Memorandum

To: Finance Committee

From: Mark W. Luberda, County Administrator

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RE: Housing Authority Proposal Options

Administration

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The purpose of this memo is to provide some analysis of and options related to the County's ARPA-funded project partnering with the Walworth County Housing Authority's (WCHA). The WCHA provided a business plan for their proposed housing acquisition; however, it is challenging to interpret exactly what the impacts are from the proposal options. Note that, unless otherwise stated, the discussions below assume property loans are acquired at 7.0% annual interest, mortgage periods are 15 years, similar maintenance costs per unit are maintained, rents are set at 80% of the allowable maximum, and a minimum goal of retained equity in each structure is 40% (meaning loans against the property don't exceed 60% of the valuation).

Example 1. If the County provides $1,000,000 and the WCHA borrows $400,000 to fund the $1,400,000 purchase, the WCHA can retain 40% equity ($560,000) in the buildings after purchase, leaving $440,000 to use as a down payment for subsequent purchases. This down payment only provides for a subsequent second purchase of $1,100,000. This only potentially allows for nine additional units to be acquired. As such, the example does not meet expectations, as it does not provide for 24 total units, much less 50.

Example 2. If the County provides $1,000,000 and the WCHA borrows $400,000 to fund the $1,400,000 purchase, but WCHA retains only 30% equity ($420,000) in the buildings after purchase, leaving $580,000 to use as a down payment for subsequent purchases. This down payment provides for a subsequent second purchase of up to $1,933,333. Although up to 15 additional units could be purchased, the net expenses would exceed the net revenues for the total project. This is not sustainable, and is, therefore, not a valid consideration.

Example 3. So, where is the breakeven point if the County provides $1,000,000 and the WCHA borrows to fund the remaining $400,000 of a $1,400,000 initial purchase? If the WCHA retains only 35.7% equity in any property purchased, they would be able to get a loan for a second purchase of $1,401,120. Both rounds of purchases would be sustainable, but the total net annual revenue would

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be only $389. There would be no room for deviation in any factors or the WCHA would operate at a loss.

Example 4. As an alternative breakeven consideration, if the County provides $1,000,000 and the WCHA borrows only $196,845, meaning they use cash on hand of $203,155; sufficient equity would remain in the initial purchase to fund up to $1,607,888 for an additional 12 units. The ongoing operating costs would equal the rental revenues. The initial property purchase would operate at a net revenue that equals the net loss of the second-round purchase, but, overall, the total project would operate at the breakeven point. This strategy would operate on the edge of sustainability for the first 15 years until the initial mortgages are paid off. Similar results occur if the County provides the $1,200,000, with the difference being that the WCHA does not have to deplete their cash reserves.

Example 5. If the WCHA can make the initial purchase of $1,400,000 without borrowing, the fiscal picture shifts toward sustainability. The analytical results are the same if the County provides the $1,400,000 or if the WCHA provides for the additional $400,000 from any other source. In this instance, retaining 40% equity in the initial $1,400,000 purchase provides cash of $840,000 for a down payment on a loan up to $2,100,000. This would allow for up to 18 units to be purchased in the second round and still remain sustainable with an annual net revenue of $16,817. Even if prices rose and only 16 units were purchased for $2,100,000, the scenario would still provide for an annual net revenue of $595.

Example 6. If the County provides $1,400,000 for the initial purchase but 50% equity is retained in each building purchased, the scenario becomes more sustainable. At this level, $1,400,000 is available for the second purchase, and annual net earnings are $43,654. That is enough for the purchase to generate enough revenue such that every 5 years an additional 4-unit building could be acquired.

Relative to example 6, if prices rise, the model remains sustainable (annual net revenue of $10,098) even if the second set of units cost up to $1,711,111 and 45% equity is retained. Similarly, if interest rates rise to 7.5%, it is still sustainable. At interest rates of 8.0%, retained equity would need to reduce slightly.

<u>Conclusion:</u> There are a lot of factors and a lot of variables, so there could literally be dozens of valid options. I have listed six options above that represent the boundaries of the various parameters.

Example 1 identifies two very important results. First, none of these scenarios gets close to providing for a total of 50 units acquired. The market simply is well beyond that level of valuation. Second, the WCHA must have resources of at least $200,000 cash and the total units acquired must be reduced to 24 for the initial investment to be breakeven. It is very reasonable for the County to consider retaining its original intent of investing $1,000,000 in the WCHA efforts. A commitment of $1,000,000 is not insignificant, and in the context of a total ARPA funding of just over $20,000,000, $1,000,000 is substantial. Providing $1,000,000 and expecting the WCHA to solve the rest of the equation is not an unreasonable proposition, but without reducing the total number of units required, the project would not likely occur. Additionally,

even with a reduction in the total units required to 24, the result would be a one-time infusion that does not generate ongoing returns.

It is worth noting that all of the scenarios presented above are positioned at the maximum factor positions. There is little room for deviation. Should interest rates or property values (sales prices) continue to rise, the scenarios above no longer quite succeed. Should the WCHA try to establish rental rates at 70% of the maximum allowable (instead of the 80%, top-of-their-range identified), the scenarios don't quite work.   Do we want the WCHA to retain the minimum expected equity positions? Do we want the WCHA to operate on the cusp of sustainability?   Or, do we want them to have some cushion? In each of the factors considered, do we want them to have some cushion so as to be able to absorb unanticipated future negative events and still be able to keep rental rates between 70% and 80% of allowable rents?

I have referenced this previously, but I believe the County's ARPA resources can be best invested if we put the WCHA in a position such that the project provides for a net revenue stream that is not only sustainable, but that furthers the development of affordable housing maintained by the WCHA. Example 6, where the County provides $1,400,000 and a total commitment of 24 units achieves that favorable position. This approach gives them flexibility to address deviations in the market place or interest rates. It gives them the flexibility to adjust rental rates within their desired range of 70 to 80 percent of the maximum allowable. Most importantly, it establishes our investment as an economic engine for the WCHA to acquire more properties in the future. Leveraging a secondary purchase of 12 units should be a minimum expectation; leveraging and ongoing economic generator spurring the WCHA's expansion into further ownership of affordable housing properties is an attainable option if the County so desires.

MWL