

# Preserving Permanent Supportive Housing in Los Angeles:

## What Will It Take?



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## Acknowledgments

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## PSH Preservation Working Group

Enterprise values the ongoing partnership and intellectual contributions of the Los Angeles Permanent Supportive Housing (PSH) Preservation Working Group, whose members are listed below. The experiences, knowledge and housing portfolios of this peer exchange were instrumental to our ability to comprehend and articulate the challenges and opportunities of preserving an aging PSH portfolio in Los Angeles.

A Community of Friends	LA Family Housing
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Hollywood Community Housing Corporation	SRO Housing Corporation

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## About Enterprise Community Partners

Enterprise is a proven and powerful nonprofit that improves communities and people’s lives by making well-designed homes affordable. We bring together the nationwide know-how, partners, policy leadership and investments to multiply the impact of local affordable housing development. Over 35 years, Enterprise has created nearly 470,000 homes, invested \$28.9 billion and touched millions of lives. Join us at [www.EnterpriseCommunity.org](http://www.EnterpriseCommunity.org).

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## Introduction



**P**reservation of permanent supportive housing (PSH) should be viewed as a necessary and complementary tool in the affordable housing toolbox and an integral step in the Los Angeles County region’s long-term goal of ending homelessness. Sustaining these vital nonprofit-owned, project-based community resources for the long-term allows Los Angeles to realize the growth and adaptation in the homeless delivery system that was envisioned with the passage of Proposition HHH and Measure H.

PSH programs serve as ground zero for the execution of the Housing First model – our collective efforts to move chronically homeless populations directly from the streets or shelter into permanent housing. Reinvesting in and modernizing our aging PSH stock will help Los Angeles fulfill its strategic homeless policy goals as well as the pledge made to voters to sufficiently resource the delivery system with evidence-based strategies like PSH.

Reinvestment and modernization also can help strike a better balance between PSH production and preservation needs, while achieving the following important public outcomes.

- Strong PSH assets are sound financially over the long-term horizon of ownership and are modernized physically to meet the new demands of serving high-acuity households.
- Sustainable organizations have the resources and technical expertise to adapt and thrive in a housing-first environment, to manage and reposition aging portfolios, and have the capacity to accelerate development pipelines to meet increased production targets.
- The most vulnerable homeless are supported in their transition from streets to home in an environment where they can thrive and succeed in rebuilding their lives.
- An efficient housing delivery system is aligned across jurisdictions, demonstrates strong portfolio and risk management, and balances the allocation of public resources to achieve shared production and preservation goals.

Within this framework, there are more discrete benefits to establishing preservation as a public priority. It is considerably less expensive (by a margin of 30-50 percent) than new construction and allows high-cost communities like Los Angeles to add or extend affordability protections well into the future.



Preservation allows committed, mission-driven nonprofit owners that acquired properties over 20 years ago to:

- Modernize aging building infrastructure, particularly in three key areas that in the last two decades have seen new policy standards instituted at the federal, state, and local levels:
  - Energy-efficiency
  - Accessibility
  - Seismic upgrades
- Restructure insufficient, dated rental subsidies that did not keep pace with increases in inflation and that contemplated units targeted to homeless individuals who needed light services but in the last decade been redirected to the chronically homeless with no increased subsidy rates to cover security, higher case management costs, and more wear and tear on the units.<sup>1</sup>
- Secure funding to adequately address heightened case management and security needs, while lowering turnover rates and bad debt collections.

Regulatory affordability commitments may typically run for 55 years, yet actual planning for the property’s physical and/or financial viability is closer to 30 years. Preservation also allows new and current residents to make strides toward their housing stability and self-sufficiency goals. Modernizing PSH helps to ensure low-income, formerly homeless residents have clean, safe affordable homes. Improved building systems (e.g., heating, plumbing, electrical) and amenities (e.g., laundry, lighting, green spaces, security and accessible entries) also improve the health and quality of life for many residents, especially people who are in recovery, grappling with mental health issues or facing other serious medical conditions.

We cannot increase the supply of PSH unless we safeguard the PSH stock we already have. Project-based permanent supportive housing (PSH) developments are the bedrock of the homeless delivery system in Los Angeles County. Yet, a substantial amount of the existing project-based PSH inventory faces long-term sustainability challenges. Of the five Los Angeles area PSH developers that we surveyed for our analysis, 25 percent of their portfolios is in some state of physical and/or financial risk, with approximately 1,300 units that must be preserved within the next five years.

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1. Restructuring rental subsidies is focused on increasing rental income and generating cash flow to sustain long-term operations.



Interest in at-risk PSH follows earlier research on the PSH financing system in Los Angeles. In 2014, Enterprise analyzed project performance data for 39 PSH developments in the greater Los Angeles area.<sup>2</sup> The analysis concluded that while the vast majority of projects demonstrated strong financial performance over the initial life of the project (15 years), only six properties in the sample could expect to operate successfully (i.e., generate positive cash flow and reserve balances) through the 40-year extended-use period in California without some level of capital improvements.

In 2016, Enterprise launched the Los Angeles PSH Preservation Initiative to provide leadership and mobilize the PSH development community around the consensus on capacity building and public policy solutions. This report documents what we learned from this effort. It illuminates the importance of PSH preservation as a critical step in the region's multilayered homelessness response, the uniqueness of the aging Los Angeles PSH portfolio, and what is at stake if we do not respond in a more strategic way.

The document concludes with specific public policy recommendations, framed around six primary objectives:

1. Set specific targets and priorities for preservation efforts.
2. Protect expiring affordability covenants.
3. Mitigate operating cost escalations.
4. Establish dedicated or prioritized capital resources.
5. Ensure rent subsidies are flexible, sustainable and attached to all unsubsidized units.
6. Align funder policies.

These steps and others must be guided by one clear principle: Preserve the greatest amount of at-risk PSH units with the least amount of resources.

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2. Marc Tousignant et al., Financing Permanent Supportive Housing in Los Angeles: Challenges and Opportunities in a New Era. Los Angeles, Calif.: Enterprise Community Partners, 2014. [www.enterprisecommunity.org/resources/financing-permanent-supportive-housing-los-angeles-challenges-and-opportunities-new-era](http://www.enterprisecommunity.org/resources/financing-permanent-supportive-housing-los-angeles-challenges-and-opportunities-new-era)

## The Case for Preserving Permanent Supportive Housing in Los Angeles



Los Angeles needs a strategic PSH preservation program. The absence of such a program reflects a few factors, including the novelty of this work in the public finance sphere, which has historically been transaction-focused to address project recapitalization needs individually. In addition, state and local leaders often are understandably reluctant to divert limited public resources from the production pipeline amid pressure to accelerate development.

However, state and local policymakers have shifted their focus in recent years to investing valuable capital resources in the creation of new PSH units with long-term rental assistance and integrated case management services. PSH production is projected to triple in the coming years. However, even with this influx of desperately needed resources, there are concerns about the PSH development community's capacity to meet production targets while many of these same owners are challenged with sustaining aging housing assets that are at breakeven operations or facing chronic deficits.

Policymakers and funders must embrace a PSH strategy that extends beyond jurisdictional and departmental lines and recognizes the unique challenges with the aging PSH inventory. More education is critical to helping them identify the risks and consequences of inaction.

Best practices have evolved since the earliest site-based PSH was developed decades ago. The earliest supportive housing projects were neither structured financially nor designed physically to meet the modern demands of delivering PSH to today's high-acuity, chronic homeless population. Original building designs lack proven elements of success such as sufficient onsite space for supportive services personnel and programming.

Without public policy interventions, physical improvements and financial investment, these assets will remain negative or marginal performers and unsustainable for the mid- to long-term. It's important to take measures to ensure stability of the homelessness delivery system and support the health, safety and housing security of our most vulnerable citizens. The following sections describe these factors in greater detail.

## Physical factors

The greatest peril at the physical level is a need to modernize apartment buildings that have been in existence for nearly a century. The earliest PSH properties were acquisition/rehabilitation projects from the 1980s and 1990s, and, for the most part, represent a building stock that was originally constructed long before that era. For example, one of the largest PSH developers in the region reported that 76 percent of its portfolio was constructed from 1907-1952, with the largest share dating to the 1920s.

At the time of acquisition, nonprofit owners performed moderate rehabilitation due to limited tax credit and public capital financing and high interest rates on conventional debt limited borrowing. This resulted in less-efficient energy systems, little or no seismic reinforcement and fixtures and finishes that were less durable. Design programs for affordable housing were limited, and supportive housing was a new concept for which little consideration was given to the location of common areas and back office spaces as they related to the delivery of on-site services.

Buildings that accessed public debt through the state of California or city of Los Angeles, and were syndicated through the Housing Credit program (LIHTC), despite 55-year restrictions, the scope of rehab and the financial structure insured viability for only the initial 15 years of compliance. In the early days of the LIHTC program, the replacement reserves required were only \$250 per unit per year, and rehab projects were not required to have capitalized replacement reserves in the development budget.

Fast forward to today: Public lenders require permanent supportive housing to fund replacement reserves at twice the levels (\$500 per unit per year), and if it is a rehab project, then one year of replacement reserves must be capitalized in the development budget. In addition, public agencies have stricter design standards and requirements for the use of more sustainable materials and the inclusion of more amenities. Because of these new requirements, projects developed in the last decade have a better chance

of positive cash flow between years 20 and 30 years of operation than the first 15 years of projects funded under LIHTC from 1986 to 2000.

Another modernization concern endemic to the aging PSH stock is that not all projects meet modern accessibility standards, such as those set forth by the Fair Housing Act, which requires all “covered multifamily dwellings” designed and constructed for first occupancy after March 13, 1991, to be readily accessible to and usable by persons with disabilities. However, accessibility standards were being refined through that decade culminating with The Fair Housing Act Design Manual (“Design Manual”) (August 1996, revised April 1998). As a result, not all PSH properties constructed in the 1990s conform to Fair Housing design standards.

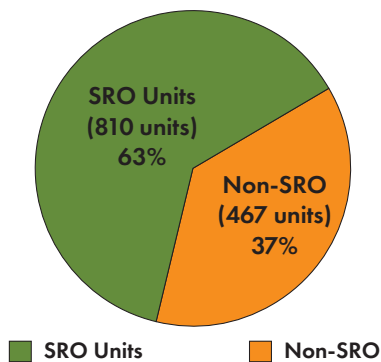
Generally, in affordable housing financed or assisted by a program administered by the city or CRA/LA, including bond financing, the housing provider is responsible for the costs associated with a reasonable accommodation or modification for accessibility. These older PSH projects often do not generate cashflow or have the resources to cover the cost of reasonable accommodations or modifications, and are exposed to lawsuits for not meeting Fair Housing design standards.

Today, there are a range of rehabilitation needs associated with this aging PSH inventory. Except for a small minority of aging PSH buildings (approximately 30 percent) that were new construction and/or can still generate sufficient cash flow and healthy reserves, nearly all will require outside investment to complete overhauls of aged building systems – HVAC, mechanical, electrical and plumbing – as well as ADA upgrades and other improvements related to energy-efficiency. Even the plethora of SRO-style buildings, those with shared baths and kitchens that are emblematic of the earliest PSH models in Los Angeles, require unit-specific and common space reconfiguration to be eligible for any additional public investment.



The review of a recent PSH resyndication project that packaged two distressed SRO buildings illustrates the breadth of physical needs within this inventory. Improvements included the following scope of work: enhanced community rooms and renovated outdoor courtyards; new HVAC, including cooling and heating; new appliances in units, including refrigerators and microwaves; additional supportive services spaces; all new plumbing systems, including new sinks, toilets and bathroom renovations; major electrical systems upgrades; new furnishings in units and common areas; energy and water efficiency upgrades, including solar panels and solar hot water systems; and accessibility upgrades, including the addition of an elevator in one of the buildings.

**Property Configuration: SRO Units**



A case for the preservation of a subset of classic SRO-style hotels has also been made by committed owners and residents. There are some older and smaller properties where the loss of a significant number of rooms that house extremely low-income tenants would result in their displacement should these SROs be banned and unless they are reconfigured to accommodate efficiencies. With modest physical improvements of \$15,000 to \$35,000 per unit, these SRO hotels could continue to provide adequate housing for another 30 years for some extremely low-income residents who would otherwise become homeless. About 600 units within these classic SRO hotels currently have no recapitalization options and have maturing or matured CRA loans that threaten the credit rating of their owners. Without the ability to either roll over or obtain forgiveness of any of these old CRA loans, these properties will remain in limbo as they near the end of their current useful lives. (See Appendix A for more information.)

**Financial factors**

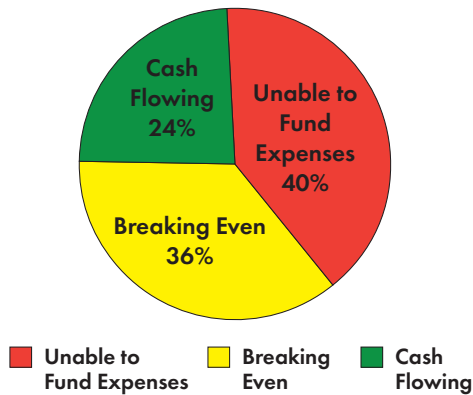
Upgrading the physical infrastructure in older developments is just one facet of preserving the region’s PSH stock – one that is less effective without first resolving the structural financial feasibility challenges associated with these assets. Significant underfunding of operations and inadequate case management funding are two sources of financial stress. The issue has been exacerbated by the emphasis in recent years on dedicating (or incentivizing) available PSH toward individuals or families who qualify as chronically homeless because this population generally entails higher costs due to the need for supportive services and potentially higher operating costs unanticipated during the underwriting process.

Moreover, if formerly homeless residents cannot secure VA and other benefits that were anticipated during the underwriting process, PSH owners have limited options when it comes to absorbing the higher costs because their capital and operating subsidy contracts have been set. In addition, the nascent Coordinated Entry System requires them to accept higher acuity referrals.

Older PSH developments were typically coupled with HUD McKinney-Vento Continuum of Care (CoC) operating and rent subsidies, namely through the Shelter Plus Care, SRO Mod Rehab Section 8, and/or Supportive Housing Programs. These grants were awarded at contracted amounts that were not increased upon subsequent contract renewals. In the 1990s, these contracts were awarded as project-based and sponsor-based rental assistance for terms ranging from three to 10 years. As the McKinney program faced Congressional budget restrictions in the early 2000s, contract awards were eventually limited to just one year with annual renewal options, thereby increasing the perceived risk of lenders and investors financing new projects and requiring new reserves to address the increased appropriations risk.

Only recently have project sponsors received cost of living adjustments (COLA), which is standard today in project-based Section 8 contracts. Under the McKinney contracts, owners had to request annual increases, unlike project-based Section 8 contracts where the housing authorities automatically review rent increases annually. However, many sponsors did not know the process to request

### Financial Health (by projects)



increases under the McKinney contracts. Once supportive housing owners became aware, and requested increases, adjustments were only for that year and there was no “catch-up” provision, negatively impacting the long-term financial health of these projects.<sup>3</sup>

The gap also has been hard to fill with participant rent because of a 2011 federal policy shift that required these subsidies to be prioritized to those who are chronically homelessness and likely to lack any source of income. Many do not qualify for SSDI or VA benefits, for example:

- Disability benefits will not be paid if a person’s disability is mainly caused by drug and/or alcohol abuse – if the person is still using drugs or alcohol.
- An ineligible immigrant status disqualifies a person from SSDI benefits.
- If a homeless veteran’s discharge or service is other than honorable (i.e., must be honorable, under honorable conditions, general), they are not eligible for service-connected and general disability payments that can range from \$133 to over \$3,300 a month.

### Public policy factors

The physical and financial barriers that define the PSH preservation threat have grown more significant with the confluence of related public policy shifts that govern the region’s homelessness response. The federal emphasis on housing first, targeting PSH capital and operating resources to those experiencing chronic homelessness, and the mandate for CoCs to establish Coordinated Entry Systems (CES) to standardize and coordinate assessment and intervention strategies have served to recast the mold in which PSH operates within the homelessness delivery system.

What has emerged in the wake of these changes is an intentional shift to house a tenant population that is more vulnerable (aka high-acuity) and in need of intensive case management and clinical care, which necessitates higher operating costs and supportive services demands. PSH providers estimate that certain operating cost line items (e.g., maintenance, pest control, security) have jumped to 25-50 percent on average in the past two years alone. These factors – housing and servicing high-acuity residents and escalating operating costs – put an added strain on PSH developments (and owners), which is especially profound in older PSH buildings with little to no financial margin to spare.<sup>4</sup>

Even though CES has been operating since 2013 in Los Angeles, the system’s effect on PSH project performance, occupancy and residential stability is just beginning to emerge. By design, the system prioritizes the highest acuity households for placement into PSH. That is a positive outcome from the standpoint of a community calibrating client need with its most service-rich affordable housing assets. CES presents a fundamental shift for PSH providers: housing a high-acuity population and transferring facets of the marketing and lease-up functions away from their direct oversight to a network of community-based matchers

3. The HUD rental assistance contract amount is calculated based on Fair Market Rents (FMR) without factoring in program participant rent contributions. Tenants are required to pay approximately 30 percent of their income in rent. Therefore, projects with CoC may have funds remaining after paying rent and other eligible activities. When rental assistance funds are remaining, a PSH owner may use excess rents to cover rent increases, as long as the unit rent still meets rent reasonableness standards, even if it exceeds FMRs. These CoC subsidies can also cover 30-day vacancy payments. If the owner pays rent beyond FMR levels for some units in a project, and/or vacancy payments, they must ensure they have sufficient funding to serve the contracted number of program participants for the remainder of the grant term. This cannot be done by the annual contract awards increasing (contract rents were capped), it must be financed through program participant rent contributions or lower rents in other areas of the community. The shortfalls in subsidies not fully covering expenses has grown over time as stagnant CoC contract rents fell well below market and program participant rent contributions could not fill the gap.

4. An Enterprise analysis of 33 of the oldest nonprofit-owned, project-based PSH developments in Los Angeles (defined as at least 20 years since initial acquisition/rehabilitation) found that 75 percent of properties are at breakeven operations or are unable to fund expenses and reserve deposits.

and housing navigators. This shift has resulted in significant (and often financially burdensome) delays in processing new referrals as existing units are turned over and re-leased through the system.

PSH owners, particularly those with less experience serving chronically homeless populations, also report insufficient case management capacity to stabilize tenants who often come to them after living for years on the streets or cycling in and out of institutional settings. Owners describe higher resident attrition rates within the first year of tenancy (between 10-25 percent of CES referrals) and more deaths among newly housed chronically homeless residents than ever before.<sup>5</sup>

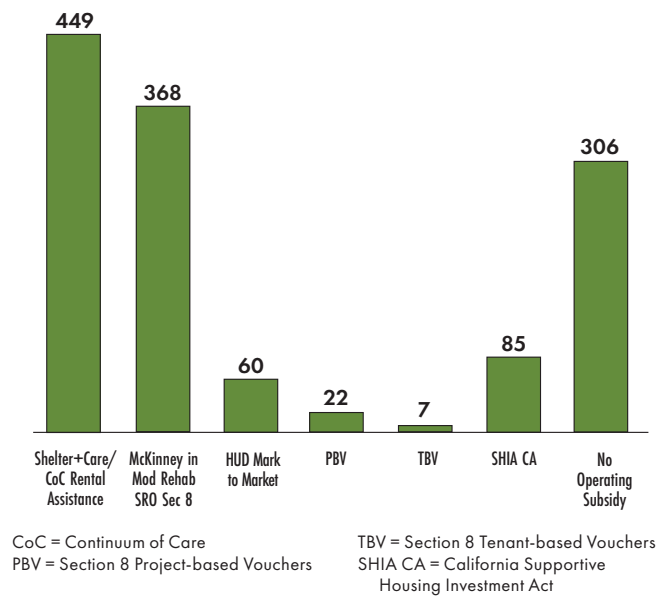
For the PSH development community, as contract rents have stagnated, the focus on serving the chronically homeless has come without corresponding new supportive service funding or higher subsidy contract rents. While the former is the subject of the proposed change that would come from implementation of Measure H, concerns remain regarding the lack of alignment among capital funders with respect to allowances for supportive services expenses within program guidelines.<sup>6</sup>

If a building secures a project-based Section 8 or Veterans Affairs Supportive Housing (VASH) contract, for instance, public lenders and the Federal Home Loan Bank Affordable Housing Program have different criteria for: 1) capitalizing social services reserves in development budgets; and 2) the amounts of annual cash flow distributions that can pay for resident services ahead of scheduled loan payments (and always after public loan servicing fees). This lack of program alignment can negatively impact project syndication and/or the restructuring of debt on existing PSH projects. Only the Los Angeles County Flexible Housing Subsidy Pool covers operating expenses and service dollars to sufficiently support the transfer of chronically homeless to independent living, supporting their efforts to break the cycle of homelessness.

The principal fundraising dilemma for PSH preservation projects is an apparent “catch-22.” PSH preservation projects are no longer competitive or eligible for new homelessness assistance funding through state or local capital funding programs because the projects’ formerly homeless and chronically homeless residents are (by definition) housed, even though these developments receive PSH subsidies and assisted units are still restricted upon turnover to persons experiencing homelessness.

Even new affordable housing capital streams coming online, such as the state’s No Place Like Home (expected in 2018) and the city of Los Angeles Proposition HHH (fall 2017) programs, which grew from public pressure to expand the supply of project-based PSH, reaffirm this public preference to create new PSH units for households currently experiencing homelessness. Proposition HHH expressly only supports new developments. In the end, PSH owners are left with limited options to reposition aging PSH buildings unless they choose to undergo costly relocations or execute highly coordinated, phased construction schedules.

### Operating Subsidies (by units)



5. Rent payment ends the day the person died, but the unit may be offline for two months if the Los Angeles County coroner comes in and environmental clean-up of the unit is needed. As noted above, the McKinney/CoC contracts could finance up to a 30-day vacancy, but only if there were sufficient funds in the contract, which is rare. If a unit is under a project-based Section 8 contract, sometimes the Housing Authority may insert vacancy loss payments in the AHAP/HAP agreement. HUD allows 60-day payment for 80 percent of the contract rent. The County Flexible Subsidy Program does not have vacancy loss payments.

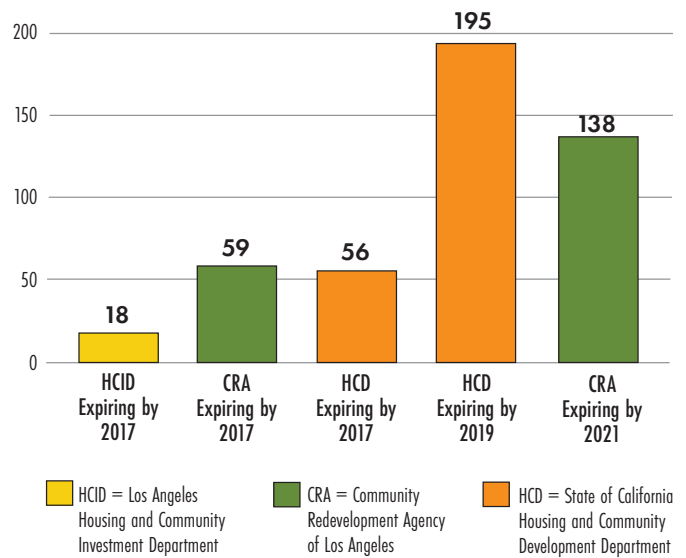
6. The approved funding recommendations for Measure H, authorized by the Los Angeles County Board of Supervisors in June 2017, include up to \$7.5 million in first-year funding to augment on-site supportive services in existing PSH. The County Health Agency estimates that this funding could cover Integrated Case Management Services (ICMS) for up to 2,000 current PSH households.

# L.A.'s Aging PSH Portfolio: A Closer Look

A key facet of the Los Angeles PSH Preservation Initiative has been the creation of the Los Angeles PSH Preservation Workgroup, comprised of seven of the leading nonprofit PSH developers in the region, including five that carry the largest (and oldest) inventory of PSH, representing more than 6,000 units.<sup>7</sup> To inform our public policy recommendations and ensure that they respond to the unique characteristics of this earliest cohort of project-based PSH in Los Angeles, we compiled information about each preservation project<sup>8</sup> that is owned and operated by a workgroup member, to better understand the characteristics of these properties.

To date, we have identified 1,297 aging PSH units within 33 projects that are owned by five nonprofit affordable housing development organizations. With the exception that all the projects are located within the city of Los Angeles, the respective portfolios are hardly uniform from one organization to the next, which inhibits broad generalizations about trends and themes. Nonetheless, analyzing the aging PSH cohort offers some important observations that should inform preservation strategies being considered by state and local housing officials. These are described briefly on the following page.

**Expiring Affordability Covenants (by units) as of September 2017**



7. Enterprise has been convening this workgroup since January 2016 to foster a practitioner-oriented peer exchange unique to PSH preservation needs. The group has also been instrumental in providing input and guidance on the initiative’s capacity building and public policy agenda. We have been collecting project-level preservation data for each member of the workgroup, through a preservation project tracking tool, which led to the identification initially of more than 1,600 units that are considered at-risk and that members are seeking to reposition within the next five years. Two organizations in the workgroup have “younger” inventories (e.g., have not yet reached Year 15) and thus were not included in this analysis

8. “Preservation project” is defined as one that requires refinancing or recapitalization in the next five years, according to estimates by the building owner. The capacity and appetite for undertaking preservation projects varies significantly across these organizations. As reference, one organization alone has a five-year recapitalization strategy to rehabilitate 14 of its aging PSH properties by 2020, with the goal to create a stronger real estate-owned schedule, portfolio performance record, and balance sheet, in turn assisting the organization in the continuation of its role in developing new PSH. This agency is at the forefront of the PSH preservation movement, having adopted a long-term vision along with creating personnel positions unique to this focus. Other members have less mature preservation strategies as they are conducting portfolio-wide analyses to determine recapitalization needs and approaches, often reliant on outside consultants to provide technical support and guidance.

## Analysis: L.A.'s Aging Portfolio

<p><b>Financial health</b></p>	<p>With only 25 percent of aging projects reporting positive cash flow, a concerning three-quarters of the inventory is considered in poor financial condition: 39 percent are strained to fund expenses while 36 percent of projects are breaking even. This characteristic has long-term implications for state and local housing finance agencies that are anticipating repayment and may be reluctant to write off or modify this soft debt.</p>
<p><b>Rehabilitation costs</b></p>	<p>The estimated total cost to rehabilitate these 33 projects is \$44 million. The average rehab cost per unit is \$72,000. Just under one-half (45 percent) of the overall inventory requires less than \$20,000 per unit in average rehabilitation expenses. This suggests that a modest public investment can make a substantive impact toward sustaining this housing stock for the long-term and be accomplished without resyndication.</p>
<p><b>Subsidy commitments: capital</b></p>	<p>The oldest cohort of PSH projects was nearly exclusively financed through the city of Los Angeles (32 of 33 projects). More than one-half of projects (57 percent) are supported through a Community Redevelopment Agency of Los Angeles (CRA) commitment. This may be unsurprising for some given that the earliest PSH investments occurred through the CRA. Ten projects were financed with State Housing and Community Development Department loans. Only three properties included a county of Los Angeles loan.</p>
<p><b>Subsidy commitments: operating/rent subsidies</b></p>	<p>The most common rent subsidies in this cohort are federal (HUD) Continuum of Care subsidies, which are found in 63 percent of the inventory. Shelter Plus Care (388 units) and SRO Mod Rehab (368 units) grants were widely accessed in the early years (late 1980s to early 1990s) of the federal homelessness response and appear readily throughout the inventory. The large amount of SRO Mod Rehab units offers potential in that this subsidy type is now eligible through the federal Rental Assistance Demonstration (RAD) program. Less encouraging, a surprising 306 units located in at-risk PSH properties receive no rental assistance support. The latter subset should be an immediate priority given that project-based rental assistance is indispensable for PSH owners to sustain operations.</p>
<p><b>Configuration type</b></p>	<p>Sixty-two percent (810 units) of this aging PSH inventory consists of single room occupancy (SRO) units. This configuration type dominated early PSH examples in Los Angeles but is currently out of favor with public funding guidelines that require at least individual kitchens and baths.</p>
<p><b>Expiring affordability covenants</b></p>	<p>The risk of expiring affordability restrictions is not a common characteristic in this aging PSH cohort, contrary to most affordable housing preservation candidates. This is largely because of 55-year commitments through the state of California and the relative youth of the PSH industry in the region. However, there are limited cases of projects with expired (or soon to be) affordability covenants, which represents an immediate opportunity for the city and state to protect their long-term affordability. PSH owners reported that at least one CRA covenant (59 units) has expired to date, with another 133 units set to expire in the next five years. At the state level, 251 units with California HCD restrictions are set to expire by 2019.</p>

## Policy recommendations

The policy recommendations outlined below reflect the consensus of the PSH Preservation Workgroup members. These recommendations are intended to serve as global direction for the establishment of strong footing on which the region can launch a preservation strategy – a strategy that can evolve and adapt as the inventory matures.

While the full set of recommendations may be found in Appendix B, the following offers some ways in which policymakers and state and local housing officials can begin to respond.

- **Set priorities:** With so much public pressure to reduce (if not end) chronic homelessness and expand the overall supply of PSH, it is important that policymakers not lose sight of sustaining and revitalizing the existing PSH stock, especially given its pivotal role in housing referrals through the Coordinated Entry System. It is vital that resources are dedicated to preservation leads that can work across jurisdictional lines. They can work with PSH stakeholders to establish reasonable targets (units) and priorities for preservation efforts. This will require differentiating which projects need a deeper recapitalization path versus those that may require a more modest investment or simply a modification or extension of the current loan agreement.
- **Protect expiring covenants:** Almost one-third of the oldest PSH projects in Los Angeles that were financed through the city of Los Angeles or state of California have affordability restrictions that are set to expire in the next five years. Ensuring these assets remain affordable and restricted as such should be a top priority.
- **Establish dedicated or prioritized capital:** Without a dedicated source of capital to achieve consensus preservation goals, aging PSH projects will not be competitive or eligible for the available capital programs that exist or are emerging on the public funding landscape. If the city and county of Los Angeles and the state of California combined to set aside \$7 million annually, they would be on track to preserve 1,300 PSH units within the next five to seven years.
- **Ensure rent subsidies are flexible, sustainable, and attached to all unsubsidized units:** In conjunction with setting aside capital funds, we need to rethink the current slate of rental assistance arrangements, which are largely Continuum of Care subsidies from an earlier era. They are proving to be insufficient to generate the revenue needed to sustain operations. Allowing greater flexibility for project owners to move commitments across buildings and pursue alternatives, such as the RAD program, will help to offset escalating operating costs and improve cash flow. There are also 306 units in at-risk PSH buildings that were developed without long-term rental assistance contracts and thus require immediate support to sustain operations.
- **Alignment of funder policies:** PSH project owners are asked to demonstrate long-term compliance across several public financing programs that often have conflicting restrictions despite a common purpose to promote project feasibility. Program components such as loan servicing fee requirements, supportive services cost allowances, and the use of cash flow or project reserves for capital expenses are notable areas for future alignment.
- **Mitigate operating cost escalations:** The costs of operating PSH are on the rise by all accounts, though we are still learning the impacts on organizational and project budgets. For the majority of aging PSH buildings that are in poor financial health, this trend is particularly damaging – especially for those supported through federal rent subsidies that have been relatively static. We should acknowledge that housing and serving higher-acuity residents is more expensive and creates a need for more supportive services. Two measures stand out: 1) strengthening CES efficiency to reduce lease-up times, and 2) making it easier for PSH owners to implement weatherization and/or other energy-efficiency improvements. Both have a tangible impact on the bottom line.

# Next Steps

As the initiative matures, we will continue to examine the needs of the Los Angeles region’s aging PSH portfolio and use that knowledge to work with PSH financing stakeholders to implement solutions. We look forward to partnering with PSH finance stakeholders to wrestle with the barriers and recommendations identified, and we call upon them to express the same urgency in coordinating funding and regulatory decisions for existing properties as they do now with pipeline projects.

With 1,300 aging, at-risk PSH units identified through our working group member cohort, representing close to 25 percent of the project-based inventory among the PSH Preservation Workgroup member portfolios, it is imperative to work with regional housing finance partners to establish priorities for capital investment and interagency funder alignment. As we learned, the aging PSH portfolio is far from homogenous, yet one finding rang clear: The city of Los Angeles financed 97 percent of these PSH developments, and therefore will be a keystone partner in developing and advancing a strategic response – not to mention fostering cooperation with other public finance peers at the local and state level.

The fact that most of this housing is configured as SRO-style apartments also stands out. It will unquestionably be one of the more formidable hurdles to overcome, since it forces us to rethink the future and utility of that model within the menu of housing choices under consideration as a means to end homelessness in Los Angeles.

This research focused on a relatively small cohort of PSH owners. There are potentially a small number of properties not on our immediate radar that we wish to identify and track in partnership with state and local housing finance agencies. Since PSH owners are just beginning to recapitalize or redevelop their earliest PSH properties, that knowledge will continue to grow as these examples do. We are eager to develop case studies and shine a light on best practices that



illustrate the successes and challenges accompanying the unique task of preserving aging PSH assets.

At the same time, we acknowledge that the current PSH financing climate is fiercely oriented toward the acceleration of production to meet the demands of what has been, in recent years, a growing chronic homeless population in Los Angeles. There is little question that the successful execution of Proposition HHH in the city of Los Angeles, with a stated goal to create 10,000 PSH units in the next 10 years, is a top priority for the region. As a result, PSH preservation advocates will continue to have to explore other options for capital support.

As we track our success in implementing these measures and making progress on the region’s strategic homeless objectives, we hope this research underscores a key area of importance: those same mission-driven PSH development organizations that we are counting on to meet accelerated production targets are the same entities that own and operate a growing number of aging properties with distinct physical and financial needs. Balancing production and preservation efforts provides a more sustainable pathway forward to ensure that organizational capacity and financial stability are not impediments to our success.

## Appendix A: Proposal to Preserve Existing SRO Permanent Supportive Housing with Less Than \$1.5 Million Per Year Over Five Years

A number of supportive housing providers in Los Angeles have long provided stable living environments with supportive services through the single room occupancy (SRO) approach. Of the approximately 1,300 aging PSH units that were identified as at-risk in our analysis, 810 (63 percent) represented SRO configurations. Many of these SRO-style buildings are not suitable for conversion to apartments. However, these valuable resources could be preserved over a five-year period with relatively modest infusions of public funds compared to the cost of building new housing communities. The following is an example of resources required over a five-year period to improve and sustain the SRO Housing Corporation portfolio, which is comprised solely of SRO units in buildings not suitable for conversion to apartments without major cash infusions and a substantial reduction in permanent supportive housing.

SRO Housing Corporation owns 15 SRO's. During our survey, the organization cited six as their highest priority for preservation over the next five years; they are the some of the region's earliest PSH developments (before the PSH model even existed), consisting of 366 units, all of which are SROs. The organization has worked hard to maintain its properties and keep this valuable resource for its clients; however, there is not much life left in the buildings without the funding to make systems improvements and replacements. The life of these properties could be extended for another 20 or more years if the shared kitchens and baths and community rooms are remodeled, and new systems are installed.

One unique characteristic associated with the SRO portfolio, as well as the portfolios of similar nonprofit organizations, is that historically it had been supported with local financing through the City of Los Angeles Community Redevelopment Agency (CRA). At the time of those initial funding commitments, there was tacit intent to continue extending the loans but not expect repayment. That funding



has since matured or will be within the next five years as well as the accompanying affordability restrictions. The CRA provided SRO Housing with a vital source of gap funding for over a decade, approximately \$1.5 million, which was used to cover many of the organization's older properties that operated at a loss. When the state dissolved the CRA program in 2012, that funding ended and created a significant gap that needs to be addressed. Even though the organization is mission-driven to continue housing and serving a vulnerable, formerly homeless population, it is a challenge to keep these properties maintained due to costly and persistent maintenance issues. In fact, many units are being abated (e.g., project-based rental assistance payments have stopped), resulting in the properties operating at a substantial loss. While SRO Housing Corporation works with the city of Los Angeles to extend and amend the loans, capital needs remain to resource important upgrades to community rooms, kitchens, and bathrooms.



The following proposal is a five-year plan, which could be adopted for all nonprofits that operate aging SRO housing portfolios, thereby preserving this vital resource at a relatively low cost.

**STEP 1:** Amend and extend the original CRA loans for all properties to forgive accrued interest, discontinue accruing interest going forward and extend the maturity date for an additional 20 years with provisions allowing continued term extensions if the properties continue to meet the purpose(s) for which they were created.

Rationale: These properties serve a very low-income clientele, with most of these properties operating at a loss, lucky if they breakeven. There is no potential the properties will ever generate sufficient income to repay the loans, and there is no public benefit to accruing interest that will never be repaid.

**STEP 2:** Implement a five-year plan to finance the renovation of all six buildings. The estimated cost is \$20,000 per unit for a total of \$7,320,000. Over the course of five years, this averages out to less than \$1.5 million annually

This example, based upon six of SRO Housing’s single room occupancy portfolio, illustrates how cost-effective a renovation and preservation approach would be. It is not feasible to replace or replicate this amount of housing at a maximum of \$30,000 per unit through new construction or substantial rehabilitation. Such an undertaking would involve reconfiguration to create apartments with private kitchens and baths – a more extensive approach that would result in a substantial reduction of units available to house low-income individuals and families in need.



## Appendix B: PSH Preservation Workgroup Policy Recommendations

The following policy recommendations reflect consensus from the PSH Preservation Workgroup members and are organized categorically according to three key themes associated with PSH: 1) capital and financing, 2) rental assistance and operations, and 3) supportive services. These recommendations are intended to serve as global direction for the establishment of strong footing on which the region can launch a preservation strategy – a strategy that can evolve and adapt as the inventory matures..

### Capital

- Establish dedicated preservation leads at the city and county of Los Angeles with capacity to work across jurisdictional lines and review interagency conflicts on preservation policies.
- Establish annual PSH preservation targets (in relation to units), differentiating which need a deeper recapitalization that may require syndication/ resyndication versus a more modest cost path.
- Secure dedicated or prioritized capital for PSH preservation through existing or emerging PSH capital programs.
- Advocate that capital programs available for PSH preservation do not make an existing PSH project (and its residents) ineligible for funding under target population requirements.
- Review, adopt, and/or adjust (if necessary) state and local recapitalization policies to better address PSH preservation needs.
- Advocate for public lenders to adopt policy to forgive interest on soft loans as part of recapitalization plans when necessary. For example, if the property meets certain physical and financial characteristics.



Vendome Palms, remodeled unit

- Revisit, extend and modify restrictive CRA covenants; assess the number of expiring CRA properties and protect their long-term affordability.
- Reconcile conflicting funder restrictions over the use of either project cash flow or reserves for necessary capital expenses.
- Work with state HCD to align Loan Portfolio Restructuring (LPR) Program objectives with local project restructuring needs.
- Ensure that seismic and accessibility upgrades are accounted for sufficiently within project scopes.
- Work with utility companies and weatherization program administrators to ensure that energy-efficiency programs are more attractive, user-friendly, streamlined and compatible with, and/or folded into, affordable housing financing programs.

## Operations and Rent Subsidies

- Streamline and create predictable Year 15 dispositions processes, city and county respectively.
- Allow asset management fees beyond Year 15.
- Create replacement or more sustainable rental assistance arrangements, e.g., converting eligible subsidies to RAD where feasible.
- Allow flexibility for project sponsors to shift CoC-funded rental assistance awards across different buildings during rehabilitation phases (i.e., convert Project-based to Sponsor-based).
- Mitigate escalations in operating costs.
- Increase CES matching efficiency to reduce delays in re-leasing units.
- Secure long-term renewals (e.g., 15 years) for CoC-funded and other rental assistance contracts to facilitate refinancing possibilities.

- Ensure developers can access and obtain vacancy relief from PHAs when units are vacant (e.g., receive 80 percent of contract rent for up to 60 days).
- Engage state HCD to determine the future of SHIA program and what alternatives need to be in place to extend or sustain operating commitments.
- Determine and track expiring Capitalized Operating Subsidy Reserves (COSRs) through the Mental Health Services Act (MHSA) and Veterans Housing and Homeless Prevention (VHHP) programs; develop a replacement strategy or program for buildings with expiring COSRs.

## Supportive Services

- Align capital funder requirements for the use of capital or operating costs to fund supportive services expenses.
- Work with public sector partners to identify and utilize available funding to augment on-site supportive services in existing PSH.



Vendome Palms, before



Vendome Palms, after



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