HOUSING PRESERVATION NEWS

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Preservation of PHD Apartments in Los Angeles Demonstrates Impact of Federal Stimulus and State Preservation Notice Law

Editor's Note

The preservation of Professional Housing and Development apartments (PHD) by Little Tokyo Service Center (LTSC) and the Korean Youth and Community Center (KYCC) demonstrates how California's Affordable Housing Preservation Notice Law can be used to quickly bring together key stakeholders to preserve at-risk housing. It is also an example of how local government housing agencies can help nonprofit housing organizations make a difference despite many obstacles. The PHD Apartments also illustrate the unique challenges of preserving and rehabilitating a scattered-site property that is currently occupied. Finally, this case study highlights the critical role that the American Recovery and Reinvestment Act of 2009 played in stabilizing affordable housing production, preservation and creating jobs.

Background

In June 2004, the owner of the 83-unit PHD Apartments in Los Angeles sent tenants and local governments a 12-month notice to opt out of the Section 8 contract, pursuant to federal HUD requirements. Though in compliance with federal requirements, the owner was not aware that California Notice Law also required him to send separate notices to the list of Qualified Preservation Entities until he was informed by the City of Los Angeles Housing Department (LAHD).

Consequently, in the summer of 2005, the owner notified LAHD, tenants and Qualified Preservation Entities of his desire to sell the property. The owner had prepaid the subsidized 236(j)(1) mortgage in December 2001, and the project-based Section 8 contract was set to expire in July 2005.

As a certified Qualified Entity by the State of California, LTSC received the "Notice of Opportunity to Submit a Purchase Offer" from PHD's owner in July 2005. LTSC began its community development work in Los Angeles' Little Tokyo neighborhood over 30 years ago, but then expanded to affordable housing and real estate development in 1993. Under the Asian Pacific Islander Housing Collaborative, LTSC began partnering with community-based Asian Pacific-Islander organizations in Los Angeles to provide real estate technical assistance and to ensure equitable development in other older ethnic enclaves, including Chinatown, Filipinotown, and Thai Town.

Given PHD's location in Los Angeles' Koreatown neighborhood, a densely populated five square mile area where increasing rental costs threaten to displace the community's older Latino and Korean residents, LTSC approached KYCC to partner in preserving the development. With LTSC as the managing general partner and KYCC as the service provider and main community conduit, they made several fair market value purchase offers to the owner. In August 2007, they finally acquired the property using high-leverage financing from the Low Income Investment Fund.

Financial Challenges

Shortly after acquiring the property, LTSC worked with HUD staff in Los Angeles to preserve affordability by extending the Section 8 contract for 20 years and increasing the contract rents under the Mark-Up-To-Market renewal option. Then in July 2008, LAHD stepped up to provide $4.5 million in HOME funds from the City of Los Angeles Housing Trust Fund.

During late 2008 and early 2009, unforeseeable economic conditions forced LTSC to reevaluate its financing strategy. First, during the months preceding the California's bond freeze, policy changes at the California Department of Housing and Community Development put acquisition/rehab projects at a disadvantage to receive Proposition 1C funding. Unable to secure Multifamily Housing Program (MHP) funds and assemble a financing package with bonds and 4% Low-Income Housing Tax Credits (LIHTC), LTSC shifted to a 9% LIHTC structure. This was made possible by the extraordinary support of LAHD, and the project received a 9% LIHTC award in August 2009.

LTSC faced a second challenge, however, when the frozen capital markets and evaporating demand for LIHTC investment left them unable to secure an investor. Throughout this time of uncertainty, CHPC helped LTSC to anticipate the opportunities that pending economic recovery legislation might offer and guided them in pursuing these avenues when the American Recovery and Reinvestment Act (ARRA) was enacted in February 2009. In December 2009, the California Tax Credit Allocation Committee (TCAC) awarded the project a cash-in-lieu grant of ARRA funds, which eliminated the need for an investor.

This solution to the investor problem created new issues: the bank previously committed to PHD chose not to lend to projects that received cash-in-lieu awards and lacked tax credit investors. Fortunately, the additional time to close permitted by the ARRA award allowed LTSC to pursue FHA financing. The FHA 221(d)(4) Substantial Rehabilitation Program offered the most aggressive stance in the market on Section 8 underwriting as well as the promise of non-recourse financing (lenders for ARRA cash-in-lieu projects typically demanded full recourse to the borrower). As a result, LTSC was able to raise substantially more debt under the FHA program to fund additional rehabilitation.

"We navigated treacherous waters for several years to pull together the PHD financing and were battered again and again by unexpected—and unprecedented—issues. In the end, we were able to do it in a way that protects both the tenants and LTSC and preserves an important affordable housing resource. But we would not have gotten this far without the dedication, creativity, and flexibility of LTSC's partners, including LAHD, the Los Angeles HUD office, and TCAC," noted Paul Beesemyer, CHPC's Southern California Program Director.

While the difficult process of assembling financing in the midst of a recession was successful, the added time put severe financial strains on LTSC. The prolonged holding period required an extension to the acquisition loan in mid-2009. Given the drop in property values, LTSC was forced to use cash reserves to pay down the principal in order to extend the acquisition loan. And although PHD's cash flow helped cover monthly interest payments, LTSC had to use its own cash to make the full interest payments.

"Our organizational mission as a non-profit, neighborhood based organization helped us stay focused on making this a successful project and weather these extreme challenges," said Thomas Yee, PHD project manager. "It is the commitment of all our partners in this deal for seeing this project through for the Koreatown community."

PHD Apartments: Sources and Uses

Uses		Total		Per Unit
Acquisition	$	8,400,000.00	$	101,205.00
Hard Costs	$	1,442,549.00	$	17,380.00
Contingency	$	212,000.00	$	2,554.00
Financing Costs	$	2,864,730.00	$	34,515.00
Other Soft Costs	$	2,110,451.00	$	25,427.00
Total	**$**	**15,029,730.00**	**$**	**181,081.00**

Sources		Total		Per Unit
PNC Bank (FHA Insured Loan)	$	5,264,500.00	$	63,428.00
LAHD - Housing Trust Fund	$	4,575,000.00	$	55,120.00
ARRA (Cash in Lieu)	$	4,638,120.00	$	55,881.00
Deferred Developer Fees	$	552,110.00	$	6,652.00
Total	**$**	**15,029,730.00**	**$**	**181,081.00**

Lessons Learned

Speaking to an audience of over 130 property owners, local government officials, and housing advocates at the Los Angeles Affordable Housing Preservation Summit in May 2011, Dean Matsubayashi, LTSC's Director of Community Economic Development, shared key insights learned by his team over the six years it took to preserve the PHD apartments.

Matsubayashi discussed the importance of recognizing that occupied developments in relatively desirable neighborhoods will necessarily come with higher acquisition costs. With a stable population of long-time residents, PHD's preservation also required extensive inter-agency coordination around temporary relocation, both before and during construction. In addition, streamlined processes within HUD and relationships with the local HUD leadership proved invaluable in pushing the project along and helping LTSC deal with the unique timing challenges and deadlines.

"At the LA HUD office, we have some key leadership who really stepped up and pushed the project forward. But not all offices will have that kind of leadership. So it's important that certain process are in place to help with timing challenges that will inevitably arise with affordable housing Tax-Credit deals," said Matsubayashi.

Lastly, PHD's preservation demanded "greater patience and flexible funding" on both the front and back end. LTSC's hardships in carrying the acquisition loan for an extended period demonstrate the need for upfront funding by local government to help offset acquisition costs. And if this is not possible, developers of preservation properties need access to high-leverage, patient capital to fund acquisitions.

"There is definitely an urgency to preserve affordability in Los Angeles, but what role we all play and how much risk we take on in the process needs to get figured out. There could be an advocacy role, there could be a policy role, there could be a development role. And all those pieces need to be in place to make it happen," said Matsubayashi.

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, please contact our Housing Preservation Specialist, Nadia Shihab at nshihab@chpc.net or 415-433-6804 x 316, or our Housing Policy Manager, Marilyn Wacks at mwacks@chpc.net or 415-433-6804 x 313.

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