St. Paul Village
Cincinnati, Ohio
Photo courtesy of Ohio Capital Corporation for Housing

Diamonds in the Rough

The Best of Times and Worst of Times for Preservation Deals

Barker Management Incorporation, an affordable housing developer and management company based in Anaheim, Calif., is nearing the completion of rehabilitation of a 140-unit existing affordable apartment property in Long Beach, Calif. called New Hope Home.

Partnering with New Hope Home, Inc., a local non-profit that has only this one project, Barker Management is substantially renovating the 40-year-old, eight-story, HUD Section 202 property for seniors. It is upgrading the apartments, systems, and common areas and significantly increasing the property's efficiency and sustainability, though such features as new energy-efficient windows and lighting, a white roof, synthetic grass and water-efficient plants, water retention programs, and the use of recycled carpet and non-VOC paint.

"This deal will be LEED-certified," says Barker Management President Peter Barker.

The $22 million project was funded with tax-exempt bonds issued under the federal New Issue Bond Program, a HUD Section 221(d)(4) mortgage, and equity generated by 4% federal low-income housing tax credits. The project-based Section 8 rental assistance contract was extended to 20 years.

Barker Management generated the deal from its portfolio. "We'd been involved in the management of this property for almost 40 years," says Barker. "We broached them with the idea of renovating the property, allowing them to have some cash to do other deals and some additional ongoing revenues, and to modernize the building. And they embraced the idea."

Barker's company, which manages about 10,000 units in California, Nevada, and Phoenix, develops just in California and currently only does preservation projects. Barker says the company has done a number of preservation transactions in the past five years, predominantly involving HUD properties (Section 202, 236) but also an expired LIHTC project.

Best and Worst of Times

Regarding current opportunities for developers and owners for affordable rental housing preservation trans-

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actions, National Housing Trust President Michael Bodaken calls it "kind of the best of times and the worst of times."

Preservation projects entail the rehabilitation, usually with acquisition, of a wide array of multifamily rental properties financed, subsidized, or assisted under various federal or state housing programs. Prime candidates are HUD Section 8, 236, and 202 properties; Rural Housing Service Section 515 projects in rural communities; and older LIHTC properties approaching, at, or past the end of their 15-year compliance period. But there are other types as well – even conventional apartment properties – that can be candidates for deals.

Bodaken, developers, syndicators, and others interviewed by the *Tax Credit Advisor* said there are currently a host of both positives and challenges for preservation transactions. On the plus side, they noted that many state housing credit agencies have special incentives for preservation projects in their qualified allocation plans and LIHTC program rules governing their award of 9% housing tax credits, such as "set asides" of a minimum portion of their annual 9% tax credits, extra points in application scoring, and other preferences. According to NHT official Tracy Kaufman, a new state-by-state analysis by NHT of states' 2012 QAPs shows an uptick to 18 states with preservation set-asides and an increase to five states directing a 30% basis boost to preservation projects (Indiana, Iowa, Michigan, Missouri, Washington, D.C.).

States With Set-Asides for Preservation Projects in Their 2012 Qualified Allocation Plans

(as of March 2012)

State	Size of Preservation Set-Aside *(Percentage of Total Available 9% Credit Authority)*
Delaware	50%
Ohio	35%
Florida	35%
Alaska	33%
Wisconsin	30%
Michigan	25%
Oregon	25%
Georgia	25%
Indiana	20%
West Virginia[1]	15%
Texas	15%
Pennsylvania	15%
Mississippi[2]	15%
South Carolina	12%
North Carolina	10%
Iowa	10%
California	5%

[1] West Virginia has a 15% set-aside for rural development and a 25% set-aside for HUD preservation or new construction.

[2] Mississippi sets aside $1 million of its $6.3 million in LIHTCs for historic or rehabilitation developments. There are specific requirements for qualifying historic projects but none for rehabilitation projects applying under this set-aside.

[3] Although New Jersey's most recent QAP doesn't establish a specific preservation set-aside, it does ensure that at least one preservation project receives LIHTCs.

Source: National Housing Trust, www.nhtinc.org

Developer Bryan Shumway of The Wishcamper Companies, Inc., based in Portland, Me., has also seen points in some states his company works in for projects with rental assistance.

Bryan Shumway

Other positives, sources reported, include:

- **High current pricing** for both 9% and 4% tax credits, plenty of tax credit equity, and greater receptivity by syndicators and investors to deals financed by tax-exempt bonds and 4% credits – the most common funding sources for preservation deals. "We have not had any difficulty raising equity," says developer Pam Goodman of Boston-based Beacon Communities Development LLC. Adds Barker, "We've found the equity market [in California] to be pretty strong...for 4% and preservation deals as long as they pencil well."

Pam Goodman

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- **The greater viability of tax-exempt financing.** Plenty of bond authority is available in most if not all states, and bond interest rates are relatively low. In addition, the "cash collateralized" structure now pervasively used for tax-exempt issues, which employs short-term tax-exempt bonds to access 4% credits and harness even lower short-term taxable rates to provide very low-rate construction and long-term permanent debt financing, makes more bond deals viable. *(For details on structure, see* Tax Credit Advisor, *April 2012, p. 14.)* "We're seeing a lot of people trying to pencil out bond deals right now," says Madison, Wisc. CPA Don Bernards of Baker Tilly Virchow Krause LLP.

Don Bernards

- **A large and growing supply of existing properties that are potential candidates for preservation deals.** These include HUD and Rural Housing Service projects, "Year 15" LIHTC properties, and others. Bodaken noted the largest single segment of federally subsidized projects, Section 8, is about 1.2 million units nationwide.
- **A willingness – even eagerness – by HUD to approve waivers and make other accommodative actions** to facilitate trans-

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A Snapshot of Preservation Deals

Following are some recently completed or current affordable rental housing preservation transactions discussed by developers and others interviewed by the *Tax Credit Advisor.*

Cumberland Homes

SPRINGFIELD, MASS.

At the end of 2011, Boston-based Beacon Communities Development LLC completed the substantial rehabilitation of this multiple-building, 76-unit multifamily rental property, utilizing equity generated by federal low-income housing tax credits, state low-income housing tax credits, state historic tax credits, and HOME funds in a transaction that involved a sale and the refinancing of the existing debt. Beacon Communities Development President Pam Goodman said the company acquired the site about 15 years ago but had not done any rehab. "It was really time to undertake a preservation. And there were also some pretty significant structural issues with the buildings," she said. Ninety percent of the property's apartments are LIHTC units while 10% are market rate.

Todd Creek Apartments

MEMPHIS, TENN.

ALCO, a Memphis-based developer/owner/manager, is renovating this 150-unit garden apartment Section 8 property that it purchased out of bankruptcy proceedings in December, says ALCO President & COO Robert Hyde. The property, in financial trouble at the time, was originally built in the late 1960s by the previous nonprofit owner, and had a HUD Section 221(d)(3) mortgage on it that ALCO paid off at closing. The company funded the new $7 million deal with equity raised from the sale of 4% federal housing tax credits, a first mortgage capitalized by proceeds of 30-year tax-exempt bonds floated by a Memphis issuer, and a loan of federal HOME funds from the city, and obtained a 10-year freeze on property taxes. The tax credits and bonds were placed with a local bank, and ALCO took over the existing project-based Section 8 contract covering all units. ALCO is spending about $30,000 per unit in rehab on the property.

Sycamore Place

BRIDGEPORT, CONN.

The Wishcamper Companies, Inc., a Portland, Me.-based developer/owner/manager with about 7,500 units in some 15 states, closed in November 2011 on a transaction to acquire and renovate this high-rise HUD Section 236 property that has 118 apartments and project-based Section 8 rental assistance, says President Bryan Shumway. Funding sources included equity generated by 4% housing tax credits and debt funded by tax-exempt bonds issued under the federal New Issue Bond Program. The developer also did a decoupling of the Section 236 Interest Reduction Payments contract. A second project about to close will involve the acquisition/rehabilitation of a 180-unit property in South Carolina that is near the end of its LIHTC compliance period. The

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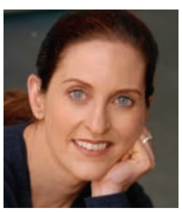
actions to preserve and extend the affordability period for existing HUD properties.

On the other hand, industry officials noted that are current challenges to doing preservation transactions, including:

- **A shrinking supply of federal, state, and local gap funds and soft debt** – usually required for most preservation transactions to pencil out. "Scarce resources is the biggest challenge," says developer Robert Hyde of ALCO, based in Memphis, Tenn. Annual funding for the federal HOME program, a common gap filler, has been cut by 37.5%. Many other state and local resources have been scaled back (e.g., trust funds). And California has ended the set-aside of local redevelopment funds for affordable housing and dissolved the local redevelopment agencies that provided these funds and land for affordable housing deals. "The RDA money was a critical component to us," in about 75% of its deals, says Linda Mandolini of Hayward, Calif.-based nonprofit Eden Housing, Inc., which develops and owns properties primarily in the 10-county Bay Area.


Robert Hyde


Linda Mandolini

- **Fierce competition for existing affordable properties in some markets, particularly on brokered sales, which is boosting acquisition prices.** In addition to competition from other "affordable" buyers wishing to purchase available existing LIHTC projects to do a new preservation transaction, there is also often bidding now by a growing number of "yield-driven" buyers – often traditional purchasers of market-rate apartments – interested purely in economic return rather than tax benefits, says Armand Tiberio, of the Tax Credit Group of Marcus and Millichap Real Estate Investment Services. He noted his firm is seeing robust buyer demand for LIHTC and Section 8 properties. "We're


Photo by Will Dann of the Tax Credit Group of Marcus & Millichap
Armand Tiberio

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transaction will be funded by a cash-collateralized tax-exempt bond issue, new 4% tax credit equity, and a HUD Section 221(d)(4) mortgage.

Riverside Village

LEOMINSTER, MASS.

In 2011, Schochet Associates, Inc., a Boston-based developer/owner/manager, completed the renovation of this 312-unit garden apartment family rental property in which it partnered with the nonprofit owner, the Retirement Housing Foundation. The property, built in the early 1970s and still subject to "ELIHPA" use restrictions, had a Section 236 mortgage on it that was prepaid – and its Interest Payments Reduction contract decoupled – as part of the $20 million transaction. Funding sources included the proceeds of tax-exempt bonds issued by MassDevelopment and placed with Boston Private Bank, and equity generated by 4% credits for about 280 of the units – the remaining units are occupied by over-income tenants. The developers obtained a "comfort letter" from HUD assuring that the existing project-based Section 8 – covering 193 units – will be extended for 20 years and funded when it renews in 2014. Enhanced vouchers were obtained for the non-Section 8 residents.

St. Paul Village I

CINCINNATI, OHIO

A recent ribbon-cutting was held for this newly renovated property for seniors that has efficiency and one-bedroom apartments. The $13.5 million transaction involved the renovation and reconfiguration by local nonprofit Episcopal Retirement Homes and the Model Group of this existing three-building project – built in 1975 under HUD's Section 236 program and funded later with Loan Management Set Aside Section 8 – that had been plagued by many vacant efficiency apartments. The density was reduced from 124 to 103 units, with upgrades made to the apartments, buildings, and common areas. The transaction was funded by equity generated by 9% federal housing tax credits awarded by the Ohio Housing Finance Agency and syndicated by Ohio Capital Corporation for Housing, and a variety of HUD programs, including a new Section 221(d)(4) mortgage, Section 236 decoupling, processing through Mark-to-Market with Note Assignment, TCAP and Exchange funds, and a loan of federal HOME funds from the city. There is a continuing project-based Section 8 contract for 71 of the units. TCA

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now having to compete with lots of other folks," says developer Richard J. Henken of Boston-based Schochet Associates, Inc. Adds Shumway, "We're starting to see private equity come to some of these deals that have project-based Section 8."

Richard Henken

- **High costs in some markets.** "The challenge in Northern California is that land is expensive, impact fees are high, and it's not the cheapest place to build," says Mandolini. "So you really can't build without some public subsidy."
- **The end of the New Issue Bond Program**, which provided borrowing rates even lower than regular tax-exempt bond issues and which is very limited in availability prior to its cessation at year end.
- **The massive rehab needs of some properties due to years of accumulated deferred maintenance.**
- **Investor concerns about possible Section 8 risks.** The Obama Administration's budget proposal for HUD is to "short fund" some Section 8 contracts in FY 2013, and there are broader fears of further federal belt-tightening. "The uncertainty with the budget is creating some difficulties in Section 8 deals," says Shumway.

So where are the opportunities for affordable developers and owners, today and in the near future, for new preservation transactions?

- **Backyard transactions.** A natural place for developers and owners to start is to sift through their current portfolio of existing properties (LIHTC, Section 8, other) to see which need significant renovations that could be addressed by a recapitalization event such as a re-syndication. The developers that were interviewed reported that many of their preservation transactions are re-workings of older properties in their portfolios as new acquisition/rehab deals.
- **Private equity and low-rate intermediate-term debt** to buy out partners (GP, LP, or both) or acquire properties and hold them for a future recapitalization transaction (e.g., tax credit re-syndication). Fannie Mae's 7-6 adjustable-rate mortgage (ARM) product is one popular debt product being used by developers and owners to acquire or refinance properties (all-in rate of 3.35% on May 2). Bernards says 3- and 5-year conventional bank loans are also available. Centerline Capital Group is raising investor capital for a new, $25-50 million non-LIHTC fund that will provide equity to developers to enable them to acquire existing multifamily properties and hold them for a future transaction such as a major refinancing or major rehab with new tax credits, said executive Michael Riechman.
- **HUD's new FHA LIHTC pilot program.** Being rolled out initially in HUD's Hub offices in Boston, Chicago, Detroit, and Los Angeles, this is designed to cut HUD processing times for FHA Section 223(f) loans for LIHTC projects. Tracy Peters of Red Mortgage Capital LLC, one of 20 participating lenders in the pilot, believes the initiative could significantly increase the use of Section 223(f) loans rather than Section 221(d)(4) loans for preservation transactions. In addition to faster processing times – HUD's goal is to cut it to 60 days – the pilot will provide lower borrowing rates and have larger maximum rehab amounts than standard 223(f) mortgages (as high as $40,000 per unit versus $17,500), Peters noted. The participating lenders met with HUD officials in early May to finalize the pilot before beginning to take initial applications. "We're looking at the Super F program," says California developer Peter Barker. *(For details of pilot, see* TCA, *March 2012, p. 8.)*
- **New or sometimes overlooked gap funding sources.** These can include energy and (where applicable) historic tax credits, energy loans and utility rebates, pre-development and acquisition loans, and other resources. Bodaken said a new trend unfolding in some states is the development of multifamily energy retrofit programs capitalized by "public utility benefit" funds. These are extra charges placed by public utility companies on their customer's utility bills. The National Housing Trust is working with eight states and the District of Columbia on such multifamily retrofit programs – some are up and running. In Maryland, $12 million in public utility benefit monies has been transferred to the state housing finance agency to help finance

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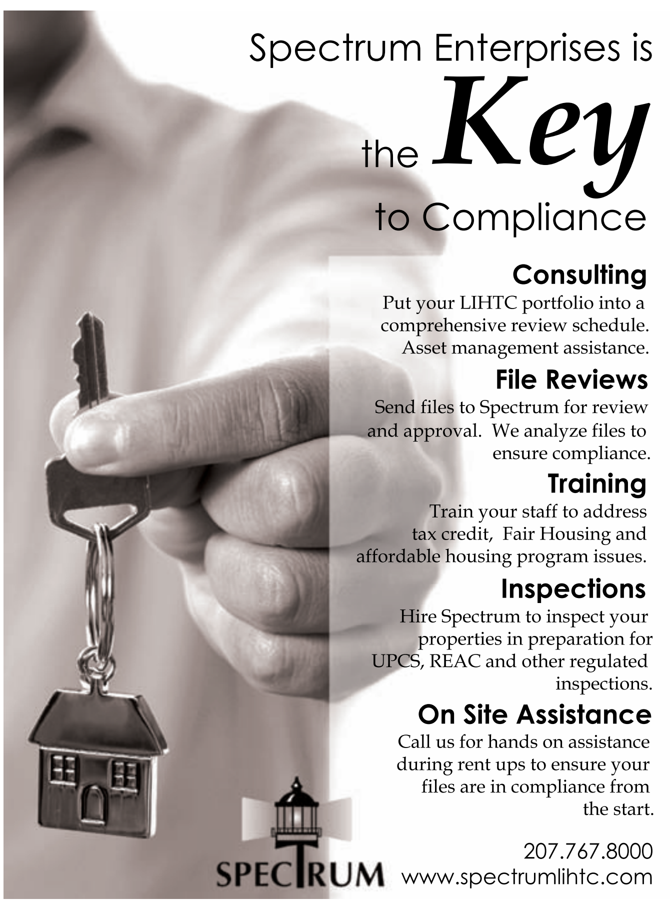
energy retrofits of existing multifamily properties. In a different vein, an initiative called the Ohio Preservation Compact offers pre-development loans of up to $500,000 and acquisition loans of up to $1 million for preservation projects. The loans are originated by a community development financial institution (CDFI) of the Ohio Capital Corporation for Housing, a nonprofit LIHTC syndicator. Ohio Capital is a partner in the Compact along with the Ohio Housing Finance Agency (OHFA) and the Coalition on Homelessness and Housing in Ohio. The $18 million revolving loan fund was capitalized by initial monies from the John D. and Catherine T. MacArthur Foundation, OHFA, and a number of local banks.

- **HUD regulatory and policy changes, creative new interpretations, waivers, etc.** Sometimes these can make a preservation transaction possible. A November 2011 Office of Housing letter, for example, removes previous roadblocks to the sale of certain existing HUD properties (e.g., 236, 221(d)(3)) owned by nonprofits that would like to use the sales proceeds for non-housing charitable purposes, thereby creating a potential sources of new properties *(see* Tax Credit Advisor, *May 2012, p. 18)*. In Chicago, nonprofits Mercy Housing Lakefront and National Housing Trust/Enterprise found the solution for a large preservation transaction in a closer reading of HUD's disposition rules (*see article on p. 35*). And in California, Eden Housing Inc. is working with HUD to create a deal structure to preserve six small HUD 202 properties in its portfolio all at once, using 4% federal housing credits, state housing tax credits, and a subordination by HUD of its 202 loans. Eden Housing is also trying to get state law amended to facilitate the preservation of some older affordable projects financed under state housing programs, according to Mandolini.



- **Straight refinancings.** This reduces a property's debt service costs and can free up dollars to make needed repairs or light rehab. Red Mortgage Capital's Tracy Peters says his firm is starting to see refinancings – to FHA Section 223(a)(7) loans – of Section 236 projects that have been "decoupled," and anticipated that there may be opportunities starting in the near future to do similar refis for 236 projects that haven't been decoupled.


Tracy Peters

- **Pooled transactions.** While most preservation transactions are "one-off" deals involving a single property, in certain circumstances "pooled" transactions are possible, in which multiple existing properties are aggregated for simultaneous acquisition/rehab by one owner or buyer in one transaction, often financed with tax-exempt bonds and 4% tax credit equity. The Wisconsin Housing Preservation Corporation has employed this mechanism to renovate 21 mostly small and rural Section 8 properties in Wisconsin *(see article on p. 2)*. And Baker Tilly's Madison, Wisc. office, says Don Bernards, is working on a $90 million transaction in which a developer will acquire and renovate six post-Year 15 LIHTC projects with 1,200 units in Texas, using bond financing

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Hal Keller

and 4% tax credit equity without gap dollars. "Portfolio transactions can make a lot of sense," says Hal Keller of Ohio Capital Corporation for Housing, such as instances in which a developer is purchasing a portfolio of properties.

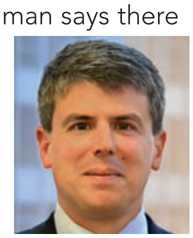
- **Use of notes.** Henken said Schochet Associates is been using soft notes a fair amount to help finance the purchase of properties. "We give the seller a soft note, a cash flow note, and fill gaps that way." He noted the company was about close on the purchase of a 144-unit property in Connecticut in which the soft notes will total about $6,000 per unit.

- **Potential legislative changes.** There are pending bills and legislative proposals that if passed could help preservation transactions. Pending bills would amend the LIHTC program to establish a minimum rate of 4% for the 30% present value housing credit for non-bond financed acquisition costs. The Administration has also proposed legislative changes to allow 4% credits for qualified preservation projects that utilize tax-exempt bond authority, even if bonds aren't actually issued, and to make permanent the Rural Housing Service's Multi-Family Revitalization Program, which is now a demo.

Don't Scrimp on the Rehab

According to sources, the essential requirements for a viable and successful LIHTC preservation deal are a strong sponsor, strong property management, a reasonable acquisition price, and a proposed scope of rehabilitation work that will fully address the property's current and long-term physical needs and is satisfactory to syndicators, investors, and lenders.

Center Capital Group's Michael Riechman says there is no hard-and-fast uniform rule for the minimum required amount of rehab expenditures for preservation deals. "It's really deal-by-deal, market-by-market," he notes. "It's looking at what the property needs and making sure you have the right scope of work." But he suggested that proposed rehab below $10,000 per unit is likely a non-starter.



Michael Riechman

Ohio Capital's Hal Keller says a 9% deal ideally should have $25,000-$40,000 per unit in hard rehab costs, although he noted bond deals generally can't afford this much without substantial gap funds. "There is no appetite for moderate rehabilitation in the industry," he says, explaining that equity providers all want "more substantial rehabilitation" and not mod rehabs every five years or so.

The State of Housing Preservation

As all affordable housing developers and owners know, putting together a preservation LIHTC deal that will succeed now and long term is no small feat. But it can be done – with the right property, resources, and partners.

"We all have to do more with less," says developer Richard Henken.

Notes Bodaken: "The state of housing preservation is good and stable and growing, and I don't expect that to change anytime soon. If the market improves, there'll be more and more opportunities." TCA