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Title: Resolution to Approve a Contract with Avalon Housing, Inc. for Activities Related to its Merger with Washtenaw Affordable Housing Corporation (WAHC) (\$295,000.00 Ann Arbor Housing Trust Fund)

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Resolution to Approve a Contract with Avalon Housing, Inc. for Activities Related to its Merger with Washtenaw Affordable Housing Corporation (WAHC) (\$295,000.00 Ann Arbor Housing Trust Fund)
Attached for your review and approval is a resolution to approve a contract with Avalon Housing, Inc. for activities related to its merger with Washtenaw Affordable Housing Corporation (WAHC), including management of WAHC’s properties and operations during the transition period prior to the formal merger. \$295,000.00 in initial funding is requested from the Ann Arbor Housing Trust Fund to support the merger.

The Office of Community Development (OCD) and the Michigan State Housing Development Authority (MSHDA) have been working with Washtenaw Affordable Housing Corporation (WAHC) on a long-term strategy to maintain WAHC’s units as affordable housing. In early 2007 Corporate FACTS, a firm that specializes in assessing the performance of non-profit real estate developers, evaluating real estate portfolio’s and developing sustainable strategies for neighborhood revitalization, was hired by MSHDA and the City to analyze WAHC’s housing portfolio, property management plan, finances, and staffing. The analysis concluded that WAHC’s long-term viability was at risk due to excessive debt, organizational challenges and financial instability. An agreement was reached with the Avalon Housing Corporation to merge operations with WAHC and seek remedies to preserve WAHC’s substantial housing portfolio.

The Office of Community Development is working with Corporate FACTS, WAHC, and Avalon to implement a short-term transition plan and to develop a long-term feasibility strategy to ensure a successful merger. In the short term, Avalon has agreed to take over the management of WAHC’s properties and operations to facilitate this merger, and will work to increase WAHC’s cash flow by filling vacant units.

The goal of this merger, and any funds provided to support it, is to protect the City and State's substantial investment in affordable housing and maximize the number of affordable housing units available for low-income residents in our community. The merger is also expected to create a viable business model and long-term strategy to ensure Avalon continues as a strong and sustainable non-profit housing provider. This process is a significant undertaking and will have long-term implications for the permanent affordable housing stock not only in the city, but throughout Washtenaw County.

Staff recommends that Council approve this resolution in order to facilitate a twelve month merger transition plan running from July 08 through June 09, during which Avalon will take on administrative oversight of WAHC operations while working with the Office of Community Development and Corporate FACTS to complete the analysis and due diligence necessary to develop a viable and sustainable merged organization.

Background

Washtenaw Affordable Housing Corporation (WAHC)

WAHC was created in 1991 to develop affordable housing for low-income residents in Washtenaw County. During that time WAHC acquired multi- and single-family units. WAHC currently owns 84 units in Ann Arbor and 43 units in Ypsilanti. WAHC's tenants are typically 10% AMI to 50% AMI, and include a high proportion of families with children. 18 of WAHC's unit's are set aside for homeless families and individuals from POWER, CSTS, and SOS. WAHC provides on-site support to tenants utilizing a less intensive service model than those of Avalon and MAP.

As market conditions have changed, the OCD and the local housing providers have had to change strategies to be successful. Operating costs have outpaced projections, while rental income has not. Consequently, the OCD has worked with affordable housing providers to minimize debt, increase energy efficiency to lower operating costs, standardize materials to lower maintenance costs, and acquire rent subsidies to cover the cost of operations. WAHC's properties relied more heavily on private financing at the time of acquisition than other non-profit housing providers the City has invested in. Large debt payments diverted funding for maintenance, leading to deterioration of the properties and higher vacancies. Higher vacancy rates mean less revenue and further deterioration of the properties. In addition, WAHC has had 4 different property management companies and 3 directors in the past 5 years which has contributed to its difficulties. In fact, WAHC is currently without a director, and, as a result, has an immediate and critical need for management and oversight of its day to day operations. During this period, the OCD worked diligently with WAHC to help address its financial and organizational challenges, with limited success.

As recently as 2005, one of WAHC's properties, Parkhurst Apartments, was foreclosed upon. The City worked with WAHC, Mercy Loan Fund and the National Equity Fund to refinance the property and provide emergency rehabilitation funds and capital reserves. The Parkhurst foreclosure prompted the hiring of Corporate FACTS in 2007.

WAHC has experienced annual losses averaging \$172,361 for the past three years and other financial difficulties dating back to at least 2001. Further, WAHC was not able to develop additional properties because investors were not willing to invest new funds until the existing properties had positive cash flow and long-term maintenance strategies. A healthy non-profit housing developer typically earns about 35% of its revenues from real estate/development-associated fees. Lack of developer fees further handicapped WAHC's management capacity.

To date, there is \$3.7 million of debt collateralized by properties owned by WAHC. Of the \$3.7 million outstanding, WAHC is responsible for mortgage payments totaling \$134,740 annually. The City has \$1.2 million in mortgage liens on these properties. In addition, a subsidiary of WAHC, Parkhurst Apartments, LDHA, LLC, has an additional \$2.4 million in debt with annual mortgage payments of \$89,417. The City has a \$1 million lien on Parkhurst Apartments.

Corporate FACTS is analyzing the debt capacity of these properties, based on current rents. Corporate FACTS will also be analyzing the market to determine the appropriate rent structure based on the condition of the units and the target tenant incomes. In the meantime, the mortgages must be paid to keep the properties from going into foreclosure. The City's investment is at risk if a private lender forecloses on the properties. The OCD and Corporate FACTS are working with these lenders to avoid foreclosure. The City has invested federal HOME funds in several of the properties, which must be repaid to HUD if the properties are sold and discontinue providing affordable housing. An analysis of the properties that do not have federal HOME funds has already been conducted. Those properties (11 units in Ann Arbor and 1 unit in Ypsilanti) will be sold as discussed below.

Avalon Housing

Avalon Housing was created in 1992 to develop and manage permanent affordable housing with support services <http://avalonhousing.org/supportive-housing/> for people with very low incomes and disabilities. The organization grew out of an emergency shelter program in an effort to develop a long-term solution to homelessness. Avalon has 210 supportive housing units scattered at 19 different sites throughout Ann Arbor. Avalon's experience includes project development and rehabilitation, property management and maintenance, and provision of supportive services.

Avalon has experience with both capital financing and rehabilitation which will be crucial in securing funding for needed rehabilitation at WAHC properties. Of Avalon's 210 units of housing, all but 30 were purchased and then underwent rehabilitation under Avalon's direction. Avalon is currently investing \$400,000 in capital needs at its existing properties and over \$750,000 in rehabilitation of new acquisitions.

Avalon has garnered local and statewide recognition for its expertise with complex sources of housing financing for nonprofit housing development and management. The organization has extensive experience securing and managing grant, loan and equity financing through MSHDA, HUD, Federal Home Loan Bank, Michigan Interfaith Trust Fund and Local Initiatives Support Corporation (LISC). Avalon has four projects funded through Low Income Housing Tax Credits which requires the creation and management of Limited Partnerships. These hold management agreements with Avalon, as well as for-profit subsidiary corporations. Additionally, all financial audits have been clean for the agency's 16 year history.

Avalon has developed an approach to housing provision that combines traditional property management with additional specialized interventions to increase housing stability for at-risk tenants. These strategies include accommodations for disabilities, extended rent payments, and other activities that address the underlying causes of homelessness. Extending this approach to WAHC properties will provide an opportunity to reduce vacancies and turnover, and improve the quality of life for more vulnerable residents living within WAHC's stock.

Avalon provides and contracts for services to residents who need additional support to maintain

housing. These services will complement and support WAHC's recent addition of a resident services component which is aimed at enhancing tenant stability and quality of life.

Project Plan

The goal of this merger is to preserve the greatest number of affordable housing units for low-income households in our community, while ensuring that Avalon Housing remains a strong and sustainable non-profit housing developer and provider.

Units like those currently held by WAHC, restricted to low-income individuals and families have become much scarcer despite community efforts such as the Blueprint to End Homelessness and its plan to create 500 units of affordable housing. In fact, more than 800 units of housing restricted to low-income households have been lost over the past ten years in Ann Arbor alone.

Activities over the next 12 months will focus on immediate oversight of WAHC's capital assets and day-to-day operations. Additionally, Avalon will work with WAHC, OCD, MSHDA, and Corporate FACTS to analyze and evaluate its current operations in order to identify merger-related restructuring and reinvestments that will create a sustainable merged organization. Specific activities to be undertaken by Avalon in coordination with key investors will include:

- Taking over management oversight and responsibility for WAHC's property and administrative operations effective immediately;
- Providing financial oversight, including working with WAHC vendors on outstanding payables and completion of required audits;
- Analyzing financial and physical operations of the WAHC portfolio, property by property, including assessment of market competition;
- Conducting an updated capital needs assessment and developing a plan to finance improvements for all properties in the WAHC portfolio;
- Determining the scope and cost of work needed to address deferred maintenance and capital needs and to stabilize WAHC properties in order to successfully integrate them into Avalon's stock. This will include recommendations and plans for physical improvements, refinancing strategies and financial restructuring;
- Conducting a feasibility study to determine which properties should remain in the portfolio of a merged organization;
- Developing and implementing a plan for the transition of WAHC property management activities from Piper Realty, a for-profit corporation based in Flint, to Avalon's in-house property management operations;
- Bringing existing WAHC staffing levels, compensation, and training into line with community and industry standards, and integrating WAHC staff into Avalon operations;
- Analyzing for potential expansion of Avalon's mission as it relates to target tenant population and geographic service area;
- Developing a sustainable business model including analysis and recommendations regarding mixed income housing development, operating efficiencies, fundraising potential, public support, developer fees and other key elements of affordable housing provision;
- Projecting staffing structure and organizational budget for a larger, merged organization for 2009, identifying ongoing funding needs and plan for fundraising and community support.

In order to complete the above activities, Avalon will need to hire the following consultant and staffing support:

- A Merger Project Manager who will work with Avalon's administrative team to coordinate the merger process and provide management oversight at WAHC for both properties and administrative operations. This person will oversee on-site day-to-day operations at WAHC and coordinate merger activities. This will include a focus on the organizational needs of both Avalon and WAHC to ensure that operations at WAHC run smoothly during the interim and that Avalon remains a strong and effective housing provider as this proposed merger is completed. This position is budgeted at \$100,000 for 12 months and will discontinue once the merger process is completed.
- A Construction Project Manager to evaluate, plan and oversee the extensive work needed at WAHC properties and to integrate this work into Avalon's existing rehab activity. This person will be responsible for: prioritizing work, writing specifications for bids, overseeing the bid process, construction management and contractor oversight. A capital needs assessment already completed for WAHC properties suggests an immediate need for \$1.5 million in capital improvements. Avalon's capital needs assessment has identified \$250,000 in improvement needs to current stock. WAHC currently has 3 open rehab contracts totaling \$169,000, and Avalon currently has 6 open rehabilitation projects totaling \$1,315,000. The sources of funds are City HOME funds, Low Income Housing Tax Credits, Federal Home Loan Bank, Ann Arbor DDA, Public Service Commission, MSHDA and Washtenaw County. The Avalon projects have built-in rehab service delivery funds to pay for half of this position's salary but the WAHC rehab contracts do not. In addition, the work spent on evaluating, planning and overseeing the implementation of the capital needs assessments for both Avalon and WAHC do not have any other revenue source. Historically, rehab and capital improvement planning and oversight would be absorbed by Avalon's management or executive staff, who flex as needed to ensure coverage of crucial agency activities. However, the merger, and corresponding planning and change management activities has existing staff extended to capacity, and thus unable to devote the requisite time to the scope of current and imminent capital improvements for Avalon and WAHC's portfolios. This position is budgeted at \$40,000 (half-time) for 12 months with the expectation that ongoing rehabilitation contracts will pay for this position beyond the initial 12 months.
- An additional Property Maintenance employee to ensure that WAHC properties are maintained in a manner that is consistent with industry standards. This position will be budgeted at \$50,000 (full-time) for 12 months with the expectation that increased occupancy will generate rental income to pay for this position permanently.
- Third-party fees relating to the merger including:
 - o Legal fees: Restructuring ownership of properties financed with subsidy programs requires attention to compliance issues at the local, state and federal levels. Properties using the Low Income Housing Tax Credit are particularly sensitive to changes.
 - o Accounting fees: The transfer of properties with multiple liens and sources of financing requires careful attention to accounting issues. Despite non-profit sponsorship, properties using the Low Income Housing Tax Credit require particular attention so investor funds are protected.
 - o Contractual and material costs of the communications and community engagement work necessary to successfully manage this process. This work will position Avalon to build a broader base of community support-a critical step in sustaining a larger, merged organization. Avalon staff, its board and its donor base are integral to diversifying

operational support and generating a philanthropic commitment that complements traditional sources of non-profit housing revenue-rents, grants and fees for service. Expanded contractual work during the transition period will be used to increase Avalon’s community engagement and, by the conclusion of the merger, expand Avalon’s ongoing ability to attract community support. In-kind support from the City can play an important role as well. City staff has experience and skills in the areas of communications and design, as well as a broad understanding of community engagement. These costs are budgeted at \$70,000 for 12 months.

- Compensation for Avalon for taking on immediate oversight of WAHC operations and broader asset management. This compensation supports the work of Avalon’s senior staff that will be responsible for major decisions in the areas of disposition of properties, financial oversight, grant management, reduction of payables and a range of issues related to improving operations at WAHC. Avalon will assume primary responsibility for securing additional funding for merger-related activity, and has already secured almost \$800,000 in funding for capital needs and staffing related to the transition. The addition of WAHC property operations to Avalon’s portfolio represents a 50% increase in property and asset management. Avalon’s Director of Operations will spend up to 20 hours a week helping to manage WAHC’s staff and systems and making necessary changes. Avalon’s Director of Finance will be responsible for shifting WAHC’s financial management systems as they are brought into Avalon’s operations. Avalon’s Executive Director will have overall responsibility for the merger and asset management decisions. Ultimately, this merger will succeed if Avalon’s successful operations and management can be extended to the WAHC properties. These fees are budgeted at \$300,000 for 12 months. The total fee compensation for merger activities is significantly less than developer fees associated with similar subsidized acquisition projects, which are typically set at 15% of total development costs and would be well over \$1 million for a similar number of units.

Avalon has already identified funding for more than half of the work entering into the planning period, and has committed to bring in additional funds to offset costs throughout the implementation period. Below is an estimate of total project costs, and secured and potential revenue sources.

| 12-month Project Expenses | | |
|-----------------------------|-------|------------------|
| Type | | Amou |
| Planning & Merger-related | | \$120,000 |
| WAHC Oversight & Operations | | \$140,000 |
| Indirect Staff Costs & Fees | | <u>\$300,000</u> |
| | Total | <u>\$560,000</u> |

| Projected Project Revenues | | |
|----------------------------|-----------|------------------|
| Source | Status | Amount |
| City of AA | Approved | \$ 35,000 |
| City of AA | Requested | \$295,000 |
| Washtenaw County | Approved | \$ 25,000 |
| LISC | Requested | \$ 25,000 |
| Sale of South Main | Projected | \$ 50,000 |
| MSHDA | Approved | <u>\$130,000</u> |

\$560,000

In addition, Washtenaw County has already contributed \$96,600 for WAHC operational support and merger-related activity that has occurred between January 2008 and July 2008.

One important source of funding for merger activities and support of WAHC's significant capital needs will be the sale of select WAHC properties. To this end, City Council has already approved the immediate sale of 723 S. Main Street, 13 Metroview and 5 Trowbridge to enable WAHC to pay off existing debt and maintain its properties as the merger is completed. Main Street, Metroview, and Trowbridge have met their federal affordability requirements and can be sold without penalty of repayment.

There is currently a purchase offer for \$665,000 on the property at 723 S. Main. The current debt is \$132,000 to Comerica Bank, and \$187,889 to the City. 13 Metroview and 5 Trowbridge are each expected to sell for approximately \$65,000. The current debt on 13 Metroview is \$49,723 for a line of credit, and \$47,500 to the City. The current debt on 5 Trowbridge is \$50,776 to Michigan Interfaith Housing Trust Fund, \$18,202 to the City, and \$10,000 to Washtenaw County. All debt owed to the City and County will be reinvested in WAHC and Avalon operations and properties. It is likely that the sale of single family properties will not generate enough proceeds to repay the City's debt. Consequently, the City may need to write-off all or a portion of its debt and release its lien.

Future Capital Needs

Corporate FACTS has completed a capital needs assessment of WAHC's properties and will conduct an assessment of Avalon's properties, to determine the investment needed to keep the properties functional. Each property will require a different strategy and funding sources.

Reinvestment in under-maintained properties is a key aspect of merger activities, as WAHC properties have become caught in a cycle of deferred maintenance, deteriorating conditions and high vacancy rates. Addressing these critical capital needs is a necessary step in addressing this problem. As described in the proposal, a complete plan for addressing capital needs will be included with a report at the end of the first six-month planning period. It is worth noting, however, that significant work is already underway.

Avalon Housing proposes to oversee significant rehabilitation throughout the combined housing stock. Over \$1 million of rehabilitation funding is already committed to Avalon and work is either underway, under contract or has specifications being written for bid. Moreover, OCD is currently managing rehabilitation contracts at WAHC properties. Additionally, capital needs assessments have been prepared for each WAHC and Avalon property and they suggest a total of \$1.8 million in rehabilitation work to be completed in the first year, with an additional \$1 million by the end of year five. Of the \$1.8 million in work identified as still needed in the first year, Avalon has two MSHDA grants secured for \$789,000.

Additional Information and Implications

The loss of WAHC's housing portfolio would likely have a significant negative impact on low-income individuals and families in our community, especially when understood in the larger local housing

context. As stated previously, Ann Arbor has already lost more than 800 units of restricted affordable housing in the past ten years. Additionally, several of the local co-ops are nearing the end of their HUD financing period, and thus will be permitted (upon majority resident approval) to convert from affordable to market-rate housing.

At the same time, the community's Blueprint to End Homelessness calls for the creation of 500 units of affordable housing. There is no question about the need or value of adding housing units for those who are low-income or below. It is, however, difficult to identify where the community will find resources of a magnitude that meets the need. Preserving existing affordable units needs to continue to be a priority, even as new projects are developed.

Preserving units does not mean simply reinvesting funds. It also includes ongoing accountability and performance by housing providers. The Office of Community Development is committed to working with our financial partners to closely monitor the existing affordable housing properties within the City, provide technical assistance, and intervene when necessary to correct any problems.

Staff recommends that Council approve this resolution in order to facilitate a twelve month merger transition plan running from July 08 through June 09, during which Avalon will take on administrative oversight of WAHC operations while completing, with the Office of Community Development and Corporate Facts, the analysis and due diligence necessary to develop a viable and sustainable merged organization, including \$295,000 from the Ann Arbor Housing Trust Fund to support the merger.

Prepared by: Jennifer Hall, Housing Program Manager
Mary Jo Callan, Community Development Director

Reviewed by: Jayne Miller, Community Services Administrator

Approved by: Roger W. Fraser, City Administrator

Whereas, The Office of Community Development (OCD) and the Michigan State Housing Development Authority (MSHDA) have been working with Washtenaw Affordable Housing Corporation (WAHC) on a long-term strategy to maintain WAHC's units as affordable housing;

Whereas, An analysis of WAHC concluded that the organizations long-term viability was at risk due to excessive debt, organizational challenges and financial instability;

Whereas, An agreement was reached with the Avalon Housing Corporation to merge operations with WAHC and seek remedies to preserve WAHC's substantial housing portfolio;

Whereas, In the short term, Avalon has agreed to take over the management of WAHC's properties and operations to facilitate this merger, and will work to increase WAHC's cash flow by filling vacant units;

Whereas, The goal of this merger is to protect the City and State's substantial investment in affordable housing and maximize the number of affordable housing units available for low-income residents in our community and to create a viable business model and long-term strategy to ensure Avalon continues as a strong and sustainable non-profit housing provider; and

Whereas, Avalon requires additional resources in order to facilitate a twelve month merger transition plan running from July 08 through June 09, during which Avalon will take on administrative oversight of WAHC operations while working with the Office of Community Development and Corporate FACTS to complete the analysis and due diligence necessary to develop a viable and sustainable merged

organization;

RESOLVED, That the Mayor and Council approve a contract with Avalon Housing, Inc. for initial activities related to its merger with Washtenaw Affordable Housing Corporation (WAHC), including management of WAHC's properties and operations during the transition period prior to the formal merger;

RESOLVED, That Mayor and Council appropriate \$295,000.00 from the Ann Arbor Housing Trust Fund to fund this contract for merger-related activities; and

RESOLVED, That City Administrator be authorized to take all necessary administrative actions to implement this resolution.