CITY OF CAMBRIDGE
Community Development Department

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MEMORANDUM

To: Cambridge Affordable Housing Trust
From: Christopher Cotter, Housing Director and Cassie Arnaud, Housing Planner
Date: January 24, 2019
Re: Funding Request for Preservation of Fresh Pond Apartments

Staff is requesting that the Trust approve a preliminary, conditional commitment of up to $18,000,000 in Trust funding to preserve Fresh Pond Apartments. These funds would be paid directly to the owner in exchange for preserving affordability at Fresh Pond Apartments for another 50 years. In addition to the $18 million being requested, it is anticipated that up to an additional $5 million may be needed to capitalize a rent phase-in reserve and to complete the transaction. We have reviewed the details of the proposed preservation plan in depth with the Project Review Committee and they recommended that we bring this request to the Trust for full review and approval, as described below.

Background:
As you may recall, Fresh Pond Apartments is a 504-unit affordable rental development located on Rindge Avenue in North Cambridge. Fresh Pond was built in the late 1960s under a now defunct federal housing finance program which provided below-market financing in exchange for a period of affordability. Approximately two-thirds (338) of the units receive funding through a project-based Section 8 contract through HUD and the remaining 166 units do not receive HUD funding but are kept affordable under the terms of the original affordable restrictions. Those restrictions were extended in 2000 and are due to expire at the end of 2020.

Staff have been in active discussions with the owners of Fresh Pond Apartments on what would be needed for them to agree to extend affordability beyond 2020. The owners have expressed a clear interest in preserving Fresh Pond and have been working cooperatively with staff on a plan.

Preservation Plan:
After assessing a range of possible approaches, we have settled on a plan which involves two main steps.

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The first step is to preserve the 338 HUD Section 8 units by extending the HUD Section 8 contract for another twenty years, the longest period allowable by HUD. The owner will agree to extend the HUD Section 8 contract as long as HUD agrees to increase the Section 8 rents. This rent increase can be achieved through a "HUD Mark up to Market" (MUTM) transaction, an approach which has been used successfully at several other former expiring-use properties in Cambridge. In exchange for our supporting the owner's MUTM request to HUD, the owner will have to agree, in writing, to continue to renew the Section 8 contracts in the future.

The second part of the transaction is to preserve the remaining 166 units which do not receive rental subsidies from HUD. This step will involve paying the owner the difference between the market value of the property if it were to be converted to market-rate after 2020, and the restricted value if it were to remain affordable at affordability levels we determine. In exchange for this "value differential" payment, the owner will need to agree to maintain affordability of these 166 units for another 50 years at affordability levels we determine now.

At this time, we estimate the "value differential" to be between $17 million to $18.5 million. This estimate is based on a set of assumptions, some of which we control, some of which must be negotiated with the owner, and some of which depend on the timing of various aspects of the transaction. For instance, while we can determine the affordability mix, we must reach agreement with the owner on assumptions such as rents, operating costs, and the interest rates used to calculate the value. Similarly, the timing of the MUTM transaction and the levels of rent increases approved by HUD will impact the figure.

We believe that we are close to reaching agreement with the owner on most assumptions, and that the final figure will need to be determined once we know the timing and details the preservation transaction. While we could wait until 2020, when most details will be known, we believe that there is substantial value in reaching agreement with the owner now, at least on methodology and the terms, with the potential option to adjust the final figure up or down before finalizing the transaction. As a result, we are proposing that this request for up to $18 million be conditioned on staff coming back to the Trust to confirm the final funding amount needed.

<u>New Affordability Requirements and Phase-in Reserve:</u>
We are proposing that the new affordability requirements be set to roughly mirror the income mix of existing tenants at Fresh Pond. Using this approach, 90% of units (454 units) would remain affordable to households earning up to 80% AMI, 6% (32 units) would be affordable to households earning 80-100% AMI, and 4% (18 units) would be affordable to households between 100-120% AMI. We may recommend amending this income mix if the income profile of existing tenants changes substantially before we complete the transaction.

In the meantime, we are evaluating the impact which the new income mix will have on existing tenants. While tenants in existing HUD Section 8 units and those with existing Section 8

mobile vouchers should not experience a rent increase, most other tenants will see rent increases as current rents for many residents have been capped at extremely low levels.

In order to help transition these tenants to the rent structure under the proposed preservation plan, we are also developing a plan to create and fund a rent phase-in reserve. The reserve would be held in escrow by a third party and the City/Trust would be able to recapture funds over time if they are not needed. We are still analyzing various phasing options but anticipate offering more generous phasing to lower-income tenants and more rapid phasing to higher-income tenants. In addition, we are exploring ways to incentivize eligible tenants to take, and hopefully project-base, any Enhanced Vouchers which are expected to become available from HUD through the preservation transaction. At this time, we estimate that up to $5 million may be needed for this reserve. We have discussed this approach with PRC and the owner and want to begin discussion of this approach with tenants and advocates.

RECOMMENDATION:

While we recognize that $18 million is a substantial funding request, especially when combined with funding for a phase-in reserve, the successful long-term preservation of Fresh Pond Apartments would be an enormous achievement, ensuring that literally hundreds of low- and moderate-income Cambridge families can remain in the community. While the owner has been open to and supportive of finding a preservation solution, they have the right to convert to market-rate housing if we cannot reach agreement on terms. The cost of losing this affordable resource to the market would be devastating and the cost to replace these 504 units would be prohibitive.

A combined total commitment of $23 million is in line with our previous estimates of funding needed to preserve affordability of the 504 affordable units at Fresh Pond Apartments and what we have used in our funding projections. A commitment of this amount, however, will require appropriation of additional City funds to supplement Trust funds as we have discussed. This preservation transaction would take place in FY2020. We will finalize the plan to fund this commitment in the coming months as we refine the total amount of funding needed, assess revenue available to the Trust in FY2020 and work with the City Manager and City finance team to appropriate additional funds needed to fully fund this commitment.

We discussed the details of the proposed transaction with the Project Review Committee in depth over the course of two meetings earlier this month. After discussion, they recommended that we bring this request to the Trust for review and approval. However, they recommend that approval be conditional and subject to further review as details become more clear.

Specifically, the PRC recommends that the Trust approve the request for up to $18,000,000 in Trust financing for the preservation of Fresh Pond Apartments, as described above and subject to the following conditions:

- The conditional funding commitment should be time-limited and should expire on December 31, 2019 unless staff has brought a final request back to the Trust for final approval;
- Final Trust approval shall be subject to the following:
    - Trust approval of final preservation plan;
    - Trust approval of process for formalizing the preservation plan, such as a Memorandum of Understanding, agreement, contract, or other legal structure;
    - Trust approval of final funding requests for both the "value differential" payment to the owner and the "rent phase-in" capitalization amount;
    - Trust approval of the process for monitoring and maintaining affordability over time, and monitoring use of rent phase-in reserve, including satisfactory provisions for City/Trust to recapture excess rent income and/or reserve funds that are not needed;
    - Appropriation of City funds necessary to fulfill this commitment.