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Preserving Multifamily Rental Housing:

Improving Financing Options in New Jersey

February 2000

A joint report by
the Federal Reserve Banks of New York and Philadelphia

NJ's privately owned multifamily rental housing plays a critical role in providing affordable housing throughout the state. Small entrepreneurs operating small and medium size rental buildings in urban areas struggle to provide housing in relatively low-cost markets while maintaining a viable long-term investment in their buildings and communities. The moderate rehabilitation required to stabilize these units can be completed at a fraction of the cost of new construction or gut-rehabilitation, yet this neglected housing continues to deteriorate and disappear. These renovation projects have difficulty qualifying for conventional financing and housing subsidies, the former because of inherent financial constraints and the latter because existing subsidy programs favor larger projects, new construction, and home ownership. Yet the success of the state's recent construction and home ownership initiatives is likely to depend on preservation of the surrounding rental stock. Promoting investment in these buildings would offer a timely, efficient, and strategic response to housing needs in low- and moderate-income areas, would contribute to the redevelopment of the state's cities, and would complement new construction, home ownership, and smart growth initiatives.

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EXECUTIVE SUMMARY

There are 212,441 housing units in buildings of five or more units in low- and moderate-income census tracts in New Jersey.

Multifamily rental buildings represent a substantial portion of NJ's housing stock, particularly in the state's central cities. The 1990 US Census indicates there are approximately 471,000 rental units in structures with five or more units in New Jersey. In New Jersey's central cities these units account for 26% of total dwelling units, over half of them built before 1960. In NJ's low- and moderate-income census tracts, the state's most affordable markets, there are 212,441 units in buildings of five or more units. Addressing the poor condition, ongoing deterioration, and abandonment of this housing stock is a priority noted in most New Jersey municipalities' comprehensive housing plans. *(See the section on Multifamily Market for additional data.)*

There are numerous obstacles to the preservation of these multifamily rental buildings. Cash flows are restricted by low rents, high maintenance due to age and obsolete systems, high taxes, and rent controls. The resulting thin margins create a disincentive to maintain properties and spin these buildings into a cycle of abandonment. Bank lending policies favor larger loans and projects because of high transaction costs and the lack of a secondary market. Government housing subsidies target home ownership and new or substantially renovated units, with funding programs too complicated to attract smaller owners. *(See the section on Obstacles to Financing for a more complete discussion.)*

***An effective Preservation program could "save"* 25,000 units over 10 years.**

At an average per-unit rehab cost of $10,000, it is possible to "save" units that without intervention would be vacant within a few years. A program that targets 1% of the market annually could preserve 25,000 housing units over 10 years and effectively respond to the trends of deterioration and abandonment in NJ cities, while responding to the needs of small owners in these communities. *(See the Typical Building section for a discussion of building finances.)*

This document outlines two financing strategies, based on programs used in other multifamily markets to preserve existing, occupied multifamily rental housing in low- and moderate-income communities: a debt-based solution that mixes public and private loan dollars, and an equity-based solution that relies entirely on private investment.

A source of low-interest rehabilitation loans that "blend" public and market-rate loan dollars for rehabilitation and refinancing would enable owners to renovate without reducing already low

A debt-based solution enables owners to renovate without reducing already low cash flows.

cash flows and without raising rents while allowing private lenders to share risk with the public sector. Assuming an average per-unit loan size of $20,000 ($10,000 in rehab plus $10,000 in refinancing) and a 50-50 "blend" of public and private loan funds, an effective loan program could preserve affordable rental housing at public-sector cost of $5,000 per unit. *(See Debt-Based Solution in the Closing the Gap section for an explanation of the program and its costs.)*

An equity-based solution maximizes private investment and requires no direct public-sector dollars

An equity pool that invests in small multifamily rental buildings would provide a below-market return for five or more years, with a refinancing by the owner at improved terms to provide an exit for investors. Investors would presumably be motivated by competition for CRA "qualified" investments. The equity investment would have minimal impact on the owner's cash flow and requires no direct financial support from the public sector. To minimize risk, an effective intermediary would manage the fund and provide technical assistance to the original owners, who would continue to manage the buildings. *(See Equity-Based Solution in the Closing the Gap section for an explanation of the program and its costs.)*

Both preservation programs described in these pages serve several of New Jersey's important housing and policy goals:

Cost Effectively Preserve Affordable Units
Preserves deteriorating rental units before they require costly gut-rehab or new construction;

Leverage Private Investment
Attracts private capital to support existing investments by small owners;

Create Jobs
Creates opportunities for local entrepreneurs, including small nonprofits, to invest in their communities;

Preserve Open Space
Limits sprawl by recycling existing housing stock and infrastructure while revitalizing urban areas;

Support Existing Development Success
Complements other community development initiatives—financial resources for rehabilitation should not diminish those already available for other programs.


Multifamily Market
FOR
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MULTIFAMILY MARKET

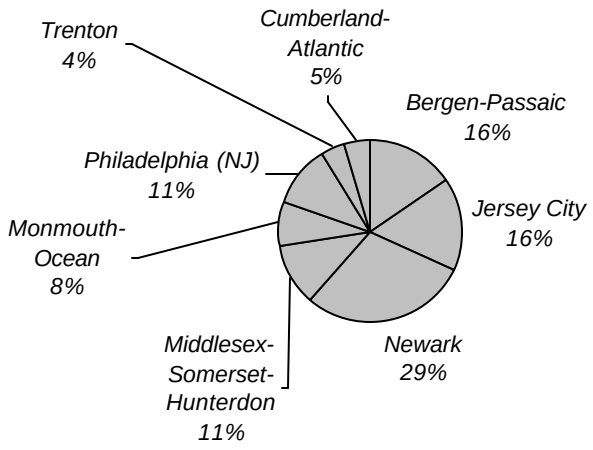
Multifamily buildings represent a substantial portion of NJ's housing stock, particularly in the state's central cities. The 1990 US Census indicates there are approximately 471,000 rental units in structures with five or more units in New Jersey. This represents 16% of the total number of residential units in the state. In the central cities of NJ, multifamily units represent 26% of all dwelling units.

In low- and moderate-income census tracts throughout the state, there are 212,441 housing units in buildings of five or more units.*

These buildings are likely to be old: 40% of NJ's multifamily rental units and 52% of central city multifamily rental units were built before 1960. Addressing the poor condition, ongoing deterioration, and abandonment of this housing stock is a priority noted in most New Jersey municipalities' comprehensive housing plans.

The tables that follow break out rental units in multifamily buildings as a percentage of the overall housing stock in the state of New Jersey, in central city areas, and in individual MSAs throughout the state. The distribution of multifamily rental units across the state is summarized in the pie chart below.

Distribution of Multifamily Units by MSA
(471,000 total units)



* The number of multifamily units in LMI tracts is 1990 census information taken from the Federal Reserve CLAS system. All other data in this market summary are 1990 census information from the public use microdata sample at the University of Virginia Geospatial and Statistical Data Center.

New Jersey Multifamily Rental Units

Occupied[1] New Jersey Housing Units:
Tenure by Number of Units in Structure
1990 Census Public Use Microdata Sample

Number of Units in Structure	State of New Jersey			NJ Central Cities[2]		
	Non-Rental Units	Rental Units	Total Units	Non-Rental Units	Rental Units	Total Units
1-4 units	1,759,355 64%	442,182 16%	2,201,537 80%	326,170 45%	181,116 25%	507,286 70%
5-19 units	40,274 1%	229,190 9%	269,464 10%	8,606 1%	95,849 13%	104,455 14%
20-49 units	10,660 0.5%	104,052 4%	114,712 4%	3,848 0.5%	42,055 6%	45,903 6%
50+ units	18,837 1%	94,991 3%	113,828 4%	5,590 1%	50,869 7%	56,459 8%
Other	14,625 1%	22,815 1%	37,440 2%	3,146 0.5%	9,620 1%	12,766 2%
Total Units	1,843,751 67%	893,230 33%	2,736,981 100%	347,360 48%	379,509 52%	726,869 100%

Occupied[1] New Jersey Rental Units:
Year Structure Built by Number of Units in Structure
1990 Census Public Use Mircrodata Sample

Number of Units in Structure	State of New Jersey			NJ Central Cities[2]		
	1960 or Later	Before 1960	All Rental Units	1960 or Later	Before 1960	All Rental Units
1-4 units	173,745 19%	268,437 30%	442,182 50%	59,946 16%	121,170 32%	181,116 48%
5-19 units	128,934 14%	100,256 11%	229,190 25%	37,219 10%	58,630 15%	95,849 25%
20-49 units	53,495 6%	50,557 6%	104,052 12%	17,303 4%	24,752 7%	42,055 11%
50+ units	72,787 8%	22,204 2%	94,991 10%	36,998 10%	13,871 4%	50,869 13%
Other	10,309 1%	12,506 1%	22,815 3%	4,043 1%	5,577 1%	9,620 3%
All Rental Units	439,270 49%	453,960 51%	893,230 100%	155,506 41%	224,003 59%	379,509 100%

Occupied Housing Units in New Jersey MSAs 1990 Census Public Use Microdata Sample (PUMS)							
MSA	Total Units	Rental Units	Rental Units, 5-19	Rental Units, 20-49	Rental Units, 50+	Total Rental Units in Buildings 5+ (as a % of total units)	Plus Additional 10% Vacant Units[3]
Bergen-Passaic (0875)	462,709 100%	156,637 34%	34,593 7%	15,977 3%	16,328 4%	66,898 14%	73,587
Central City[2]	92,391 100%	50,804 55%	12,129 13%	3,510 4%	6,084 7%	21,723 24%	23,895
Jersey City (3640) All Central City	208,494 100%	132,379 63%	37,622 18%	18,265 9%	14,300 7%	70,187 34%	77,205
Newark (5640)	613,288 100%	241,345 39%	53,300 9%	38,077 6%	32,877 5%	124,254 20%	136,679
Central City[2]	128,999 100%	91,000 71%	20,189 16%	12,389 10%	16,926 13%	49,504 39%	54,454
Midd-Som-Hunt (5015)	363,532 100%	97,331 27%	34,493 9%	9,113 3%	4,914 1%	48,520 13%	53,372
Central City[2]	94,107 100%	34,489 37%	10,322 11%	3,991 4%	2,821 3%	17,134 18%	18,847
Mon-Ocean (5190) --No Central City	404,807 100%	80,444 20%	19,149 5%	7,358 2%	7,436 2%	33,943 9%	37,337
Phila.(NJ) (6160)	396,357 100%	95,459 24%	28,444 7%	10,569 3%	8,437 2%	47,450 12%	52,195
Central City[2]	44,954 100%	15,704 35%	1,989 4%	858 2%	1,885 4%	4,732 10%	5,205
Trenton (8480) --All Central City	117,221 100%	36,335 31%	9,490 8%	2,171 2%	4,693 4%	16,354 14%	17,989
Cumberland (8760) & AtlanticCity(0560)	170,537 100%	53,300 31%	12,073 7%	2,522 1%	6,006 4%	20,601 12%	22,661
Central City[2]	40,703 100%	18,798 46%	4,108 10%	871 2%	4,160 10%	9,139 22%	10,052
New Jersey Total (% of total units in state)						428,233 (16%)	471,056
New Jersey Central City Total (% of total units in central city areas)						188,773 (26%)	207,650

NOTES on TABLES

1 Because housing information in the PUMS database is based on a sample of responding households, vacant units are not included. There were 280,599 vacant units in New Jersey in 1990, 10% of the PUMS sample.

2 "Central City" includes Public Use Microdata Areas (PUMAs) identified as "Central City" or as "Central City and Outside Central City"—this is generally limited to urban areas but in some cases includes adjacent communities.

3 The statewide vacancy rate is just over 9%; it's lower in the northern part of the state and higher in the southern part of the state.

4 Rounding may result in percentages in these tables adding up to slightly more or less than 100%.

Obstacles to Financing

OBSTACLES TO FINANCING

Recognizing the low level of lending to and investment in NJ's multifamily rental stock, the Federal Reserve Banks of New York and Philadelphia organized meetings with concerned bankers, owners, and government representatives to identify the issues. From these meetings, a list of obstacles and a corresponding list of recommendations were created. These lists were reviewed and evaluated by three different focus groups whose members included lenders, owners, and managers of multifamily properties, and government representatives. Both the committee and the focus groups recognize that promoting investment of this kind depends on a number of factors and that efforts to address the problem must overcome several obstacles simultaneously.

Many obstacles block the upgrading or refinancing of these properties. The committee and focus groups identified the following factors as contributing to the problem:

Cash Flow

1. *Deferred Maintenance*
   The age and condition of many of these units require substantial amounts of money to upgrade them, but this sum is often in excess of the properties' after-rehabilitation value.

2. *Thin Margins*
   Rental income barely covers the operating expenses, let alone the additional debt needed for rehabilitation expenses.

3. *Rent Controls*
   Rent control ordinances affect the ability to raise rents to a level that covers the operating expenses and rehabilitation cost.

4. *High Real Estate Taxes*
   The tax burden of many of these properties limits the ability of the property to pay debt service or other operating expenses.

5. *Water and Sewer Costs*
   Older, overcrowded buildings use more water because of leaks from older plumbing and excess water use from overcrowding.

6. *Red Tape*
   There is no tax incentive to upgrade buildings, and the abatement process is often onerous to the "nonprofessional" borrower.

Lending Policies

1. *Difficult for Banks to Deliver Credit to Small Customers*
   Most financial institutions with real estate banking departments concentrate their

lending on bigger projects with more experienced developers, property owners, and managers. Typically, owners of small properties are inexperienced as developers and managers. Business lenders who may originate loans under $1,000,000 often do not consider loans where the basis of repayment is real estate income versus that generated by an operating business.

2. *High Closing Costs*
   Even when financial institutions provide this type of real estate loan, the transaction costs can be prohibitive.

3. *Short Terms and Amortization*
   The smaller financial institutions that originate these loans often do so at terms that are difficult for the property to sustain. Typically, these loans have 20-year amortization periods and five-year terms requiring an expensive re-finance every fifth year. Interest rates are often double digit.

4. *Secondary Market*
   There is no existing workable secondary market in which to place these loans.

5. *FHA: Almost There*
   The FHA created a new program in 1997 to finance 5- to 20-unit properties. While the program provides market rate terms for small projects, as currently designed, the processing procedures are unrealistically complicated for the loan size and profile of the typical customer.

6. *Paperwork*
   The owners of small multifamily properties, while successful in their own profession, are often "nonprofessional" real estate borrowers. The typical process of real estate finance is unknown or overwhelming to them.

7. *Few Loan Alternatives for Five- and Six-Unit Buildings*
   Five- and six-unit properties have an additional regulatory issue in NJ. The state's Department of Banking and Insurance requires that these properties be financed by licensed residential bankers, but most residential lenders lend on 1- to 4-unit properties, which are the standard for the secondary market. Meanwhile, most commercial mortgage bankers consider only properties with 7 or more units.

Government Policies

1. *No Dedicated Subsidy Source*
   There is no significant and dedicated source of subsidy funds available to these properties to offset the rehabilitation costs or provide the incentive to do so.

2. *High Taxes, Low Income*
   The tax burden of many of these properties limits the ability of the property to pay debt service or other operating expenses.

3. *Rent Controls too Rigid*
   In some municipalities, rigid rent controls affect the ability to raise rents to a level that covers the operating expenses and rehabilitation cost, removing any incentive to make significant capital improvements.

4. *Too Small for Tax Credits*
   Because of syndication costs, the size of these properties makes them unlikely candidates for low-income-housing tax credits, a major source of equity for rental housing construction in the last 10 years.

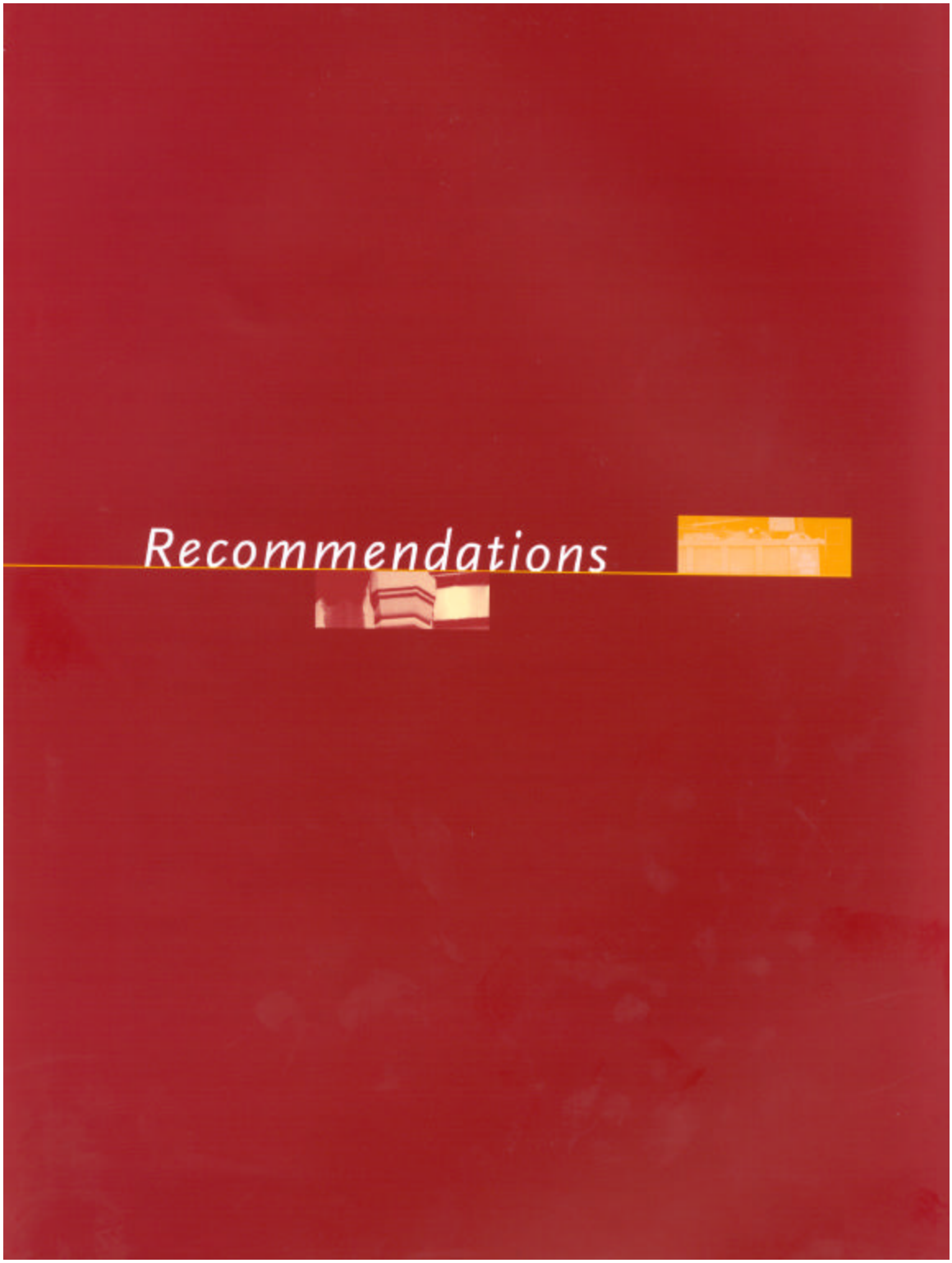
5. *Tax Credit Scoring System*
   The tax credit scoring system favors vacant or new buildings with larger units (two to three bedrooms) and social services, preventing owners of typical small, occupied rental buildings from qualifying.

6. *General Subsidy Squeeze*
   The policy of tying other housing subsidy sources to tax credits leaves little general subsidy monies for other projects, such as small multifamily properties.

7. *Regulatory Burden*
   The annual certification and compliance with income and deed restrictions associated with existing subsidies are difficult for owners of small properties. While geographically targeted subsidy programs have existed in the past, there is currently no alternative to income verification.

8. *High Taxes + Low Rents = Disinvestment*
   Real estate taxes are high throughout NJ, often discouraging reinvestment. In some cases, high taxes interfere with the ability of the owner to borrow the debt needed to improve the property.

9. *Lead-Free Standard*
   Draconian measures intended to remove all lead paint cost more than apartments are worth. "Lead-free" programs result in low compliance and do little to aid the children the standard is intended to protect.


Recommendations

RECOMMENDATIONS

The committee and focus group members developed a comprehensive list of solutions. Not all of the recommendations are acceptable to all stakeholders. Moreover, in some cases, two or more must be implemented simultaneously to achieve the desired result. Despite the complexity, each deserves thoughtful consideration by all parties.

Lending Policies

1. *Standardized, Fixed-Rate Financing*
   These properties need the benefit of dependable market rate financing that single-family and large multifamily properties currently have, including the following:

   a) providing long-term (30-year), self-amortizing loans;
   b) accepting loan-to-value ratios of 80% or higher;
   c) accepting debt coverage ratios of 1.2;
   d) recognizing commercial income;
   e) reducing loan documentation/costs;
   f) eliminating personal guarantees.

2. *Mortgage Insurance*
   Mortgage insurance can provide a form of guarantee that will bring private lenders into the permanent mortgage market.

3. *A More Accessible Secondary Market*
   With standardized loans and mortgage insurance, a secondary market providing liquidity will likely develop.

4. *Modified FHA Small Projects Program*
   The FHA Small Projects Program responds to recommendations 1, 2, and 3 above; however, the long processing time and financing costs make it inappropriate for these projects. The program could be revised to address the nature of the property and borrower. While the loan terms are attractive, at a bare minimum, third-party expenses could be reduced and processing time shortened as in the SBA Preferred Lender Program. Additionally, there should be a staff devoted to these types of loans, just as banks separate small-business lenders and corporate lenders.

5. *Technical Assistance*
   Technical assistance is needed for many property owners with multifamily properties. There is a difference between TA for project feasibility/financing and for ongoing property management—both of these are needed. Lenders can help provide this information, as they have with first-time homebuyers and small-business owners.

Government Policies

1. *New Dedicated Equity or Subsidy Source*
   A new source of capital equity or subsidy, targeted to LMI neighborhoods and without income restrictions on individual units, would greatly increase the borrowers' ability to improve a property to code or to modernize it and still carry an affordable debt service. Targeting LMI neighborhoods is consistent with the public purpose of many state and federal funding programs and has proven in the past not to gentrify the neighborhood.

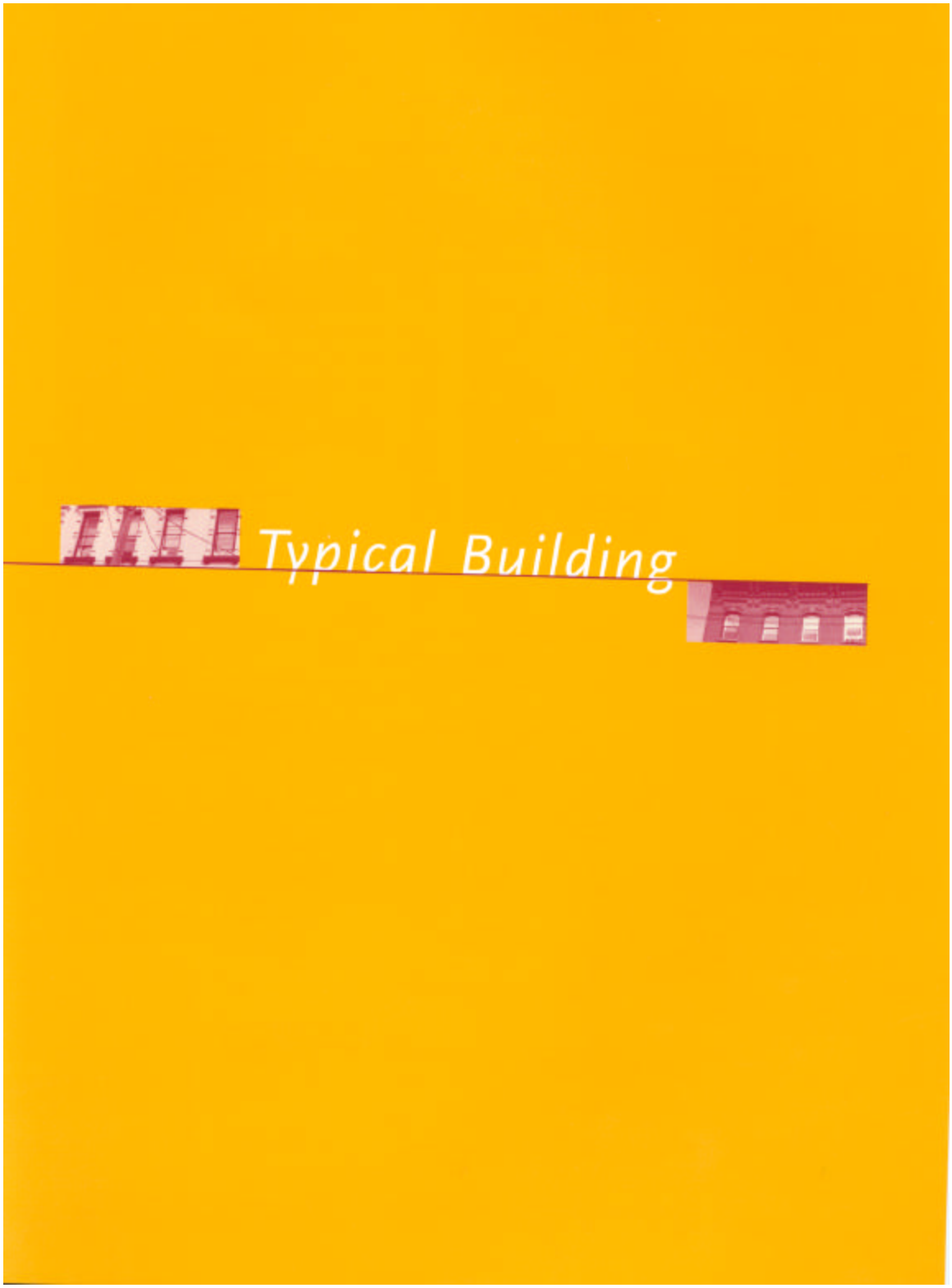
2. *Improved Tax Policy*
   Real estate tax assessment policies should be changed to provide an owner with the incentive to make improvements. This new process needs to be consistently and uniformly applied in all municipalities, similar to HMFA's procedures for Payment in Lieu of Taxes (PILOT) when its financing is used.

3. *Technical Assistance*
   Technical assistance is needed for many of the property owners with multifamily properties. There is a difference between TA for project feasibility/financing and for ongoing property management—both of these are needed

4. *Improved Rent Controls*
   Promote routine, expeditious processing of rent increases to pay for capital improvements and, where government provides a subsidized rehab loan in tandem with a bank loan, permit rent restructuring immediately upon completion of construction so that the new debt, taxes, and operating expenses can be paid.

5. *Rehabilitation Code*
   The construction code for rehabilitation has been changed, and the modifications should have a positive impact on the upgrading of existing buildings. It is important that all owners, architects, and local officials be knowledgeable about these code changes, so that owners are encouraged to upgrade systems as cash flow permits, rather than all at once.

6. *Lead Safe vs Lead Free*
   Abating lead paint is an important goal, but not at the expense of affordable housing. Lead safe should be the standard when lead free is not feasible. This requires state, local, and federal coordination.


Typical Building

TYPICAL BUILDING

The following demonstrates how implementing the committee's recommendations affects the economics of a multifamily property. For the purposes of this paper, a "typical" small rental building would be 15 units, masonry construction, built before 1960. The building is located in an urban LMI neighborhood and may be surrounded by 1- to 4-unit buildings. The owner is not a full-time real estate professional. Although the units are occupied, several building systems have substantially deteriorated.

Project Address	Low- or moderate-income area
Developer & Contractor	Owner contracts directly
# units	15 units
Per-unit monthly rent	$500
Vacancy	7%
Annual pre-tax expenses	$3000 per unit
Taxes	15%
Existing Debt	$10,000 per unit
Scope of work	approx. $10,000 per unit

Scope is limited to selected building systems as described below.

SCOPE OF WORK
(Summary)

Costs by Trade:
(Without Davis Bacon or Prevailing Wage Requirement)

Trade Item	Total Cost	
SITE WORK	5,250	
DEMOLITION & SHORING	5,000	
MASONRY & WATERPROOFING	11,540	
ROUGH CARPENTRY	1,200	
WINDOWS & GLAZING	19,200	
PLASTERING	2,000	
DRYWALL	11,250	
CERAMIC TILE	6,250	
PAINTING	7,950	
PLUMBING	43,500	
ELECTRICAL	26,250	
Subtotal	*$ 139,390*	
Contractor's Fee (5%)	$ 6,970	
Contractor's Overhead (5%)	$ 6,970	
TOTAL	**$ 153,329**	
	$ 10,222	***Per unit***

Now let's look at what happens under three different financing scenarios.

Assuming financing is available at market rates (assume 8%, 20-year amortization, 1.30 debt coverage ratio), this property has the ability to service debt of $200,314, or $13,354 per unit (see Scenario #1). Unfortunately, if the property needs the $153,329 in rehabilitation assumed in our "typical" building, the owner must finance more than two-thirds of it ($103,015) from his own pocket or forgo the improvements.

If the debt financing, however, has a longer (30-year) term and lower debt coverage ratio (1.20), as in Scenario #2, the building's ability to carry debt improves. With these terms, the "typical" property can now carry $247,304 in debt. That still leaves the owner with a need to finance approximately one-third of the improvements ($56,025) from his own resources or forgo the improvements.

A third recommendation of the committee was to reduce the real estate taxes on these properties, particularly if it could be done as an inducement to upgrading the building. Scenario #3 demonstrates that if our "typical" property's real estate taxes were reduced from 15% of effective gross income to 7.5%, the property could support debt of $306,683. That covers its existing debt of $150,000 and the full renovation expense of $153,329.

Scenario #1
CONVENTIONAL FINANCING
(Private loan at 8% for 20 years, 1.30 DCR)

Gross Rental Income (15 Units @ $500/mo.)	$90,000
Less: Vacancy @ 7%	$6,300
Effective Gross Income	*$83,700*
Expenses: ($3,000 per unit annually)	$45,000
NOI Before RE Taxes & Debt Service	*$38,700*
Real Estate Taxes	$12,555
NOI Before Debt Service	*$26,145*
Debt Coverage Ratio (DCR)	1.30
NOI Available for Debt Service	$20,112
Constant	0.1004
Maximum Debt	**$200,314**
Maximum Debt per Apartment	**$13,354**
Cash Flow After Debt Service	$6,033

Scenario #2
CONVENTIONAL FINANCING
WITH MORTGAGE INSURANCE

Gross Rental Income (15 Units @ $500/mo.)	$90,000
Less: Vacancy @ 7%	$6,300
Effective Gross Income	*$83,700*
Expenses: ($3,000 per unit annually)	$45,000
NOI Before RE Taxes & Debt Service	*$38,700*
Real Estate Taxes	$12,555
NOI Before Debt Service	*$26,145*
Debt Coverage Ratio (DCR)*	1.20
NOI Available for Debt Service	$21,788
Constant	0.0881
Maximum Debt	**$247,304**
Maximum Debt per Apartment	**$16,487**
Cash Flow After Debt Service	$4,358

*This scenario assumes that with mortgage insurance as a credit enhancement, banks will reduce debt coverage ratio to 1.2 and increase amortization to 30 years.

Scenario #3
CONVENTIONAL FINANCING WITH MORTGAGE INSURANCE AND TAX ABATEMENT

Gross Rental Income (15 Units @ $500/mo.)	$90,000
Less: Vacancy @ 7%	$6,300
Effective Gross Income	*$83,700*
Expenses: ($3,000 per unit annually)	$45,000
NOI Before RE Taxes & Debt Service	*$38,700*
Real Estate Taxes	$6,278
NOI Before Debt Service	*$32,423*
Debt Coverage Ratio (DCR)*	1.20
NOI Available for Debt Service	$27,019
Constant	0.0881
Maximum Debt	**$306,683**
Maximum Debt per Apartment	**$20,446**
Cash Flow After Debt Service	$5,404

*This scenario assumes that with mortgage insurance as a credit enhancement, banks will reduce debt coverage ratio to 1.2 and increase amortization to 30 years.

The previous scenarios demonstrate that changing the terms of financing and lowering tax expense can generate the cash flow to upgrade the multifamily housing stock in New Jersey. While these changes seem to be sufficient for the "typical" property, there will be other multifamily properties that require a subsidy, grant, or equity to make it economically feasible. This is the concern noted under "New Dedicated Equity or Subsidy Source" in the Recommendations section. To address this, the report discusses two methods of closing the financing gap. One is called the debt-based solution and the other is the equity-based solution. Both are described more completely in the following section.

Closing the Gap

A) Debt-Based Solution

B) Equity-Based Solution

DEBT-BASED SOLUTION: A PUBLIC-PRIVATE REHABILITATION LOAN PROGRAM

Nature of the Program

The proposed loan program blends low-interest public dollars with market-rate private dollars to promote the rehabilitation of vacant or still-occupied rental buildings. The public funds are loaned, not granted, and typically repaid over 30 years. The bank and governmental funds are loaned in co-first position during construction. Once the construction loan is converted to a permanent loan, the government's mortgage is subordinated to the bank's loan. Underwriting, origination, construction monitoring, and servicing are delegated to the private lender. It is important that monies to fund the government's portion of the program not be diverted from existing housing programs.

Eligible Buildings

Eligible buildings are five-family or larger apartment buildings or mixed-use properties, located in targeted low- and moderate-income neighborhoods, that need to have essential building systems replaced and to be brought into compliance with code. Subsidy eligibility is based on inability of project cash flow to support additional debt at market interest rates for needed rehabilitation.

Eligible Borrowers

Eligible borrowers include both for-profit and not-for-profit owners or purchasers of eligible buildings in geographically targeted LMI areas.

Leverage

Government loans will be matched with private financing and new equity investment. Where rents and rehabilitation needs are moderate, the private share rises. Where rents are low and building needs are greater, the government share rises. The ratio of public to private debt ranges from 70:30 to 50:50 to 30:70. Owner equity contributions will range from 10% to 20% of development costs, seeking a rate of return of 10% to 20%.

Program Features

- A bank loan[*] at market interest rate combined with a public loan at below-market interest rate of 1%, up to 30 years (self-amortizing). The "blended" rate allows loan amounts large enough to cover development costs.
- Leverage government agency's staff capacity by delegating underwriting to pre-approved private lenders pursuant to agreed-upon terms.

[*] To be most effective, underwriting standards on the bank loan would include 80% loan to value, 1.20 debt service coverage, and 30-year amortization / 30-year term.

- Lender fully shares construction risk in a co-first mortgage arrangement with funding pari passu during the construction period. After construction is done, the public mortgage becomes fully subordinate. Subordination is needed to enlist long-term mortgage investors who won't purchase a shared-lien position.
- Geographically targeted to particular LMI neighborhoods in which the operating income of the typical apartment building cannot support sufficient private financing to accomplish the needed rehabilitation.
- Required owner equity of 10%.
- No deed restrictions.
- No tenant income certification (initial or annual recertification).
- Due-on-sale.
- Rehabilitation work eligible for tax abatements and exemptions.

Scenario #4
BLENDED RATE LOAN (30/70)
WITH MORTGAGE INSURANCE

Gross Rental Income (15 Units @ $500/mo.)	$90,000
Less: Vacancy @ 7%	$6,300
Effective Gross Income	*$83,700*
Expenses: ($3,000 per unit annually)	$45,000
NOI Before RE Taxes & Debt Service	*$38,700*
Real Estate Taxes*	$12,555
NOI Before Debt Service	*$26,145*
Debt Coverage Ratio (DCR)#	1.15
NOI Available for Debt Service	$22,735
Constant	0.0708
Maximum Debt	**$321,113**
Maximum Debt per Apartment	**$21,408**
Cash Flow After Debt Service	$3,410

*Scenarios 4, 5, and 6 assume no tax abatement.
#For Scenarios 4, 5, and 6, we assume there will be a lower overall DCR if the public loan is subordinate to the private loan.

Scenario #5
BLENDED RATE LOAN (50/50)
WITH MORTGAGE INSURANCE

Gross Rental Income (15 Units @ $500/mo.)	$90,000
Less: Vacancy @ 7%	$6,300
Effective Gross Income	*$83,700*
Expenses: ($3,000 per unit annually)	$45,000
NOI Before RE Taxes & Debt Service	*$38,700*
Real Estate Taxes	$12,555
NOI Before Debt Service	*$26,145*
Debt Coverage Ratio (DCR)	1.15
NOI Available for Debt Service	$22,735
Constant	0.0609
Maximum Debt	**$373,313**
Maximum Debt per Apartment	**$24,888**
Cash Flow After Debt Service	$3,410

Scenario #6
BLENDED RATE LOAN (70/30)
WITH MORTGAGE INSURANCE

Gross Rental Income (15 Units @ $500/mo.)	$90,000
Less: Vacancy @ 7%	$6,300
Effective Gross Income	*$83,700*
Expenses: ($3,000 per unit annually)	$45,000
NOI Before RE Taxes & Debt Service	*$38,700*
Real Estate Taxes	$12,555
NOI Before Debt Service	*$26,145*
Debt Coverage Ratio (DCR)	1.15
NOI Available for Debt Service	$22,735
Constant	0.0511
Maximum Debt	**$444,908**
Maximum Debt per Apartment	**$29,661**
Cash Flow After Debt Service	$3,410

COSTS OF A PUBLIC/PRIVATE LOAN PROGRAM

Assumptions

For this estimate, it is assumed that defaults and prepayments offset risk, and therefore, the discount factor is equivalent to the taxable bond rate. The cost to government is calculated as the difference between the cost to retire the bonds and the present value of the loan repayments made under the rehabilitation program.

Government borrows at same term as government lends, say, 30 years
Discount factor = government borrowing rate

Rates used to develop scenarios are:

Below-market lending rate	*1.00%*
Bank interest rate	*8.00%*
Public-private "mix"	*50:50*
"Blended rate"	*4.75%*
Government borrowing rate w/ overhead and servicing	*6.50%*
Discount factor	*6.50%*

Comparative rates:

US 30-yr. Bond	6.00%
Issuance, overhead, servicing	0.50%
Government loan rate to borrower	1.00%
High quality corporate (Aaa)	6.75%
Municipal tax exempts (Aaa) (revenue)	5.20%
Municipal taxable	7.20%
Equity yield	15-20%

Building assumptions:

Moderate rehabilitation scope	$10,000 per unit
Existing debt per unit	$10,000 per unit
Average building size	15 units
Range of monthly rent	$300 to $750
Income range of tenants	Low- and moderate-income

PRODUCTION GOAL:
25,000 units over 10 years, or 11% of eligible units in LMI census tracts.

ANNUAL PRODUCTION GOAL:
2,500 units per year @ avg. of 15 units per building = 167 transactions per year

Average loan size = $ 20,000 per unit
($10,000 in rehab costs, plus refinance of $10,000 existing debt per unit)

Average public loan	$ 10,000 per unit x 2,500 units	= $ 25,000,000 per year
Average private loan	$ 10,000 per unit x 2,500 units	= $ 25,000,000 per year
Average equity	$ 1,600 per unit x 2,500 units	= $ 4,000,000 per year
Totals:	**$21,600 per unit x 2,500 units**	**= $ 54,00,000 per year**

ANNUAL COST TO GOVERNMENT:

Present value of government bond obligation (6.5%, 30 years)	$25,000,000
Minus present value of cash flow from loan repayment at 1% (@ 6.5%, 30 years)	$12,589,000
Present value cost to government	$12,411,000
Divided by number of units	2,500 units
Per-unit subsidy	*$ 5,000 per unit*

ANNUAL COST TO PRIVATE SECTOR:

Because the private sector lends at what it determines as the market rate, there is zero cost to private-sector lenders.

ANNUAL LEVERAGE:

Total annual investment	$ 54,000,000
Divided by government annual expenditure	$ 12,411,000
leverage	4.35 times

EQUITY-BASED SOLUTION: A LIMITED-RETURN PRIVATE EQUITY POOL

Nature of the Program

The proposed equity pool would make equity investments in small multifamily properties to enable owners to undertake moderate renovation. Investors would receive a limited annual cash return (5-7%) paid out of cash flow. The actual amount would be determined on a per project basis. With a purchase or refinancing of existing debt at more favorable terms, owners can pay for both renovation and the return to investors with minimal impact on existing cash flow. The owner would refinance and buy out the equity pool at a negotiated time, e.g., five years. The pool, which would be managed by a single bank or other intermediary, would present a qualified investment opportunity for financial institutions seeking CRA credit.

Eligible Buildings

Rental apartment buildings or mixed-use properties with five or more units located in LMI census tracts. Because no public subsidies are involved, and the CRA allows targeting by geography, there is no requirement to target the program further, for example, by tenant income.

Eligible Borrowers

Eligible borrowers include both for-profit and not-for-profit entities.

Program Features

- Private equity investment combined with bank loan at market rate with mortgage insurance and 30-year amortization.*
- Bank loan in first position.
- Investors' equity unsecured.
- Owners' equity contribution of 10%.
- Cash on cash return to equity investors – projected minimum of 5% from building's cash flow.
- Exit for investors after five, seven, or 10 years, as negotiated.
- Geographically targeted to LMI census tracts

* To be most effective, underwriting standards on the bank loan would include 80% loan to value, 1.20 debt service coverage, and 30-year amortization / 30-year term.

Scenario #7
EQUITY-BASED SOLUTION
(Private loan at 8% at 30-year term, equity investment return of 5%)

Gross Rental Income (15 Units @ $500/mo.)	$90,000
Less: Vacancy @ 7%	$6,300
Effective Gross Income	*$83,700*
Expenses: ($3,000 per unit annually)	$45,000
NOI Before RE Taxes & Debt Service	*$38,700*
Real Estate Taxes*	$12,555
NOI Before Debt Service	*$26,145*
Debt Coverage Ratio (DCR)	1.20
NOI Available for Debt Service	$18,706
Constant	0.0881
Maximum Debt	**$212,330**
Maximum Debt per Apartment	**$14,155**
Cash Flow After Debt Service	$7,439
Cash Flow After Return to Equity Investor	$2,889

*Assumes no tax abatement for this scenario.

Scenario #8
EQUITY-BASED SOLUTION
(Private loan of 8% at 30-year term, equity investment return of 5%)

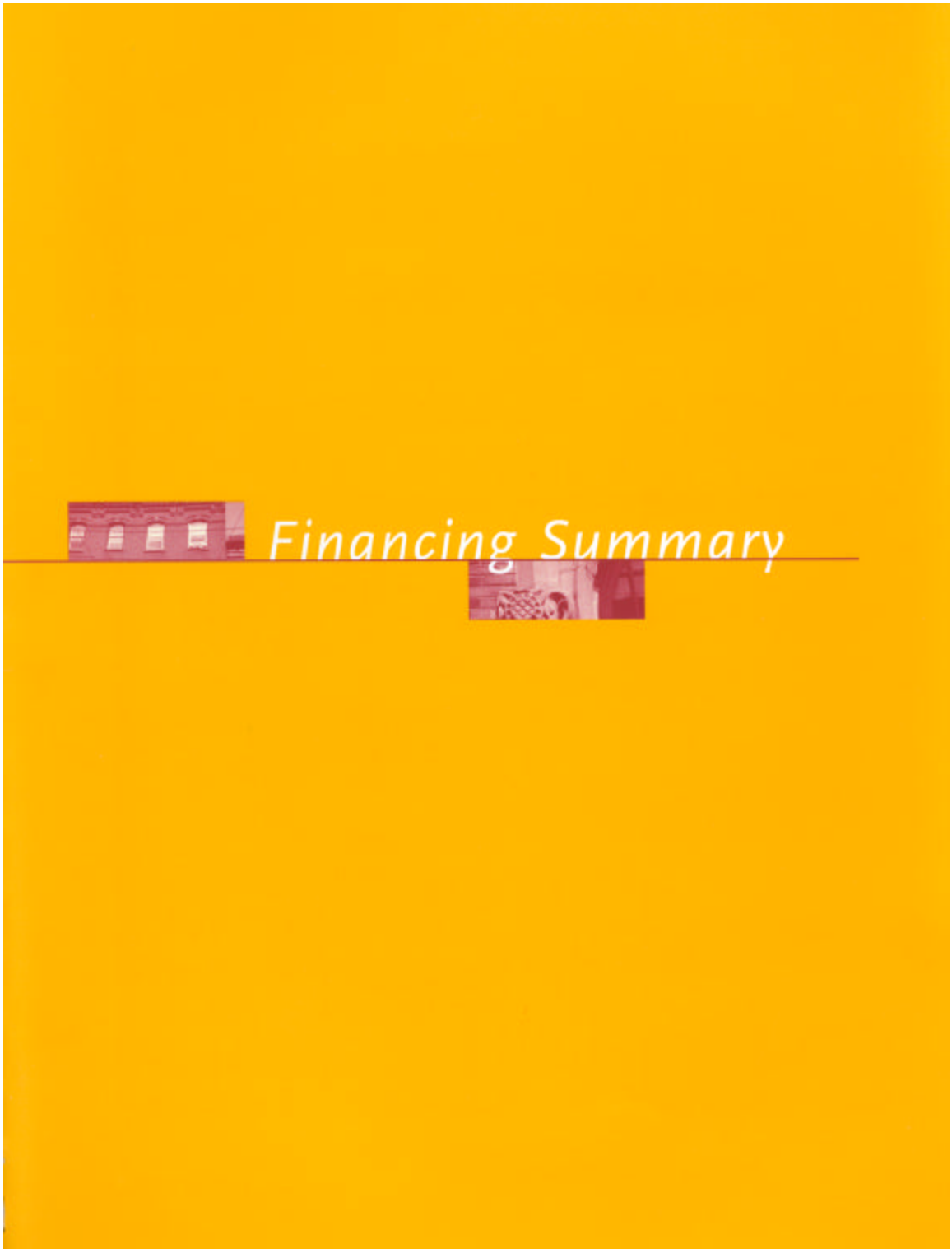
Gross Rental Income (15 Units @ $500/mo.)	$90,000
Less: Vacancy @ 7%	$6,300
Effective Gross Income	*$83,700*
Expenses: ($3,000 per unit annually)	$45,000
NOI Before RE Taxes & Debt Service	*$38,700*
Real Estate Taxes*	$12,555
NOI Before Debt Service	*$26,145*
Debt Coverage Ratio (DCR)	1.20
NOI Available for Debt Service	$13,362
Constant	0.0881
Maximum Debt	**$151,665**
Maximum Debt per Apartment	**$10,111**
Cash Flow After Debt Service	$12,783
Cash Flow After Return to Equity Investor	$5,200

*Assumes no tax abatement.

EQUITY-BASED SOLUTION EXIT
(Refinancing at 8%, 30-year amortization)

Income Growth:	Starting Gross Rental Income	$ 90,000
	x 5 years' rent growth at 3%=	$ 104,335
	-7% Vacancy	(7,303)
	Effective Gross Income	*$ 97,032*
Expenses:	Pre-Tax Expenses @ $ 3,000 per unit*	(45,000)
	RE Taxes (15% of EGI)	(14,555)
	Net Operating Income	**$ 37,477**
New Debt Service:	Debt Coverage Ratio	1.20
	NOI Available for Debt Service	$31,206
	Maximum Debt	**$354,209**
	Maximum Debt Per Unit	***$23,614***
Cash Flow:	Annual cash flow to owner	$6,271

* For the purposes of this scenario, capital improvements hold maintenance expenses steady over time. It may be more realistic to assume an increase in expenses.


Financing Summary

Summary of Impact of Financing Changes

Assume: $10,000 per unit existing debt or acquisition price
$10,222 Rehabilitation Cost (See Typical Building)
Total Cost of $303,329

Gross Rental Income (15 Units @ $500/mo.)	$90,000
Less: Vacancy @ 7%	$6,300
Effective Gross Income	$83,700
Expenses: ($3,000 per unit annually)	$45,000
NOI Before RE Taxes & Debt Service	$38,700

	Scenario #1	**Scenario #2**	**Scenario #3**	**Scenario #4**	**Scenario #5**	**Scenario #6**	**Scenario #7**	**Scenario #8**
Real Estate Taxes	$12,555	$12,555	$6,278	$12,555	$12,555	$12,555	$12,555	$12,555
NOI Before Debt Service	$26,145	$26,145	$32,423	$26,145	$26,145	$26,145	$26,145	$26,145
Debt Coverage Ratio (DCR)	1.3	1.2	1.2	1.15	1.15	1.15	1.40	1.96
NOI Available for Debt Service	$20,112	$21,788	$27,019	$22,735	$22,735	$22,735	$18,706	$13,362
Constant	0.1004	0.0881	0.0881	0.0708	0.0609	0.0511	0.0881	0.0881
Maximum Debt	$200,314	$247,304	$306,683	$321,113	$373,313	$444,908	$212,330	$151,665
Debt Compared to Total Cost ($303,329)	0.66	0.82	1.01	1.06	1.23	1.47	0.70	0.50
Maximum Debt per Apartment	$13,354	$16,487	$20,446	$21,408	$24,888	$29,661	$14,155	$10,111
Maximum Cost per Typical Apt.							$20,222	$20,222
Cash Flow After Debt Service	$6,033	$4,358	$5,404	$3,410	$3,410	$3,410	$7,439	$12,783
Cash Flow After Return to Equity Investor	n/a	n/a	n/a	n/a	n/a	n/a	$2,889	$5,200

MULTIFAMILY COMMITTEE

The Multifamily Housing Preservation Committee was formed in early 1998 to identify obstacles to financing the renovation of multifamily rental units and to make recommendations for overcoming those obstacles. Of particular concern was the unmet credit need for the rehabilitation of older, urban, small to mid-size multifamily properties. In 1999 three focus groups met to evaluate the committee's list of obstacles and recommendations.

The Multifamily Housing Preservation Committee is composed of individuals and organizations involved in developing, owning, managing, and financing multifamily properties in NJ:

Committee Participants

Dianna Beck-Clemens	Summit Bank
Walter Cohn	Cohn & Cohn
Eileen Della Volle	Summit Bank
Maryann Diak Stern	HUD Multi Family Programs
Susan Dimetros	City of Elizabeth - Home Improvement Program
Christopher Garlin	The Domus Corporation
Jonathan Gershen	The Gershen Group
Bob Graham	New Jersey Community Loan Fund
Phillip Hoffart	Fairmont Development Corp. - YWCA
Bill Inglefield	Union County Div. of Community Development
Charles Jones	Fannie Mae
Carla Lerman	Episcopal Community Development
Anne Li	New Jersey Community Loan Fund
Marie Mascherin	Quaker Capital
Dede Myers	Federal Reserve Bank of Philadelphia
Luis Ona	PICO
Justin Peyser	Community Preservation Corporation
Preston Pinkett III	PNC Bank
Stuart Portney	Metro Company
Robert Riggs	Federal Reserve Bank of New York

Michelle Richardson	Chase Manhattan Community Development Corp.
Elizabeth Rodriguez Jackson	Federal Reserve Bank of New York
Annemarie Uebbing	Jersey City Division of Affordable Housing
Gordon Ur	TICIC
Evelyn Wolff	NW Capital

In addition to the participants listed above, the committee consulted with representatives of the New Jersey Housing and Mortgage Finance Agency (HMFA) and the New Jersey Division of Community Affairs (DCA). Focus group participants are listed on the next page.

Multifamily Housing Focus Group Participants

Gary Altomara	NJ DCA
Anna Auerbach	*NJHMFA*
Craig Baskerville	*Elizabeth Development Company*
Barry Lee Black	*NHSA*
Macey Bullock	Maylock Realty
Sally Digges	Neighborhood Reinvestment Corporation
Gerard Graddy	Wrigley Park Development
Frank Haaz	American Affordable Housing Group
Bob Huether	Summit Bank
Lester Johnson	Maylock Realty
Peter Kasabach	Isles, Inc.
Diane Kinnane	NJ DCA
Karen Kollias	Neighborhood Reinvestment Corporation
Amy Lempert	Community Development Trust
Robert E. Levy	Mortgage Bankers Association of New Jersey
John Murray	Commerce Bank, N.A.
William O'Dea	Elizabeth Development Company
James Oser	Chambers Street Partners
Rick Owen	Fleet Bank, N.A.
Justin Peyser	Community Preservation Corporation
Marcial Robiou	Business Consortium Fund
Victoria Rose	Sovereign Bank
Ron Rukenstein	Community Grants & Planning
Richard Spears	Powerhouse Realty
Annemarie Uebbing	Jersey City Division of Affordable Housing
Paul Van Cleve	Meridian Property Company
William Waits	New Jersey Department of Banking & Insurance
Stanley Weeks	City National Bank of New Jersey

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