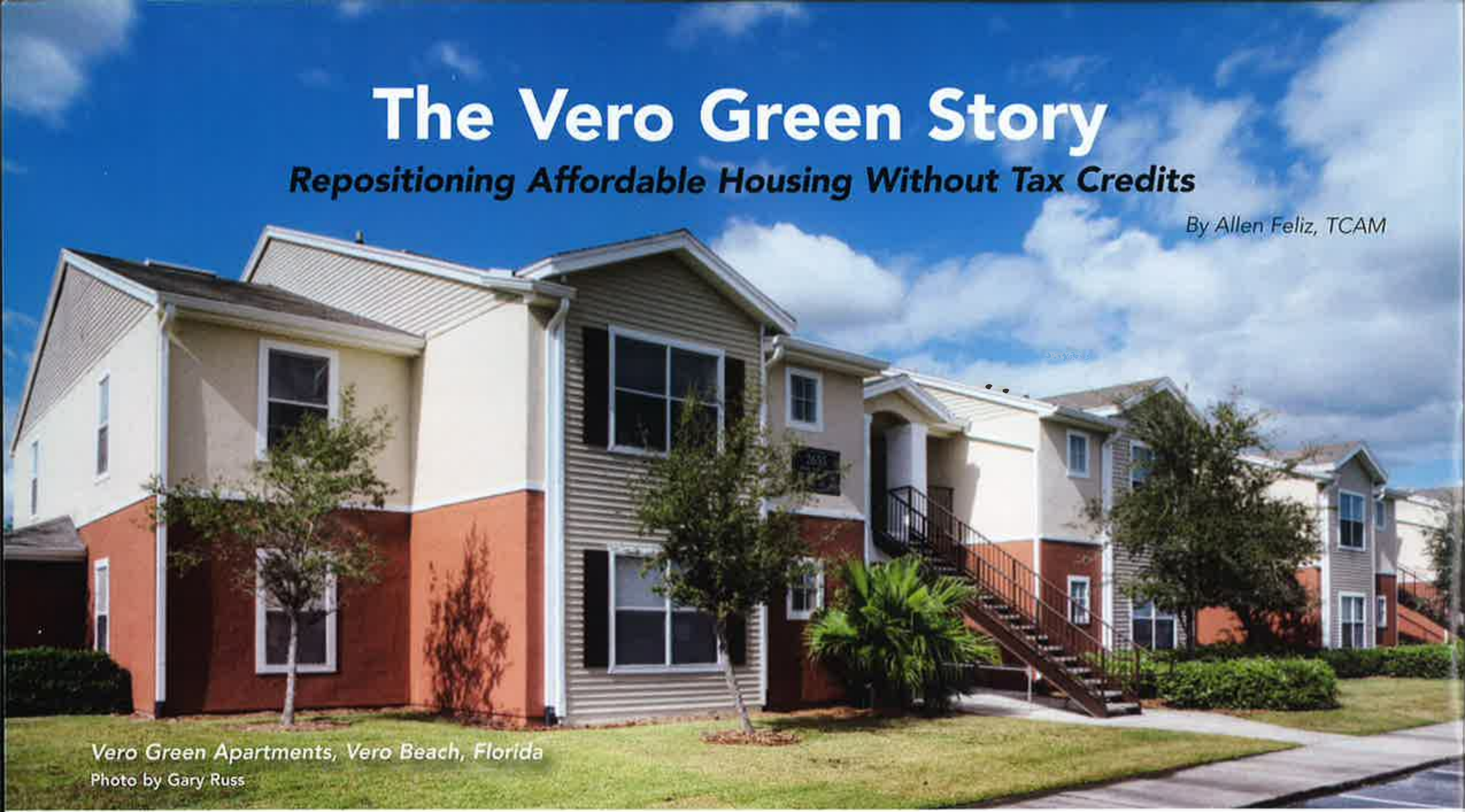
The Vero Green Story

Repositioning Affordable Housing Without Tax Credits

By Allen Feliz, TCAM



Vero Green Apartments, Vero Beach, Florida
Photo by Gary Russ

Vero Green Apartments, a multifamily rental development in Vero Beach, Fla., is a former low-income housing tax credit property that was purchased out of foreclosure by R.J. Finlay & Co., a real estate company, in March 2010.

A recent refinancing concludes the turnaround of this formerly distressed property that is now providing dramatically upgraded housing to residents as well as positive cash flow for the owner. While the property is no longer in the LIHTC program, residents still enjoy affordable rents and this preservation effort was achieved without a fresh batch of housing tax credits.

The Vero Green story demonstrates how a property's operations can be improved in a challenging environment and how affordable rental housing can be preserved, at least temporarily, without housing tax credits.

Constructed as LIHTC Property

Vero Green Apartments (formerly Walker Avenue Club Apartments) was built in 2002 as a LIHTC property in this small city (pop. 15,000) on the Atlantic Coast about 190 miles south of Jacksonville. The 172-unit development consists of two- and three-bedroom apartments in 11 two-story walk-up and wood-framed garden-style buildings.

The property was originally financed by tax-exempt bonds and 4% housing credits, subject to a land use restriction agreement (LURA) requiring at least 40% of the units to be rented to tenant households earning 60% or less of the area median income (AMI).

Allen Feliz

Disaster Strikes

Vero Beach, like many other communities across the country, suffered greatly in the recent recession. The unemployment rate in Indian River County nearly tripled from January 2007 to January 2010 (from 4.5% to 13.3%), and hasn't improved (13.9% in August 2011).

Rental occupancy levels dropped throughout the market as well. A 2009 appraisal report for Vero Green Apartments noted an average countywide vacancy rate of more than 15% for affordable and subsidized rental housing developments and above 20% for many projects.

Vero Green Apartments suffered, too. Occupancy and rents dropped, operating deficits mounted, and more and more maintenance was deferred, further depressing occupancy levels. The property's occupancy rate consistently declined, from 90% in July 2006 to 68% in July 2007, 50% in July 2008, and 47% in February 2009.

In 2009, the owner defaulted on the mortgage and the lender foreclosed, resulting in the removal of the property from the LIHTC program. R.J. Finlay & Co. purchased the property from the lender in March 2010 for approximately 62% of the outstanding mortgage bal-

Vero Green, continued on page 31

Vero Green, continued from page 30

ance, with the intent to reposition the development and restore it to profitability.

Capital, Management, and Marketing Improvements

Upon acquiring Vero Green Apartments, R.J. Finlay & Co. initiated capital improvements and management and marketing upgrades to turn around the property's operations. At the outset, the property had 30 idle apartments, dated exterior painting, missing outdoor signage, and poorly kept grounds. Common area amenities were inferior to those of competing local market-rate developments charging similar or lower rents.

Working with TCAM, R.J. Finlay & Co. invested in a $440,000 capital plan that resulted in restoring the down units to service, improving the landscape and signage, and adding amenities including a new fitness area and business center.

To implement its management and marketing plan, R.J. Finlay & Co. hired a new property management company – Finlay Management, Inc. – in December 2010. This firm marketed the property to prospective tenants both online and in print advertisements, and carefully monitored the effectiveness of its advertising campaign, making adjustments as necessary. R.J. Finlay & Co. revamped the existing Web site for the property. And Finlay Management kept a close watch on the market and competitors, constantly adjusting rents and concessions in line with changing market conditions.

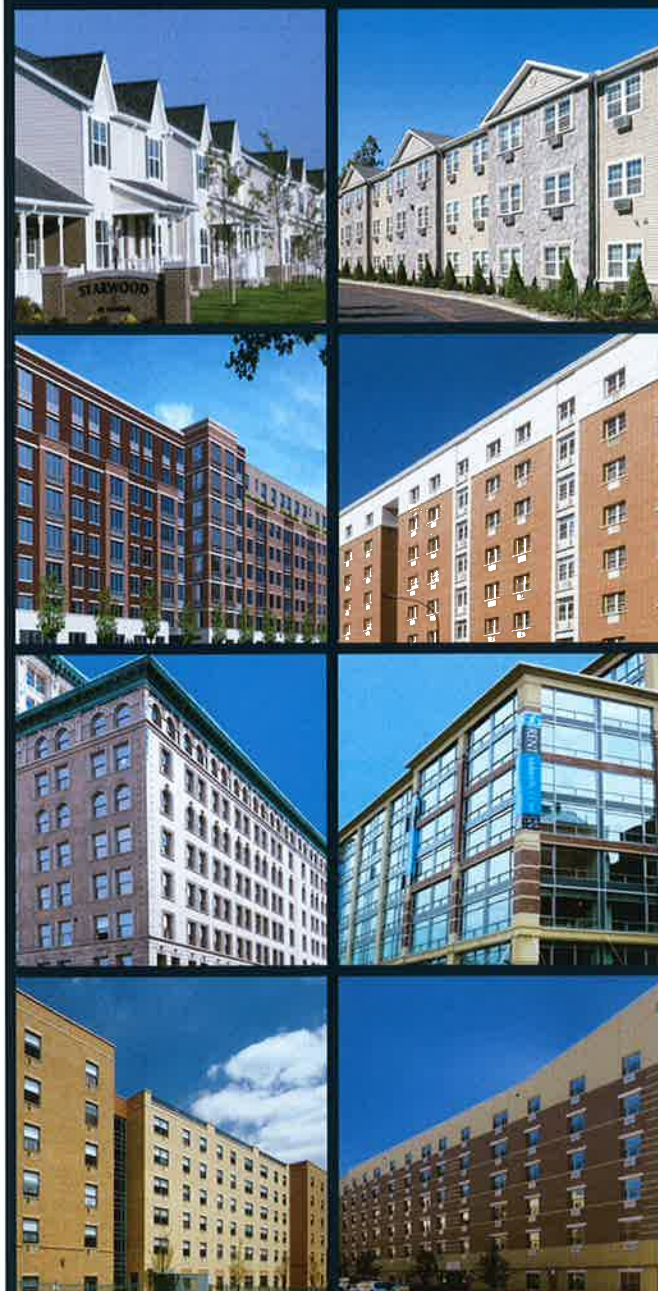
Operational Success

The capital, management, and marketing improvements have yielded strong results at Vero Green Apartments:

- Occupancy increased from 76% in December 2010 to 96% in August 2011, even though the unemployment rate has not improved.
- Resident satisfaction has improved dramatically, as demonstrated by tenant surveys at apartmentsratings.com from 2010 and 2011. Comments posted online throughout this transition period reveal higher tenant satisfaction with the turnaround time for routine maintenance requests and the quality of maintenance work, the courtesy and knowledge of management staff, and the quality of site amenities.

Vero Green, continued on page 32

First Sterling



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Vero Green, continued from page 31

- Annual operating expenses decreased from $5,366 per unit in 2009, the last year before R.J. Finlay & Co. took over, to $4,166 per unit (annualized) as of August 2011. Operating improvements have allowed lower advertising costs, while capital improvements have reduced maintenance expenses. In addition, the refinancing of the property reduced annual debt service costs.
- Revenues rose by approximately 45% from December 2010 to August 2011. The primary reason was increased occupancy due to improved tenant satisfaction and retention, improved marketability (from capital improvements), and the removal of the LIHTC tenant income restrictions.
- A substantial increase in value. While the property was purchased for $5.3 million in March 2010, in the spring of 2011 it appraised at $12 million.

Lessons Learned

While the LIHTC tenant income and rent restrictions no longer apply to Vero Green Apartments, effective monthly rents have barely changed, after rent concessions are considered. In August 2011, the average effective rent for apartments was $705 per month, compared to $695 per month in March 2010. While just 32% of the tenants as of March 2010, in 46 of the 142 occupied units at the time, have remained, factors other than affordability were the likely reasons why many of the others moved out.

The absence of LIHTC restrictions has permitted a wider range of tenant incomes, boosting occupancy. Households with incomes above 60% of AMI can now rent at the property. Before, for example, three-person working families earning more than $25,080 a year couldn't qualify for the two-bedroom apartments. As a result, families of workers down the street in the service industry making $26,000 to $43,000 were shut out of Vero Green Apartments when it was a tax credit property.

Admittedly, removing LIHTC income restrictions is not an ideal remedy for struggling affordable properties. Absent long-term affordability protections, "low-income" housing is not assured, especially as owners are able and motivated to charge higher rents as markets improve. But the Vero Green experience suggests modest ways to improve the LIHTC program.

Vero Green Apartments Operational Improvement

	August 2010	August 2011	% Change
Occupancy Level	73%	96%	+23%
Net Operating Income	$211,326	$545,557	+158%
Physical Upgrades	• New site signage • 30 formerly down-units brought on line • Newly landscaped grounds • Newly painted building exterior • Resurfaced parking lot • New washers and dryers • Refurbished clubhouse • New fitness area and business center • Energy efficiency upgrades – replacement of incandescent light bulbs with fluorescent light bulbs.		

For instance, a more flexible set-aside requirement allowing LIHTC properties in certain markets to rent to a wider income band would help such communities provide much-needed housing to low-income tenants, and assist owners and operators in managing occupancy and overall operations. President Obama's FY 2012 budget proposal, in fact, recommends an amendment to the LIHTC program that would allow a property to qualify for housing credits if at least 40% of the units are occupied by tenants with incomes that average no more than 60% of AMI. Some tax credit units could be occupied by households with higher incomes, up to 80% of AMI, provided a similar number of units are occupied by tenants with incomes below 60% of AMI, such that the <u>average</u> income for all tax credit unit tenants doesn't exceed 60%.

In the end, however, changes to LIHTC set-aside requirements and restrictions are no substitute for focused and experienced ownership and management. As Vero Green reminds us, the critical steps to repositioning an aging multifamily development under challenging market conditions include (a) improvements to enhance the property's marketability and competitiveness; (b) strong management and a consistent marketing plan; and (c) a focus on tenant retention and satisfaction. TCA

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