for Twin Oaks Apartments and Villa Vasona Apartments, Rice said.

Stacie Altmann of RBC Capital Markets Tax Credit Equity Group gave several reasons for RBC's attraction to the two projects. "The initial attraction was the sponsor," she said. "They're an outstanding, well-respected sponsor, especially with this product type. On top of that, the Los Gatos and Vacaville markets are top-tier markets in the California tax credit world. Los Gatos is a top-tier CRA market and an affluent suburb in the Bay Area, so long-term housing demand there is excellent. And Vacaville is pretty much right between Sacramento and San Francisco, so it's a great commuter market to either area as well as also having very high demand." **TCA**

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