The Preservation Challenge:

PROJECTIONS & POLICIES FOR MAINTAINING NON-PROFIT AFFORDABLE HOUSING IN PHILADELPHIA

August 2022

LISC PHILADELPHIA

STONE SHERICK CONSULTING GROUP

Wilson Associates, Inc.
Real Estate & Community Development Advisory Services

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FRP Community Homes in West Philadelphia

Philadelphia's Preservation Challenge: According to The Pennsylvania Housing Finance Agency's (PHFA) 2020 Comprehensive Housing Study, there is an **unmet need for nearly 72,000 affordable housing** units for Philadelphia's low and extremely low-income households.[i] This has become even more challenging in that Philadelphia has lost **roughly 24,000 unsubsidized low-cost rental units, or naturally occurring affordable housing, with rents (including utilities) that were less than $750 per month.**[ii] This problem has only deepened during the COVID-19 pandemic, with almost **21% of Philadelphia landlords putting a property up for sale in 2020, a more than 600% increase than the previous year.**[iii]

As of 2019, a PEW report found that almost **52% of renters in Philadelphia spent 30% or more of their income on rent and utilities.** Philadelphia's rent burden rate of 51.9 percent was the highest among comparison cities, and significantly higher than the national average of 45.1 percent.[iv]

The worsening affordability gap and the loss of unsubsidized units has increased the urgency of preserving nearly **34,152 units**[v] of publicly assisted affordable rental housing stock as these properties age and/or rental assistance contracts expire. As a general rule residents in publicly assisted affordable rental housing pay no more than 30 percent of income toward rent.

Developing a multi-faceted strategy that preserves existing publicly assisted affordable rental housing, amidst the need for new units and diminishing public resources, is at the heart of the Philadelphia's preservation challenge. This challenge is all the more acute in neighborhoods experiencing the displacement of residents by rising rents and loss of affordable units.

PHILADELPHIA NON-PROFIT PRESERVATION BY THE NUMBERS

34,152: Number of affordable units in Philadelphia

4,795: Number of units owned by non-profits that at risk of going offline over the next 15 years.

101: The number of projects necessary to preserve all 4,795 units.

65%: The percentage of these projects may not be eligible for PHFA's Low Income Housing Tax Credit (LIHTC) program based on unit count.

$112 million: The funding gap created by the lack of eligibility for LIHTC.

Overview of Report Findings for Non-Profit Building Owners

1. ***Financial Projections & Findings:***

- Over the next 15 years, **101 non-profit owned projects comprising 4,795 units** in Philadelphia will require new capital investments to be preserved as affordable housing**.**
- In today's dollars, these projects will require an **estimated $22.7 million dollars in predevelopment costs, and a total investment of $793 million.**
- **65% of the projects (1,511 units) may not be eligible for Low-Income Housing Tax Credit (LIHTC) funding.** The total number of units under the tax credit program is determined by the Pennsylvania Housing Finance Agency (PHFA) through the Qualified Allocation Plan (QAP). In recent years PHFA has listed twenty-five units as the minimum threshold to be awarded either type of tax credit. Additionally, PHFA issues annual RFPs for the 4% tax credit program with separate requirements which are updated annually. However, for the purpose of this report, PHFA's 2022 minimum for 4% LIHTC was used to inform projections. In 2022, the policy required a minimum of 50 units for 4% LIHTC. [1]
- As a result, **over the next 15 years, there will be an unmet need for approximately $112 million to support non-profit owned preservation projects that do not qualify for LIHTC funding.**

2. ***Issues Facing Non-Profit Building Owners:***

- Stakeholder and non-profit building owner interviews affirmed **non-profits' commitment to preserving affordable rental housing in vulnerable neighborhoods across Philadelphia**.
- In addition, interviews underscored **the importance of government and organizational commitment to asset and property management that will result in long term affordability.**
- Non-profits face unique barriers to preservation, which include **a complex financing system and significant predevelopment costs** which are required to preserve properties.

Policy Considerations for Non-Profit Building Owners and Stakeholders

- The state requirement of a **40-year affordability period for Low Income Housing Tax Credit properties should be extended beyond that period into perpetuity**, with resources committed and available to make that happen.
- **Preservation goals and preventing displacement have implications for how projects need to be underwritten** to take those needs into account and to ensure the adequate funding of operating and replacement reserves.
- There is an **urgent need to develop policies and new resources that will adequately fund those properties that are currently ineligible for tax credit financing.**
- Public and private entities should commit to using **actionable data for transparent, predictable, and equitable processes that identify and prioritize at-risk properties for preservation.** This will be a powerful tool for ensuring safe, decent, affordable housing for Philadelphians that are most vulnerable to displacement.

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[1] *Please see note on the Low-Income Housing Tax Credit program below on page 11.*

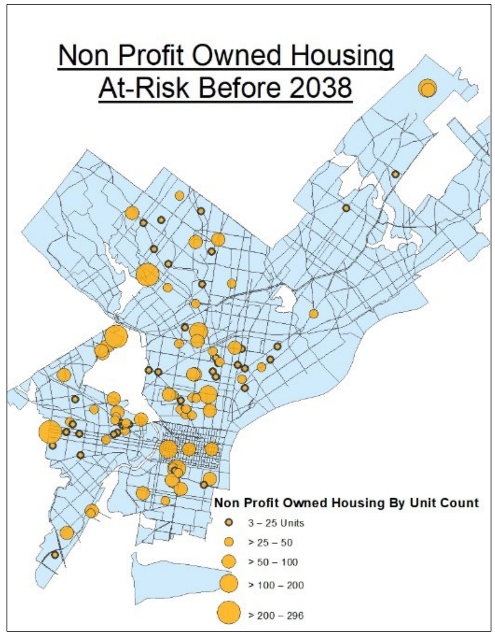
Report Purpose, Project Team, & Funding Support

Report Purpose Supporting non-profit organizations to develop and preserve affordable housing is central to Local Initiatives Support Corporation (LISC Philadelphia's) mission. **This report focuses on non-profit owned properties in Philadelphia moving towards expiration between 2023 and 2038.** Property owners will need new financing, including new Low Income Housing Tax Credit (LIHTC) awards, to replace obsolete systems, upgrade for energy efficiency, and modernize apartments. Preserving existing affordable housing is less expensive than building new and helps protect previous public investments.[vi] , [vii] ; however, without adequate funding, owners may need to opt out of rental assistance programs, convert to market-rate housing, or sell properties. **Map 1 illustrates the magnitude of Philadelphia's publicly assisted challenge, and the nearly 4,800 units owned by non-profit owners.**

Map 1: Non-Profit Owned Housing At-Risk Before 2038

Over the next fifteen years approximately 4,800 non-profit owned publicly assisted units will reach the end of a rental assistance contract or a restricted covenant agreement.

Of these units, approximately 1,700 are owned by LISC's not-for-profit housing partners, and may require some form of preservation intervention over the next fifteen years.



Source: National Housing Preservation Database

Report Background & Goals: LISC Philadelphia (LISC) is committed to addressing the most critical preservation needs of Philadelphia's non-profit property owners. Since 2017, LISC's programmatic focus has concentrated on capacity building and predevelopment investments to support non-profit affordable housing owners with preservation needs. Through this work, LISC and non-profit partners have also identified specific needs to support housing stability in some of Philadelphia's most vulnerable neighborhoods as follows:

- **Resident Services:** Increased demand for services due to lack of stable income, food insecurity, and enhanced behavioral and physical health needs.
- **Building Condition & Property Management**: Building repair needs have increased due to deferred capital improvements, unit-turn over and property damage. Property costs have increased due to loss of rent, increased property maintenance, utility costs, and increased purchasing of materials and supplies.
- **Organizational Business Planning and Asset Management**: Evaluating organizations' property and asset management activities, including but not limited to, oversight of project feasibility in view of the market, development of property management operating policies, hiring Property Managers, and oversight of the operation and financial performance of the portfolio.

To build on this work, LISC commissioned **Wilson Associates, Inc**. to research non-profit organizations' needs with respect to asset and property management, and **Stone Sherick Consulting Group, LLC** to assess the financial and capital improvement needs of non-profits' portfolios. The findings from the combined research will be used to inform the design of a Non-Profit Preservation Initiative that will support the long-term affordability of non-profit-owned rental housing.

Project Scope and Project Team

Together, LISC and the project team developed a framework which included two methodologies for this report. These consisted of interviews with non-profit building owners and stakeholders, and a model for projecting the financial and capital needs of non-profit owned properties. These served as the foundation for determining the projected organizational, financial, and capital needs of non-profit building owners over the next fifteen years (2023-2038).

Funding Support

LISC is grateful to Pennsylvania Housing Finance Agency – Pennsylvania Housing Affordability and Rehabilitation Enhancement Fund **(PHFA PHARE)** for their generous support in funding the financial model and analysis prepared by Stone Sherick Consulting Group LLC.

Financial Analysis & Projections:

Stone Sherick Consulting Group, LLC *Lauren Williams, Senior Development Project Manager*
SSCG specializes in Real Estate Development Consulting Services and Owner's Representative Services for residential, commercial and industrial real estate development projects, primarily within the City of Philadelphia. Over the last 30 years we have been involved in the development and completion of over 18,000 dwelling units, more than 900,000 square feet of commercial and industrial development with a value of over $2,200,000,000.

SSCG utilized their extensive experience in this area to analyze preservation project cost and produce projections of the financing and capital needs of non-profit owned affordable rental housing in Philadelphia over the next 15 years.

Non-Profit and Stakeholder Interviews & Analysis:

Wilson Associates, Inc. *Lamar Wilson, Project Principal*
Wilson Associates, Inc specializes in technical assistance and professional coaching services to organizations engaged in neighborhood revitalization and related strategic planning. Client organizations have worked with the principal of the firm, Lamar Wilson, to assess the feasibility of proposed affordable housing projects, and to help secure equity and debt financing to support investments. Mr. Wilson also helps philanthropic organizations, governmental agencies, and financial intermediaries craft business plans, assess impacts of alternative funding priorities, and frame policies and systems to drive outcomes and impacts of their work serving under-resourced communities operating in their corresponding market areas. For virtually all of those assignments, Mr. Wilson has conducted primary and secondary data collection, stakeholder interviews, and facilitated focus group discussions and community forums, activities that inform project recommendations, priorities, and strategies for consideration.

Wilson Associates conducted interviews with PA Housing Finance Agency (PHFA) and the National Equity Fund (NEF), as well as a sample of Philadelphia non-profit owners with sizeable inventories, in order to solicit perspectives on non-profit's asset management, property management, and overall capacity needs.

Project Management & Research:

LISC PHILADELPHIA

Local Initiatives Support Corporation (LISC) Philadelphia: *Carolyn Placke, Senior Program Officer, Project Director; Dan Swain, Assistant Program Officer, Project Manager & GIS Mapping*

LISC Philly is one of 38 local offices of the nation's largest community development organization. LISC works alongside residents and partners, to create resilient and inclusive communities of opportunity across America – great places to live, work, visit, do business and raise families. LISC invests in historically disinvested communities across the country in order to close gaps around health, wealth, and opportunity. Over our 40+ years, LISC Philadelphia has supported the creation of 9,194 affordable homes and 2.7 million square feet of commercial space representing $600 million in total investment.

Financial Projections

Overview: This section highlights key findings of Stone Sherick's financial projections for preservation of 101 non-profit-owned developments consisting of 4,795 affordable rental units. It also illustrates the complexity of preservation, and the financial barriers non-profits face in preserving publicly assisted affordable rental properties.

Further detail on the methodology behind these numbers is available in the Methodology section of this report.

Key Findings

- Over the next 15 years, **101 non-profit owned projects comprising 4,795 units** in Philadelphia will require new capital investments to be preserved as affordable housing**.**
- In today's dollars, these projects will require an **estimated $22.7 million dollars in predevelopment costs, and a total investment of $793 million.**
- **65% of the projects (1,511 units) may not be eligible for Low-Income Housing Tax Credit (LIHTC) funding.** The total number of units under the tax credit program is determined by the Pennsylvania Housing Finance Agency (PHFA) through the Qualified Allocation Plan (QAP). In recent years PHFA has listed twenty-five units as the minimum threshold to be awarded either type of tax credit. Additionally, PHFA issues annual RFPs for the 4% tax credit program with separate requirements which are updated annually. However, for the purpose of this report, PHFA's 2022 minimum for 4% LIHTC was used to inform projections. In 2022, the policy required a minimum of 50 units for 4% LIHTC.[2]
- As a result, **over the next 15 years, there will be an unmet need for approximately $112 million to support non-profit owned preservation projects that do not qualify for LIHTC funding.**

Lipscomb Apartments in Bella Vista, Philadelphia

[2] *Please see note c*

Budget Estimates

1. Predevelopment Costs

Each project will have unique predevelopment needs based on the length of time since the last renovation, type of building, and expertise of the development team. Predevelopment is typically comprised of initial due diligence (i.e. environmental reports), architectural fees for initial design, acquisition costs, and other soft costs needed to prepare the project in its early stages.

In Stone Sherick's experience, these costs range from $200,000 to $250,000 per project. A predevelopment budget for a typical 50-unit project is included below as an example. *It is important to note that these costs must be financed either by debt or by the non-profit developer until long term funding can be secured.*

Typical 50 Unit Project Predevelopment Budget	
Attorney Fees	$30,000
Accounting Fees	$5,000
Architect Fees	$50,000
Financing Fees	$30,000
Consulting Fees	$80,000
Survey & Environmental Assessment	$15,000
Reports and Fees	$10,000
Contingency	$6,600
Total	**$226,600**

Based on the universe of 101 non-profit preservation projects, this results in a possible range of $20.2 million to $25.3 million of predevelopment need. For purposes of the report, the average cost of $225,000 per development is utilized resulting in ***an estimated need of $22.7 million.***

2. Hard costs

Hard costs are defined as the construction costs typically included in the contract with a general contractor. These include the cost of materials such as concrete and steel as well as the general contractor's overhead, profit, and other costs.

Construction Cost Comparison **Stone Sherick Consulting Group- Preservation Projects**					
	Total Units	**Total SF**	**Cost / SF**	**cost/unit**	**Total cost**
AWF 1&2	86	Not Available		$ 115,822	$ 9,960,692
Lipsomb	65	67,150	$ 73	$ 75,859	$ 4,930,817
Fitzwater Homes	22	16,102	$ 238	$ 174,196	$ 3,832,312
PEC Imani Preservation	55	65,283	$ 76	$ 90,209	$ 4,961,508
HACE Lehigh Park	74	45,403	$ 102	$ 62,583	$ 4,631,106
Mt Carmel Gardens	47	35,766	$ 117	$ 89,035	$ 4,184,622
WCRP Lila Crippen**	46	51,964	$ 88	$ 99,093	$ 4,558,282
WCRP KD **	44	59,385	$ 78	$ 105,111	$ 4,624,904
HACE Villas Caribe	81	101,946	$ 84	$ 106,175	$ 8,600,165
		Average Cost	**$ 107**	**$ 102,009**	

While the scope of a preservation project can vary significantly, it is Stone Sherick's experience that per unit costs are comparable across projects. Based on extensive experience, Stone Sherick has concluded that a range of $100,000 to $115,000 per unit is reasonable. Multiplied by the 4,795 units included in this analysis, the estimated hard costs range from $479.5 million to $551.4 million. For purposes of this model, the average of the minimum and maximum will be used as the hard cost estimate. ***This results in a hard cost line item of $515.5 million*.**

3. Soft costs

Soft costs are comprised of all expenses that are not directly tied to the materials and labor covered in the hard costs of construction. Typically, these include all professional fees (attorney, engineering, and architect) as well as financing costs and contingency. A soft cost budget for a typical 50-unit project is included as an example.

Typical Soft Costs	
Financing Fees	$120,000
Attorneys Fees	$100,000
Engineering	$300,000
Architect Fees	$450,000
Contingency	$48,500
Subtotal	**$1,018,500**

In Stone Sherick's experience, these costs range from approximately $900,000 to $1.1 million per project. Based on 101 projects, this results in a possible range of $90.9 million to $111.1 million of soft cost need. *For purposes of the Preservation Plan, the average cost of $1 million per project is utilized resulting in* ***an estimated need of $101 million.***

4. Developer Fee

Non-profit developers are entitled to a developer's fee in order to cover their staffing and overhead expenses during the development process. PHFA calculates this amount based on the cost of construction with a maximum of $2.0 million per project. In Stone Sherick's experience, the developer fee is rarely less than $1.5 million, resulting in a per project average of $1.75 million. Based on the number of nonprofit projects, the estimated developer fee need is between $151.5 million and $202.0 million with *an average of* ***$176.8 million.***

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Combined Financial Projections and Timing

The previously described estimates were combined to reach an estimated **total financing need of $793.2 million over the 2024- 2038 period**.

Budgetary Estimates	
Estimated Hard Costs	**$515,462,500**
Includes materials, labor, and GC overhead and profit	
Soft Costs	**$101,000,000**
Includes professional and financing fees	
Developer Fee	**$176,750,000**
Includes developer overhead and staffing	
Combined Need	**$793,212,500**

The projects, however, will not occur simultaneously meaning that projects at risk of market rate conversion within the next few years will be in need of funding prior to projects with subsidy expiration in the later years of the considered timeline. The anticipated timing of these funds based on subsidy expiration is included in the graphic below resulting in an average **yearly expenditure of approximately $32 million**.

Timing of Funds	Year 1-3	Year 4-6	Year 7-9	Year 10-12	Year 13-15	Total
# of Projects Expiring	16	11	23	28	23	101
# of Units Expiring	497	435	1074	1414	1375	4,795
Predevelopment Need	$3,600,000	$2,475,000	$5,175,000	$6,300,000	$5,175,000	$22,725,000
Total Financing Need	$82,216,186	$71,959,841	$177,666,366	$233,910,839	$227,459,267	$793,212,500

Capital Needs Projections

Overview: Affordable housing preservation project have a myriad of potential sources. Many developers may seek non-competitive, 4% LIHTC; however, a significant portion of projects would not be eligible today for this source based on PHFA's 2022 Qualified Allocation Plan (QAP), and the requirement for a minimum of 50 units. 4% LIHTC projects must also raise significant additional funding, often in the range of $6-$8 million, from non-LIHTC sources.

Projects that are ineligible or infeasible at 4% LIHTC would need to seek competitive 9% LIHTC which may result in longer lead times and increased costs due to multiple application submissions. Additional funds are currently available from the City of Philadelphia's Housing Trust Fund in the form of a maximum of $3.0 million per LIHTC project. Other soft sources such as Federal Home Loan Bank (FHLB) and PHFA PHARE Housing Trust Fund are not taken into consideration here, but may be available to non-profit developers.

Available Funding Sources	
9% LIHTC	$433,910,798
4% LIHTC	$127,228,144
City of Philadelphia	$202,000,000
NPI	$30,073,558
Total	***$793,212,500***

A Note on the Low-Income Housing Tax Credit (LIHTC) Program: Created by the Tax Reform Act of 1968, LIHTC is considered the most important funding source for affordable housing on a national level. There are two versions of LIHTC available to developers. The first is 4% LIHTC. This is awarded "as-of-right" meaning that if a developer can submit a feasible application to their State Housing Authority, they are allowed to receive the tax credits without competition. The resulting funding received is significantly less; however, than the 9% LIHTC option. This said, 9% LIHTC is competitive and frequently requires two or three expensive applications. In the Commonwealth of Pennsylvania, the competition occurs annually, resulting in long project timelines.

PHFA has informally proposed that projects with under 25 units cannot apply for 9% LIHTC. In the event this becomes formal policy, affordable housing developers would become more reliant on City of Philadelphia resources, increasing the needed funding from $232 million to $367 million. Despite the increased support from the City, Stone Sherick estimates that there would be a financing gap of approximately $112 million. This could at least be partially mitigated by seeking alternative sources such as the Federal Home Loan Bank or PHFA PHARE funds; however, this would increase the complexity, cost, and timeline of preserving this units. Small non-profits may be unable or unwilling to pursue these avenues.

Available Funding Sources	
9% LIHTC	$186,915,421
4% LIHTC	$127,228,144
City of Philadelphia	$303,000,000
NPI	$64,000,000
Total	***$681,143,564***
Gap	*$112,068,936*

A Note on Vouchers and Private Debt

Recently, the Philadelphia Housing Authority has made a significant number of project-based vouchers available to affordable housing developers. A project-based voucher allows a project to receive a HUD-determined Fair Market Rent while guaranteeing that no tenant will pay more than 30% of their income, even if their income is $0. The PHA vouchers have the ability to significantly improve project cash flow, alleviating budgetary pressure on non-profits. This improves the non-profits ability to maintain a comfortable living space for tenants as well as serving extremely low income or no income individuals and families without the risk of eviction and homelessness.

Vouchers also create the possibility of utilizing private debt as a capital source. Two sample proformas are included below. Both represent a 50-unit facility serving residents earning incomes at or below 30% AMI. The first proforma does not have project- based vouchers while the second proforma does, demonstrating the improved cash flow and ability to support debt of the second project.

Proforma- No Project-Based Vouchers

In this scenario, the property produces negative cash flow by year 2, complicating the maintenance of the property and increasing the risk of evictions and homelessness for tenants.

	LIHTC Rents (30% AMI)	# Of Units
1 BR	$593	15
2 BR	$711	35
	Total	50

30% AMI LIHTC 10 Year Operating Proforma (Typical 50 Unit Project)											
		Year 1	*Year 2*	*Year 3*	*Year 4*	*Year 5*	*Year 6*	*Year 7*	*Year 8*	*Year 9*	*Year 10*
Rental Income		$405,360	$413,467	$421,737	$430,171	$438,775	$447,550	$456,501	$465,631	$474,944	$484,443
Vacancy	5%	$20,268	$20,673	$21,087	$21,509	$21,939	$22,378	$22,825	$23,282	$23,747	$24,222
Effective Gross Income		$385,092	$392,794	$400,650	$408,663	$416,836	$425,173	$433,676	$442,350	$451,197	$460,221
Management Fee	8%	$30,807	$31,424	$32,052	$32,693	$33,347	$34,014	$34,694	$35,388	$36,096	$36,818
Admin		$10,000	$10,300	$10,609	$10,927	$11,255	$11,593	$11,941	$12,299	$12,668	$13,048
Utilities		$40,000	$41,200	$42,436	$43,709	$45,020	$46,371	$47,762	$49,195	$50,671	$52,191
Op & Maintenance		$55,000	$56,650	$58,350	$60,100	$61,903	$63,760	$65,673	$67,643	$69,672	$71,763
Payroll		$135,000	$139,050	$143,222	$147,518	$151,944	$156,502	$161,197	$166,033	$171,014	$176,144
Taxes & Insurance		$64,000	$65,920	$67,898	$69,935	$72,033	$74,194	$76,419	$78,712	$81,073	$83,505
Supportive Services		$20,000	$20,600	$21,218	$21,855	$22,510	$23,185	$23,881	$24,597	$25,335	$26,095
Replacement Reserves		$25,000	$25,750	$26,523	$27,318	$28,138	$28,982	$29,851	$30,747	$31,669	$32,619
Investor Service Fee		$5,000	$5,150	$5,305	$5,464	$5,628	$5,796	$5,970	$6,149	$6,334	$6,524
Total Operative Expenses		$384,807	$396,044	$407,611	$419,518	$431,777	$444,397	$457,389	$470,763	$484,532	$498,707
Net Operating Income		$285	($3,250)	($6,961)	($10,856)	($14,941)	($19,224)	($23,712)	($28,414)	($33,336)	($38,487)

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Proforma- Project-Based Vouchers

In this scenario, the property produces positive cash flow for at least 10 years, facilitiating the maintenance of the property and a comfortable environment for all tenants, including extremely low or no income residents. The project is further able to support a $2.5 million mortgage which provides needed capital for preservation and reduces the non profit's dependency on subsidy sources.

	HUD FMR Rent	# Of Units
1 BR	$1,071	15
2 BR	$1,298	35
	Total	**50**

Rental Subsidy 10 Year Operating Proforma (Typical 50 Unit Project)

		Year 1	*Year 2*	*Year 3*	*Year 4*	*Year 5*	*Year 6*	*Year 7*	*Year 8*	*Year 9*	*Year 10*
Rental Income		$737,940	$752,699	$767,753	$783,108	$798,770	$814,745	$831,040	$847,661	$864,614	$881,907
Vacancy	5%	$36,897	$37,635	$38,388	$39,155	$39,938	$40,737	$41,552	$42,383	$43,231	$44,095
Effective Gross Income		$701,043	$715,064	$729,365	$743,952	$758,831	$774,008	$789,488	$805,278	$821,384	$837,811
Management Fee	8%	$56,083	$57,205	$58,349	$59,516	$60,707	$61,921	$63,159	$64,422	$65,711	$67,025
Admin		$10,000	$10,300	$10,609	$10,927	$11,255	$11,593	$11,941	$12,299	$12,668	$13,048
Utilities		$40,000	$41,200	$42,436	$43,709	$45,020	$46,371	$47,762	$49,195	$50,671	$52,191
Op & Maintenance		$55,000	$56,650	$58,350	$60,100	$61,903	$63,760	$65,673	$67,643	$69,672	$71,763
Payroll		$135,000	$139,050	$143,222	$147,518	$151,944	$156,502	$161,197	$166,033	$171,014	$176,144
Taxes & Insurance		$64,000	$65,920	$67,898	$69,935	$72,033	$74,194	$76,419	$78,712	$81,073	$83,505
Supportive Services		$20,000	$20,600	$21,218	$21,855	$22,510	$23,185	$23,881	$24,597	$25,335	$26,095
Replacement Reserves		$25,000	$25,750	$26,523	$27,318	$28,138	$28,982	$29,851	$30,747	$31,669	$32,619
Investor Service Fee		$5,000	$5,150	$5,305	$5,464	$5,628	$5,796	$5,970	$6,149	$6,334	$6,524
Total Operative Expenses		$410,083	$421,825	$433,908	$446,342	$459,137	$472,304	$485,854	$499,798	$514,147	$528,915
Net Operating Income		$290,960	$293,239	$295,457	$297,611	$299,695	$301,704	$303,635	$305,480	$307,236	$308,897
Debt Service		$179,865	$179,865	$179,865	$179,865	$179,865	$179,865	$179,865	$179,865	$179,865	$179,865
DCR		*1.62*	*1.63*	*1.64*	*1.65*	*1.67*	*1.68*	*1.69*	*1.70*	*1.71*	*1.72*
Residual Cash Flow		$111,094	$113,374	$115,592	$117,746	$119,830	$121,839	$123,770	$125,615	$127,371	$129,032

Common Themes and Areas for Further Consideration

Tioga Arms Apartments in North Philadelphia

Overview: Stone Sherick Consulting Group has been involved in many recapitalization projects to preserve affordable housing over the past several years in Philadelphia. Projects included general occupancy or family units and senior housing in all sections throughout the city. All of the units are owned or have a managing member who is a non-profit organization.

Many preservation engagements do not move past the feasibility stage. The reasons for moving forward (or not) were varied. Ideal conditions for moving forward were with a well -established non-profit, who had experience with development and were well capitalized to be able to provide for predevelopment costs required to sustain the project momentum until closing on the financing.

The primary reasons for projects not moving forward after feasibility were due to concern over capital needed during predevelopment, varied opinions within an organization on mission and focus, lack of understanding of the process and the risks and rewards associated with the process. Often, something unfamiliar and complicated seemed too heavy a lift for the organization, which speaks primarily to organizational capacity.

Key Finding: The preservation process is a difficult endeavor that requires complex financing maneuvers to do a significant capital improvement and complex construction coordination; however the benefits outweigh the challenges. In all cases, quality of life for tenants is significantly improved when their units are upgraded for health, safety and enjoyability. If affordable housing is not preserved, these same tenants must relocate, disintegrating the communities and livelihoods that have been built over the past decades.

1. **Organizational Capacity:** The capacity of non-profit organizations engaging in preservation work is varied, yet even the most sophisticated organization with capital and high-capacity requires assistance with the financial modeling and restructuring due to the complexity of the project.

Organizations with a higher capacity could perform much of the required leg work and predevelopment work, while organizations with little or waning capacity over the years struggled to stay focused on the task and abandoned the project. Organizations with little to no capacity that were self-aware of their abilities were able to entrust the process to the consulting team to complete the project.

2. **Financial Complexity:** A clear theme with all preservation projects is that they are financially complex regardless of the source of funds pursued for the recapitalization effort. Existing soft and/or hard debt needs to be recast, extended, or refinanced and additional financing needs to be secured typically on a competitive basis. Multiple government agencies or institutions such as CDFI's and/or banks need to be involved and approved of the recapitalization plan.

In addition to the capital refinancing, projects that originated with HUD financing (HUD 202, HUD 236, etc…) and have a federal Housing Assistance Payment (HAP) contract also need to be refreshed with potentially new and increased rental payments via a market study process.

Additional financing is typically needed and applied for to introduce a much-needed capital infusion into the project for deferred maintenance items and general upgrades to large capital improvements.

The most commonly proposed financing sources were 4% and 9% LIHTC, FHLB, PHARE, City of Philadelphia soft funding, and a partial sale of the affordable units once regulatory agreements expire. Clients most commonly preferred the soft funding sources, despite longer timelines, due to lower out-of-pocket or financed predevelopment costs.

3. **Capital Needs and Construction Process:** Project operations and management are as varied as the organizations. Many units have not been well maintained or managed, increasing the complexity of the project as well as the need for capital. General occupancy units tend to have more significant wear and tear, while senior units have had a more gentle use.

Common renovation needs are:

- Outdated systems (i.e. upgrade to central air conditioning, roofs, plumbing and electric upgrades and new windows). Typically, an attention to energy efficient windows and products is considered.
- Outdated finishes/ normal wear and tear
- Emergency capital needs such as water infiltration, health and safety violations, etc.

Due to high occupancy rates in each of the projects, there was no relocation proposed. In some cases, buildings were able to utilize vacant units due to attrition to shift residents around. In some cases, tenants were temporarily located in alternative housing for the briefest of time and then returned to their finished unit.

From a capacity perspective, non-profits would benefit from more technical knowledge and support or the funding to hire appropriate consultants.

4. Management: Organizations can choose to self-manage, hire 3rd party management agents, or do a combination of the two. Interestingly, there is no correlation between property management style and the condition of the units at the time of the reports. There is, however, a strong correlation between the project's operating budget and unit condition. If units are rent subsidized by a HAP contract, Project Based Vouchers or other vouchers such as HOPWA, Shelter Plus Care or internal rent subsidies, the chances for a well-maintained project are higher. Nonsubsidized units tend to be less maintained.

5. Market Pressure: Several projects in gentrified or on the cusp of gentrifying neighborhoods are considering the opportunity to let the restrictive covenants burn off and convert to market rate by selling to a private developer. The cash being offered is significant and organizations that are cash strapped and/or deal fatigued are considering/soliciting for a sale. This coupled with pressure from the market make the threat of conversion real.

Neighborhood	Market Rate Risk	Units	Properties
Greater Center City	Highly at Risk	717	12
Francisville/ Sharswood/ Spring Garden	More at Risk	442	9
Mantua/ West Powelton	More at Risk	784	17
Cecil B Moore	More at Risk	269	6
Fairhill/ Kensington	Less at Risk	301	11
Germantown/ Mt Airy	Less at Risk	584	10
North Philadelphia	Less at Risk	677	17
Greater South Philadelphia	Less at Risk	302	5
Greater West Philadelphia	Less at Risk	527	11
Northeast Philadelphia	Less at Risk	192	3
Total		***4795***	***101***

Non-Profit & Stakeholder Interviews

Non-Profit Building Owner Overview: The four Philadelphia non-profits that agreed to be interviewed by Mr. Wilson, principal of Wilson Associates, Inc, for this project were *Asociación de Puertorriqueños en Marcha (APM); People's Emergency Center (PEC); Mount Vernon Manor (MVM); and Women's Community Revitalization Project (WCRP)*. Together, the non-profits own and manage a total of 1,135 affordable housing units.

Key Findings

Neighborhood Context: Eleven different neighborhoods, across seven zip codes are served by one or more of the four non-profits and lie within the seven zip codes that comprise large geographies. Essentially all seven zip codes are experiencing *rapid increases in rent levels* over the past couple of years according to project related data, studies and anecdotal information to which these groups have access; different sections of 19104 are currently showing signs of moderate to high rates of rent increases. This trend threatens housing affordability for low-income households in general, as well as non-profit owners' ability to preserve their rental inventories and serve their broader constituency.

Table 1: Rental rate increases by ZIP Code

19104 – moderate to rapid
19121 – rapid rise
19122 – rapid rise
19133 – rapid rise
19134 – rapid rise
19144 – rapid rise
19146 – rapid rise

Source: Non-profit interviews, June 2022[3]

Management Practices: These four non-profits have a combined 1,135 affordable rental housing units under management. The number of units managed by the organization itself is 873 or nearly 80% of the total, versus those managed by an outside management company retained by the non-profit – 262 or approximately 20% of that total. Mount Vernon Manor, which operates in the Mantua neighborhood, contracts all of their 159 units to an outside firm and emphasized that their overall asset management function is to "manage the manager" on a regular basis.

Management Functions: The non-profits' perceptions of their responsibilities and distinctions between "asset management" and "property management" overlapped in some cases and diverged somewhat in others. The purpose of this portion of the interviews with each was simply to get their impressions of each and how they see those functions in managing their properties, directly or indirectly. Based on those discussions, the groups categorized functions under each heading as follows:

[3] Includes independent market studies for their projects; TRF; and TRF Policy Map tool.

Based on those discussions, the groups categorized functions under each heading as follows:

- Asset management
  - Marketing, promotion and leasing
  - Income and expenses monitoring
  - Budget-to-actual tracking
  - Procurement
  - Investor relations
  - Compliance monitoring and reporting

- Property management
  - Rent collection
  - Maintenance, repairs and procurement
  - Capital improvements
  - Resident services/tenant relations
  - Unit turnover

Preservation Needs and Challenges

Developing and preserving affordable rental housing is a major part of each non-profit organization's purpose and mission considered in this report. Each group acknowledged the difficulty in doing both, especially the cobbling together of resources – public and private in nature – while at the same time sustaining their day-to-day operations.

The Non-Profit Perspective: On the question of preservation needs over the next several years, the responses fell into four distinct asset and property management categories as described below. All are based on each group's commitment to preserving their units as *assets on their balance sheets* and *assets of their service areas* for the purposes of serving tenants deserving of high-quality affordable housing to enhance their overall quality-of-life:

1. <u>Financial Resources</u>

- Funding to address rent arrears that grew during COVID and help ensure long-term affordability; and
- Technical support to purchase their properties from the Low-Income Housing Tax Credit investor, and become full owners at the end of the LIHTC compliance period.

2. <u>Physical Improvements</u>

- Energy efficient upgrades
- Roofing, flooring and fixtures
- Windows and doors

3. Support Services to Address
- Tenant health and quality-of-life needs
- Food insecurities, unemployment, and trauma-related risk factors
- Occupancy impacting accelerated wear and tear on the units

4. Human Resources
- Professional development for the next generation of asset and property management staff
- Pay equity to retain, train and promote existing staff and attract new staff

COVID Related: The COVID-19 pandemic impacted the business and the housing portfolios of each group. In general, COVID exacerbated problems lower income households were experiencing daily, and over many years and generations pre-COVID, as all four non-profits emphasized. In particular, and across all the groups' responses to that question, tenants and business was affected in the following ways:

1. Tenant population
- Residents more isolated, spending more time than typical in their units
- Health and wellness issues more visible and acute (food insecurity, substance abuse, trauma, and stress)

2. Operations and cash flow
- Accelerating wear and tear on the units and sites
- Increasingly unpaid rent
- Higher operating costs, particularly property and hazard insurance
- Inability to increase rents without causing displacement or homelessness

The Stakeholder Perspective: In discussions with senior management of the Pennsylvania Housing Finance Agency (PHFA), which provides tax credits and debt financing for affordable rental housing projects throughout the state, and the National Equity Fund (NEF), which provides investor equity for such projects across the country, perspectives were shared with the LISC research team about specific challenges of and opportunities for non-profit to address the preservation of Philadelphia projects in their respective portfolios. Preserving affordability is a major focus of both entities and they each actively monitor changes in the performance of such projects over time as fundamental parts of their own business performance. Each have in-house risk analysis capacity and tools to measure and track project performance for the purposes of identifying "troubled projects" in the regular course of their work. In qualifying and underwriting those transactions, among the key factors each examine in underwriting the capacity of non-profit project sponsors to perform as an owner of affordable rental developments include, for example, experience managing rental housing; the number and performance of projects in their housing portfolio; and how well deals are packaged and underwritten.

With respect to key issues and needs impacting the immediate and long-term affordability of such non-profit portfolios, these two stakeholders noted the following:

1. *Project budget related*
   - High property insurance costs
   - Bad debts and uncollected rents, both pre-COVID and currently
   - Negative working capital and replacement reserves not being spent down when called for
   - Deferring maintenance to the latter stages of the affordability compliance period

2. *Intra-organizational capacity related*
   - High staff turnover
   - Limited staff who are responsible for multiple operational and management responsibilities

3. *Project financial related*
   - Engaging project stakeholders and partners frequently in tracking and evaluating project performance, with particular attention to monitoring budget-to-actual expenses and revenues over time
   - Ensuring that governing boards or standing committees are in place, charged with financial oversight and compliance, and have the capacity to fulfill such responsibilities
   - Equipping asset and property management staff with the tools they need to: (a) assess the needs and performance of individual projects in real time; and (b) recommend and take actions to address those needs as proactively as possible to protect their entire affordable housing portfolio
4. *Pandemic related*
   - Covid-19 revealed and potentially exacerbated tenants' lack of digital access, food insecurities, and some social justice issues (based on who tends to be evicted)

STONE SHERICK
CONSULTING GROUP

Elevating the Voices of Non-Profit Owners on Preservation of Affordable Housing

Overview: This section highlights expressions made or questions raised by the four groups interviewed by Mr. Wilson during the course of the conversations, and are particularly noteworthy.

1. The Business of Affordability
   - We want the business of developing, managing and preserving affordable rental housing to work, and we want to do it, the business, well.
   - A question posed to the board of one of the non-profit's about whether affordable rental housing is even a line of business we want to be in long term: "Some units have had to be rebuilt from scratch, and aren't generating income during that process to boot."

2. Affordability as a Universal Goal
   - The 40-year affordability period should be both conceived of and legislated to extend beyond that period into perpetuity, with resources committed and available to make that happen.
   - The challenge of housing affordability is not just about our set of projects, but housing in general in and for all neighborhoods.

3. Internal Governance is an Asset
   - Property and asset management board committees have experienced staff we tap into. Previously, there was no formal way of making those formal decisions of acquisition and disposal of properties. Important to formalize how it's being done, and look holistically.

4. Government as a Partner
   - As projects mature, intervention and support by the City and PHFA is needed to enhance affordability over time, and as operating costs increase. Preservation goals and preventing displacement have implications for how projects need to be underwritten to take those needs into account and to insure the adequate funding of operating and replacement reserves.

Governmental Support for Preservation: According to the non-profits interviewed, both the City and PHFA are aware of and generally helping to address project issues and preservation needs. Support from each varies in degree and over time.

Among the recommendations offered up include ensuring that preservation be taken more into account during the underwriting phases of packaging affordable housing projects to ensure adequate and sustainable funding of development and operating costs that affect building quality and design, which in turn plays a big and important role in the operations, maintenance, and day-to-day management of such projects.

Conclusions & LISC Philadelphia's Commitment

Preservation of affordable rental housing has been identified as a priority by non-profits, state and local agencies. This report seeks to build understanding of the projected preservation needs of Philadelphia's non-profit building owners over the next fifteen years, and to spur collective action to address those needs. The project team employed two methodologies. The first included developing a model to project the financial and capital needs of non-profits. The second included interviews with four non-profit building owner across the city and two investor stakeholders.

When combined, the two methodologies revealed common themes with respect to neighborhood context, organizational management practices, and the impact of COVID-19. However, non-profits expressed distinct and pressing needs, when describing asset and property management functions and the impact of COVID-19. These needs focused on factors leading to or impacting housing stability for residents and long-term affordability of the property.

In addition, both methodologies, underscore the importance of "place" and changing market conditions in neighborhoods where non-profits have owned and operated affordable housing for decades. Among the core challenges non-profits have managing their projects long term, perhaps the most significant one is their *ability to hold onto* and/or their *interest in holding onto* their projects, versus selling the asset as private offers to "buy-them-out" become harder and harder to decline as the corresponding neighborhood market heats up and begins supporting higher rents.

<u>LISC's Commitment:</u> LISC's housing strategy aims to preserve neighborhood assets and promote growth, protecting long-term residents and meeting community needs for affordable, and equitable housing options. To this end, LISC will be a leading voice in advocating for policies and resources that will ensure the preservation of all 101 at-risk properties.

In addition, LISC will continue to work closely with community-based non-profit partners in neighborhoods to ensure preservation of affordable rental housing stock, particularly in communities of color through a new Non-Profit Preservation Initiative (NPPI). The initial phase of LISC's NPPI will focus on units moving to expiration, and are located in neighborhoods where the loss of affordable housing is most acute.

The Non-Profit Preservation Initiative (NPPI) will support the following programmatic areas:

- Feasibility and Predevelopment
- Development of Organizational Business Plans
- Housing Stability, Eviction Prevention, and Economic Mobility
- Facilitate action oriented discussion that will identify systems and policy changes needed to further preservation of publicly assisted affordable rental housing

LISC is grateful for the time and expertise of our project partners, and especially the non-profits and stakeholders willing to engage in conversations about Philadelphia's preservation landscape for non-profits. It is our hope this report will help inform and solve the challenges non-profit building owners face now and in the future.

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