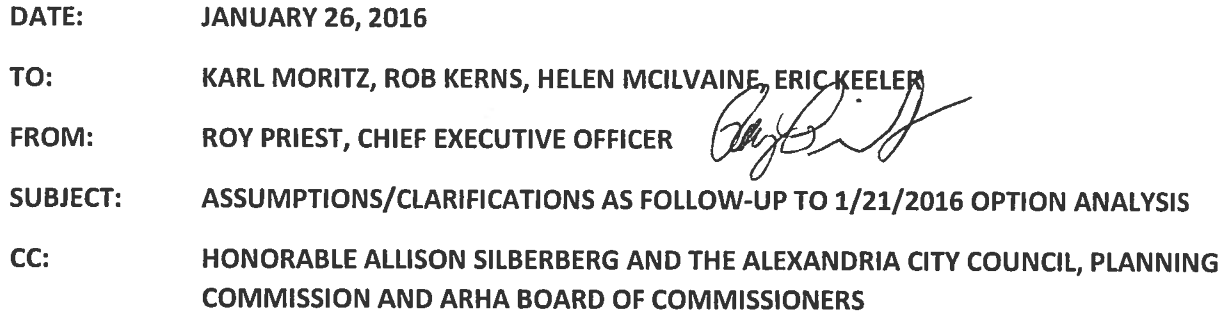
MEMORANDUM



DATE: JANUARY 26, 2016

TO: KARL MORITZ, ROB KERNS, HELEN MCILVAINE, ERIC KEELER

FROM: ROY PRIEST, CHIEF EXECUTIVE OFFICER

SUBJECT: ASSUMPTIONS/CLARIFICATIONS AS FOLLOW-UP TO 1/21/2016 OPTION ANALYSIS

CC: HONORABLE ALLISON SILBERBERG AND THE ALEXANDRIA CITY COUNCIL, PLANNING COMMISSION AND ARHA BOARD OF COMMISSIONERS

I. Preamble:

Per our conference call of Friday, January 22nd, we are providing this memorandum to enhance the information that was included in a January 21, 2016 Memorandum Subject, Ramsey Homes Update. I felt the call was productive and I hope that you found our responses to your questions to be useful. By way of follow-up to that conversation, we are memorializing the discussion herein and providing additional information for clarification.

The ARHA 53-unit concept is not modeled in the January 21 Memorandum from Mr. Priest to the Mayor and Council (the "Memorandum") as we believe the information relative to our competitive Reservation Application is proprietary and, it is reasonable to assume that, if ARHA is willing to invest the significant amount of resources required to apply for Tax Credits, we believe that our Ramsey Homes application could fall within the competitive range and be awarded. We continue to caution that this process is highly competitive and no applicant could possibly be aware of the outcome going into the process. While modeling the competitive range is informative, the number and size of the requests competing for the limited funding is also highly important to the outcome and this information could not be known at this time. The analysis in the Memorandum dealt with five critical areas of analysis; those areas of analysis were:

Competitive Range	The 2015 round of applications scored in a range of 550 – 660. In 2016, the Qualified Allocation Plan has been amended so that zoning is no longer a 40-point category, but is instead a threshold requirement, so worth zero points. Given this, we revised the potential range based on trending to be last year's range, less 40 points, or 510 – 620. Equally important is the number and size of requests which we cannot model at this time.
Debt Coverage Ratio (DCR)	DCR is the tool used by tax credit investors as the indicator of financial strength. It is the ratio of cash available for debt service. Investors will complete their own underwriting to determine the DCR and they will complete that underwriting using the most conservative information available. If 9% Tax Credit funding is not a possibility, **either the City must provide grants in the amount of the foregone 9% Tax Credit capital, plus any soft debt**, or debt must be raised to cover the development costs. There must be sufficient income to service any form of debt. DCR of less than 1.00 means negative cash flow.

Cash Flow	There must be a critical mass of units to provide sufficient income, less operating expenses to service debt (if required for gap financing), or to support a healthy DCR.
ARHA Land Asset	The acquisition value used in the model was taken from the City of Alexandria Tax Assessor's website. It is typical to use this as the best information available at the time of a Reservation Application. If the investor requests an appraisal, this will be ordered prior to the financial closing but not far enough in advance for the document to become stale. The BEMP, page 10, "Conclusion", states, "*The decision to redevelop these public housing sites is ultimately at ARHA's discretion and is highly dependent upon what will be economically feasible at the time. The BEMP provides sufficient flexibility to enable ARHA to achieve its mission of providing quality housing to persons of low income* ***in a manner that allows ARHA to capitalize on its major asset – its land,*** *which is held in trust primarily for the benefit of its residents.*" Where there is not sufficient rental income, ARHA would not be able to capitalize on the value of its land asset and ARHA is not in a position of contributing the value, which it would have to do to make the project sources balance with the uses. Through its prior redevelopment efforts, ARHA has used its land value to subsidize its operations and those of underperforming assets in order to make up for the on-going loss of federal subsidies and to maintain a viable business model. The land value is recaptured in the form of below-market loans, payable with residual receipts over 30 years.
Developer fees	It is difficult to entice an investor to invest in a project where the developer is not being compensated, as a lack of income could cause the developer to go out of business before the end of the compliance period. Investors want to see the developer received a **minimum** of 50% prior to the Placed-in-Service date and, the least amount possible being paid over the first 10 years in the compliance period. The developer fee must be equal to or less that the fees allowed by VHDA and HUD Safe Harbor Standards and must be able to be paid prior to the Placed-in-Service date or must be deferred and paid within the first ten (10) years of operations. Again, there must be a healthy enough DCR to support payment of the developer fee with operating income if some portion of the fee is to be deferred. There are also IRS imposed penalties for non-payment of the deferred developer fee.

The below provides further detail relative to the Cash Flow and DCR and its application per option analyzed.

II. Cash Flow Projections per Option: The cash flow for each option was modeled from actual projects in our portfolio that were the most recent and/or relative, with tweaks for obvious differences; the cash flow must be modeled to determine if an option is sustainable long term and to see that it has enough cash flow to service debt, in the event debt is needed for gap funding.

- *Estimated Annual Percentage Increase in Revenue (Must be ≤ 2%).* ARHA has never received a 2% increase in rent. Trended increases are less than 1% and in some cases, HUD has decreased the amount of subsidy it has provided for rents. The income for the minimal PH units was modeled using a HUD RAD rent ($483/month for a 2-bed), which is higher than our current income. The balance of the fifteen (15) extremely-low income units were modeled with a Housing Choice Voucher rent as the households would be entitled to a Tenant Protection Voucher. An investor will underwrite to the lower tax credit rents for all units except the PH units. The presence of the extremely low-income units is the motivation for a critical mass of higher (50% – 60%) AMI units.
- *Estimated Annual Percentage Increase in Expenses (Must be ≥ 3%).* The expenses for the new construction units were modeled based on the 54-unit James Bland V Project, which is the most recently completed by ARHA. The rehabilitated units were modeled based on Pendleton Park, which was our most recent preservation project. Please note, VHDA does not view projects with expenses that are less than $4,000/unit annual as realistic. This $4,000 is best-case scenario, so the assumption is that it is new construction. Our range of $4,000 - $6,000 is on the low side and was based on a mix of rehabilitated and new construction units. By way of reference, it is informative to note that ARHA's annual cost to operate its most recent redevelopment project, James Bland Phase V, is $7,150 per unit. James Bland V is 54 units of new construction. Conversely, Pendleton Park was acquired and rehabilitated one year prior to the James Bland V project and is a 24-unit preservation project that is costing ARHA $15,636 per year to operate. It is demonstrated with these two projects that costs are directly attributable to the size (economies of scale) and age of a project. We did not have comparable costs to operate a rooftop amenity but assumed costs associated with the common toilet rooms (one per building), water, janitorial, electrical, secured access, replacement of furnishings that are exposed to the elements, and annual provision of specialty plants for the vertical gardens.

A Higher Annual Percentage Increase in Expenses (5%) was used in order to make accommodation for: 1) the inclusion of rehabilitated units, and 2) to account for the lack of an annual increase in revenues. The product does not result in an outcome that is significantly different from the levels that we are actually operating at.

III. Negative Cash Flow: If the Project scores within the competitive range, it must have a Debt Coverage Ratio of 1.0 to be considered sustainable. In our past projects, investors have required a DCR of 1.15 to 1.2 to purchase the Tax Credits. If there are not enough sources of "free money" such as the Tax Credit capital contributions from the sale of the Tax Credits, debt must be used to close the gap in the Total Development Costs (TDC). The projects must then be capable of generating enough income to cover the debt service required.

All of the options modeled, with the exception of the 51-unit model, fell below 1.0 over the course of the 15-year compliance period. Given that the 51 unit option demonstrated a

healthy operating proforma, and scored above the minimum score of 325 for non-competitive 4% Tax Credits, we modeled it with 4% Tax Credits. With 4% Tax Credits, the IRS requires that any gap financing required to fund the TDC be made up of tax-exempt bond debt. A project can use other sources but there is a minimum amount of bond debt relative to the TDC. The 51-unit option using 4% Tax Credits and bond financing did not demonstrate sufficient cash flow to pay the debt service.

IV. Total Development Costs by Option:

- Option 1 (rehabilitate 15 existing units): Hard Costs were provided by the 3rd party Construction Manager at Risk. Soft costs were based on current obligations and the cost to pay those prior to engaging 3rd parties to develop an alternate concept. There would be no funds to pay a developer fee and ARHA would have to contribute the land. This option is not competitive for Tax Credits, nor is it an eligible use of the HUD RHF Grant Funds. All development costs of **$3,670,308** must be paid via a grant from the City. It does not presume that ARHA would be completing any of the off-site improvements.
- Option 2 (rehabilitate 2 buildings and build 22 infill, new construction units): ARHA used the TDC budget provided by the City staff. These figures are extremely conservative as they are not inclusive of increased soft cost incurred by ARHA since modeling this option in September of 2015. The HUD RHF Grant Funds could be used only for the new construction units. The option is not competitive for Tax Credits, thus to advance the option would require a grant from the City of **$7,809,394** ($6,067,110 + $1,642,284 + $100,000).
- Option 3 9% LIHTC (leave one existing building standing and construct 49 new units in one 4-story high building): This option was modeled off of new square footages provided by the architects for vertical construction times the cost per square foot they are required to design to. The land development cost remained constant and the CMAR provided the cost for the garage. Soft costs were based on current obligations and the cost to pay those prior to engaging 3rd parties to develop an alternate concept. The developer fee is per VHDA and the acquisition cost is again per the City. The HUD RHF Grant Funds could be used only for the new construction units. The option is not competitive for Tax Credits, thus to advance the option would require a grant from the City of **$13,857,482** ($12,757,482 + $1,000,000 + $100,000). ARHA would also have to contribute the land and improvements and forgo any developer fees.
- Option 3 4% LIHTC (leave one existing building standing and construct 49 new units in one 4-story high building): This option was modeled off of new square footages provided by the architects for vertical construction times the cost per square foot they are required to design to. The land development cost remained constant and the CMAR provided the cost for the garage. Soft costs were based on current obligations and the cost to pay those prior to engaging 3rd parties to develop an alternate concept. The developer fee is per VHDA and the acquisition cost is again per the City. The HUD RHF Grant Funds could be used only for the new construction units. The option meets the minimum score to apply for non-competitive 4% Tax Credits, therefore we modeled the option as a 4% Tax Credit transaction with tax exempt bond financing. The result was that bond mortgage causes the Debt Coverage Ratio (DCR) to fall to 0.82 in the first

year. With a DCR of less than 1.00, even if you secured an allocation of 4% Tax Credits, you would not be able to sell the project to investors. The end result would be the same as the Option 3 9% LIHTC described above in that it would require a grant from the City of **$13,857,482** and an ARHA acquisition and developer fee contribution.

- Option 4 (leave one existing building standing and construct 39 new units in one 3-story high building): This option was modeled off of new square footages provided by the architects for vertical construction times the cost per square foot they are required to design to. The land development cost remained constant and the CMAR provided the cost for the garage. Soft costs were based on current obligations and the cost to pay those prior to engaging 3rd parties to develop an alternate concept. The developer fee is per VHDA and the acquisition cost is again per the City. The HUD RHF Grant Funds could be used only for the new construction units. The option is not competitive for Tax Credits, thus to advance the option would require a grant from the City of **$12,236,861** ($11,136,861 + $1,000,000 + $100,000). ARHA would also have to contribute the land and improvements and forgo any developer fees.
- Option 5 (rehabilitate 2 buildings and build 21 infill, new construction units): ARHA used a derivative of the TDC budget provided by the City staff for Option 2. These figures are extremely conservative as they are not inclusive of increased soft cost incurred by ARHA since modeling this option in September of 2015. It also presumes we would be completing the off-site improvements. The HUD RHF Grant Funds could be used only for the new construction units. The option is not competitive for Tax Credits, thus to advance the option would require a grant from the City of **$8,130,281** ($7,030,281 + $1,000,000 + $100,000).

V. Replacement Housing Factor (RHF) Fund Grant: ARHA expects to use $855,428 of RHF funds achieved through its Glebe Park and James Bland redevelopment efforts to redevelop 6 of the total 53 unit project as public housing.

What are Replacement Housing Factor (RHF) Fund Grants?[1]

They are Capital Fund Grants that are awarded to PHAs that have removed units from inventory for the sole purpose of developing new public housing units. The Capital Fund formula rule at 24 CFR 905.10(i) provides that a PHA may receive RHF grants for public housing units *demolished or sold* for a period of up to five years.

What are the eligible uses of RHF funds?

A PHA may *only* develop or acquire public housing rental units with RHF funds. All replacement housing must be undertaken in accordance with public housing development regulations found at 24 CFR Part 941, which includes requirements for mixed-finance development.

[1] www.hud.gov

VI. Affordability:

We originally modeled the project based on 27 units at 60% AMI and 26 units at 50% AMI. We originally modeled the project this way based on the 2015 VHDA application affordability ratio that yielded the highest score. Understanding that to VHDA the 50% and 60% are ceilings and, locally, we are committed to maintaining the current 15 at 30% AMI, we had our consultants change the cover to reflect the 15 at 30% and on 8/28/2015 we did replace the page from the 8/21/2015 submission.

VII. Parking Calculations based on Affordability:

We have revisited the parking calculations and are attaching the work sheets. The initial worksheet provided by Planning staff in April was calculated based on the original mix of 27 units at 60% AMI and 26 units at 50% AMI. While our consultant revised the cover and amended the submission, they seem to have made an error in their calculations. In using the worksheet provided by Planning staff, it appears that the number of parking spaces required with the 30% lower income served is 26 and we are actually providing 3 more than is required. If we are incorrect please let us know, otherwise, we would like to be able to say we are providing 3 more than is required.