Policy Brief:

Preserving Permanent Supportive Housing in Los Angeles

September 2022

The Importance of Preserving Permanent Supportive Housing

Preserving and modernizing our existing project-based permanent supportive housing (PSH) should be viewed as an integral strategy toward the region's long-term goal to end homelessness and a companion approach that aligns with PSH production efforts. Ensuring the long-term sustainability of a growing universe of PSH assets offers tangible benefits for policymakers, owners, residents and their communities, including:

- Protecting and extending housing affordability for another generation of use (e.g., 30-55 years)
- Upgrading major building systems to improve energy-efficiency, performance, and compliance
- Redesigning dated physical layouts to be more compatible for on-site supportive services delivery, community building, and building management
- Improving financial health and increasing operating income through loan restructuring, recapitalization, and adding or modifying rental subsidies
- Improving the quality of life and ensuring the housing stability for vulnerable BIPOC households

Background and Purpose of this Research

Since 2015, Enterprise Southern California has been leading a regional initiative to preserve a cohort of aging, at-risk supportive housing across Los Angeles County. We do so through research, convening and educating practitioners and policymakers, technical assistance and training, and public policy advocacy. This brief builds upon two earlier risk assessments, respectively, from 2017 and 2019. During the fall 2021, Enterprise partnered directly with PSH owners, through interviews and surveys, to collect and analyze project-level data. In some cases, the research simply updated data from our last set of findings from 2019, in other cases we gathered information on at-risk projects for the first time.[1] This research brief serves as a biennial risk assessment of the aging PSH stock across Los Angeles, to ensure policymakers and housing officials have a clear understanding of the PSH risk profile in Los Angeles and that solutions are calibrated to those risk characteristics.[2]

[1] There are two nonprofit PSH owners that are reflected in this assessment that were not in 2019: Abode Communities and Little Tokyo Service Center CDC.

[2] For the purposes of this assessment, risk is defined as one or more of the following criteria: 1) projects with affordability restrictions expiring within the next five years; 2) projects that require physical or financial restructuring within the next five years to remain viable; and 3) projects that are at least 15 years since they were placed in service or since their original acquisition and rehabilitation date.

Preservation Barriers

Just like creating and operating PSH is distinctive relative to other forms of affordable housing — from its specific financing sources, deeper income targeting, higher operating costs, and focal population (those exiting homelessness) — so is preserving aging, at-risk PSH properties. Preservation strategies therefore must address these unique elements and barriers to be successful. Preservation barriers fall into three main categories but boil down to this simple maxim: the earliest supportive housing projects in Los Angeles, created largely through acquisition and rehab approaches of existing housing stock (including SRO buildings), were simply not designed to meet modern expectations and demands. The barriers are physical, financial, and public policy-related in nature, as follows:

- **Physical:** PSH owners are looking to address deferred maintenance needs, upgrade outdated building systems, create or expand supportive services spaces, renovate common areas, and add features to meet accessibility requirements and other mandates related to energy efficiency and seismic risk.
- **Financial:** Aging PSH projects generally run on thin financial margins and receive insufficient operating support to cover escalating costs like utilities, security, maintenance, and long-term vacancies. As a result, within this aging cohort, we are seeing depleted project reserves, underwater financials, and owners needing to offset deficits through their own organizational resources.
- **Public Policy:** The shift to "housing first" and the continued expansion of the Coordinated Entry System (CES) requires PSH owners to sustain aging buildings that were not structured financially to absorb higher operating expenses and lengthy vacancies that have become commonplace and commensurate with delivering high quality PSH for the highest acuity households. Owners also face a limited to nonexistent set of public finance tools that either make these projects ineligible or non-competitive for recapitalization financing, thereby delaying opportunities to infuse needed capital to restructure the financing and complete rehabilitation.

A Deeper Look at Aging PSH in Los Angeles

Since our first risk assessment five years ago, the region's at-risk PSH portfolio has grown significantly, up now to 2,637 PSH units within 57 projects, a 15% increase (in units) from the previous assessment in 2019. Our findings reveal an aging portfolio that is showing worsening trends around financial health, as more projects are reporting breakeven or negative financials, and rising levels of near-term affordability risk. Contrasted with a static rental subsidy environment amid escalating operating costs, far outpacing original and now archaic budget assumptions (relative to modern expectations) and limited financial avenues to pursue recapitalization and rehabilitation strategies, there are serious structural concerns that threaten the long-term viability of our earliest PSH stock. Before we examine more finite physical and financial characteristics and suggest some policy recommendations, here is a high-level summary.

Table 1: At-Risk PSH Portfolio Characteristics

	2019	2021
Total Projects	50	57
Total PSH Units	2,238	2,637
Median Year Built	1930	1925
Financial Health: Percentage of Projects Reporting Breakeven Operations or Worse	72%	81%
Total Rehabilitation Cost (only rehab projects)	$114,114,060	$148,116,348
Average Rehab Cost per Unit	$56,979	$63,498
Projects/Units with Expired Affordability Restrictions (by December 2021)	Projects: 9 Units: 505	Projects: 12 Units: 649
Projects/Units with Near-Term Affordability Risk (by December 2026)	Projects: 10 Units: 510	Projects: 5 Units: 243

Physical Characteristics

- **Geographic Distribution:** Because of where the earliest PSH projects were created, reflective of acquisition and rehabilitation approaches within the city of Los Angeles (such as older SRO buildings transferred through the Community Redevelopment Agency or CRA), they tend to be concentrated geographically. For instance, more than one-half (51%) of at-risk projects are located within Los Angeles City Council District 14, with the balance occurring in Council Districts 13 and 1, respectively (see Figure 1). That lack of geographic disparity is also evident countywide. Across the Los Angeles County Service Planning Areas (SPAs), a staggering 82% of at-risk projects are in SPA 4 (Metro), which covers downtown Los Angeles and Hollywood (See Figure 2).

Figure 1: Distribution of At-risk PSH Properties by Los Angeles City Council District

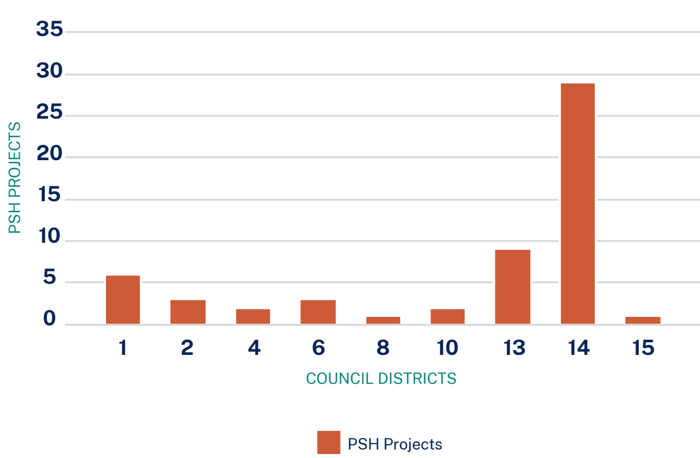
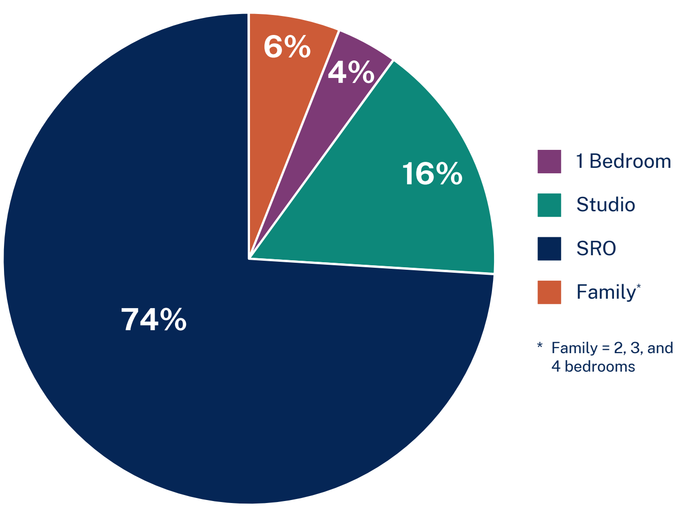


Figure 2: Distribution of At-risk PSH Properties by Los Angeles County Service Planning Area

- Unit Type: Single Room Occupancy units represent 74% of the entire at-risk PSH inventory. In many respects, this housing type has come to define the "face" of the earliest PSH examples across Los Angeles (and frankly in other communities with similar housing stock like San Francisco, Oakland, even Sacramento). This model of PSH is significant because it has fallen out of favor with public funders and investors that prefer or require "complete" units in the form of studios and efficiencies. Additionally, SRO owners are experiencing lengthy delays finding qualified referrals through the local CES, which speaks to a deepening policy dilemma as to the best use and target population for these programs (See Figure 3).

Figure 3: Types of Unit Configurations across At-risk PSH Portfolio

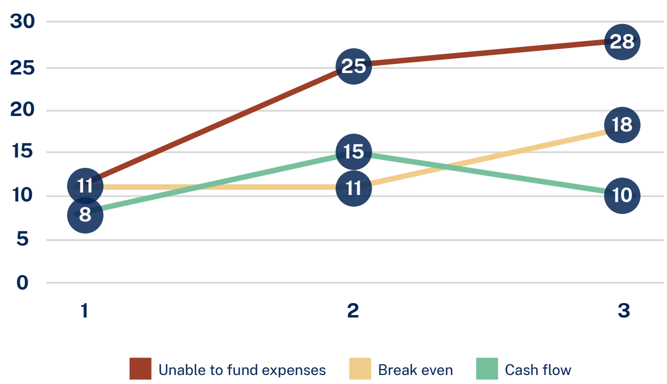


- On-Site Service Combability: Older PSH buildings typically lack sufficient space to accommodate a full suite of on-site supportive services. Accordingly, only 44% of projects reported adequate on-site services space. Interestingly, owners are now reporting that 65% of units are connected to the county's **Intensive Case Management Services Program** through programs like Housing for Health, which is utilizing county Measure H funding to provide clinical level supportive services in PSH through public private partnerships with the Department of Health Services (DHS). Based on the original building design, especially for those properties constructed nearly 100 years ago, dated layouts that are endemic to older properties create challenges for best practice service delivery that recommends integrating as much social services as possible within the building. Given that CES protocols prioritize the highest acuity households for available PSH slots, ensuring adequate physical space to accommodate service delivery is a central motivation to preserve and reconfigure properties and rather integral to community building, stabilization and recovery, and the overall care that residents receive.

- Accessibility, Energy-Efficiency, and Seismic Needs: As part of the anticipated rehabilitation scope, nearly all projects will incorporate accessibility (91%) and energy efficiency (89%) improvements, and to a lesser degree, seismic (54%) retrofits. One at-risk building (LA Family Housing's Delano Apartments) was identified through the city's new mandatory retrofit program and has since been retrofitted, the only project in our sample to be subject to that requirement.[3]

[3] In 2015, the City of Los Angeles passed Ordinance 183893, which requires the retrofit of pre-1978 wood-frame soft-story buildings and non-ductile concrete buildings. The goal of the mandatory retrofit programs, under the ordinance, is to reduce these structural deficiencies and improve the performance of these buildings during earthquakes.

Figure 4: At-risk Project-level Financial Health (2017-2021) (by projects)



Financial Characteristics

- Financial Health Status: The at-risk PSH portfolio continues to be challenged sustaining healthy financial operations, continuing a downward trend from two years ago. Some eight out of ten projects (81%) are reporting breakeven operations or worse, with one-half of all projects "underwater" and unable to fund expenses, up 20% from the previous estimate in 2019. Given that rent subsidies and cost allowances have remained relatively static during this time, this suggests that higher demands on the property associated with serving a high acuity population and notable spikes in operating costs, like utilities, maintenance, and insurance, are placing greater pressure on operating budgets. Increasingly, owners are subsidizing operations through their own organizational resources (See Figure 4).

- Project-based Operating Subsidies:

    - A sizable number of PSH units (798) continue to lack project-based operating subsidy, which is a fundamental component of modern PSH project financial structuring but was a less common, or at least consistent tool, in the earliest project-based PSH examples. The absence of rental or operating subsidy represents a major threat for healthy operations and the long-term viability of the asset. This figure jumped substantially from the previous 2019 assessment due to the addition of an unsubsidized 150-unit classic SRO building that received capital financing through the city's Community Redevelopment Agency (CRA). Regrettably, the limited supply of housing vouchers and rent subsidies (city and county housing authorities are nearly at their project-based voucher caps for instance) means that the scarce resources that are available are only paired with "new" housing projects (essentially new construction) and therefore this constraint continues to endure, feeding into the erosion of the at-risk portfolio's financial health (see Figure 5).

    - Those with subsidy receive support through federal programs like the HUD Continuum of Care (971 units), SRO Moderate Rehab (772 units), or Section 8 Project-based Voucher (PBV) (340 units) programs. The sizable SRO Mod Rehab portfolio is particularly significant because those projects are eligible to convert to PBVs through the federal Rental Assistance Demonstration (RAD) program, which offers a superior rental rate and is more attractive to PSH investors and underwriters given the assurance of a long-term contractual commitment. A total of 15 SRO Mod Rehab projects are eligible for RAD conversions, which should be a top regional priority within a larger set of preservation strategies (see Figure 5).

Figure 5: Types of Project-based Operating Subsidies within the At-risk Los Angeles PSH Portfolio (by units)

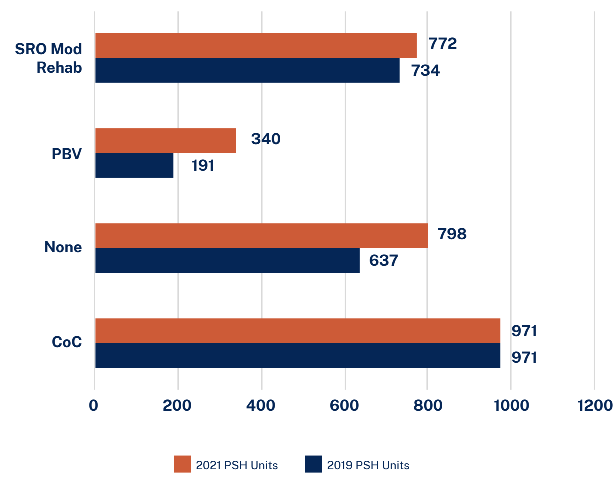
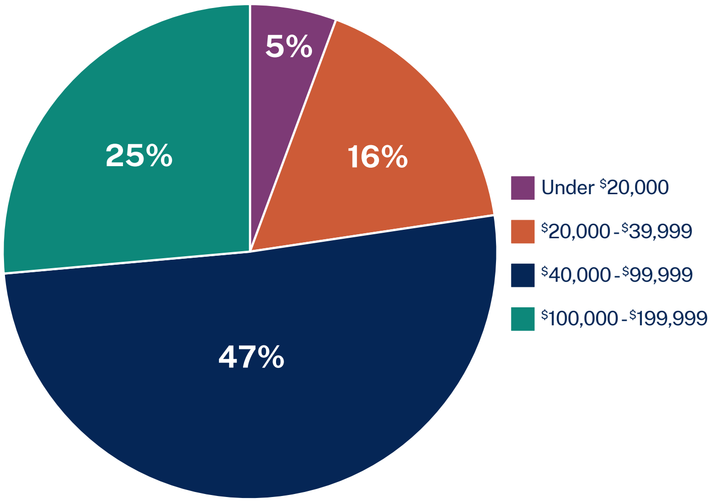


Figure 6: Rehab Costs Per Unit (by % of Projects)



- Rehab Costs: The average estimated rehab cost per unit (RCPU) is $63,498, up 11% from 2019. Across all the at-risk PSH projects, total rehabilitation costs equal approximately $148 million. Nearly 20% of projects require less than $40,000 rehab cost per units making them more challenging to reposition and ineligible for housing credit resyndication. There continues to be little state and local "soft" recapitalization financing, either dedicated or incentivized, for existing, subsidized PSH properties, especially for those that are not facing affordability expirations within the next five years (See Figure 6).

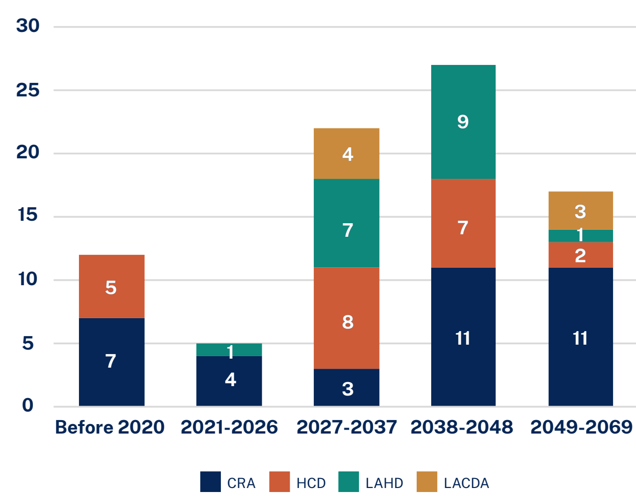
- Capital Financing: Consistent with the geographic distribution of at-risk projects, the oldest cohort of PSH projects was almost exclusively financed (94%) through the City of Los Angeles, either the now-defunct CRA program and/or more recent affordable housing loan programs from the Los Angeles Housing Department (LAHD). The portion of projects with State Housing and Community Development Department (HCD) funding has remained consistent, at 38%, while the number of county-financed projects (e.g., the Los Angeles Community Development Authority or LACDA) has been modestly on the rise, up to six projects in 2022 (from 4 in 2019).

- Affordability Risk: In its strictest sense, preservation risk for affordable housing is measured typically according to the degree to which project-level affordability protections are set to expire in the next five (5) years, viewed within the industry as "near-term" risk. The aging, at-risk PSH portfolio carries a significant degree (892 units) of near-term affordability risk, but that characteristic is not representative of the majority (66%) of aging units, which instead are becoming unviable over time mainly due to physical and financial needs. Nevertheless, one-quarter of units (649) have expired affordability restrictions while an additional 243 units are facing near-term expirations. Together, these two figures indicate that essentially one-third of all at-risk PSH units have lost or will be losing their affordability protections in the next five years. If we look on the horizon for the next five-year window, through December 2031, another 786 units are set to expire, nearly as much as the near-term figure. With 1,678 at-risk PSH units facing expirations in the next 10 years, these figures suggest a rising and formidable affordability threat that will need closer monitoring and redress, even as local housing officials work to resolve long-term recapitalization needs (see Table 2). If we look at affordability risk in the context of capital funder type, near-term risk is shared by the city of Los Angeles, specifically CRA-financed buildings, and legacy projects that received rehabilitation support from the state of California (HCD). Even farther out, over the next ten to fifteen years, properties that received financing from the county CDA and LAHD (non-CRA) begin to emerge as affordability threats, as do a growing number associated with the HCD portfolio (see Figure 7).

Table 2. Degree of Affordability Risk across At-risk PSH Portfolio, by Units (as of December 2021)

Affordability Risk	Number of Units	Percentage of All At-risk PSH Units (rounded) (n=2,637)
Expired (as of December 2021)	649	25%
Near-term (by December 2026)	243	9%
Subtotal (Expired & Near-term)	**892**	**34%**
Medium-term (by December 2031)	786	30%
Total	**1,678**	

Figure 7: Project Affordability Expirations (by projects and public funder)



Six Strategies for Preservation

Amidst public pressure to reduce chronic homelessness and expand the supply of PSH, policymakers should not lose sight of sustaining and revitalizing our existing PSH stock, especially given its pivotal role in protecting affordable housing for vulnerable households, to prevent additional homelessness, and addressing rehousing needs through the local CES. Here are six strategies that policymakers and state and local housing officials can draw upon to modernize our aging PSH stock.

Set Priorities

Local housing officials can work with PSH stakeholders to establish reasonable unit targets and priorities for preservation efforts. This will require differentiating risk within the larger aging PSH portfolio, like those projects facing near-term affordability expirations and that need to be renewed along with loan modifications or extensions. Others need modest investments or a deeper recapitalization path. Preserving projects that align with civic mandates can also help localities to meet additional public policy priorities, such as reducing the carbon footprint in the housing sector and ensuring programs are meeting state and federal accessibility standards.

Protect Projects with Expired and Near-term Affordability Risk

Ensuring that the oldest PSH projects financed through the city of Los Angeles or the state of California remain affordable for another generation of use, with restrictions in place, should be a top and immediate priority, so that the region does not lose desperately needed affordable/ PSH units.

Establish Dedicated or Prioritized Capital

Simply put, aging PSH projects do not fare well with our current public finance tools and therefore we continue to see these early PSH projects age over time with little to no pathway for repositioning. Our experience suggests it is necessary to have dedicated sources of public capital for aging PSH projects to be competitive or eligible for available and emerging capital funding programs. Programs like the state Portfolio Repositioning Program, administered by HCD, which targets the state's legacy, affordable housing portfolio with near-term affordability risk, are important steps in the right direction. Yet they are narrow, one-time interventions, that are unlikely to reach the need without wider eligibility criteria (e.g., qualifying risk for projects with affordability expirations in the next ten years rather than five) and more predictable funding to give time for PSH owners to prepare.

Ensure Rent Subsidies are Flexible, Sustainable, and Attached to All Unsubsidized Units

The current slate of rental assistance subsidies, such as those through the federal Continuum of Care program, has proven insufficient to generate revenue needed to sustain modern PSH operations. Owners are feeling the pressure to offset escalating operating costs and improve cash flow. We should aggressively pursue alternatives, such as the Rental Assistance Demonstration (RAD) program, as an early preservation strategy that fits nicely in this voucher-constrained environment. One-third of the at-risk PSH units are eligible for RAD conversion, which offers higher rents and longer-term contracts.

Align Funder Policies

PSH project owners are asked to demonstrate long-term compliance across several public financing programs that often have conflicting restrictions. Program components such as loan servicing fee requirements, supportive services cost allowances, and the use of cash flow or project reserves for capital expenses are notable areas for future alignment.

Conduct a Deeper Cost Analysis of PSH Operating Costs and Mitigate Cost Escalations

The costs of operating PSH are on the rise though we are still learning the impacts on organizational and project budgets. We need to revisit our cost allowances and assumptions, informed by deeper economic analysis on operating trends, to document and acknowledge that housing and serving higher acuity residents is more expensive and requires additional resources. Efforts to strengthen the performance of the regional Coordinated Entry System, like improving housing placement timelines and referral attrition, are also vital to reduce project-based PSH vacancies and the substantial financial loss that presents to PSH owners.

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