

Seattle Housing Levy Housing Preservation Fund

Preserving Existing Levy-Funded Rental Housing

Over the next decade, as the affordable housing portfolio ages, Seattle will face a new set of challenges. Seattle was at the forefront of cities providing local support for affordable housing, passing its first voter-approved housing tax measure in 1981. Thousands of units that were funded during the first generation of projects are now reaching the 20-year mark. Currently only 9% of Seattle's portfolio has been in operation for more than 20 years. By 2016, one-third of the portfolio (3,300 units) will have been in operation for over 20 years.

Year 20 is a major milestone for all rental housing in both the private and subsidized markets. Between years 20-30, many of the most expensive major building systems such as boilers and roofs begin to fail. Most properties will need to replace these systems around year 20 in order to ensure these buildings continue to provide good quality housing over the long-term. This means that one-third of OH's portfolio will likely need significant rehabilitation by 2016.

An area we are considering for a new levy program is to set-aside funds specifically to address capital needs in the existing 11,000+ unit levy-funded portfolio, which includes both units in OH's portfolio as well as units developed in the Senior Housing Bond. As discussed in greater detail below, the intent is not pay for the entire cost of the portfolio's needs, but rather to undertake a comprehensive assessment of the portfolio and fund the gap after other resources have been tapped. The reasons to include a Housing Preservation Fund for the existing portfolio in the 2009 Levy are:

- It would cost \$2 billion to replace the existing housing units in the Levy portfolio.
- We can prevent displacement of existing tenants.
- We can extend the length of the affordability period for these units at a fraction of the cost that it would take to building new units.
- Preservation of existing buildings has significant environmental benefits.

Defining the Need

Unlike the private market where rental properties are generally sold every 10 to 12 years, Levy-funded buildings are held for the long-term by their owners. When private buildings change ownership, the new owners typically make substantial investments in capital improvements. For example, buyers invested

an average of \$12,000 per unit in 2007 following a building's change of ownership (Dupre and Scott, 2008). These capital investments are often partially paid for through additional private debt supported by substantial rent increases. In a sample of buildings purchased from 1995-2005, average rent increased 15.5% within one year following a building's change in ownership (Dupre and Scott cited in OH, 2007). Because the intent of funding housing through the Levy is to maintain long-term affordability for low and low to moderate income people, Levy funded buildings do not receive cash infusions due to substantial rent increases.

To roughly quantify the capital replacement needs that the OH portfolio will encounter during the next levy term OH contracted with the Housing Development Center, a nonprofit consultant based in Portland. The Housing Development Center has strong expertise in affordable housing asset management, from doing training, project consulting and financial workouts on behalf of developers and public lenders in Washington, Oregon and Colorado. For those wishing to review the entire HDC study, please contact Bill Rumpf (Bill.Rumpf@seattle.gov).

Currently, data does not exist to do precise estimates. Approximately 40% of OH-funded projects have completed capital needs analyses, but the quality and detail in these studies varies widely. The Housing Development Center used a sample of capital needs assessments from 33 properties and extrapolated estimates for the full portfolio.

They estimate that average capital needs for projects reaching the 20 year mark, as well as projects that had just moderate rehabilitation at initial development, will need an average of \$6,000 per unit in repairs. Overall, that implies total capital costs of approximately \$56 million, including soft costs, during the next 7 year levy period. The Housing Development Center estimates that project reserves will cover about one-third of these costs, leaving a funding need estimated at \$38 million through 2016. The local contribution to this gap might be one-third of that amount if we work with other public funders and housing sponsors to plan for the portfolio needs. Accordingly, the local funding gap after other resources are tapped is probably in the \$12-\$15 million range.

Formulating a Financial Strategy—Multiple Approaches

The Housing Development Center notes that there are a number of ways that portfolio recapitalization could be funded. The strategies they mention include:

- Use of existing reserves
- Operating changes to increase replacement reserve deposits
- Refinancing of private debt where feasible.

- Tax credit resyndication
- Additional subsidized gap financing.

OH has seen a number of projects complete fairly significant capital updates without OH funding through favorable refinancing. Several older developments have sold Transferable Development Rights (TDR) to generate cash. A recent project secured New Markets Tax Credits and resyndicated as a bond/4% tax credit development. OH has provided new capital to several projects where the initial sponsor experienced financial difficulty and deferred maintenance on their project, and we provided new funds to one building that experienced severe earthquake damage, where non-city fund sources had been fully utilized.

Promoting State-of-the-Art Asset Management Practices

Investing in the recapitalization of properties in OH's portfolio is a strategic policy choice. OH estimates that the replacement cost of the units developed through the levy and other locally-administered programs is nearly \$2 billion. In the current levy, a majority of projects have been new construction, but in the 1986 and 1995 levy, a number of buildings were acquired and had modest to moderate rehabilitation, so they will face necessary repairs sooner. Part of preserving the financial viability of these projects is seeking opportunities for operating efficiencies through retrofits that save energy or water use.

OH has submitted a joint application with the state Department of Community Trade and Economic Development (CTED) and Impact Capital to the MacArthur Foundation's *Window of Opportunity* Initiative, which will provide grants and low-interest loans for state and local preservation efforts. Our proposal was selected as a finalist and we are hopeful about being selected when decisions are made by the end of this year. MacArthur funds would provide pass-through funds for nonprofits to do thorough capital needs assessments and to promote advanced asset management practices.

We anticipate that this preservation program area would be sufficient to cover just a portion of likely replacement costs. There is a high degree of collaboration among public funders in Washington State, which has led to common annual report forms and consolidated monitoring visits, but further examining ways that compliance and monitoring costs can be reduced is part of easing the cost squeeze on nonprofit borrowers. We would use this levy period to refine a combination of funding approaches and efficient operating practices because this preservation issue will be even larger in subsequent levies as the portfolio continues to age.

Environmental Benefits of Reinvesting in Existing Portfolio

The National Trust for Historic Preservation summarizes the benefits of preserving the existing housing stock quite succinctly:

There are considerable environmental benefits to choosing rehabilitation over demolition for older buildings. We are much too inclined to think of buildings in general as disposable, rather than as a renewable resource. A 2004 report from the Brookings Institution projects that by 2030 we will have demolished and replaced 82 billion square feet of our current building stock. Since it is estimated that there are about 300 billion square feet of space in the United States today, that means we anticipate demolishing nearly 1/3 of our building stock in the next 20-25 years.

A few things to consider if that estimation plays out:

- It will take as much energy to demolish and reconstruct 82 billion square feet of space as it would to power the entire state of California - the 10th largest economy in the world with a population of about 36 million people - for 10 years.
- If we were to rehab even 10% of this 82 billion square feet, we would save enough energy to power the state of New York for well over a year.
- Construction debris accounts for 25% of the waste in the municipal waste stream each year. Demolishing 82 billion square feet of space will create enough debris to fill 2,500 NFL stadiums.

Source: National Trust for Historic Preservation