C I T Y O F C A M B R I D G E
Community Development Department

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MEMORANDUM

To: Cambridge Affordable Housing Trust
From: Project Review Committee
Date: February 27, 2020
Re: Preservation of Fresh Pond Apartments, 362-364 Ridge Avenue, Cambridge

In January 2019, the Trust made a conditional commitment of funding for the preservation of affordability at Fresh Pond Apartments with the understanding that we would come back to the Trust to update and finalize the request once the preservation plan was in final form. We are pleased to report that after years of discussion and negotiation, agreement on terms has been successfully reached with the owner and the plan to preserve all 504 units is ready to be finalized.

Background:
Fresh Pond Apartments is a 504-unit affordable rental development built in the late 1960s under a now-defunct federal program which provided below-market financing in exchange for a period of affordability. The Fresh Pond units have been kept affordable under the terms of an affordability restriction (Use Agreement) among the owner, City and HUD. The Use Agreement has required two type of affordability at the property:

- *HUD Section 8 units*: approximately two-thirds (338) of the units have been subsidized through a project-based Section 8 contract with HUD

- *BMIR units*: the remaining one-third (166) of the units have been kept affordable at "BMIR" rent levels set by HUD. BMIR refers to a HUD program called the "Below Market Interest Rate" program. In addition, the owner has been required, under the terms of the Use Agreement, to rent up to 40 of the BMIR units to CHA voucher holders. At the most recent count, there were 35 CHA voucher tenants at the property.

The Use Agreement was amended in 2000 and is due to expire on December 31, 2020.

It has been a top priority of the City to preserve and extend affordability at Fresh Pond beyond 2020. The following memo outlines the preservation plan and final request for Trust funding.

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Preservation Plan and Updated Funding Request:

As you may recall, the preservation plan involves two parts:

Preservation of HUD Section 8 units: The first step, which is already in process, is to preserve the 338 HUD Section 8 project-based units through a Mark Up To Market (MuTM) transaction, whereby the owner will enter into a new 20 year Section 8 project-based contract with HUD, the longest period currently allowable by HUD, in exchange for higher Section 8 rents. The owner submitted a MuTM application to HUD last year and has just been informed that the application has been approved and the new 20 year contract is now being finalized. No City or Trust funding is needed for the MuTM transaction and existing tenants in HUD Section 8 units will experience no change in rent.

Preservation of BMIR units: The second step is to preserve the remaining 166 units by providing a direct payment to the owner which reflects the difference in value between the units if they were to be converted to market-rate housing and the units if they were restricted as affordable. In exchange for this "value differential" payment, the owner will maintain affordability of these units for another 50 years at affordability levels determined by the City.

While the general preservation approach is unchanged from what was presented to the Trust last year, the implementation details have had to be adjusted on multiple occasions in response to a series of external circumstances such as increases in market rents and changes to HUD program policies. While some changes had the potential to reduce the amount of Trust funding needed, subsequent changes unfortunately more than reversed those benefits. As a result of these factors, the "value differential" payment has increased since last year. The most recent calculations result in an affordable value of $22,443,877 compared to a market value of $57,764,23 for the BMIR units. As a result, the owner has requested $35 million to preserve the 166 BMIR Units.

In addition to the $35 million needed to buy down affordability of the 166 BMIR units (the "value differential" payment), it is estimated that up to $5 million be set aside for a rent phase-in reserve to transition current tenants to the new affordability structure.

As a result, it is anticipated that a total of $40 million in Trust funding will be needed to successfully complete the preservation of Fresh Pond Apartments.

We are therefore now requesting that the Trust commit up to $35 million to preserve the affordability of the 166 BMIR units, and up to $5 million to establish a reserve to assist in transitioning residents from current rents to rents under the new affordability program. Funding for this combined commitment of up to $40,000,000 should be made available from the following Trust funds:

- $8,175,000 in City budget funds (FY 19 & FY20 permit fees);
- $5,000,000 in City budget funds (FY 20 taxes);
- $8,500,000 in incentive zoning funds;
- $3,325,000 in Community Preservation Act funds;

$15,000,000 in City funds pursuant to a special appropriation to the Trust to be considered by the City Council on March 2, 2020.
The remainder of this memo provides more detail on the preservation plan.

New Affordability Requirements

The preservation plan involves establishing new affordability requirements based on the income profiles of current BMIR tenants. The new tiers are: under 80% AMI, 80-100% AMI and 100-120% AMI. The majority of current BMIR units will remain under 80% AMI. The Section 8 units, including units currently occupied by voucher holders, will also remain under 80% AMI. The following tables summarize the anticipated future affordability breakdown at Fresh Pond:

Proposed affordability requirement at FP:				
	<80%	80-100%	100-120%	Total
1BRs	125	2	1	128
2BRs	314	13	9	336
3BRs	38	1	1	40
Total:	477	16	11	504

Proposed affordability by % at FP:				
	<80%	80-100%	100-120%	Total
1BRs	24.8%	0.4%	0.2%	25.4%
2BRs	62.3%	2.6%	1.8%	66.7%
3BRs	7.5%	0.2%	0.2%	7.9%
Total:	94.6%	3.2%	2.2%	100.0%

It is unlikely these tiers will perfectly match the tenancy in place at the time of the closing of the preservation transaction, as units will turnover and incomes will change. As we prepare for the closing, we will develop procedures for certifying tenant incomes and adjusting affordability tiers as needed. For instance, if there are a greater number of over 80% tenants than currently assumed, one option could be to add more middle-income units to the project which would result in a reduction in funding provided to the owner to reflect a lower value differential. Likewise, if there are more under 80% tenants than currently assumed, the number of low-income units could be increased, potentially requiring an additional payment to the owner to reflect a larger value differential, or an alternative solution could be pursued such as relocating the household to an available project-based unit.

Current Rents, Future Rents, and Rent Phasing

Current Rents at Fresh Pond:

Section 8 Rents. Approximately 75% of tenants at Fresh Pond (373) are living in either a project-based Section 8 unit or have a Section 8 mobile voucher and pay rents which equal 30% of their income. As rents are adjusted annually, all tenants in Section 8 units are paying 30% of their income on rent.

BMIR Rents. The remaining 25% of tenants (131) pay a flat "BMIR" or "BMIR Market" rent. The BMIR rent is set by HUD. The BMIR market rent is equal to 110% of the BMIR rent and is paid by tenants who are either over income or who decline to income certify.

	2019 BMIR Rent	2019 BMIR Market Rent
1BR Rents:	$1,033	$1,136
2BR Rents:	$1,220	$1,342
3BR Rents:	$1,330	$1,463

At present, most tenants in BMIR units are paying at or below 30% of their income on rent, including 33% who are paying less than 20% of their incomes on rent. However, there are some tenants whose rent is over 30% of their income. In some cases, cost-burdening is tied to cases of over-housing (e.g. 1 person living in a 2-bedroom). However, efforts are being made to secure rental subsidies for eligible cost-burdened households in advance of the preservation transaction.

Rent/Income Ratio	*< 20% R/I*	*20-30% R/I*	*30-35% R/I*	*35-50% R/I*	*>50% R/I*
# Units	*43*	*61*	*7*	*11*	*7*
% Units	*33%*	*47%*	*5%*	*9%*	*5%*

Proposed New Rents for Fresh Pond:

Section 8 Units: no change; tenants will continue to pay 30% of their income on rent

BMIR Units: new flat rents will be established. Existing tenants will be phased to the new rents. Future tenants will pay the full rent at initial occupancy. The flat rents for each tier are based on 30% of HUD area median income (AMI) of a prototypical household (1.5 persons per bedroom) and are set below the maximum AMI to ensure a window of affordability:

- Under 80% rents are set at 70% AMI
- 80-100% rents are set at 90% AMI
- 100-120% rents are set at 105% AMI

The following table summarizes what those new tier rents would be using HUD 2019 AMI figures and the above-described methodology:

Sample Tier Rents (2019 AMIs)			
	<80%	80-100%	100-120%
1BR	1,487	1,911	2,230
2BR	1,785	2,295	2,678
3BR	2,062	2,652	3,094

Proposed Rent Phasing

Consideration has been given to the impact which the new affordability requirements will have on existing tenants. Phasing will not be needed for tenants in HUD Section 8 units and those with existing Section 8 mobile vouchers as they should not experience rent increases. However, rents for most other tenants will increase as the BMIR rents have been capped at extremely low levels.

At this time, it is estimated that $5 million should be set aside to capitalize the rent phase-in reserve. As tenant incomes are certified and the details of the phasing plan are finalized, it is possible that less funding will be needed in which case the commitment would be reduced. The Trust will control the rent phase-in reserve and will have the right to recapture unused rent phasing funds after all tenants eligible for assistance have transitioned to new rent amounts.

An initial rent phasing plan has been developed, based on the following considerations:

- Lowest income tenants should be phased most gradually
- Highest income tenants should be phased most quickly
- Efforts should made to avoid significant rent increases, particularly in the early years
- Phasing will continue for a maximum of 10 years (through 2030)
- Phasing will only be offered to existing tenants in BMIR units on the date of preservation (i.e. new tenants will pay the full tier rent)
- Phasing plan must be financially feasible to implement

In addition, the following are being considered and will likely be incorporated into the final plan:

- Different phasing will be considered for cost-burdened tenants who cannot access Section 8 resources which would bring rent down to 30%
- Different phasing may be considered for existing tenants whose income exceeds 120%
- Different phasing may be considered for tenants who are underhoused (e.g. 1 person living in a 2BR)
- Asset limits will be established and may impact eligibility for assistance
- Prohibitions will be established for tenants who might own residential property and may impact eligibility for assistance
- Different phasing may apply to tenants composed of unrelated roommates (upon turnover, units will be filled according to the City's tenant selection preferences including prioritizing family-sized units for households with children)

Our initial phasing approach would cap rent increases as follows for tenants living in BMIR units at the time of the preservation closing:

"STANDARD" RENT PHASING –					
	<50% AMI Tenants	50-80% Tenants	80-100% Tenants	100-120% Tenants	120%+ Tenants
Year 1 (2021)	3%	3%	5%	10%	33%
Year 2-Y10 (2022-2030)	5%	10%	15%	20%	33%

<u>Enhanced Vouchers / increasing CHA project-based units</u>

The property may be eligible for Enhanced Vouchers from HUD for each of the 166 BMIR units. Enhanced Vouchers (EVs) are made available to income-eligible tenants in certain types of expiring use buildings. Staff have had discussions with the CHA on how best to employ EVs at this property if EVs they are available. If available, the project might receive more EVs than can be initially used as some tenants might either decline or not be eligible for an EV. In this case, we expect that the CHA could increase the number of CHA project-based vouchers as units turn over. This would greatly benefit the project by creating additional deeply subsidized units and might allow for the repayment of some Trust funds as rents for project-based units are greater than the tier rents under the new affordability program.

Discussions are underway, but at a minimum, the EV resources would be used to protect affordability and assist with rent phasing. If the project can secure EVs, "special phasing" could be offered to incentivize tenants to take advantage of these HUD resources while they are available.

RECOMMENDATION:

The successful long-term preservation of Fresh Pond Apartments has been a top priority of the City for many years and will ensure that many 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 to extend affordability. The cost of losing this affordable resource to the market would be devastating and the cost to replace these 504 units would be prohibitive.

The commitment of $40 million is an extraordinary step. Staff will continue to seek opportunities to reduce the need for Trust funding as the transaction is finalized, and expects that a portion of the Trust funding will be able to be recouped over time through repayment of revenue in excess of targets agreed upon with the owner and the recapture of unused funds in the rent reserve.

Accordingly, the PRC recommends that the Trust approve this request for up to $25 million in Trust financing for the preservation of Fresh Pond Apartments, as described above and subject to the following conditions:

PROPOSED FRESH POND FUNDING REQUEST(s) VOTE:

The PRC recommends that the Trust approve the request for up to $40 million in financing for the preservation of Fresh Pond Apartments, as described above and as subject to the conditions below. This funding will be made available from the following Trust funds:

- $8,175,000 in City budget funds (FY 19 & FY20 permit fees);
- $5,000,000 in City budget funds (FY 20 taxes);
- $8,500,000 in incentive zoning funds;
- $3,325,000 in Community Preservation Act funds;
- $15,000,000 in City funds to be appropriated to the Trust pursuant to a special appropriation to be considered by the City Council on March 2, 2020.

Funding of the Rent Phase-In reserve shall be conditioned on the following:

- Rent Phase-in reserve will be held by the Trust, the City or by a third-party entity acceptable to the Trust
- Rent Phase-in reserve will be capitalized in an amount adequate up to $5 million to meet anticipated rent phasing needs over a period of no more than ten years, as determined by staff and agreed to by owner;
- Development of procedures for disbursing funds to owner from reserve and for recapturing unused funds by the Trust, acceptable to staff;

Funding of the Value Differential will be conditioned on the following:

Loan(s) shall be subject to standard Trust terms and conditions including, but not limited to:

- All 504 units will be subject to a new affordable housing restriction, to include the following requirements:
    - Owner agrees to maintain affordability of 166 existing BMIR units for 50 years at affordability levels agreed to at closing;
    - Owner agrees to finalize the new 20-year Section 8 Mark up to Market contract with HUD to extend affordability of the 338 Section 8 units for 20 years, and to continue to renew the Section 8 contract for the longest period allowable as long as the MuTM program, or other similar program, continue to exist;

- Loan(s) will have an annual interest rate of 3%, or such other rate approved by CDD Staff, and a term of 50 years;
- Loan(s) will be subject to a penalty rate of 8%. The penalty rate is only applied upon violation of the affordability restriction;
- Payments of "excess rental income" will reduce the outstanding principal balance; "excess rental income" will be defined in the loan documents and represents the difference between the affordable rents used to calculate the initial Value Differential, trended, and the actual rental income received for those affordable units;
- All unpaid principal and accrued interest shall be due at maturity with an option for repayment to be further deferred if the term of affordability is extended beyond the initial 50-year affordability period;
- Staff approval of provisions for Trust recapture of excess rental income and rent phase-in reserve funds;
- tenant selection plan and internal transfer plan acceptable to staff;
- Loan shall be non-recourse.

In addition, the following special conditions shall apply to the funding of the Value Differential Payment:

- Staff approval of final affordability mix for the 166 non-Section 8 units, which may be adjusted to reflect updated information on the current income profiles of existing tenants;
- Staff approval of final Value Differential amount, which is expected to be $35 million but which may be adjusted at discretion of City staff to reflect changes to the final affordability mix and/or 2020 HUD Area Median Income figures;
- Development and approval of written procedures for implementing the new affordability program, including:
    - procedures to report on and monitor affordability;
    - procedures to monitoring uses and balances of the rent phase-in reserve;
    - provisions for City/Trust recapture of excess rental income and rent reserve funds.