



KEYSER MARSTON ASSOCIATES.
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

MEMORANDUM

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Redevelopment
Affordable Housing
Economic Development

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To: Patrick Ure, Housing Development Officer
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From: Kathleen Head
Tim Bretz

cc: Meggan Sorensen, Development Project Manager III

Date: July 25, 2016

Subject: Beachwood Apartments: HOME Subsidy Layering Review

At your request, Keyser Marston Associates, Inc. (KMA) evaluated the 45-unit Beachwood Apartments project (Project) being proposed by Century Housing (Developer). The City of Long Beach (City) plans to provide financial assistance to the Project using HOME Program (HOME) funds that are allocated to the City by the United States Department of Housing and Urban Development (HUD). This analysis is prepared in compliance with the requirements imposed by HUD.

The KMA analysis includes the following components:

1. An underwriting review to ensure that no more than the necessary amount of HOME funds, in combination with other governmental assistance, is invested by the City in order to provide affordable housing;
2. A review of the market demand assessment of the Project that was submitted by the Developer;
3. An evaluation of the Developer's capacity to develop and operate the Project;
4. An assessment of the reasonableness of the Developer Fee, cash flow, equity appreciation and profit anticipated to be generated by the Project; and

5. A review of the financial commitment documentation submitted by the Developer.

EXECUTIVE SUMMARY

The Developer is proposing to acquire an existing 45-unit apartment building restricted to disabled households located at 505 West 6th Street and 475 5th Street (Site). Forty-four (44) of the units are subject to Section 8 income and rent restrictions, with one unrestricted unit reserved for an on-site manager.

Underwriting Analysis

The Developer is requesting that the City provide \$2.1 million in HOME assistance for the purposes of acquiring the Project. The KMA analysis indicates that the proposed \$2.1 million in HOME Program assistance is necessary to provide the proposed affordable housing units.

HOME Program Requirements

1. Based on the provision of \$2.1 million in HOME assistance, at least 14 units in the Project must be designated as HOME units:
 - a. KMA allocated the HOME-designated units as 10 one-bedroom units and four two-bedroom units.
 - b. At least 20% of the units assisted with HOME funds, or three units, must be affordable to very-low income households.
2. The HOME Program regulations impose Davis Bacon wage requirements on projects that include 12 or more designated HOME units. Given that 14 units will be designated as HOME units, Davis Bacon wage standards are triggered by the inclusion of HOME funds.
3. The market review indicates that there is sufficient demand for the proposed Project.
4. The Developer has demonstrated the development capacity and fiscal soundness to undertake the Project.

5. There is sufficient cash flow available to support the operations of the Project throughout the 15-year HOME compliance period.
6. The Developer is not receiving excess profit from the Project.

PROJECT DESCRIPTION

The following summarizes the characteristics of the existing apartment complex:

1. The Site is comprised of 1.12 acres, or 48,801 square feet.
2. The Project consists of two three-story wood-frame buildings that were constructed in 1984.
3. The 45-unit Project represents a density of 40 units per acre.
4. The Project's unit mix is as follows:
 - a. Thirty-two (32) one-bedroom units; and
 - b. Thirteen (13) two-bedroom units.
5. The Project includes 31 surface parking spaces, which equates to 0.69 spaces per unit.
6. The Project must include at least three Low HOME units and at least 11 High HOME units.

FINANCIAL GAP CALCULATION

The Developer is requesting that the City provide \$2.1 million in HOME funds assistance for the purchase of the existing 45-unit apartment complex. The proposed purchase price is estimated at \$8.8 million.

Lea & Company (Appraiser) prepared an appraisal of the property on May 24, 2016. The appraisal estimates the fair market value of the property at \$8.82 million, which is approximately equal to the proposed purchase price (Appraisal). This estimate assumes that the current restricted Section 8 rents will continue to be applied.

In typical acquisition transactions, developers are able to obtain conventional loans equal to approximately 65% to 70% of the project's value. The balance of the purchase price is typically funded with cash and/or equity.

The Developer anticipates receiving a \$6.7 million acquisition loan from the Century Housing Corporation, which equates to 76% of the proposed purchase price. The Developer is requesting that the City provide HOME funds equal to the \$2.1 million remaining balance of the purchase price, which represents 24% of the purchase price. Thus, the HOME funds are effectively acting as equity in the proposed acquisition transaction.

Given that the HOME funds will be utilized to fund a smaller portion of the purchase price (24%) than typically seen in acquisition transactions (30% - 35%), it can be concluded that the request of \$2.1 million in HOME funds is warranted by the Project economics. Furthermore, it can be concluded that the HOME funds are necessary to provide the proposed affordable housing units.

HOME PROGRAM REQUIREMENTS

The City must comply with the following HOME Program requirements.

Subsidy Layering Requirements

HOME Program regulations require projects to provide a layering analysis demonstrating that the HOME assistance is required to provide affordable housing. Based on the results of the preceding analysis, it is the KMA conclusion that the Developer's request for \$2.1 million in HOME funds is warranted by the Project economics. Thus, it can be concluded that the assistance package complies with the HOME layering requirement.

HOME Unit Designation (Table 1)

HUD establishes two tests for quantifying the number of units in the Project that must be designated as HOME units. One test is referred to as the Development Cost Test, and the other test is called the Subsidy Limit Test. These tests can be described as follows:

Development Cost Test

The Development Cost Test calculates the minimum number of HOME units based on the percentage of the Project's total costs that are funded with the HOME Program assistance. The calculation for the Project is:

1. \$2.1 million in HOME Program assistance is assumed to be provided.
2. The Project costs total \$8.8 million.
3. Based on the preceding assumptions, the HOME Program assistance is equal to 23.9% of the Project costs.
4. Under the Development Cost Test, 23.9% of the 45 units must be designated as HOME units. This equates to 10.7 units, which is rounded up to 11 units.

Subsidy Limit Test

HUD establishes subsidy limits based on the number of bedrooms included in the HOME-assisted units (\$92,250). The amount of HOME funds that the City may invest on a per unit basis in affordable housing projects may never exceed the per unit dollar limits established by HUD. The 2016 HOME Subsidy Limits for Los Angeles County are as follows:

One-Bedroom Units	\$160,615
Two-Bedroom Units	\$195,305

KMA allocated the HOME units based on the pro rata distribution of the one-bedroom and two-bedroom units in the Project. As such, 10 one-bedroom units and four two-bedroom units must be designated as HOME units. This equates to a 14-unit requirement per the Subsidy Limit Test.

Designated HOME Units

The Development Cost Test results in the requirement for 11 designated HOME units, and the Subsidy Limit Test results in a 14-unit requirement. Thus, at least 10 one-bedroom units and four two-bedroom units must be designated as HOME units.

The HOME Program also requires that at least 20% of the units assisted with HOME funds be affordable to very-low income households, and the balance of the units be reserved for low income households. Thus, at least three of the 14 HOME-designated units must be restricted as Low HOME units with the remaining 11 units restricted as High HOME units.

Analysis of Market Conditions

The HOME Program regulations require Participating Jurisdictions (PJs) to assess the current market demand in the neighborhood in which the project will be located. While a formal market study is not required, HUD requires that the proposed Project be reviewed against current market data to address the issues of pricing and absorption. The following sections outline the current market data for the Project.

Market Area Dynamics

As noted previously, an Appraisal for the property was completed on May 24, 2016. The Appraiser defined the Primary Market Area (PMA) as Pacific Coast Highway to the North, Cherry Avenue to the East, Broadway to the South, and De Forest Avenue to the West. The following summarizes the demographic, economic and housing conditions in the PMA provided by the Appraisal:

1. The total population was estimated at 86,747 persons in 2015.
2. Approximately 25% of households within the PMA have one or more persons with a disability. The data demonstrates a significant need for affordable housing that accommodates households with disabilities.
3. The unemployment rate for the City of Long Beach has fluctuated between 5.1% and 13.6% over the past decade. The unemployment rate was 7.1% in 2015, and is currently at 5.1% for 2016.

Lea & Company prepared a rent study for the property on March 30, 2016 that analyzed comparable apartment projects within the vicinity of the Site. The comparable properties range from 0.30 to 0.65 miles from the Site. Based on the rent study, achievable market rents are estimated as follows:

One-Bedroom Units	\$1,575
Two-Bedroom Units	\$2,135

The average vacancy rate for the comparable apartment complexes is estimated at 3.8%.

Existing Property Conditions

The Appraisal concluded that the existing property provides good quality affordable apartments that are in strong demand in the area. The property is currently 100% occupied and consistently maintains an occupancy level of over 95%. The current property manager maintains a waiting list approximately two to three years in length.

The current fair market rents (FMRs) provided by the HUD Housing Assistance Payment (HAP) contract are set as follows:

	Current FMRs	% Below Market Rents
One-Bedroom Units	\$1,175	25%
Two-Bedroom Units	\$1,494	30%

Market Condition Conclusions

Based on the information described above, it can be concluded that the market area conditions support the proposed Project. Furthermore, the Project is currently 100% occupied and there is sufficient demand to generate a two- to three- year waiting list.

Developer's Financial Capacity

The HOME Program regulations require PJs to assess the development capacity and fiscal soundness of developers requesting HOME Program assistance. HUD guidance related to this evaluation indicates that the Developer's recent, similar, successful experience developing and operating comparable projects may be used to assist in establishing the Developer's capacity to undertake a project that is requesting HOME Program assistance.

The Developer's financial capacity can be summarized as follows:

Organization and Staff Experience

Century Housing Corporation is a 501(C)3 nonprofit organization that engages in the financing and development of affordable housing. The firm was founded in 1995, and has invested more than \$1.0 billion of capital that has resulted in the creation of more than 25,000 new affordable homes.

The Development team will consist of the following persons:

1. Ronald Griffith – President and CEO: Mr. Griffith has served as President and CEO since 2007. Before joining the firm, he was a partner in a national law firm specializing in all aspects of real estate law and finance. He also established the office of general counsel at Union Federal Bank.
2. Brian D'Andrea – Senior Vice President: Mr. D'Andrea oversees the firm's affordable housing preservation, investment and development activities. Prior to joining the firm in 2007, Brian worked for Toll Brothers, a public homebuilder, where his responsibilities varied from acquisition finance to project management.
3. Oscar Alvarado – Director of Development: Mr. Alvarado has worked in affordable housing for nearly 10 years managing diverse projects that includes projects that serve homeless, disabled, and low income seniors and families. He will provide development team support services including negotiation and the contract management and management of the other development team members.

Previous Project Experience

The Developer has acquired, rehabilitated or constructed more than 600,000 square feet of housing and supportive service space. The following summarizes three completed development projects:

Cabrillo Gateway – Long Beach, California

Cabrillo Gateway is an 81-unit apartment project that provides permanent affordable housing to families. The project's development costs totaled \$33.9 million, and it was completed in July 2015.

Century Arrowhead Vista – San Bernardino, California

Century Arrowhead Vista is a former HUD 202 property that provides units to disabled households. The project includes 40 units and development costs totaling \$6.0 million. The project was completed in 2014.

Morehouse Apartments – Los Angeles, California

Morehouse Apartments provides 40 units of permanent affordable housing for families. The apartment complex was constructed in 1995, and purchased by the Developer in 2013. The Developer is in the process of resyndicating the project as a scattered site acquisition and rehabilitation development with closing expected in the fall of 2016.

Financial Capacity

Financial Management Systems and Practices

The Developer is a 501(c)3 nonprofit organization managed by a Board of Directors and managing staff members. The Developer publishes annual reports and audited financial statements which are available on the Developer's website. The audited financial statements are prepared on the accrual basis of accounting consistent with generally accepted accounting principles (GAAP).

Financial Resources

The Developer provided audited financial statements for Years 2014 and 2015. The financial statements demonstrate that the Developer has significant cash-on-hand that can be utilized to cover any Project shortfalls.

Affordability Period (§92.252(e))

HOME regulations require that the rehabilitation or acquisition of existing housing that results in over \$40,000 per unit in HOME assistance must be restricted for a minimum of 15 years.

HOME Rents / Utility Allowances (§92.252(a))

The Developer did not provide specific utility allowance information at the time of this analysis. The City should request this information from the Developer. The following table presents the gross HOME rents, published by HUD, for Los Angeles County as of July 22, 2016:

<u>Low HOME Units</u>	
One-Bedroom	\$814
Two-Bedroom	\$977
<u>High HOME Units</u>	
One-Bedroom	\$1,086
Two-Bedroom	\$1,306

Cash Flow Analysis (Table 2)

The KMA cash flow analysis for the Project is presented in Table 2. The cash flow analysis utilizes the current FMRs applicable to the 44 Section 8 units. Additionally, KMA applied the current operating expense information for the existing apartment project, which was provided by the Developer. The income was escalated at 2.5% per year, and the expenses were estimated at 3.5% per year. Based on these assumptions, the Project generates sufficient net operating income to maintain operations of the Project throughout the 15-year covenant period.

Developer Profit

The Developer is not proposing to include a Developer Fee in the Project’s budget. The Developer and the City will each receive 50% of the Project’s residual receipts. This is a standard structure for affordable housing projects. As such, it can be determined that the Developer is not receiving excess profit from the Project.

Financial Commitment

The Developer provided an executed term sheet for the acquisition loan to be provided by the Century Housing Corporation. The term sheet describes the \$6.7 million in loan funds allocated to the purchase of the property.

Project Completion Deadline

Acquisition of existing housing must occur within six months of the contract date (§92.2). Thus, escrow must close no later than six months after the commitment of HOME funds.

Written Agreement

The City must execute a written agreement before disbursing HOME funds to the Project. The written agreement must capture the Project and financing terms that result from the underwriting process. A written agreement was not available at the time of this analysis.

SUMMARY OF FINDINGS

The following summarizes the findings of the KMA analysis:

1. It is the KMA conclusion that the proposed \$2.1 million in HOME Program assistance is necessary to provide the proposed affordable housing units.
2. At least 10 one-bedroom units and four two-bedroom units must be designated as HOME units. At least 20%, or three units, must be designated as Low HOME units.
3. The market area information concluded that there is sufficient demand for affordable housing to support the proposed Project.
4. The Developer has demonstrated the development capacity and fiscal soundness to undertake the Project.
5. There is sufficient cash flow available to support the operations of the Project throughout the 15-year HOME compliance period.

6. The Developer is not receiving excess profit from the Project.
7. The Developer did not provide specific utility allowance information for the units. The City should request this information from the Developer.

This subsidy layering review was completed based on information provided at the time of its writing. The City should ensure that all necessary documentation has been reviewed and placed in the Project file prior to formally committing and disbursing any HOME Program assistance. However, it is important to note that information, including development costs and financing amounts, may change throughout the development period. Any changes should be documented and placed in the Project file.

TABLE 1

HOME UNIT DESIGNATION
HOME LAYERING ANALYSIS
BEACHWOOD APARTMENTS
LONG BEACH, CALIFORNIA

I. <u>Unit Mix</u>				
One-Bedroom Units			32	
Two-Bedroom Units			13	
Total Units				45
II. <u>Development Cost Test</u>				
HOME Funds Requested			\$2,100,000	
Total Development Costs			\$8,800,000	
HOME Funds as a % of Total Development Costs			23.9%	
HOME Unit Requirement				11
III. <u>Subsidy Limit Test</u>				
HOME Funds Requested	\$2,100,000			
		Distribution of	Subsidy Limit /	Number of
	% of Units	HOME Funds	Unit	HOME Units
One-Bedroom Units	71%	\$1,493,333	\$160,615	10
Two-Bedroom Units	29%	\$606,667	\$195,305	4
HOME Unit Requirement	100%	\$2,100,000		14
IV. <u>Minimum Number of HOME Designated Units</u>				14 Units

TABLE 2

CASH FLOW ANALYSIS
 BEACHWOOD APARTMENTS
 LONG BEACH, CALIFORNIA

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>	<u>Year 6</u>	<u>Year 7</u>	<u>Year 8</u>	<u>Year 9</u>	<u>Year 10</u>
I. Rental Income										
One-Bedroom Units	\$451,200	\$462,480	\$474,042	\$485,893	\$498,040	\$510,491	\$523,254	\$536,335	\$549,743	\$563,487
Two-Bedroom Units	215,136	220,514	226,027	231,678	237,470	243,407	249,492	255,729	262,122	268,675
Laundry/Miscellaneous Income	4,833	4,953	5,077	5,204	5,334	5,468	5,604	5,744	5,888	6,035
(Less) Vacancy & Collection Allowance	<u>(33,558)</u>	<u>(34,397)</u>	<u>(35,257)</u>	<u>(36,139)</u>	<u>(37,042)</u>	<u>(37,968)</u>	<u>(38,917)</u>	<u>(39,890)</u>	<u>(40,888)</u>	<u>(41,910)</u>
Effective Gross Income	\$637,610	\$653,550	\$669,889	\$686,636	\$703,802	\$721,397	\$739,432	\$757,918	\$776,866	\$796,288
II. Operating Expenses										
Salaries	64,351	\$66,603	\$68,934	\$71,347	\$73,844	\$76,429	\$79,104	\$81,872	\$84,738	\$87,704
Administrative	35,263	36,497	37,775	39,097	40,465	41,881	43,347	44,864	46,435	48,060
Utilities	22,604	23,395	24,214	25,061	25,939	26,846	27,786	28,759	29,765	30,807
Operating & Maintenance	134,158	138,854	143,713	148,743	153,949	159,338	164,914	170,686	176,660	182,844
Taxes & Insurance	34,512	35,720	36,970	38,264	39,603	40,989	42,424	43,909	45,446	47,036
Property Management	<u>52,596</u>	<u>54,437</u>	<u>56,342</u>	<u>58,314</u>	<u>60,355</u>	<u>62,468</u>	<u>64,654</u>	<u>66,917</u>	<u>69,259</u>	<u>71,683</u>
Total Operating Expenses	\$343,484	\$355,506	\$367,949	\$380,827	\$394,156	\$407,951	\$422,230	\$437,008	\$452,303	\$468,133
III. Net Operating Income	\$294,126	\$298,044	\$301,940	\$305,809	\$309,646	\$313,446	\$317,203	\$320,910	\$324,563	\$328,154

TABLE 2

CASH FLOW ANALYSIS
 BEACHWOOD APARTMENTS
 LONG BEACH, CALIFORNIA

	<u>Year 11</u>	<u>Year 12</u>	<u>Year 13</u>	<u>Year 14</u>	<u>Year 15</u>
I. Rental Income					
One-Bedroom Units	\$577,574	\$592,013	\$606,814	\$621,984	\$637,534
Two-Bedroom Units	275,392	282,277	289,334	296,567	303,982
Laundry/Miscellaneous Income	6,186	6,341	6,499	6,662	6,828
(Less) Vacancy & Collection Allowance	<u>(42,958)</u>	<u>(44,032)</u>	<u>(45,132)</u>	<u>(46,261)</u>	<u>(47,417)</u>
Effective Gross Income	\$816,195	\$836,600	\$857,515	\$878,953	\$900,926
II. Operating Expenses					
Salaries	\$90,773	\$93,951	\$97,239	\$100,642	\$104,165
Administrative	49,742	51,483	53,285	55,150	57,080
Utilities	31,885	33,001	34,156	35,352	36,589
Operating & Maintenance	189,243	195,867	202,722	209,817	217,161
Taxes & Insurance	48,683	50,386	52,150	53,975	55,864
Property Management	<u>74,192</u>	<u>76,789</u>	<u>79,476</u>	<u>82,258</u>	<u>85,137</u>
Total Operating Expenses	\$484,518	\$501,476	\$519,028	\$537,194	\$555,996
III. Net Operating Income	\$331,677	\$335,123	\$338,487	\$341,759	\$344,931