California Housing Partnership Corporation
California's Experts on Affordable Housing Finance, Advocacy & Policy

HOUSING PRESERVATION NEWS

SEPTEMBER 2013

Eden Housing Pioneers a New Model for Recapitalizing Aging HUD 202 Properties

Project Background

The U.S. Department of Housing and Urban Development (HUD) funds thousands of units affordable to low-income seniors and people with disabilities in California through their Section 202 and 811 loan programs. Many of these developments are decades old and in need of significant physical improvements. Unfortunately, older properties with budget-based subsidies from programs like Section 202 have been particularly hard to recapitalize due to limitations on rent increases and leveraging new debt and equity. The loss of $1.5 billion in annual redevelopment and state bond funding in California has greatly reduced public funds available for preservation and rehabilitation of affordable housing, further complicating efforts to aid older affordable developments with major capital repair needs.

Given the large number of these aging properties in California and limited available funding, it has become increasingly important to find a way to help these properties recapitalize. Thankfully, our partners at HUD have made great strides recently to provide new tools. But it takes more than the availability of new tools to make progress; it takes a hard-nosed, experienced developer like Hayward, California-based Eden Housing to find a way to make it all work.

HUD Subsidized Mortgage Properties in California

Mortgage Type	Properties	Assisted Units	Total Units
202	443	24,314	26,122
811	166	2,049	2,133
236	98	6,429	9,366
Total	707	32,792	37,621

The Properties and Their Challenges

Fuller Lodge, San Leandro, CA

In March 2013, after years of effort, Eden Housing closed the financing and began rehabilitating six properties originally built with Section 202 loans more than twenty years earlier. Located in the East Bay cities of Fremont, Hayward, and San Leandro, two of the properties provide homes specifically for seniors, three for people with physical disabilities, and one for people with mental disabilities. All of the buildings shared a need for major physical improvements and faced complex challenges to refinancing. The small size of four of the developments, ranging from 21 to 26 units, made it impractical to refinance them using Low Income Housing Tax Credits and Tax Exempt Mortgage Revenue Bonds due to high transaction costs and high operating expenses stemming from the intensive service needs of their residents. Another complicating factor was that many of the properties were joint ventures between Eden and other nonprofit organizations, meaning that the ability to move forward was dependent on a lengthy process of obtaining agreements with multiple nonprofit boards.

At the time Eden began working on the recapitalizations, combining 202 properties for refinancing was a new technique and HUD staff and attorneys had many questions about the emerging proposal. In addition, five of the six properties required HUD approval to prepay their 202 mortgages as well as approval of the overall refinancing plan.

Working with HUD to Find Creative Solutions

To tackle the complicated refinancing process, Eden brought in a team from Mosaic Urban Development, LLC (Mosaic), led by Lihbin Shiao, as development consultant, and the California Housing Partnership Corporation's (CHPC) Senior Program Manager Greg Chin as financial consultant. With help from Mosaic and CHPC and by working closely with the HUD San Francisco office, Eden found a way to combine the four smaller properties with two larger developments - also in need of rehabilitation - under one financing package. Combining the six properties into a single refinancing also created a more attractive opportunity for lenders and tax credit investors.

Because the challenges Eden faced with these six properties are by no means unique given HUD's overall portfolio of aging properties, HUD staff were highly motivated to find ways to overcome the difficulties confronting smaller 202 properties and the complex regulatory structures in place on the loans. Lihbin Shiao notes, "Mosaic and CHPC worked with HUD to interpret regulations in a way that would facilitate a workable refinancing structure. We were one of the first refinancing proposals that combined multiple 202 properties and it was challenging for both the HUD field office and HUD in Washington, D.C. However, the ultimate success of this project has created a path that other 202 properties in need of substantial rehabilitation can now follow."

Each of the six properties went through the Mark To Market process and as a result four of the properties received higher rents under their long-term Section 8 contracts, thus increasing the amount of debt they could leverage. HUD allowed for greater use of replacement reserves to fund rehabilitation costs and approved prepayment of the loans in exchange for long-term commitments to extend affordability 20 years beyond the original maturity date for the five properties that required HUD's permission to prepay. The resulting financing structure allowed the properties to cross-subsidize each other on a one time, upfront basis through the use of seller proceeds and enabled the refinancing and rehabilitation of all of the properties to move forward.

Financial Partners Merritt Community Capital and Citi See the Project Through

Eden Issei Terrace, Hayward, CA

Once agreements were in place with HUD permitting the refinancing, the next step was to secure 4% Tax Credits and Tax Exempt Bonds for the project. Though the recapitalization depended on the properties being financially linked, the team found it beneficial to submit separate applications for each property. The final structure consisted of six bond allocations with a single bond issuance, and six tax credit allocations with one tax credit investor in a single fund. Merritt Community Capital signed on as the tax credit investor and Citi as the lender for all six properties. Six limited partnerships, with an Eden-controlled entity as managing partner, were set up to acquire each property as part of the tax credit financing process. The acquisitions increased the tax credit equity obtained for each property, enabled seller carry back loans that provided additional funding for the rehab, and allowed Eden to consolidate its stewardship of the properties.

While all six properties received their allocations in September 2012, three of the properties had claimed readiness points to make the applications more competitive for California state credits, meaning that financing had to be closed and construction started by March 2013. Luckily, Merritt Community Capital and Citi were able to come through in the crunch. CHPC financial consultant Greg Chin comments, "Karen Smyda at Merritt Community Capital and Merle Malakoff at Citibank were very dependable and flexible partners during the difficult iterative process of developing a financing plan that worked for the six properties. Both partners excelled at overcoming obstacles under pressure and embraced the challenge of refinancing the entire portfolio, an approach CHPC has used before to assist clients in recapitalizing challenging properties."

SOURCES	Construction	Permanent
Citibank Tax Exempt Loan and Bonds	$ 34,587,032	$ 26,000,145
Seller Carryback Loan	$ 11,798,848	$ 11,798,848
Existing Reserves*	$ 661,710	$ 661,710
Costs Deferred Until Perm Loan Closing	$ 5,949,667	
Income from Operations	$ 704,156	$ 1,448,319
Merritt Community Capital Tax Credit Equity	$ 3,187,427	$ 16,979,818
Total	**$ 56,888,840**	**$ 56,888,840**

USES	Construction	Permanent
Land/Acquisition		$ 27,591,139
Rehabilitation		$ 12,814,068
Relocation		$ 1,970,000
Design, Engineering, Local Permits		$ 3,167,276
Reserves and Financing Costs*		$ 5,010,950
Legal, Consulting, Dev. Fee, Other Soft Costs		$ 6,335,407
Total		**$ 56,888,840**

Renovations Underway with HUD Precedents In Place to Benefit Others

With financing in place and future operating budgets secure, renovations are now well underway on all six properties. When finished, the residents will experience a range of improvements including new roofing and exterior envelope improvements, new or improved windows and doors site work for accessibility and security, unit interior fixture and finish upgrades, and, at one location, a new, greatly needed community space. Of equal importance, other aging HUD properties are now benefitting from the agreements Eden and HUD developed for this portfolio with help from CHPC and Mosaic.

PRESERVATION SERVICES FOR NONPROFIT AND LOCAL GOVERNMENT STAFF

CHPC provides technical assistance and training to help nonprofit and government agencies build and preserve affordable homes for California families and seniors. For more information about our preservation program, please contact Housing Policy and Preservation Associate, James Pappas at jpappas@chpc.net or (415) 433-6804 x 320. For information about CHPC's technical assistance services, contact Richard Mandel at rmandel@chpc.net.

This newsletter is made possible with support from …