California Community Land Trust Network
Perpetual Home Affordability-Stewardship-Community Control

Enterprise

NORTHERN CALIFORNIA LAND TRUST

PEOPLE OF COLOR SUSTAINABLE HOUSING NETWORK

Housing Preservation for Permanent Affordability Part 2:

Nuts and Bolts of Acquisition-Rehab Development and Financing + Coop Conversion

Workshop for the Community Co-Ownership Initiative and the California Community Land Trust Network

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Sarah Scruggs, Northern California Land Trust
April 17, 2021

Gratitude to the original stewards of this land, the Ohlone people.

SOGOREA TE LAND TRUST

An urban, indigenous women-led land trust that seeks to:

- “Facilitate the return of indigenous land to indigenous people through practices of rematriation, cultural revitalization, and land restoration”
- “Heal and transform the legacies of colonization, genocide, and patriarchy and to do the work our ancestors and future generations are calling us to do”

Learn about reparations and how you could support Sogorea Te by contributing to a voluntary land tax: https://sogoreate-landtrust.org/shuumi-land-tax/

Recapping Our Last Session

- Development process
- Development costs vs. operating costs
- Capital stack
- Sizing debt

The Acquisition-Rehab Process

Identify Homes

- Identify properties
- Begin resident engagement, if possible.
- Conduct basic feasibility analysis.

Predevelopment

- Evaluate building conditions
- Identify available funding sources
- Engage owner, begin negotiation
- Community outreach and education

Acquisition

- Negotiate and finalize purchase.
- Close acquisition financing.
- Perform pre-construction tasks.

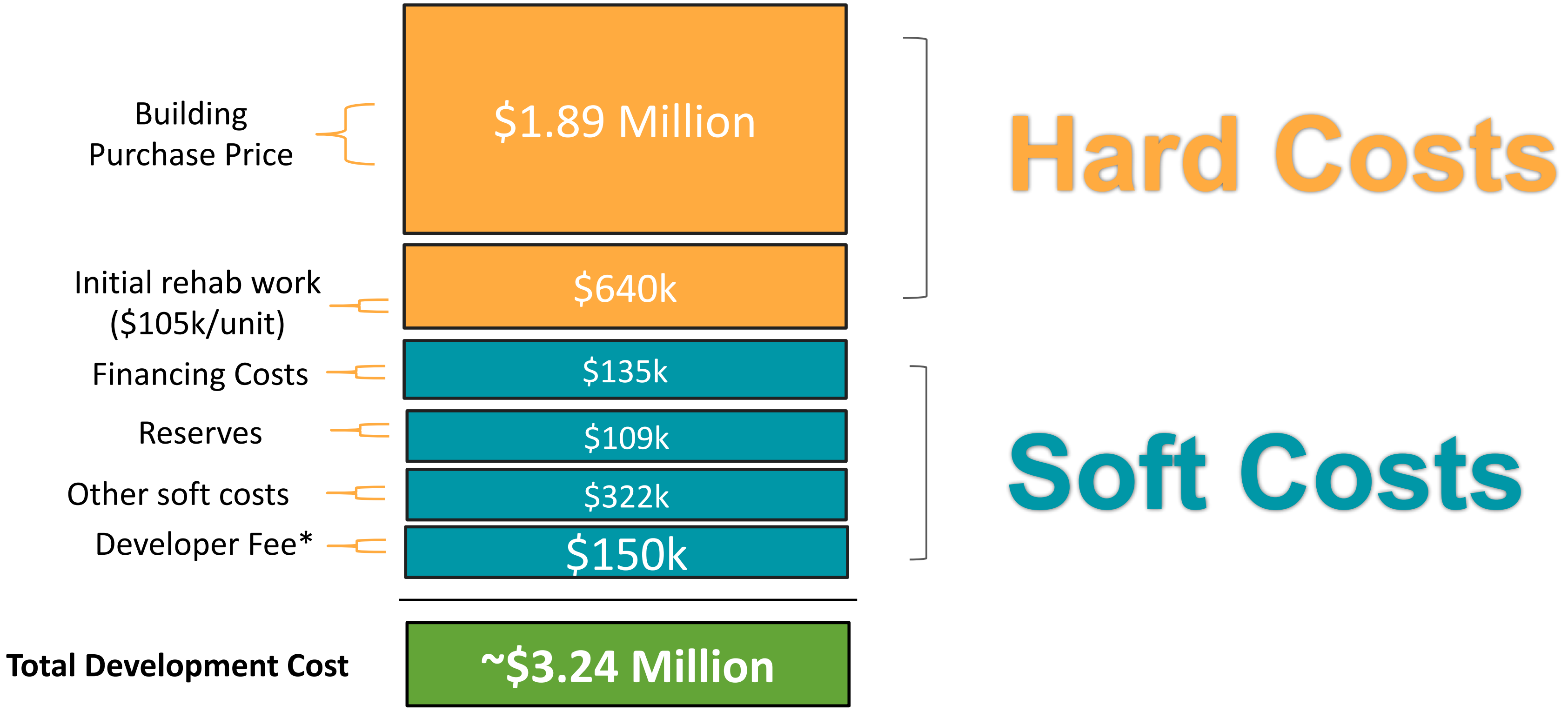
Rehabilitation

- Develop and execute construction plan.
- Communicate and coordinate rehab with residents.
- Oversee construction management.

Stewardship

- Begin ongoing property management
- Engage service providers.
- Perform asset management.

What's in a Development Budget?



Debt vs. Equity

When an affordable-housing developer is ready to build, she has to finance the property with **debt** and **equity**.

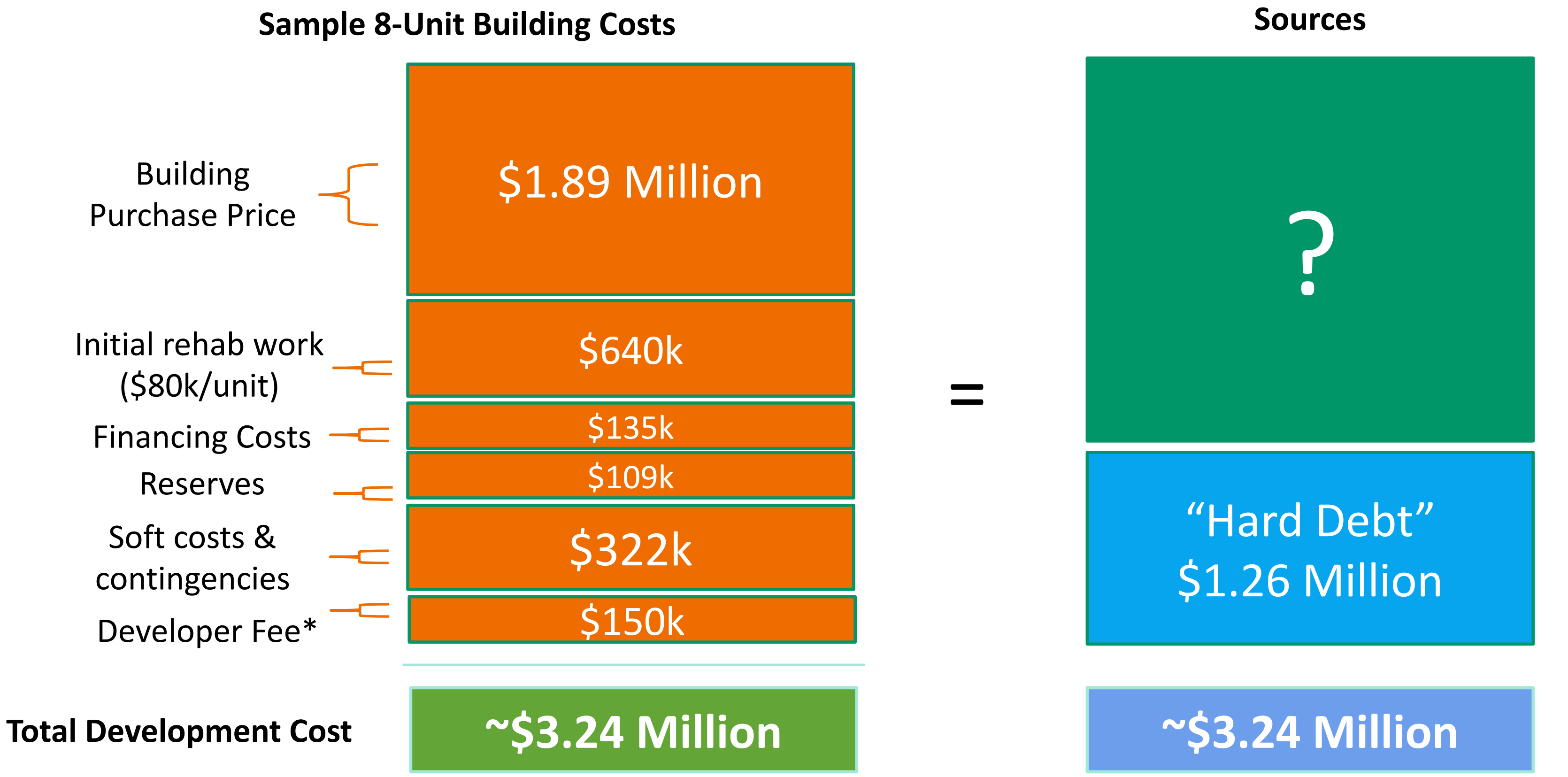
Debt

- Borrowed money with expectation of repayment at an established cost of funds (interest rate).
  - ***Hard Debt:*** contributed by a lender with the expectation that it will be paid back on a specific schedule. Sizing depends on cash flow from rents.
  - ***Soft Debt:*** public or philanthropic money with flexible expectations for re-payment. AKA Gap funding.

Equity

- A share of ownership, invested with the expectation of returns
  - Low Income Housing Tax Credit (LIHTC) equity: Cash investment with return achieved via tax credits and losses to offset the investor's tax bill

After We Secure a First Loan, a Gap Remains



After We Secure a First Loan, a Gap Remains

Sample 8-Unit Building Costs

Building Purchase Price	$1.89 Million
Initial rehab work ($80k/unit)	$640k
Financing Costs	$135k
Reserves	$109k
Soft costs & contingencies	$322k
Developer Fee*	$150k
Total Development Cost	**~$3.24 Million**

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Sources

Other - ~$160k

NCLT Equity ~ $228k

City of Berkeley ~$1.57 Million

"Hard Debt" $1.28 Million

~$3.24 Million

Today's Session - Understanding Development Cost Factors, Financial Feasibility and Co-op Conversion

1st Half

- Unpacking development costs (focus on rehab scope)
- Unpacking operating costs
- Interplay between revenue and expenses → Net Operating Income

2nd Half

- Sizing debt (doing the math)
- Filling the gap: equity and public subsidy (soft debt)
- Cost/process of converting from rental to cooperative

Example Project: 8-Unit Building in Berkeley

- $235,600/Unit
- West Berkeley, near major bus lines
- “Moderate rehab needs”
- Mix of 1 and 2-Bedroom Units

Unpacking Development Costs - Due Diligence

Sample Lender Diligence

PROJECT DILIGENCE		SPONSOR DILIGENCE
Preliminary Title Report	Additional Physical Reports	Audited Financials (3 most recent years)
Capital Needs Assessment	Zoning Analysis	REO Schedule
Building Plans & Specs	Current Tenant Rent Roll (Residential & Commercial)	Organizational Docs - Governance - Strategic Plan - Annual Report - Staffing Plan - Organizational Budget
Schedule	Current Tenant Leases (Residential & Commercial)	
Seismic Safety	**Historical Operating Expenses**	
ALTA Survey	Appraisal and Market Study	
Environmental Site Assessment	Income Certifications	

Unpacking Development Costs - Assessing Rehab Needs

What is a PCNA/PNA/CNA?

- Property Condition Needs Assessment, Property Needs Assessment, Construction Needs Assessment (etc.)
- Report examines **exterior** and **interior** needs and **building systems**, and provides a breakdown of Immediate Needs, Intermediate, and Long Term repairs
- Typically includes 20-year plan w/ budget that guides requirements for replacement reserves

Big Cost Factors:

- ADA compliance
- Seismic safety upgrades and/or earthquake insurance
- Building systems: Roofing, electrical, mechanical, plumbing, structural, drainage
- Extensive dry rot
- Major interior unit repairs
- **Temporary relocation**

Construction System	Good	Fair	Poor	Action	Immediate	Short Term	Over Term Years 1-12
5.2.1 Site Configuration and Size	X			None			
5.2.2 Utilities	X			None			
5.2.3 Grading, Drainage and Site Landscaping		X		Repair	$16,000		$3,000
5.2.4 Water and Sanitary Lines	X			None			
5.2.5 Ingress/Egress	X			None			
5.2.6 Parking, Flatwork and Walkways		X		Repair	$750		$2,400
5.2.7 Site Lighting	X			None			
5.2.8 Site Fencing and Retaining Walls	X	X		Repair			$1,000
5.3.1 Foundations		X		Repair	$8,600	$135,000	
5.3.2 Framing	X			None			
5.3.3 Building Cladding / Exteriors		X	X	Repair	$10,000	$65,000	$20,000
5.3.4 Roof Systems		X	X	Replace	$2,000	$21,150	
5.3.5 Appurtenances		X	X	Repair	$15,100	$42,200	$27,800
5.3.6 Doors and Windows			X	Replace	$2,800	$14,000	
5.3.7 Amenities		X		Repair		$2,000	
5.4.1 Water Distribution and Domestic Hot Water		X	X	Replace	$26,800		$13,500
5.4.2 Sanitary Waste and Vent		X		None			
5.4.3 Heating/Cooling System and Controls		X		Repair	$800		
5.4.4 Ventilation Systems		X		None		$1,200	
5.4.5 Electrical Service		X	X	Replace	$8,000		
5.4.6 Fire and Life Safety Systems		X	X	None	$1,200		$3,200
5.4.7 Elevators		NA		None			
5.4.8 Site Security	X	X		None			
5.5.1 Common Area Interiors and Common FF&E		X		Replace			$320
5.5.2 Dwelling Unit Summary and Units Observed	X			None			
5.5.3 Unit Finishes		X	X	Replace	$6,900	$13,000	$41,000
5.5.4 Unit Cabinets, Counters, and Sinks			X	Repair	$1,900	$5,200	$5,700
5.5.5 Unit Appliances		X		Replace	$2,800		$8,000
5.5.6 Bathroom Vanities, Basin, Shower/ Tub and Toilet		X	X	Replace	$6,400	$22,000	
Totals					$150,050	$322,750	$127,920

Summary	Today's Dollars	$/Unit
Immediate Repairs	$150,050	$18,756

Summary	Today's Dollars	$/Unit
Short Term Repairs	$322,750	$40,344

	Today's Dollars	$/Unit	$/Unit/Year
Replacement Reserves, today's dollars	$127,920.00	$15,990	$1,333
Replacement Reserves, w/12, 2.5% escalation	$156,049.03	$19,506	$1,626

- Lays out immediate and short-term construction needs
- Recommended replacement reserves

Unpacking Development Costs - From CNA to Rehab Scope

Process:

- Evaluate immediate needs
  - Do any require further study or relatively clear?
  - Order further reports as needed
- Check extent of intermediate needs -- are any big items coming up in the next 3-5 or 5-10 years?
  - How would those be covered later?
  - Is there room in the budget now to take care of them?
- **Bring General Contractor on board to better define scope and priorities**
- Listen to tenants, and manage expectations

High priorities:

- Life Safety
- Immediate repairs/deferred maintenance
- Immediate needs that affect building operations and costs (utilities/efficiencies)
- Immediate/Intermediate needs that impact quality of life and aesthetics
- Intermediate needs that will cost more to repair later or difficult to project funding availability

Energy Efficiency

PG&E Multifamily Upgrade Program (MUP)

- Solar (SOMAH) - 5+units deed restricted to residents at certain income levels, must be in disadvantaged community and have separately metered units
- ESA in-unit - no income requirements, supply solar thermal systems
- Self Generation Incentive Program (SGIP) - no income requirements

PG&E Programs

- ESA CAM common area - covers 100% of cost of energy upgrades to common areas and central systems (5+ units)
- ESA in-unit - no cost, direct install/in-unit upgrades
- CARE - monthly discount of 20% or more on gas and electricity
- FERA - monthly 18% discount on electricity only (3+ person households)
- CSD Low Income Weatherization Program - incentives for energy efficiency measures and solar installs for properties in disadvantaged communities

Operating Expenses and Revenue

Operating Expense Factors

- Age & Condition of building
  - Maintenance costs
  - Replacement reserves
  - Utilities
  - Extent of renovation plan
- Property management and staffing needs
- Resident services (if necessary)
- Property tax welfare exemption

Gross Revenue Factors

- AMIs/Rent Levels
  - Current & Targeted
- Vacancy assumptions
  - Turnover
  - Renovations
- Other revenue sources - laundry, commercial, etc.

Property Tax Welfare Exemption

- Organizational eligibility (e.g. nonprofit/charitable org)
- Project eligibility (occupant incomes & rent levels + regulatory agreement & public funding)
- Reduces or eliminates property taxes
  - Helps offset potentially higher operating expenses and lower rents
- **Issue: LEHCs are currently not covered and pay taxes based on assessed value [we'll come back to this!]**

10 Minute Stretch Break

Net Operating Income → Sizing a First Mortgage

	Year 1	Year 2	Year 3
Annual Residential Revenue	$ 334,800	$ 343,170	$ 351,749
Average Annual Vacancy Rate	10%	5%	5%
Annual Vacancy Loss	$ 33,480	$ 17,159	$ 17,587
Fixed Annual Operating Expenses	$ 121,200	$ 125,442	$ 129,832
Property Taxes	$ 52,000	$ 26,000	$ 10,400
Property Tax Reserve	$ (52,000)	$ (26,000)	
Net Operating Income (NOI)	$ 180,120	$ 200,570	$ 193,929
Senior Debt			
Debt Service	$ 168,634	$ 168,634	$ 168,634
Senior Debt DSCR	1.07	1.19	1.15

Sizing Debt – Lender Requirements

Lenders primarily look at two ratios: **Debt Service Coverage Ratio (DSCR)** and **Loan-to-Value Ratio (LTV)**

$$\textbf{DSCR} = \frac{\text{NOI}}{\text{Debt Service}}$$; Typically 1.15 - 1.20

NOI must exceed loan payment according to DSCR, i.e. with a 15 - 20% cushion

$$\textbf{LTV} = \frac{\text{Loan Amount}}{\text{Fair Market Value (FMV)}}$$; typically 80% for hard debt

Loan amount = FMV x LTV

Key Loan Factors

- Interest Rate
- Amortization Period (how long payments of principal and interest are stretched out with uniform installments)
- Loan Term (length of loan)
- Additional Reserves Required
- Fees & Costs

Filling the Gap: Equity

Terms to Know (that determine feasibility)

- "**Cash on cash**": Rate of return on equity investment from "cash flow" alone, typically on a year-to-year basis.
- **Internal Rate of Return** (IRR): Estimate of future rate of return over a period of time, including net proceeds from sale or refinance.
- **Cap rate**: $\dfrac{\text{Net Operating Income}}{\text{Property Value}}$
- **Property value** from cap rate: $\dfrac{\text{Net Operating Income}}{\text{Cap Rate}}$

Filling the Gap: Equity (cont.)

Basic Terms

- Conventional, Socially Motivated Equity
- Typically covers 25-40% of project cost
- Below market returns ~8% IRR
- Returns paid from combination of “cash on cash” annually and on “disposition” (buyout/refinance, sale)
- Affordability Targets, Restrictions

Considerations

- Refinancing assumptions
- Available Cash/Preferred Return
- Returns not guaranteed, but conservative projections
- Equity investor is a limited partner in the ownership entity with the developer

Filling the Gap: Public Subsidy (“soft debt”)

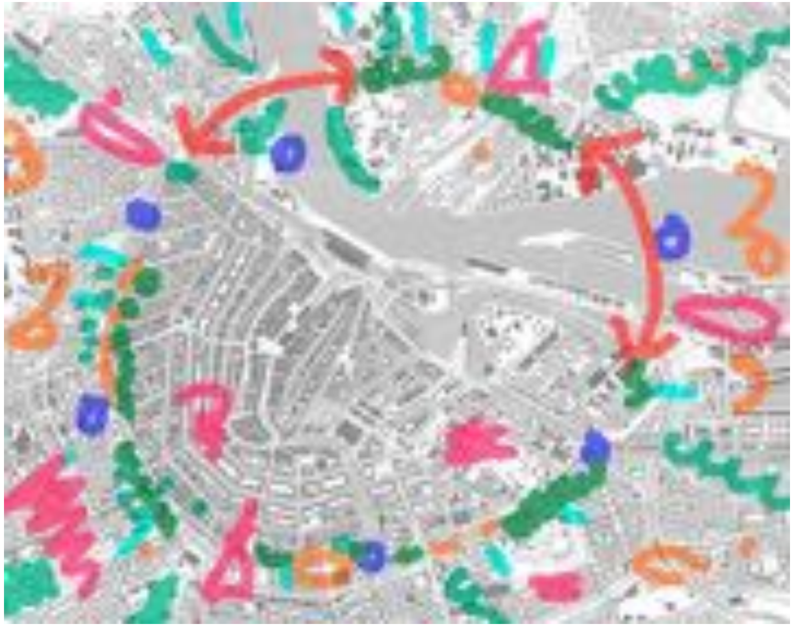
- City, County, occasionally State Funds
- Structured as a loan, but positioned behind senior loan
- More flexible terms (e.g. lower interest, non-amortizing, interest-only, etc.)
- Typically capped by $/unit, as opposed to ability to pay back a loan
- Repayment through “**residual receipts**,” if at all
- Long-term **regulatory agreement**

5 Minute
Stretch Break

What Does This Look Like for LEHCs?

There are additional steps and costs to create a Limited Equity Housing Cooperative (LEHC):

- Form a members Association
- LEHC Application to the State - need attorney to review
- Comply with any local laws (ie condo conversion)
- Sell initial shares & launch LEHC



Limited Equity Housing Cooperative (LEHC)

- Usually a nonprofit corporation
- Residents are shareholder owners and have a proprietary lease for a unit
- Residents purchase one share each and cooperative pays building mortgage/taxes
- Share value increases are limited to 10% per year (and usually much lower)
- Membership in the cooperative
- Carrying charges

LEHC as part of a Community Land Trust

There are ways to go straight to an LEHC, but the focus today will be on the scenario of a CLT initially purchasing a building and then working with residents to convert to LEHC.

Soft Costs of LEHC Conversion

Resident Trainings

Conversion process

- CLT Staff time
- Attorney
- CNA/reserve study
- Budget preparation
- Survey
- Other fees

Share Prices and Share Loans

Share Prices

Maximum of 10% of the total development cost. For example, for a $2 million project, the maximum amount of funding that can come from shareholder equity is $200,000 (10% of $2 million). The maximum share price for each member would be $20,000 ($200,000 divided by 10). There is no minimum price.

Share Loans

Currently not a lot of options in California - some banks will do share loans as an unsecured signature loan. We are currently speaking with the Berkeley Coop Credit Union about providing share loans. California is behind places like New York where the New York Federal Home Loan Bank regularly provides cooperative share loans. We will continue speaking with the local Federal Home Loan Bank to support share loans in California.

Upon Transition to LEHC, New Costs and Sources

Sample 8-Unit Building Costs

Initial Development Costs	$3.24 Million (does not all need to be paid back)
Costs related to co-op conversion	$100,000
Total Development Cost	**~$3.34 Million**

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Sources

- Shareholder Equity
- Misc. Sources (grants/additional city subsidy, etc.)
- Original City Subsidy
- “Hard Debt” Blanket loan from bank

Reminder of Initial Development Costs

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Co-op Residents' Ongoing Costs: Carrying Charges

- Carrying charges are monthly payments made by each coop member
- Used to cover ongoing operating costs and capital reserves
- May also include covering costs of property management

Property Taxation

Issues:

- Affordable rentals lose their welfare exemption from property taxes when they convert to LEHC.
- Existing property tax law provides that when an interest in a portion of property changes ownership, the interest transferred must be re-appraised at market value as a newly purchased property. This means that when a share in a housing cooperative changes hands the unit connected to that share can be taxed at a much higher rate.

Solution - AB 1206:

- Allows LEHCs to access the welfare exemption.
- Exempts LEHCs from property tax reassessment when a member of the cooperative leaves and a new member joins.
- Allows CLT properties to keep their exemption if a resident's income rises up to 140% of the area median-income.

Just introduced
and will need your support!!

WRAP UP

Contact James Yelen at jyelen@enterprise.org

For more information on CCOI, contact Sarah Scruggs at sarah.scruggs@nclt.org

California Community Land Trust Network - www.cacltnetwork.org
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People of Color Sustainable Housing Network - www.pochousingnetwork.com