City of Alexandria, Virginia

MEMORANDUM

DATE: FEBRUARY 17, 2016

TO: THE HONORABLE MAYOR AND MEMBERS OF THE CITY COUNCIL

THROUGH: MARK B. JINKS, CITY MANAGER

FROM: HELEN MCILVAINE, DIRECTOR, OFFICE OF HOUSING
KARL MORITZ, DIRECTOR, DEPARTMENT OF PLANNING AND ZONING

SUBJECT: RAMSEY REDEVELOPMENT – REVIEW OF OPTIONS

Summary

City staff's review, which is anticipated to be supported by a third-party consultant, indicates that the "Hybrid Option" for the Ramsey redevelopment cannot be ruled out by the information provided by Alexandria Redevelopment and Housing Authority (ARHA) staff over the past few weeks. City staff's limited review indicates that there are very reasonable adjustments to ARHA's cost and financing assumptions that could make the hybrid option more competitive for tax credits and financially feasible. Staff's conclusions come with the significant caveat that a more detailed analysis would be necessary to come to a firmer conclusion about the hybrid option's feasibility.

The "hybrid option" preserves one of the existing Ramsey buildings and constructs a single 49-unit building on the remainder of the property. The new structure would have a partial fourth floor. A sketch of the hybrid option is attached.

Background

In September, City Council requested a review of alternatives to the 53-unit proposal that is now docketed for the City Council's public hearing on February 23, 2016.

Through the balance of September and early October, City staff worked with ARHA to define the options and identify the resources needed to prepare the analysis requested by Council, including City funding of the additional work required from ARHA's architects and the cost of an independent third party expert. As everyone is now aware, that process stopped in October.

In January, ARHA staff agreed to share the analysis they had prepared evaluating the relative competitiveness of the options for Low Income Housing Tax Credits. Those figures were shared with City staff on Thursday, January 28. Breakdown of the components underlying the cost estimates for each option were shared on February 2 and February 9. Also on February 9, City staff requested and ARHA staff agreed to have an independent third-party consultant review of the tax credit workbooks for ARHA's Ramsey proposal as well as the "hybrid option" (also referred to as "Option 6" which preserves one existing building and provides 49 units in a new structure on the balance of the Ramsey property. The consultant performed an initial analysis on Tuesday, February 16.

The balance of this memorandum summarizes City staff's conclusions regarding the financial feasibility and tax credit competitiveness of the ARHA proposal and the Hybrid Option and the conclusions of the independent third party consultant. The memo concludes with some notes on the ARHA Board's timeline memo.

City Staff Conclusions

While the timeframe for review was extremely limited, City staff was able to reach some conclusions:

- **Among the main questions is what actions would be needed for a hybrid option that preserves one of the Ramsey buildings and allows redevelopment of the remaining site for new affordable units.** This option did not initially test well (for tax credit competitiveness) when the preserved building was included as part of the tax credit project. However, at City staff's request, ARHA tested a scenario whereby the preserved building is acquired by some other entity (it also could be retained by ARHA) and would not be part of the project competing for tax credits. The remaining site would be redeveloped with a 49-unit building which would require a partial fourth floor. **ARHA's analysis of the competiveness of the hybrid option is that it could be competitive, albeit with a score at the low end of the competitive range.**
- If the preserved building were acquired by another entity, it could be used for residential or non-residential purposes. ARHA has estimated the cost of renovating four buildings for residential purposes at $2.4 million dollars (in hard costs). City staff's review of the cost breakdown shows about $1 million of that cost is not required by the building code or regulatory agency, suggesting that **renovation of one preserved building could be accomplished for about $360,000, plus soft costs** and land acquisition costs (if the option involves acquisition by another entity), or about $90,000 per unit, if it is retained as a four-unit residential structure.
- If the preserved building is acquired by another entity (such as if it is used for purposes other than affordable housing, or if it is used for affordable housing but ARHA does not wish to own or operate it), ARHA would expect to be reimbursed for the value of the property. The only current estimate of the value of the Ramsey property is the current tax assessment of $3,792,560. If the cost to acquire one building is equal to one-quarter of the total value, **the acquisition cost would be $948,140.**
- City staff also notes that in testing the various options for tax credit competitiveness, ARHA assumed some significant costs would be constant for all options. However,

some options, particularly those that preserve buildings, would have lower costs in these categories. The effect of using the same cost estimates across all options is to make the alternatives to the 53-unit option appear less competitive. **More refined cost estimates for each option, and, therefore, better information about the competiveness of each option, would have been possible if work on the options had not been suspended last fall.**

- While ARHA found the hybrid option to be in the competitive range for tax credits, they also estimated that the hybrid option would have a debt coverage ratio (DCR) of 1.1 to 1.16 and ARHA indicated that the DCR would have to be 1.2 at minimum to attract investors. **City staff's summary review suggests that there are reasonable adjustments to ARHA's assumptions which would improve the DCR for the hybrid option to 1.2 or higher.** Moreover, City staff note that 1.10-1.15 are standard Year 1 debt coverage ratios for stabilized affordable housing projects. In addition, the tax credit consultant has advised City staff that a DCR in excess of 1.25 would potentially reduce the amount of tax credits provided by VHDA since a debt coverage ratio of 1.25 or higher indicates that there is room for a project to take on additional debt.

  Specifically, ARHA's anticipated project debt would be limited to ARHA's seller note (for the sale of the land), a City loan of up to $1 million and a $100,000 predevelopment loan to VHDA. All of these would typically be characterized as "soft pay" debt (versus "hard pay" debt), given the parties involved and their usual practices. In fact, City gap loans are almost always residual receipt "soft pay" loans – paid from cash flow, after the first trust mortgage and any deferred developer fee. But in the analysis of the Ramsey alternatives, ARHA has assumed "hard pay" debt and a higher than usual interest rate (3%) for its own loan and the City loan. City staff believes that reasonable adjustments to ARHA's planned debt structure assumptions would materially improve the debt coverage ratio.

  Examples of "creative" structuring to make the project perform better include ARHA deferring some of its developer fee and establishing more favorable terms for repayment of the seller note held by ARHA (longer amortization or pay-back period and lower interest rate, etc.) or seeking better terms for the VHDA debt.

  Other factors that negatively impact DCR are the high operating expense projections, especially given the property's real estate tax exempt status and the fact that the redevelopment will be new construction, with all major building components and systems under warranty for some period of time, lowering potential maintenance and repair costs. In addition, ARHA's stated requirement of having to aggregate all project soft costs incurred to date into successive options studied also drives total development cost to make the projects less competitive (in September City staff confirmed that this was not a VHDA/tax credit requirement).

- Whether or not both options meet a threshold of "financially feasibility," the project's cash flow is also an important element of the project to ARHA. ARHA's pro forma indicates that there is a stronger cash flow from their current proposal and shifting to the hybrid option would reduce that positive cash flow to ARHA over the long-term by some unknown degree. Less positive cash flow to ARHA means less money available to support overall ARHA system-wide operating and capital costs.

Conclusions of Independent Third Party Review

The City contracted with Ryne Johnson of Astoria LLC to review ARHA's draft tax credit workbooks for the proposed 53-unit development and for the hybrid option, the 49-unit project. ARHA was able to provide Mr. Johnson with the workbook for the 53-unit option in time for him to review it Tuesday February 16 but was not able to provide the workbook for the hybrid option until Wednesday February 17. Mr. Johnson will not able to complete his review of the second workbook until tomorrow, Thursday, February 18. As soon as he has completed his review, City staff will share that information with City Council.

Mr. Johnson's review of the 53-unit option did have an additional positive result in that he was able to provide ARHA with a number of suggestions for increasing the competitiveness of the 53-unit ARHA proposed project.

City Staff Notes on the ARHA Timeline Memorandum

In addition, on February 10, the ARHA Board of Directors provided the City Council with a memorandum entitled "Update on the Ramsey Homes Redevelopment Efforts" which includes a timeline of Ramsey-related actions from the ARHA Board's perspective.

City Staff Role

City staff's role following the September Council hearing was to try to assist ARHA in meeting their commitment to the City Council to study options. City staff's actions in this regard was to help clarify a set of options for study, identify a source of funds (other than ARHA funds) to complete the studies, and otherwise provide support for the analysis.

The timeline memorandum incorrectly suggests that the City staff had preconditions for the September 8 options that included not counting ARHA's land value, significantly reducing ARHA's developer fee, among others. The implication is that City staff was insisting that the options include elements that ARHA felt were obviously infeasible, and therefore a review of the options would be a waste of resources.

Instead, what City staff was working toward was an independent review of the options, including financial feasibility and tax credit competitiveness. So while staff indicated that elements such as the land value and developer fee should be considered, staff did not have an opinion about whether or not either element should or could be different from what ARHA was proposing.

Source of Funds for the Alternatives Analysis

The timeline memorandum indicates that ARHA was concerned about the source of funds the City was planning to use to pay for the alternatives study. A source of City funds for ARHA's consultant costs relative to the feasibility study to review options was not specifically identified.

However, the City and ARHA discussed the idea of using monies from ARHA's repayment of the Glebe Park loan (derived from proceeds of the James Bland project). Prior to suspending participation in the alternatives analysis, ARHA agreed in written and verbal communication that this would be an acceptable use of these funds. When ARHA notified the City in October that it was halting the study of the alternatives, the source of funding was not raised to City staff as the issue.

ARHA has submitted invoices to the City for work performed by its own consultants (civil engineer, construction manager at risk, architects) during the two week period last fall when ARHA was participating in the alternatives analysis. Payments totaling approximately $15,000 have been processed.

Cost Estimates

Over the summer and into the fall, staff investigated ARHA staff assertions that a renovation of even one of the existing buildings was not feasible because the renovated building would need to be brought up to current building code standards and that the Department of Housing and Urban Development would require significant and expensive improvements to achieve full ADA accessibility. City staff determined that most of these expenditures are not required, reducing the renovation cost by 40 percent.

Attachment: Hybrid Option Rendering