Testimony of Jeffrey S. Burum
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Mr. Chairman, Mr. Vice Chairman, and Commissioners, thank you for inviting me to testify before you today on the very important topic of attracting private sector investment to affordable housing preservation.

My testimony provides background information on affordable housing in California, and on National Housing Development Corporation (NHDC) and its model for preserving affordable housing. It also provides an overview of NHDC's CalPool, a $15 million, public-private equity pool for the acquisition of affordable housing in California. Finally, this testimony summarizes my recommendations for increasing the efficacy of affordable housing preservation efforts both at the federal level and in California.

I. Overview: Affordable Housing in California – The Need for Preservation

As you know, over the last decade, 'affordable housing' has gained more prominence in terms of both politics and policy in both Northern and Southern California. Every day, the myth that affordable housing is an issue affecting only the poor and unemployed is being dispelled as the real estate markets in many areas of the state increasingly push out even median income families; families working as teachers, police officers, firefighters and civil servants.

Within the affordable housing industry, several factors have converged in recent years to make affordable housing preservation, in addition to production, not only a desirable policy objective, but a necessary one in the State of California. They include the opt-out and pre-payment of federally assisted units, aging and deterioration of the existing stock, population growth and other demand that has outstripped production for more than a decade, regulatory prohibitions on development, increasing popularity of slow/no-growth and anti-density development movements[1], and the increased cost of development as all of these factors converge.

One of the most quantifiable aspects of California's housing challenge is the number of federally assisted units that are at-risk of losing their affordability.

According to the Dept. of Housing and Urban Development, as of 1997, more than 900,000 Section 8 units nationwide were at risk of losing their affordability. Nearly 10% of those units are in California, by far the largest number of at-risk units in any one state. Rising real estate values in the state have made it more

[1] Frequently dubbed 'NIMBY' sentiment, for 'Not In My Back Yard.'

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economically attractive for owners to opt out of the subsidy program, making the situation even worse.

California Housing Partnership Corporation (CHPC) recently published a risk-assessment of the state of California's federally assisted housing stock. In summary, CHPC found the following:

- **There were 148,700 federally assisted units in California's inventory as of April 2001.**
- **49,465 of these units are at high risk** of opt-out or pre-payment; these units are contained in 847 properties.
- About **11,500** units in 317 properties are also at risk, but pose a lower risk because their contracts expire after 2006.
- **20,414 units (262 properties) have already either pre-paid or opted out.**
- 15,909 at-risk units (in 154 properties) have been preserved (with the original owners in place) under Title II/VI (ELIHPA/LIHPRHA).
- Only **3,030** units in 26 properties have been **restructured with new rental restrictions** since the beginning of the opt-out/prepayment crisis in 1997.

Against this backdrop, it is evident that something must be done to save housing already in existence. Preservation is a particularly attractive option because it is cheaper than new construction, averaging around 50% - 65% of the per-unit cost of ground-up developments. In times like these, with budgets tight and California's population estimated to increase by the current population of Florida by 2025, it is tempting to focus exclusively on building new units to accommodate the new demand. However, doing so is counter-intuitive, as we are losing existing units faster than we can build them, thus operating at a net loss as a matter of course.

Beyond the cost-savings and practical need for preservation, saving the affordability and structural integrity of existing units is critical because it ensures healthy, vibrant neighborhoods. When buildings are neglected or abandoned, the entire community suffers. Blight abatement becomes a goal in and of itself, and often, local government resources are expended to counteract the negative effects of blight, rather than to implement positive programs and policies in the community.

II. Background – NHDC

In 1998, I stepped down as Executive Director of Southern California Housing Development Corporation (So Cal Housing), a regional nonprofit provider of affordable housing I had founded in 1992. I left So Cal Housing to create a nonprofit organization that could help preserve the large and growing stock of at-risk affordable housing nationwide.[2]

Two events precipitated the establishment of National Housing Development Corporation (NHDC). The first was watching as thousands of units well-suited for use as affordable housing were sold to large Real Estate Investment Trusts (REITs) for pennies-on-the-dollar in the wake of the Savings and Loan (S&L) crisis[3], and re-sold to nonprofit affordable housing providers soon thereafter at unspeakable markup prices. The second was the onset of the current opt-out and pre-payment crisis in the federally assisted housing inventory.

It occurred to me then that the existing structure of affordable housing finance was inherently slow and restrictive, limiting the ability of affordable housing providers to buy either quickly or in volume. In addition, I realized that the restrictions of existing programs and financing were often at odds with the principles of maximizing the efficient use of existing funding streams, and levering public funds with private capital.

I knew that what was needed was a preservation entity - a national nonprofit focused on the acquisition of existing multifamily real estate, and dedicated to maintaining its affordability in perpetuity – capable of successfully competing with large REITs and other private sector interests on the open market.

With that mission in mind, we formed NHDC and convened many of the largest players in the affordable housing and preservation industry to help define the industry niche NHDC could best fill.

What came out of this year-long working group was NHDC: a national, nonprofit, product-driven acquisition intermediary that preserves housing with REIT-like flexibility, but on an interim basis, eventually re-selling its inventory (without exorbitant markup) to local affordable housing providers for long-term affordability. In addition, the working group identified the expiring use properties in the federal inventory as particularly worthy of NHDC's preservation efforts.

III. NHDC Model – Guiding Principles, etc.

NHDC has developed an Acquisition/Disposition Process which we refer to as the 'NHDC Model'. It is a four-part, 60-month (maximum) model that ensures the permanent affordability of the units NHDC preserves.[4] Essentially, NHDC buys

[2] See Appendix A.
[3] So Cal Housing was the advisor to the Resolution Trust Corporation (RTC) and the Federal Deposit Insurance Corporation (FDIC) for the State of California from 1992 – 1997. It was charged with helping to identify assets that would serve well as affordable housing, and facilitate their transfer to affordable housing providers.
[4] See Appendix B.

properties (preferably in bulk to achieve economies of scale), holds them while it restructures and repositions them, and then sells them at its cost to Designated Preservation Entities.

NHDC has developed a network of local providers of affordable housing (dubbed 'Preservation Entities') consisting of 48 organizations in 11 states. These partner organizations may apply to purchase NHDC properties for sale, or may generate acquisitions and approach NHDC should they need assistance preserving at-risk properties within their mission areas.

Our acquisitions team assesses potential acquisitions with our Acquisitions Guiding Principles in mind. At the heart of these principles is the purchase of good real estate, at fair market value, without contingent resources.

IV. Public/Private Partnerships: Attracting Private Capital to the Mission of Affordable Housing

In order to purchase at-risk housing without reliance on contingent resources such as federal Low Income Housing Tax Credits or volume cap bonds, it is critical that new sources of flexible, readily available capital be developed. The creation of public/private partnerships between mission-driven, public benefit corporations and the traditional private sector is therefore imperative if substantial progress is to be made towards preserving existing rental housing.

NHDC's model is designed to promote private sector investment in affordable housing preservation. NHDC recently closed its California Investment Pool (CalPool), LLC, a $15 million equity pool created to preserve multifamily affordable housing in California.

The first and only pool of its kind nationwide, CalPool combines $13.5 million of equity subscriptions from nine private financial institutions with $1.5 million in equity from NHDC to form a public-private capital pool designed to accomplish NHDC's affordable housing preservation mission by pre-arranging non-project-specific equity funding. NHDC's $1.5 million contribution is part of $17 million in federal congressional grant monies, appropriated specifically for the acquisition and preservation of affordable housing.

Participating banking institutions[5] will receive full Community Reinvestment Act (CRA) investment-test credit for their investments in CalPool as well as earn an 8% annual average return in addition to recovering their investment capital in 3 to 5 years.

[5] Washington Mutual Community Development, Inc., IndyMac Bank, Downey Savings and Loan Association, F.A., United Commercial Bank, PFF Bank & Trust, Business Bank of California, Northern Trust Company, General Bank and Bank of the Orient.

V. Policy Recommendations for More Efficient Preservation of Affordable Housing, and Increasing Public/Private Partnerships in the Industry.

In September, 2000, I was fortunate to be named to the bipartisan, Congressionally appointed, Millennial Housing Commission. The MHC is charged with developing recommendations to improve the federal affordable housing delivery system by increasing the efficiency of its housing programs as well as encourage proliferation of public/private partnerships. I serve as the Chair of the MHC's Preservation Task Force. In that capacity, I made five recommendations to the MHC that I consider to be urgent for successful and efficient preservation of existing housing . Those recommendations are listed below, and can be adapted in principle to apply to State governments as well.

Together, the recommendations seek to fill delivery gaps and to encourage greater programmatic efficiency within the federal housing system. Although some of these recommendations are strictly within the purview of federal power, the State of California may wish to keep them in mind as it exercises the discretion it has under federal programs, and may wish to advocate for similar changes at the federal level. The recommendations are as follows:

1. **Recognize Preservation as distinct from Production and *separately fund Preservation activities*. Create sources of *interim acquisition capital for Preservation* and land purchase.** Preservation is inherently different from production. It carries with it a sense of urgency that new construction cannot. Unlike with new construction, any delay in a preservation transaction poses the risk of displacing residents and losing affordability forever. As such, preservation entities need quick, ready sources of interim capital to buy at-risk properties before placing permanent financing on them. In addition, interim capital should be available to respond to dips in the marketplace, so that affordable housing providers can take advantage of the low-point of the real estate cycle to increase the volume of the affordable inventory.[6]
2. **Implement *sustainable underwriting* standards.** Prioritize mixed income models where feasible and increase operating expense standards as well as replacement reserve level requirements so that buildings can be sustained for 30 - 50 years.
3. **Create a *funded capacity to innovate* and experiment to improve the overall delivery system by filling gaps and encouraging efficiencies.** In our current system, new ideas are frequently stifled and frozen out by the

[6] At the height of the RTC/FDIC disposition process following the S&L crisis, multifamily units in Houston, TX were commonly being sold at $5,000 per unit. Having ready capital to seize on such opportunities will not only reduce the amount of subsidies needed to operate a stable asset as affordable into the future, it will also allow housing providers to serve more families and seniors with extremely low and very low incomes.

status quo, often to the detriment of the families affordable housing serves. Any funding should include a set-aside of funds to be used as venture capital, that is, to take calculated risks on innovative ideas for improved delivery of housing.

4. **Create a *neighborhood-based funding approach* by aggregating capital for neighborhood revitalization and community renewal**, thus bringing a wholesale cost approach to communities that have the need.
5. ***Reduce regulatory barriers* to combining existing programs** by standardizing minimum regulatory requirements across programs and continue the devolution of federal programs (including Section 8) to states with enough flexibility to meet local needs and concerns.

More specific actions the State of California should take include:

1. ***Create specific funding for preservation, featuring interim finance on both a project-specific and wholesale basis.*** This fund should be large enough to accomplish significant preservation activity in all regions of the state, and should require applicants to lever state allocations from the fund with some ratio of private capital. A succinct summary of this proposal can be found within SB 372, sponsored last February by Senator Joe Dunn.
2. ***Create a State Housing Trust Fund.*** This fund can serve as the vehicle through which both innovative ideas and community revitalization projects are capitalized. An ideal source for such a fund would be Redevelopment Agencies. As an extension of their current redevelopment plans, 20% of Redevelopment Funds could be directed to the State Housing Trust Fund, which would issue Requests for Proposals (RFPs) for both innovative programs and community revitalization plans. The 'innovative programs' portion of the fund could be set up as a revolving source of funds, a 5 – 10 year loan fund of at least $10 million. Selected applicants would be required to obtain minimum private-sector leverage of the award amount, and would be required to re-pay the original fund disbursement after the 5 – 10 year demonstration period ended. Recipients of awards under the 'community revitalization' portion of the fund would be required to lever the funds not only with private capital, but with federal and local commitments as well. Applicants would be required to submit plans for the revitalization, and demonstrate both a need and broad support for the proposed project.
3. ***Motivate financial institutions to increase their participation in affordable housing.*** California can do this by structuring products that will grant CRA investment-test credit to participating financial institutions. In addition, California should seek to confer state-specific 'kicker' incentives, such as a state tax credit, to encourage banks and other private entities to invest in affordable housing within California.
4. ***Increase the State's commitment to meeting worst case affordable housing needs*** by dedicating state funding to putting additional subsidies

into federally subsidized properties, buying down rents in those buildings for deeper affordability.

5. ***Eliminate any state capital gains taxes due upon the sale of multifamily developments if they are sold to new owners who are bound to make or maintain them as affordable housing.*** This will not only encourage transfer of currently unsubsidized properties into the affordable inventory, but will also encourage owners who would otherwise hold the real estate (rather than pay capital gains) to sell their properties. The net result of this action will be to reduce owner apathy and blighted/deteriorated properties, and increase healthy new ownership.

VI. Conclusion

Together, implementing these recommendations or similar ones will create a climate in California that allows affordable housing preservation entities to operate at maximum efficiency and with increased flexibility, thus increasing the attractiveness of affordable housing investment to the private-sector.

Again, I thank you for the opportunity to share my experiences and suggestions with you this morning. I sincerely hope my testimony will be of assistance to this Commission as it continues to examine the issue of affordable housing in California.

4/20/01

APPENDIX A
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Figures cited are estimates based on various sources of available data

Matrix of Risks Facing Affordable Multifamily Properties Nationwide

	Public Housing	*Section 202*	*Older Assisted*	*FmHA 515*	*Section 8*	*HFA Financed*	*LIHTC*	*Aging conventional*
Target tenants	Poorest of poor (35% AMI and below)	Elderly (35% – 60% AMI)	Working families (35% – 80% AMI)	Rural (35% - 80% AMI)	Low- to moderate income families (35% - 80% AMI)	Broad range (35% - 110% AMI)	Working Families (40% - 60% AMI)	Working families (50% AMI & up)
Period of Production	1937-1968	1966 - Present	1969 -1975	1970 - Present	1978 - 1985	1982 – Present	1987 - Present	1935 – 1990
Sections of Act	NA	§202	§221(d)(3), §236	§515	§221(d)(4)	NA	§42 (IRC)	NA
Total Apartments Today	1,400,000	600,000	550,000	700,000	1,400,000	250,000	1,000,000	10,000,000
Greatest risk	Deterioration	Age	Deterioration	Financially unstable sponsor	Going market	Refinancing	Going market	Deterioration
Rate of loss	Low	Very low	Medium	Very low	High	Low	None Yet	High (because of volume)
Primary reason for rate of loss	Few choices	Nonprofit owners; little opt-out or prepayment risk.	Substantial minority preserved (100K of 600K)	No legal exit	Easy to opt out	HFAs active	Not 'til 2002	All
Primary vehicle for loss	HOPE VI Demolition	NA	Pre-payment	NA	Opt-Out	Refinance	Opt Out	Demolition/ gentrification
Risk Factors								
Going market	Minimal	None	Medium-high	Low (statute blocks it for contracts after 12/89)	Very high where opt-out is available (M2M)	Usually low (because of HFA rules)	High from 2002-2005 (180K units), then low	Varies widely
Sponsor reliability or financial stability	Poor	Good	Neutral	Poor	Good	Good	Neutral	Poor
Losing money	High in high density areas	Medium-low	Medium-high	High	Very low	Low	Medium	Medium-high
Deterioration	Very high	Medium	Medium-high	Medium-high	Low	Low	Low	High
Mitigating Factors Affecting Loss								
Public Interest Level	Low	Low	Very high	Very low	Very high	Low	High	Low
Available Resources	Few	Some mark up	Relatively High	Few	High	High at state level	High at state level	Few
Best Available Preservation Vehicle/s	HOPE VI (preserves real estate and affordability to some extent, but often reduces total number of units)	FY 01 laws (preserve real estate by allowing for recapitalization)	§236 IRP; 4% LIHTCs (preserve real estate) Enhanced Vouchers (preserve affordability)	RHS Recapitalization (preserves real estate)	Mark Up To Market (preserves real estate); Enhanced Vouchers (preserve affordability)	HFA refinance (preserves real estate and affordability)	HFA refinance (preserves real estate and affordability)	Acquisition / Rehab; Self-sustaining Mixed Income Structure (preserves real estate and affordability)
Analytical Tools								
Trends	Welfare reform	Congress is liberalizing recapitalization potential	Preservation via restructuring	Owners increasingly frustrated with no exit	Going market	HFAs and owners negotiate to recapitalize	180K vulnerable units; loose affordability covenants on early units.	No concerted effort to preserve; unregulated, therefore harder to track

This information summary is a rough draft, a deliberate simplification of the issues and risks associated with preserving affordable housing. It is intended to serve as a starting point for the development of further commentary from expert practitioners in the preservation community, which can ultimately be presented for adoption by the Millennial Housing Commission for its March, 2002 report. Contributors cited below.

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National Housing Trust

APPENDIX B
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NATIONAL HOUSING DEVELOPMENT CORPORATIONÒ
Acquisition/Disposition Process

0 – 36 months → 36 – 60 months

BUY	HOLD	RESTRUCTURE/REPOSITION	SELL (AT COST [1])
Operational Support ($4+ million) ϒ Congress *($ 6 million to date)* ϒ Foundations *($470K to date)* ϒ ITAG (HUD reim-bursements) **Acquisition Funding** ($50-150 mill) ϒ Congress *($ 11 million to date)* ϒ Banks *($13.5 mm to date)* ϒ Insurance/ Mortgage Co.s ϒ Other		OMHAR HUD $$ Improved Cash Flow Improved Property Mgmt. Other Cost Savings **Restructuring Tools**	**Sources of Finance**
GOAL ▪ Prevent market rate conversion	**GOAL** ▪ Maintain affordability and avoid resident displacement while preservation entities prepare to purchase	**GOAL** ▪ Stabilize and reposition properties (i.e., financial restructuring, minor rehabilitation as required)	**GOALS** ▪ Transfer to local ownership ▪ Achieve permanent affordability ▪ Asset management

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[1] 'Cost' is defined as: (i) cost of acquisition, (ii) interim financing costs, (iii) cost of any necessary renovations, (iv) an allowance for NHDC overhead costs while managing the property during the stabilization period.

[2] In this concept, a property is 'at risk' if it could lose its affordability through the expiration of Federal subsidy programs. Additionally, several other types of properties remain at risk, including upcoming expiring tax credit projects, market rate rental housing in high-cost rental markets, and markets with a limited supply of rental housing. At-risk does not imply physical deterioration or financial distress.

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