Los Angeles
HOUSING+COMMUNITY
Investment Department

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**MEMORANDUM**

TO: **PROPOSITION HHH CITIZENS OVERSIGHT COMMITTEE**

FROM: **ANN SEWILL, GENERAL MANAGER** Ann Sewill
**LOS ANGELES HOUSING + COMMUNITY INVESTMENT DEPARTMENT**

DATE: **JANUARY 7, 2021**

REGARDING: **POSSIBLE ALLOCATION GUIDELINES FOR REMAINING HHH FUNDS**

## SUMMARY

Since the adoption of the HHH Permanent Supportive Housing ("PSH") program and funding guidelines in early 2017, three funding rounds have established a pipeline of 111 approved projects, committing a total of $1,073,862,697 to support the development of 7,300 units. There are thirteen additional projects totaling 661 units in the pipeline as a result of the HHH Housing Innovation Challenge. As of December 2020, approximately $30 million remains to be allocated. This memo summarizes the various options for allocating the remaining funding that are under discussion, and the impact on timing, leveraging, and total number of units that could be funded with the different approaches.

## BACKGROUND

At the December 11, 2020 meeting of the Citizens Oversight Committee ("COC"), members of the COC and City staff discussed possible options for use of the remaining HHH funds including:

1. Allocation of up to $8 million to a construction cost Notice of Funding Availability for projects that are experiencing significant unforeseen cost increases and are contributing at least 30 percent of developer fees to cover increases.
2. Allocation of $2 million for loans of up to $200,000 <u>per project</u> to PSH projects in the Managed Pipeline not currently using HHH funding, that are in predevelopment reviews, are willing to provide the additional depth of client targeting required by HHH, and that desire to take advantage of the streamlining provisions applicable to HHH funded projects.
3. Allocation of the balance for a competitive round of innovation projects that would include lower cost PSH projects using modular developments or adaptive reuse of motels or other buildings, and also alternative facilities models such as expansion of board and care homes serving people experiencing mental illnesses who need more support than offered in PSH.

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Most of the discussion at the December meeting focused on the interest in deploying funds to purchase buildings such as motels for adaptive reuse as PSH, therefore, this working memo focuses on that portion of Option 3 above.

DISCUSSION

As noted, the focus of the discussion at the December meeting was to use the remaining funding to provide additional PSH units through the purchase and reuse of buildings such as existing motels. When using HHH funds for the production of PSH, three goals embedded in the voter-approved HHH program should be considered. These goals are: (1) leveraging City funds such that HHH funds helped increase permanent supportive housing production from 3,000 to 10,000 units over ten years; (2) using HHH funds to provide supportive housing for chronically homeless people as well as other people experiencing or at risk of homelessness, which requires reliance on rental subsidies and funding for case management and mental health services; and (3) ensuring that the housing built with HHH funds will serve people who experienced homelessness for at least fifty-five years, both from the standpoint that it was planned to last physically as well as that it was sufficiently funded to operate well over that period of time.

One model of purchasing motels to be considered was that used in Project Home Key. This model was fast because the initial funding came from only two sources – State of California Coronavirus Relief Funds and City of Los Angeles Coronavirus Relief Funds. The Project Home Key buildings in Los Angeles ranged from newly completed apartments sold before occupancy for $430,000 per unit, to hotels in excellent shape, to less well-maintained motels. It can be challenging to compare costs so staff prepared cost summaries of representative buildings based on real examples. These summaries are included as Attachment “A.” Reviewing these summaries makes clear the tradeoffs that exist between leveraging dollars to get more units, achieving speed in acquisition and development, and providing full funding of all costs needed for future operations. These summaries are included as Attachment “A.”

<u>Leveraging City Funds</u>
The average HHH subsidy per unit on the first 111 projects is $130,000, and the median total development cost per the City Controller’s last audit is $535,000. The total costs not covered by HHH are most often funded by three general categories of sources: (1) a loan from a bank or bond lender repaid by project cash flow; (2) equity investments, typically from Low Income Housing Tax Credit investors; and (3) other government funding such as No Place Like Home, Affordable Housing & Sustainable Communities, County Housing Trust fund, or the Affordable Housing Program (AHP). With the exception of the bank loan, every other source is now competitive. It is important to note that a project may get funding from more than one government funding source, in which case a typical project could be managing funding from four or five specific sources.

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Securing these additional sources requires time and adds to project costs, but the funding that is able to be leveraged with the average $130,000/unit HHH commitment is a net gain. Comparing the average cost per unit and funding sources, the use of tax credits and other government funding might add up to $80,000 per unit in costs. Some of these are for required legal opinions and studies and consultants, while others are required by investors or lenders to make the project more financially stable, such as reserves to ensure that the property can be well managed over time, even with strictly restricted rent increases. The net gain from using tax credits and other government funding is about $210,000 per unit. Over the entire portfolio of HHH projects this leveraging has allowed the City to produce 7,900 units with the available HHH funds instead of only 2,725 if the City had opted to use HHH funding to cover 100 percent of a project's subsidy per unit.

In short, leveraging allows the City to maximize HHH production but adds to production time because of the need for an applicant to seek additional funding sources.

Rent and Services Subsidies

A typical PSH project serving at least 25 percent high acuity chronically homeless people requires on-site staffing resulting in property management costs of approximately $610 per unit per month. This amount does not include the per unit share of mortgage payments, reserves, and services costs. Therefore, long-term rental subsidies are needed to make these buildings financially feasible. The shortage of Housing for Health rental subsidies means that projects would need to rely on the Section 8 program operated by the Housing Authority of the City of Los Angeles ("HACLA"), which is balancing multiple and significant demands for subsidies each year. For Project Home Key, HACLA made project-based voucher commitments to the PSH projects directly to help ensure their financial viability.

Designing for Fifty-Five Years of Successful Operations

All buildings need to be maintained and renovated periodically, so this section does not refer to the concern that lower costs equate to lower quality, as long as the funding partners set reasonable standards. However, a project must be planned so as to achieve long-term financial viability for both the owner and the project itself. Projects with restricted rents, such as PSH projects, can often experience issues related to long-term financial feasibility if the organization backing the projects does not have sufficient financial and organizational strength.

For example, buildings with restricted rents that rise modestly every year will quickly experience cash flow shortfalls as utilities, staff, and maintenance costs rise, when a conventional loan was used to acquire and/or redevelop the building if that conventional loan is so large it uses all available cash to make loan payments. Owners who rely on internal fundraising or volunteer efforts to fund project costs will find such sources to be unpredictable, unsustainable, or unreplaceable over time, which becomes a problem for the City in the event of default. Returns of investor capital that rely on refinancing as if cash flow could increase significantly will not be possible. The purchase of motels with Project Home Key

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avoided many of these problems because HACLA is capable of providing financial and organizational strength over time to offset these issues. Trying to replicate Project Home Key success on other sites in the City in the future would involve making sure that the budgets and funding structures of those projects are able to withstand the usual changes in organizational capacity, funding patterns, and operating costs at the project level, rather than requiring the owner to cover likely shortfalls.

ADDITIONAL QUESTIONS

This memo summarizes the Department’s thinking at this time, rather than recommending one path forward. There are several questions under discussion with Council offices and other stakeholders concerning possible changes in client targeting to better serve families experiencing homelessness, the use of HHH funds to support small facilities such as board and care home expansions, the availability of rental vouchers, and the use of HHH funds to support the Roadmap to Recovery. We welcome the Committee’s questions and thoughts on these issues and will return with recommendations in the coming month.

**Supportive Housing Projects Los Angeles**
**Project Prototypes**

| | Market Rate | HHH Modular Innovation | HHH Standard | Project HomeKey (Permanent) | Project HomeKey (Interim Phase) |
|---|---|---|---|---|---|
| **Costs Per Unit** | | | | | |
| Land or Property Acquisition | $72,500 | $50,500 | $50,000 | $400,000 | $271,000 |
| Hard Costs | $276,750 | $294,110 | $358,500 | $25,000 | $10,000 |
| Financing Costs | $6,800 | $30,570 | $20,000 | $0 | $0 |
| Legal Costs | $1,500 | $1,800 | $1,800 | $1,500 | $0 |
| Related Development Costs | $104,250 | $63,000 | $54,700 | $0 | $0 |
| Operating Reserves | $0 | $15,400 | $15,400 | $15,400 | $0 |
| Developer Fee | $0 | $33,000 | $33,000 | $10,000 | $0 |
| Total Development Costs | $461,800 | $488,380 | $533,400 | $451,900 | $281,000 |
| | | | | | |
| **Funding Sources Per Unit** | | | | | |
| Conventional Bank Mortgage | $346,350 | $51,730 | $125,500 | $75,000 | $0 |
| Equity | $115,450 | $159,000 | $184,000 | $0 | $0 |
| HHH | $0 | $130,000 | $130,000 | $0 | $0 |
| Other City Funding including CRF | $0 | $0 | $0 | $176,900 | $100,000 |
| Other Government Funding | $0 | $147,650 | $96,000 | $200,000 | $181,000 |
| Total Sources | $461,800 | $488,380 | $535,500 | $451,900 | $281,000 |
| | | | | | |
| **Faster Future Alternative Funding Options:** | | | | | |
| Conventional Bank Mortgage | | $51,730 | $125,500 | $75,000 | |
| Equity | | $159,000 | $184,000 | $0 | |
| HHH Funding | | **$277,650** | **$226,000** | **$376,900** | |
| Other Government Funding | | $0 | $0 | $0 | |
| Total | | $488,380 | $535,500 | $451,900 | |

**Notes**

1. Developer return on market rate project usually realized upon sale of project within a few years of stabilized occupancy, not capitalized in development budget.
2. Because cash flow is permanently limited on affordable deals, developer fee and capitalized reserves often included in development budget.
3. Estimate is that prevailing wages adds 22% to total construction costs.
4. Project HomeKey Permanent units included kitchenettes and were in good condition. Residents will prepare meals in units. Operating / staffing cost $20/night.
5. Project HomeKey Interim units in varying conditions. Meals catered in, more on site staffing and services. Operating costs $85/night.
6. Project HomeKey interim conversion costs to permanent to be determined at time of conversion in three to five years.