



HOUSING PRESERVATION NEWS

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Preserving Affordable Homes in Sacramento

Editor's Note: Our last issue of Housing Preservation News reported on at-risk properties in the Sacramento Valley. This month we highlight the successful preservation of two at-risk properties in the City of Sacramento, Washington Square III and Sherwood Court Apartments, and the partnership between the developer and local government that made this success possible.

Importance of Local Government Leadership

The City and County of Sacramento, led by the Sacramento Housing and Redevelopment Agency (SHRA), have a record of actively supporting the preservation of affordable apartments in their communities. Past preservation efforts include prioritizing funding for preservation of at-risk properties, actively using their housing elements as a tool to promote preservation, and an active monitoring program that is. The City is one of the first jurisdictions to enact a local preservation notice ordinance that requires owners of subsidized properties opting out of their Section 8 contracts or prepaying their HUD mortgages to notify SHRA specifically of the opportunity to work with them on a possible preservation transaction. SHRA solicits proposals from local affordable housing developers to acquire and preserve these at-risk properties. Since the adoption of its notice ordinance in 2004, the City has not lost any at-risk apartments and has preserved six properties totaling 567 apartments. It is this commitment to preserving affordable homes that led to the preservation of Washington Square III and Sherwood Court Apartments in downtown Sacramento.

Washington Square III and Sherwood Court Apartments

The Alkali Flat neighborhood is one of the oldest in the City of Sacramento, with a history dating back to the 1849 Gold Rush. Originally a wealthy residential enclave of Victorian homes near the City's downtown, the area gradually deteriorated as development shifted towards Sacramento's ever-expanding suburbs. Pervasive blight and a high crime rate prompted the City to adopt the neighborhood as a redevelopment area in 1972. Washington Square III and Sherwood Court Apartments, which were built in 1973 and 1974, have supplied some much-needed large bedroom affordable units to the downtown area. Sherwood Court is composed of 14 two-bedroom apartments, while Washington Square III includes 8 one-bedrooms, 16 two-bedrooms, 8 three-bedrooms and 8 four-bedrooms. Very few three-bedroom apartments and virtually no four-bedroom apartments are affordable to residents earning less than 50% of area median income in this area. All of the apartments are supported by project-based Section 8 rent subsidies.

In 2006, the owner of both properties decided it was time to leave the affordable housing management business. The two buildings, originally developed under the HUD Section 236 program, were more than 30 years old, and after years of deferred maintenance, were showing their age. Since both properties were also eligible to prepay their mortgages, the owner could had the ability to sell Washington Square III and Sherwood Court Apartments to any interested buyer – including one that would convert the properties to market-rate housing. The long-term affordability of these homes was clearly in jeopardy.

With help from CHPC, Community Housing Opportunities Corporation (CHOC), a nonprofit affordable housing developer active in the Sacramento Valley, stepped in to purchase these properties, preserve their long-term affordability, and renew them as quality housing for large households. SHRA shared CHOC's goal of preserving these apartments as affordable and helped them to acquire and rehabilitate the properties by providing financing for the project.

The New Washington Square

The properties are currently under renovation. Once completed, the renamed Washington Square will promote sustainability and healthier living for its residents. An extensive rehabilitation process, including 100% window replacement, new flooring, new cabinets, new energy-star appliances, new mechanical systems, new doors, a new roof at Sherwood Court and other key items will increase energy efficiency prolong the life of the development. The rehabilitation work will improve energy efficiency at the properties by at least 25%. Washington Square will also improve services for residents; the rehabilitation will create an on-site community room and permanent space for a bona-fide service coordinator. Children of families at both developments will be able to use the nearby Thomas P. Raley branch of the Boys and Girls Club year round, free of charge.

Financing Strategies: Building Partnerships and Leveraging the Section 8 Contract

With assistance from CHPC, CHOC was able to finance the acquisition and rehabilitation of the new Washington Square through a combination of Low Income Housing Tax Credits (LIHTC), low interest residual receipt loans from SHRA, long term extensions of the Section 8 contracts, and financing from US Bank. CHOC purchased the properties in February 2007, for \$4.2 million (\$500,000 less than their appraised value), with loans from SHRA and US Bank. Immediately following the purchase, CHOC applied for, and was later awarded, 9% tax credits under the state set-aside for "At-Risk" properties.

CHOC next made some key decisions about how to best maximize project income and secure construction and permanent financing. Because the original Section 236 mortgages had were supported by Interest Reduction Payments (IRPs), there was an option to decouple and borrow against the repositioned IRPs. After careful consideration, however, CHOC and CHPC determined that because the the potential IRP payments would be relatively small for the amount of processing and regulatory oversight required, it was not worth the extra effort to decouple and finance the IRP subsidies.

Instead, CHOC focused its energies on increasing the value of the existing Section 8 contracts in order to maximize the amount of leveraged debt. Washington Square completed Mark-up-to-Market processing, which raised rental income at the properties in exchange for a 20-year Section 8 contract. CHOC was able to use the Section 8 increment – the difference between the maximum allowable rents under the Low Income Housing Tax Credit program and the fair market rents provided by the Section 8 contract – to attract additional loans from the private lender, in this case US Bank. The bank provided the project with a 30-year loan underwritten using the tax credit rents, and an additional 20-year loan supported by the Section 8 income. Together, this amounted to \$2.61 million in private financing. CHOC also secured permanent financing from SHRA.

Financing Summary

Use of Funds	Amount
Acquisition	4,700,000
Rehab/Construction	4,047,000
Architect/Engineer	292,000
Costs of Financing	792,187
Marketing/Reserves	547,000
Legal/Other Consultants	155,329
Relocation	365,000
Developer Fee	886,000
Other Soft Costs	486,880
TOTAL Development Costs	12,271,396

Sources of Financing	Permanent	Construction	Acquisition
US Bank Perm Loan	1,049,000	8,183,652	3,350,000
US Bank Section 8 Increment Loan	1,561,000		
Seller Note (CHOC)	520,000	520,000	
SHRA - RDA	500,000	500,000	500,000
SHRA - HOME	1,138,000	1,138,000	1,138,000
Income from Operations	68,624	68,624	
Tax Credit Equity	7,434,772	934,607	
HCD Predevelopment			100,000
Costs Deferred		926,513	7,183,396
TOTAL Sources	12,271,396	12,271,396	12,271,396

Conclusion: Thanks to CHOC and active support from SHRA, Washington Square is now protected for another 55 years.