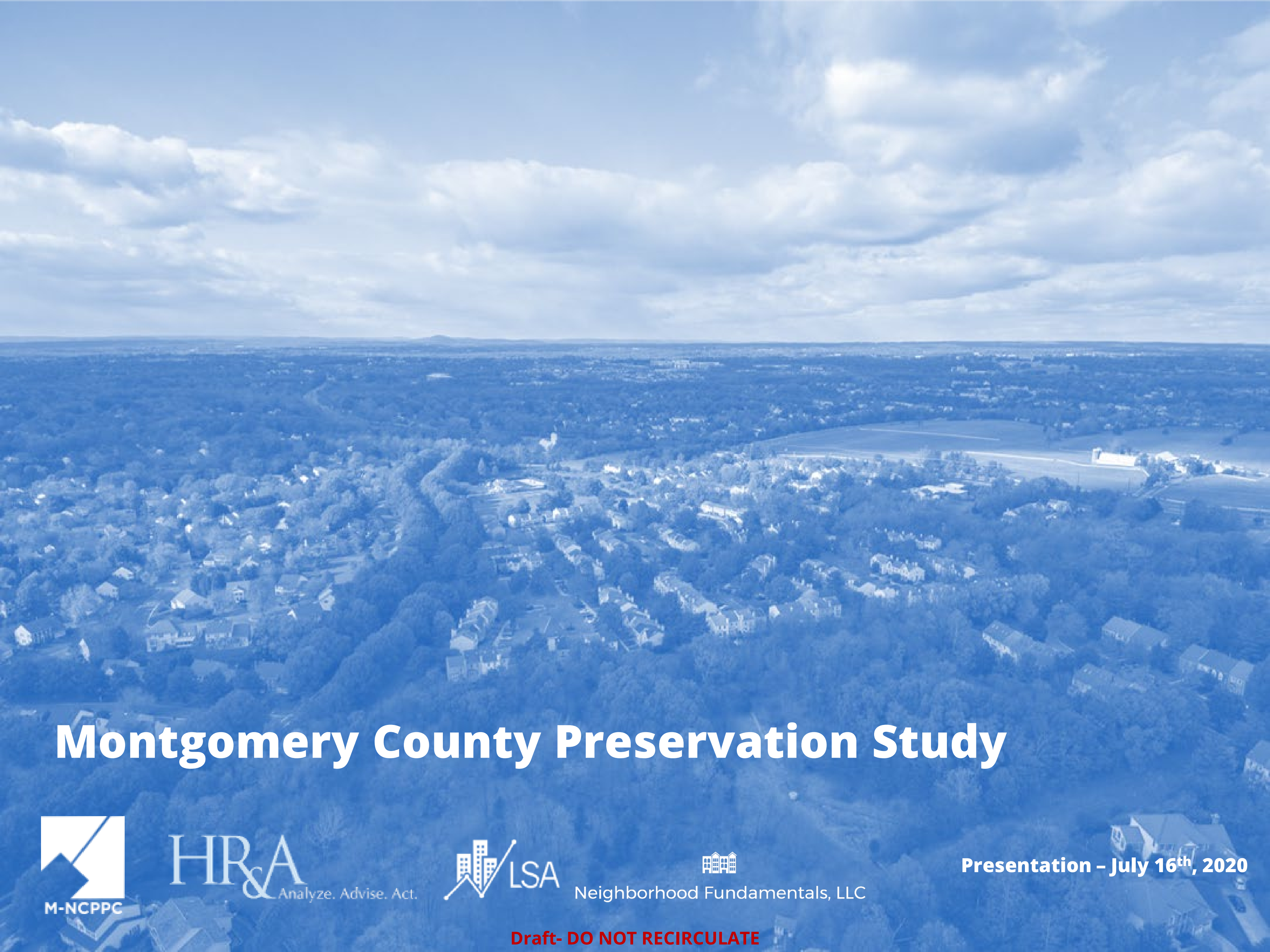


Montgomery County Preservation Study

M-NCPPC

HR&A Analyze. Advise. Act.

LSA

Neighborhood Fundamentals, LLC

Presentation – July 16th, 2020

Draft- DO NOT RECIRCULATE

Approach

Preserving the existing inventory of affordable housing is essential as part of a comprehensive approach to retain affordable options for all residents.

This study is organized around six questions:

Housing Landscape

- What are the characteristics of the County's deed-restricted and unrestricted housing stock?
- How has the County's housing stock changed over time, and how will it look in the future?

Deed-Restricted and Naturally Occurring Affordable Housing

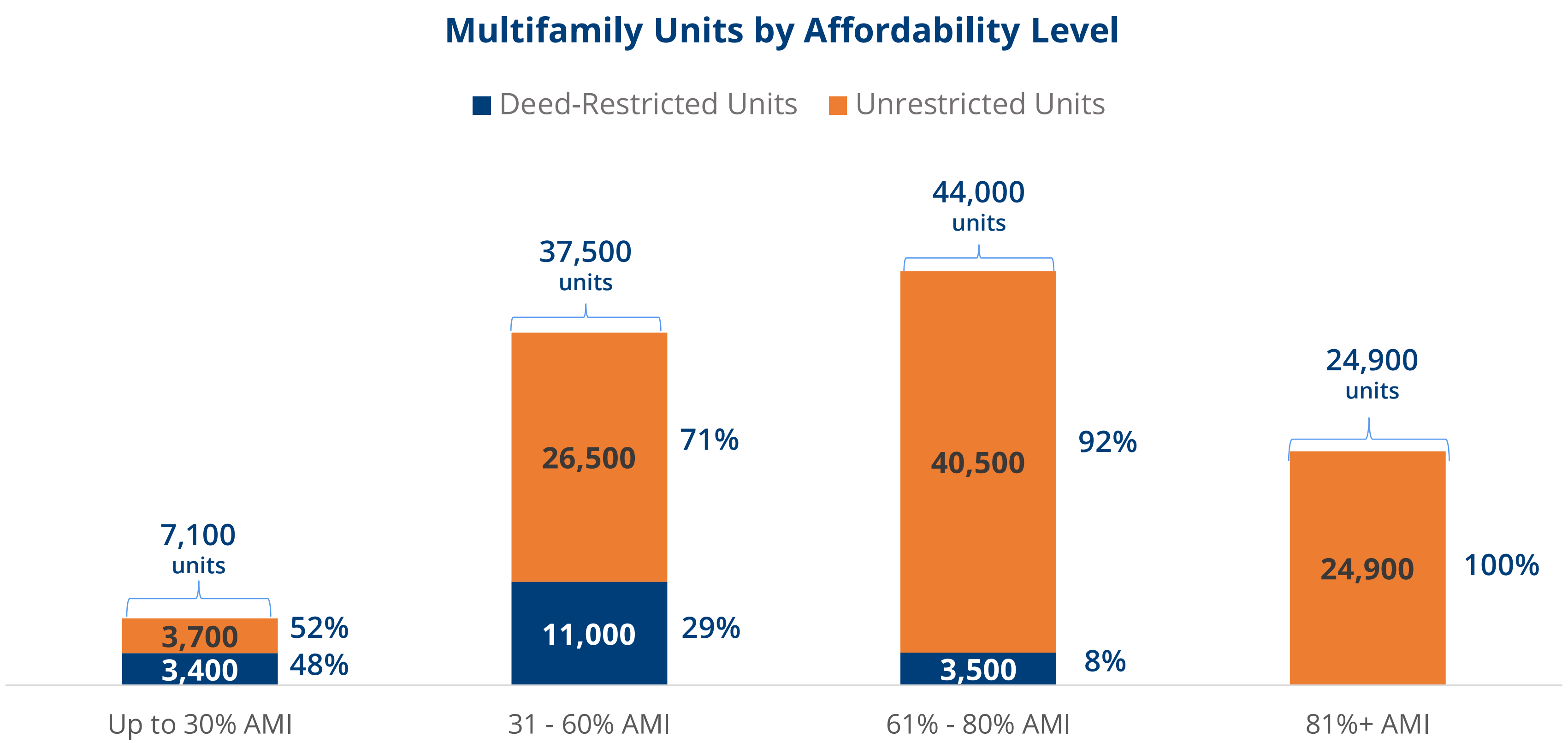
- How will the County's deed-restricted housing stock change over time?
- What are the risk criteria for units losing affordability?

Preservation Framework

- Which existing and potential funding sources, policies, tools and programs are Montgomery County using currently?
- How can the County support the preservation of affordable housing, to meet its housing goals?

Rental Housing Supply

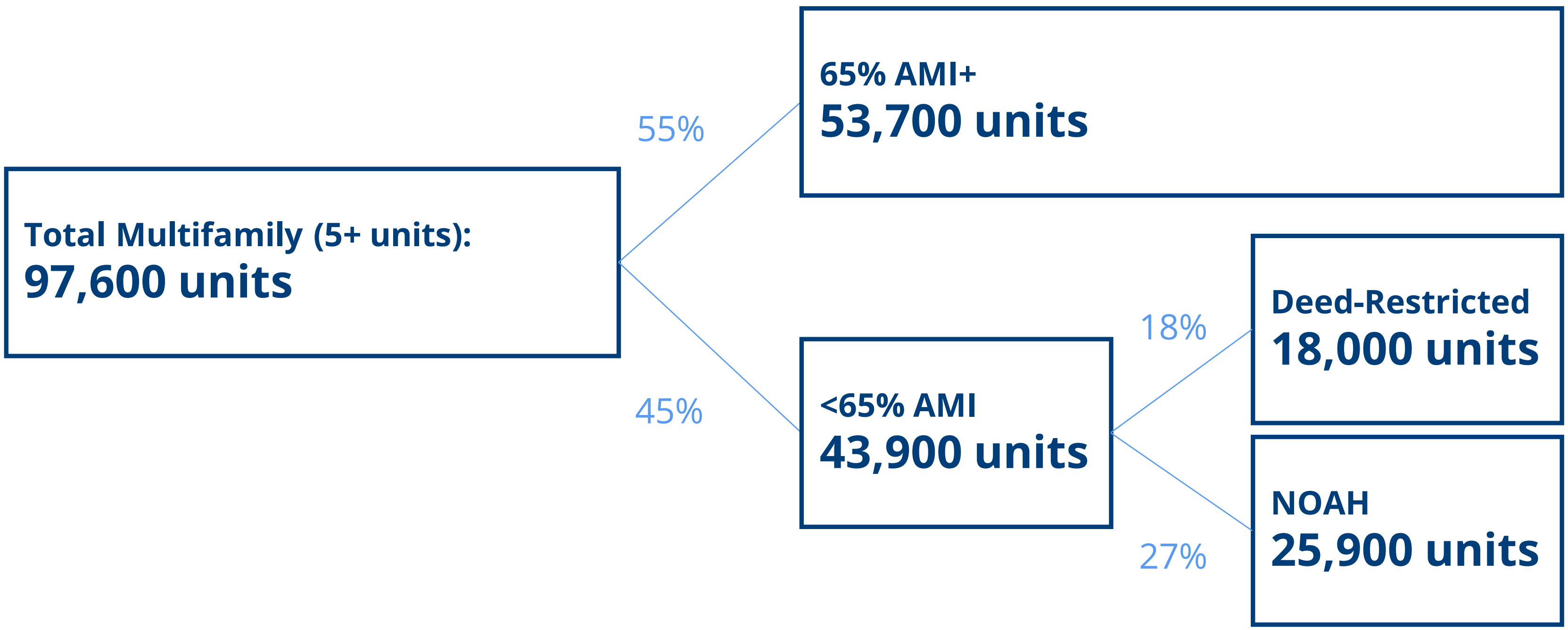
While most of the County's housing stock is affordable under 80% AMI, the vast majority is in unrestricted units—making preservation a vital component to an affordable housing strategy.



Source: ACS 2018 1-year

Current Conditions

About 80% of the County's multifamily housing stock is unrestricted, or subject to market forces. 25,900 of these market-rate units rent for less than 65% of AMI and are classified as naturally occurring affordable housing (NOAH), comprising 27% of the total multifamily housing stock.

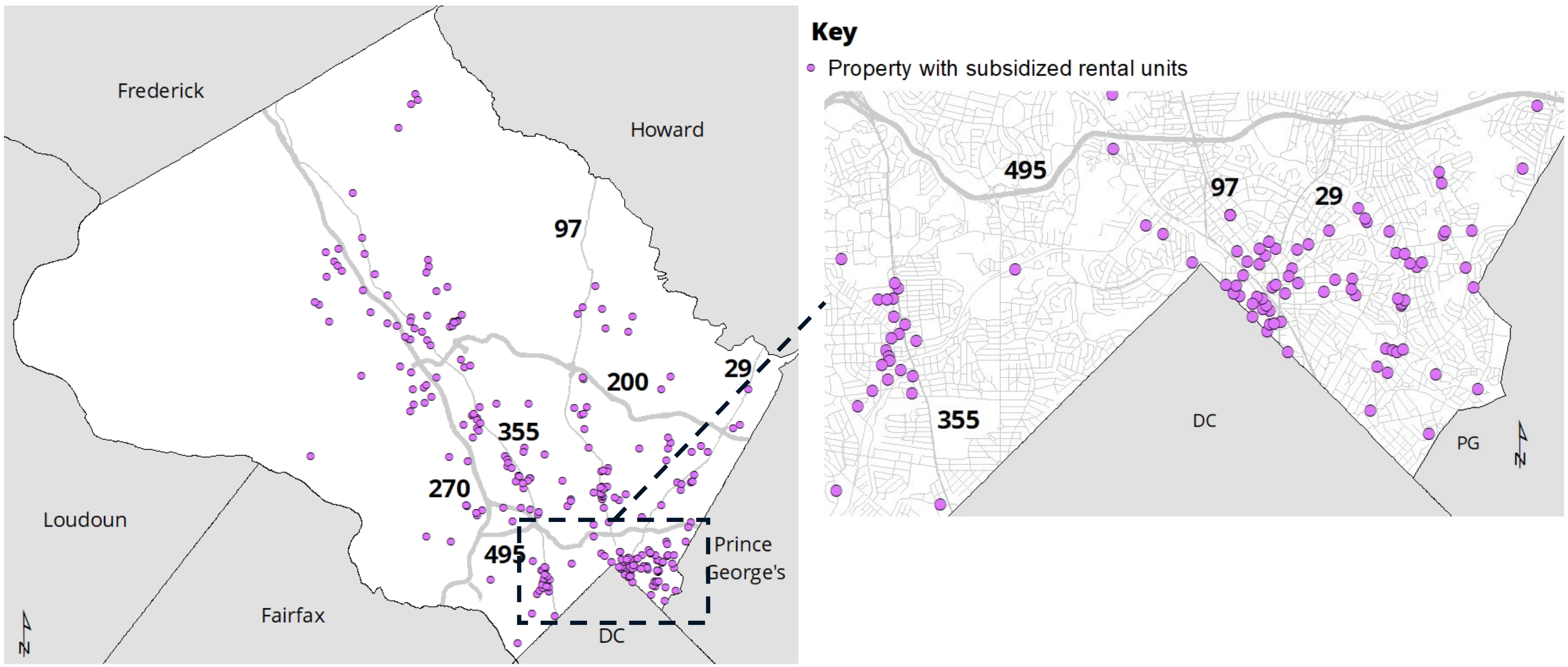


Sources: DHCA, ACS 2018 1-year

Deed-Restricted Inventory

There are approximately 18,000 units in the County's deed-restricted rental housing inventory. Most of the units are in the more densely populated areas where multifamily housing is more prevalent.

Deed-Restricted Inventory (5+ units), 2020



Source: DHCA, NHPD, HUD

Deed-Restricted Inventory Risk Criteria

A set of risk criteria was applied to the deed-restricted rental housing inventory in Montgomery County to assess the level of affordability-loss risk across deed-restricted properties, and to identify high-risk deed-restricted properties.

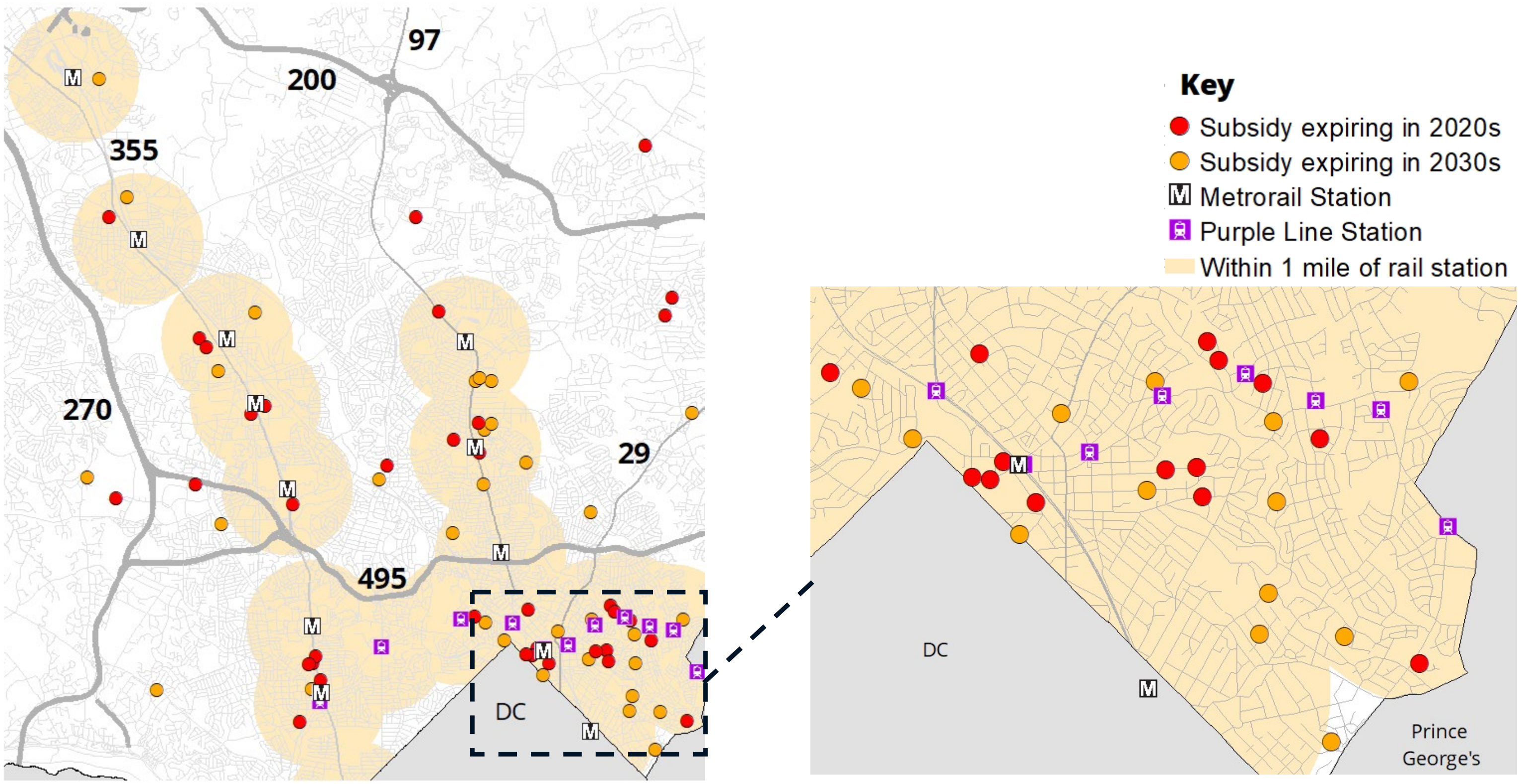
Risk Criteria	Description
Upcoming subsidy expirations	Subsidy expirations set to occur in the 2020s and 2030s. Property owners with near-term expirations are more likely to explore options ahead of the expiration date, which could include new ownership, rehabilitation, renovation, and redevelopment, all of which could impact affordability.
Ownership type	For-profit ownership or non-profit ownership. Properties owned by for-profit entities are more likely to be lost from the deed-restricted rental stock once the subsidy compliance period ends. Properties that are owned by non-profit and mission-based entities are more likely to work with the County to find solutions to extend the affordability period to align with the goals, mission, and vision of their organizations.
Age of buildings	The age of a building can play a significant role in the decision-making process of apartment owners. Many of the decisions can directly impact affordability. Typically, if a building is 30 years or older, renovations, rehabilitation, and redevelopment become more common scenarios. Major investments into a property are more likely to trigger a rent increase and could therefore impact the affordability.
Proximity to transit	Properties near transit infrastructure are more likely to command higher market rents when subsidy expirations expire, and in some cases are more likely to be facing redevelopment pressures.
Rent trends in neighborhood	Deed-restricted rental properties located in neighborhoods with rising rent trends are more likely to lose affordability when the subsidy compliance period expires.
Income trends in community	Rising income levels in communities around deed-restricted rental properties could have an impact on market-rents, and therefore increase the possibility of rent increases when the subsidy compliance period expires.

Proximity to Transit Infrastructure

About 62% of the deed-restricted units that are set to expire in the 2020s and 2030s are located within 1 mile of a rail transit station (existing or planned).

Most of these units are clustered around the Silver Spring, Bethesda, and Wheaton Metrorail stations, all of which have experienced increased development activity/pressure in recent years. There are 2,085 deed-restricted units that are expiring in the next 20 years that are located within 1 mile of a Purple Line station.

2020s/2030s Subsidy Expirations and Rail Transit

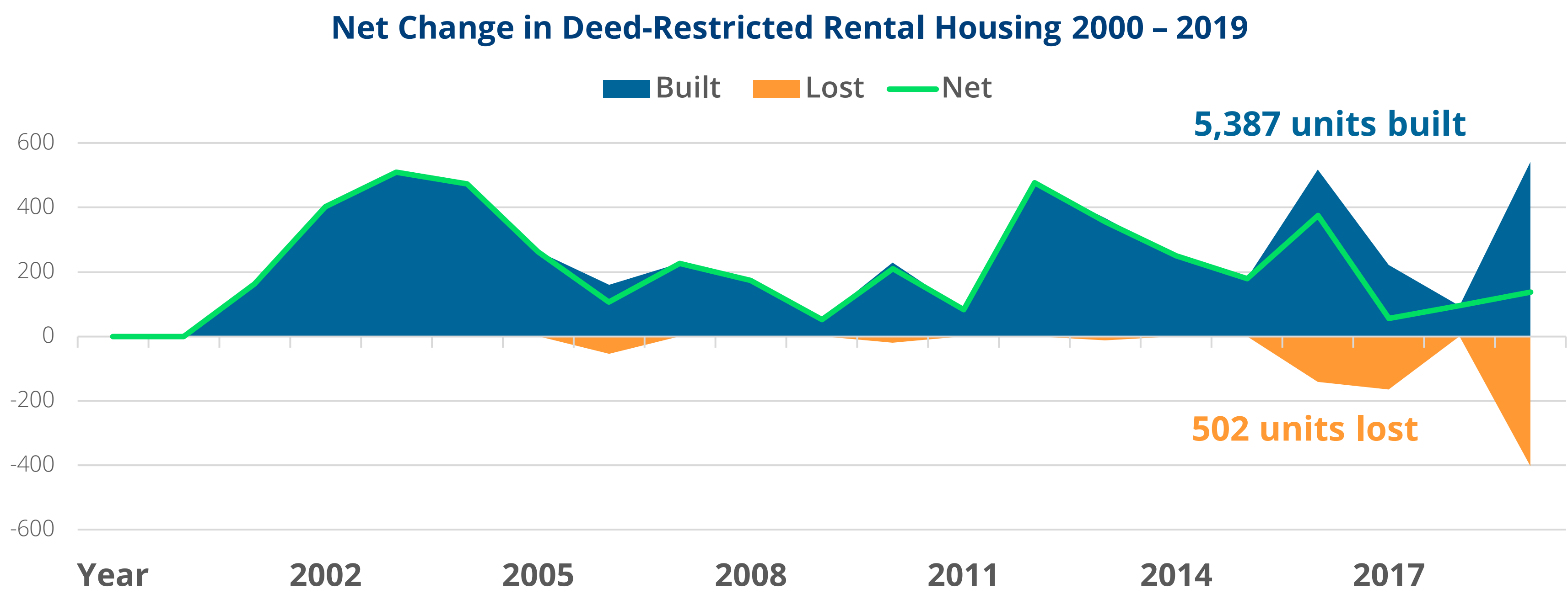


Source: DHCA, NHPD, HUD, WMATA, MDOT

Deed-Restricted Inventory Loss and Gain

Overall, the County has been gaining deed-restricted rental housing stock at a faster rate than it is being lost. Since 2000, approximately 502 deed-restricted rental housing units have been lost from the inventory.

In 2000, the County began to implement preservation strategies for the deed-restricted rental housing stock that was at risk of being lost. A series of tools and policies have been used (often in tandem) over the years to effectively preserve deed-restricted rental housing in the County.



Source: DHCA, NHPD, HUD, MD Dept. of Assessments and Taxation, Montgomery County Property Tax Records

Properties Most At-Risk

Based on the risk assessment, there are about 1,400 deed-restricted units that are the most at risk of losing affordability when their respective subsidy compliance periods expire over the next 2 decades. Notably, all these higher-risk units are affordable below 60% AMI, many of which are at or below 30% AMI.

2020s/2030s Subsidy Expirations, Higher-Risk Properties

Property Name	Subsidy Expiration	Subsidized Units	<30%	40% - 60%	60% - 80%	Rail Transit < 1 mile	Ownership Type	Building Age (Years)	Census Tract Trends (2012 to 2017) Median Rent	Median HH Income
Heritage House	2021	100	100	0	0	Yes	For-Profit	39	13%	7%
Silver Spring House	2022	46	0	46	0	Yes	For-Profit	57	9%	1%
Lenox Park	2022	82	0	82	0	Yes	For-Profit	29	7%	1%
Sligo House Apartments	2024	50	0	50	0	Yes	For-Profit	61	9%	1%
Croydon Manor	2027	96	0	96	0	Yes	For-Profit	71	7%	11%
Fields At Bethesda	2029	369	0	369	0	Yes	For-Profit	67	9%	-3%
Franklin Apartments	2030	185	185	0	0	Yes	For-Profit	65	16%	26%
Fields Of Gaithersburg	2031	168	0	168	0	No	For-Profit	46	20%	15%
Barrington Apartments	2037	310	125	185	0	Yes	For-Profit	68	24%	-4%

Source: DHCA, NHPD, HUD, MD Dept. of Assessments and Taxation, Montgomery County Property Tax Records, Census Bureau 5-Year ACS

Naturally Occurring Affordable Housing | Key Takeaways

25,900 units are currently affordable to households earning at or below 65 percent of AMI. The unrestricted units at these rent levels are naturally occurring affordable housing.

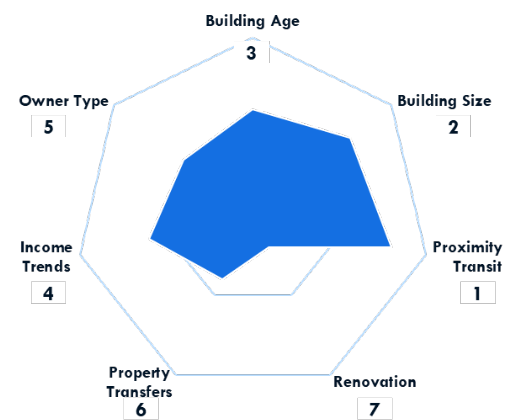
Key Takeaways

- **78% percent of all NOAH housing was built before 1990, with a plurality built from 1960 to 1989.**
- **Between 7,500 to 11,000 units of NOAH are projected to be lost between 2020 and 2030.**
- **The largest stock of NOAH is in smaller buildings—with fewer than 20 units.**
- **NOAH largely lies on the east side of I-270 and outside the Beltway and is consistent with areas that have seen less growth in high-income demand.**
- **Property ownership transfers correlate closely with rent shifts and loss in NOAH.** Between 2010 and 2019, NOAH properties made up over half (57%) of property transfers of non-deed-restricted buildings.
- **Proximity to transit is a strong signal for loss in units under $1250, especially for stations inside the beltway.**

NOAH Risk Criteria

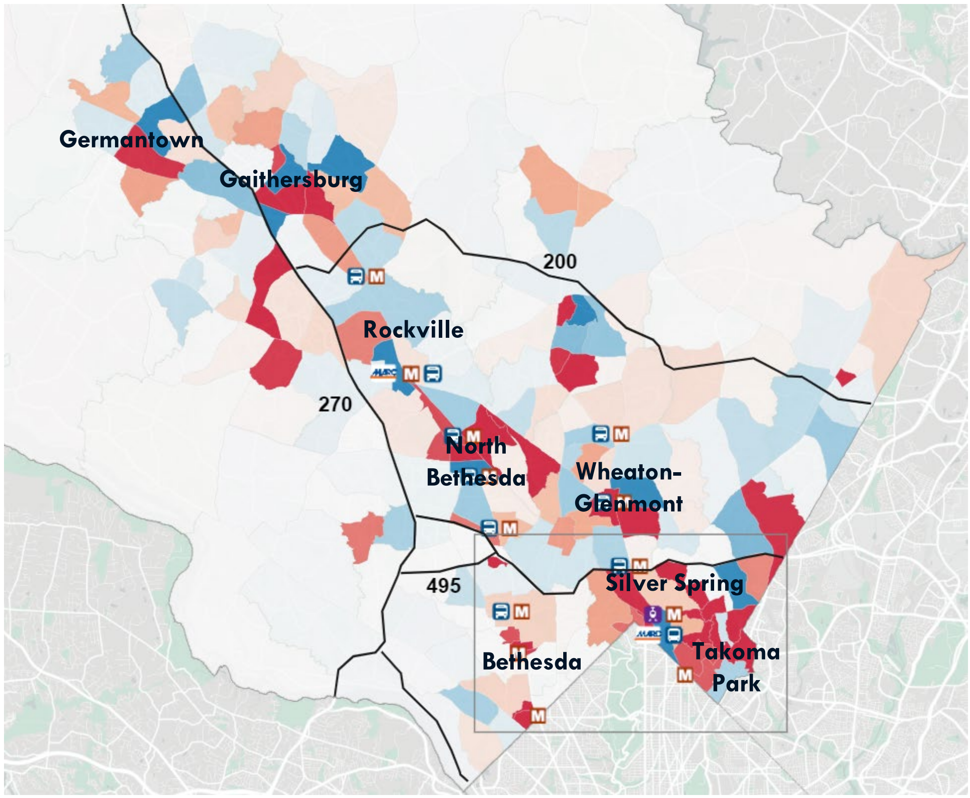
Based on our findings, proximity to transit, building size, income trends, and building age are the greatest risk indicators for NOAH units to lose affordability.

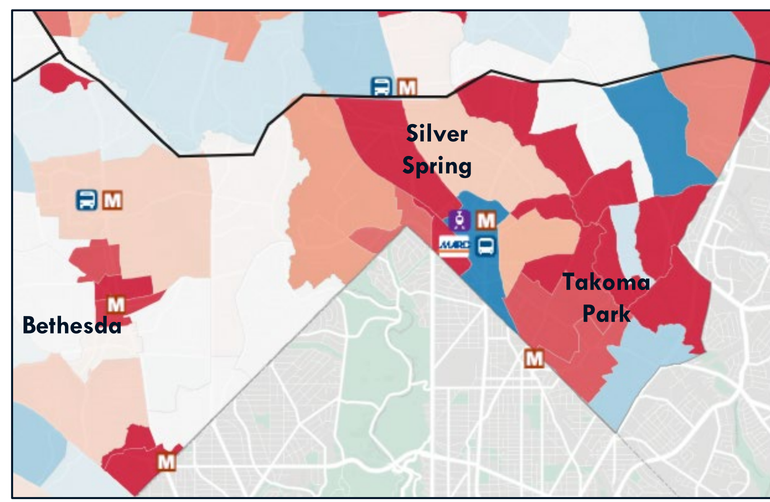
Risk Factor	
Building Age	While we did not find a linear relationship, we found that older units built between the 1960s and 1970s have the greatest risk for redevelopment or increase in prices as the neighborhood around them shifts.
Building Size	Smaller buildings are more likely to be affordable, but are losing affordability rapidly as 5 – 9 unit buildings are sold to larger investors. Larger properties that are affordable are most likely to be deed-restricted.
Proximity to Transit	Proximity to transit and new infrastructure is the strongest indicator for increase in assessment land values and rents, although jurisdictional zoning and transit access (not just proximity) remain key confounding variables.
Renovation	Although a large capital investment suggests an increase in future revenue, the data remains unclear on the quantitative effect on rents in Montgomery County. More longitudinal data may be required to assess long-term impacts.
Property Transfers	Property transfers and sales are a lagging indicator of NOAH risk—as investors see increasing rents, more transfer activity occurs.
Owner Type	Consistent with findings around building size, larger property owners (with 10+) units tend to own properties at risk of loss.



Sources: DHCA, ACS 2018 1-year

Proximity to transit is a strong signal for loss in units under $1250, especially for stations inside the Beltway.





Metro Station

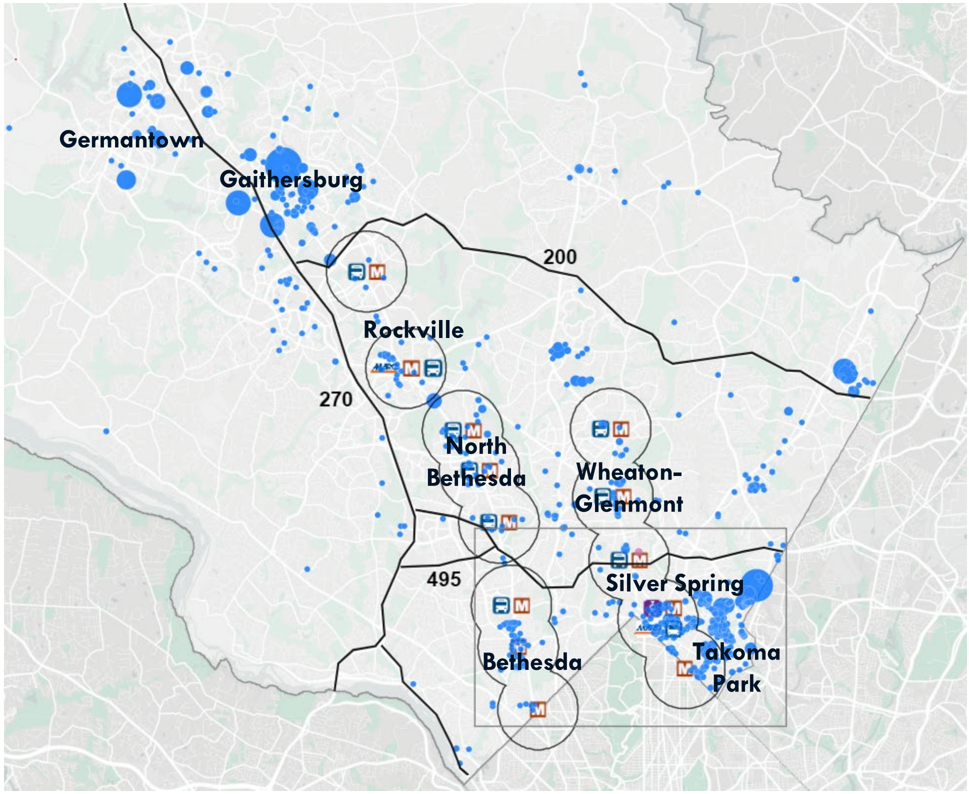
Decrease in <$1250 units — Increase in <$1250 units

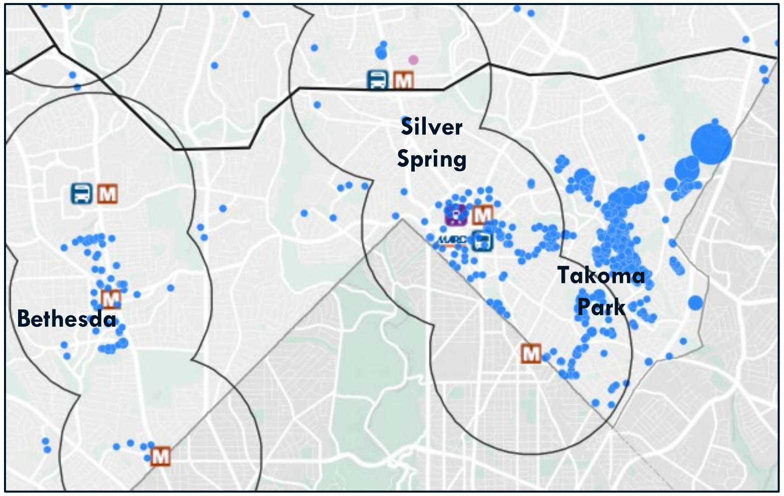
Per-acre change in units renting for <$1250, 2010-2018
(per-acre calculation to adj. for submarket density)

Sources: 2018 ACS 5-Year Estimates; MoCo Parcel Database; DHCA Data

Roughly 2,300 (or 8% of all NOAH units and 2% of the total housing stock) are "at risk" and within one mile from transit.

Inventory of NOAH Properties
+ 1-Mile Radii Around Existing High-Capacity Transit Facilities



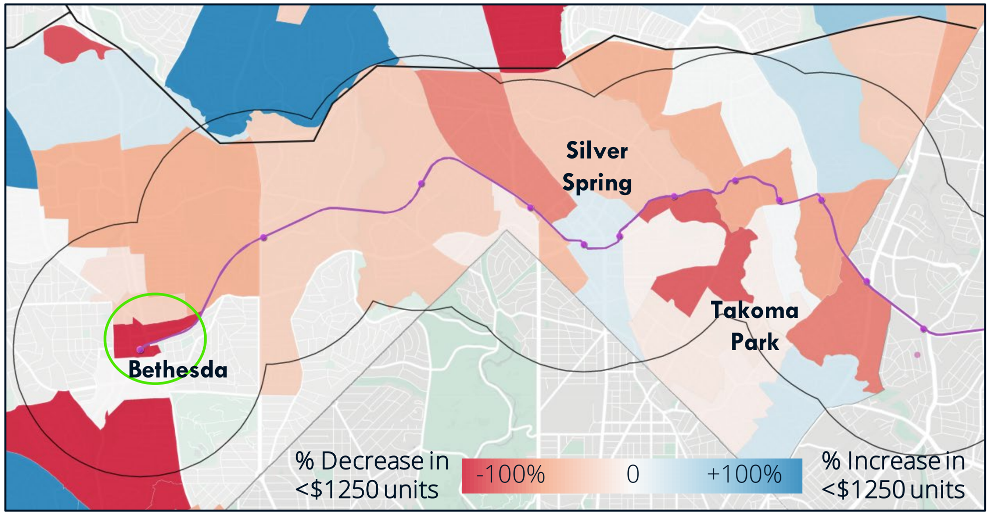


Metro Station ● NOAH units (bubble size ~ # of units)

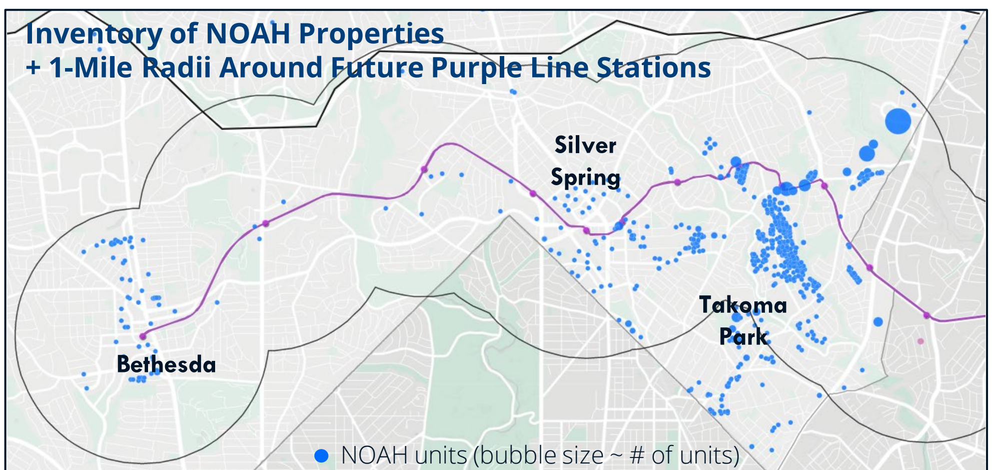
Sources: 2018 ACS 5-Year Estimates; MoCo Parcel Database; DHCA Data

Proximity to Transit – Purple Line

Percent Shift in Rental Units Priced $1250 and Below, 2010 – 2018 + Prospective Purple Line Stations



Purple Line

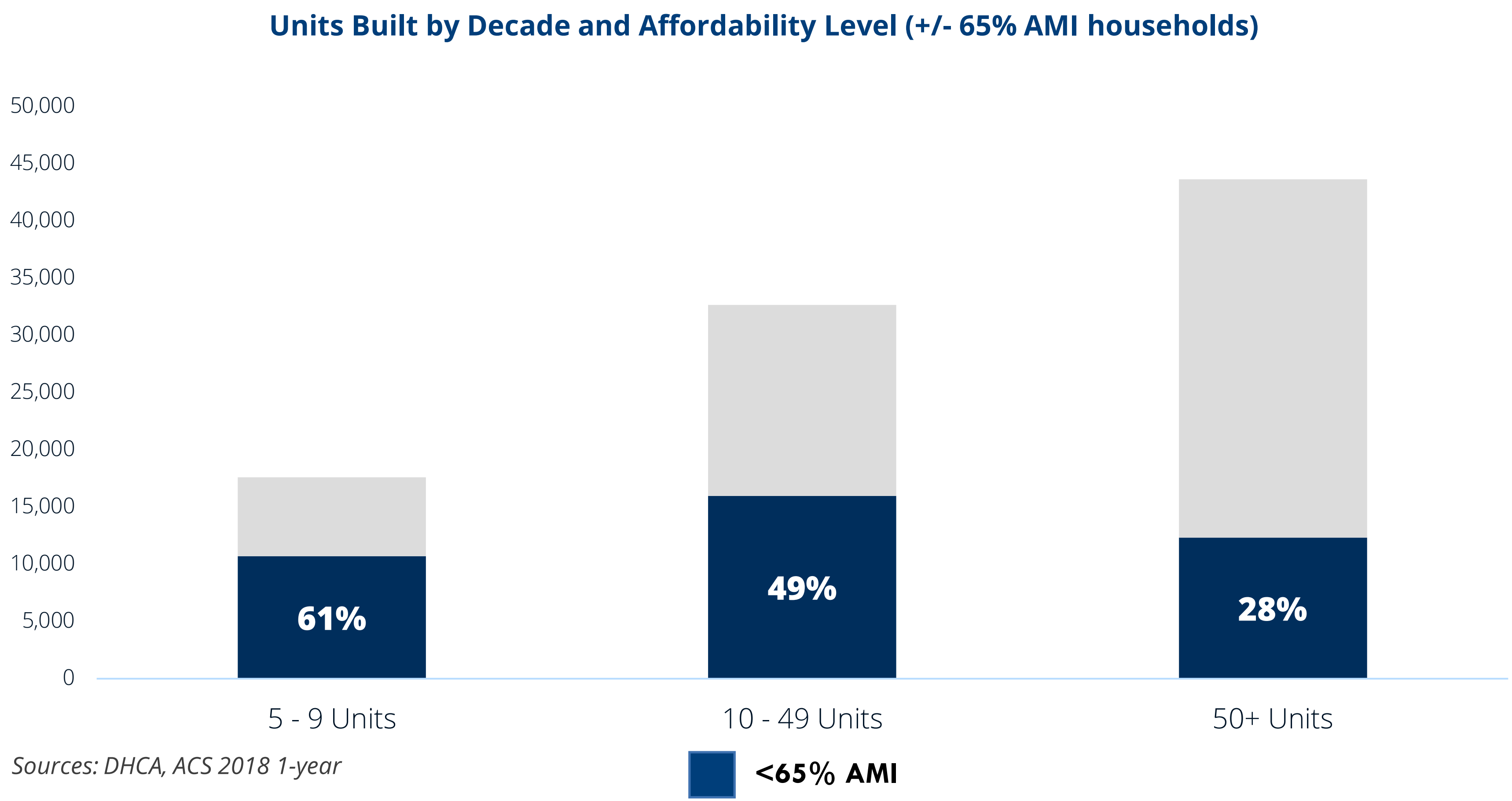


Sources: 2018 ACS 5-Year Estimates; MoCo Parcel Database; DHCA Data

Areas along the planned Purple Line have already demonstrated a rapid decrease in low-rent units in the past decade. The loss of low-rent units has been most rapid around the Bethesda Metro station.

Building Size

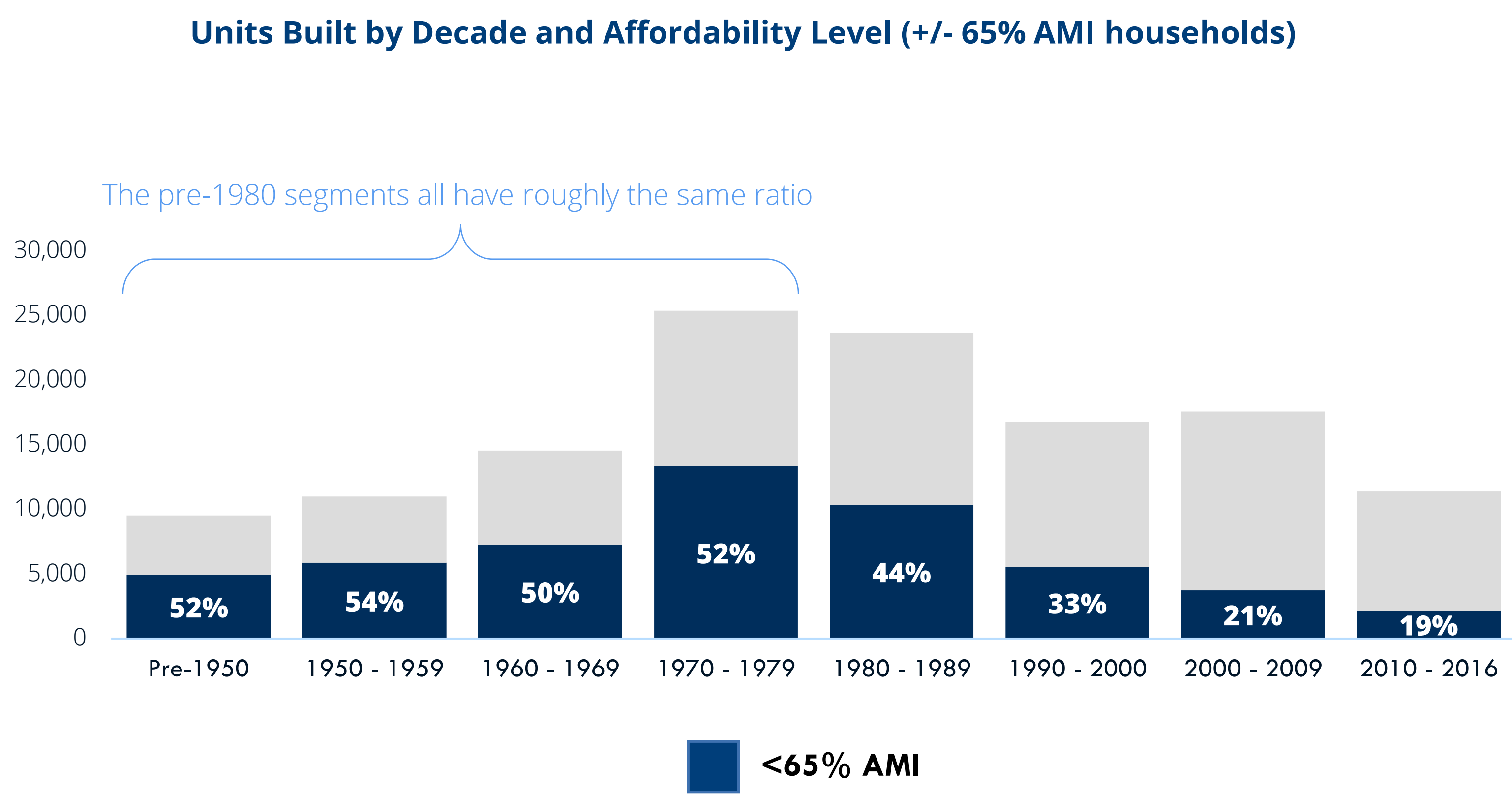
Over half of units in buildings with fewer than 50 units are affordable to households earning up to 65% of AMI.



Sources: DHCA, ACS 2018 1-year

Building Age

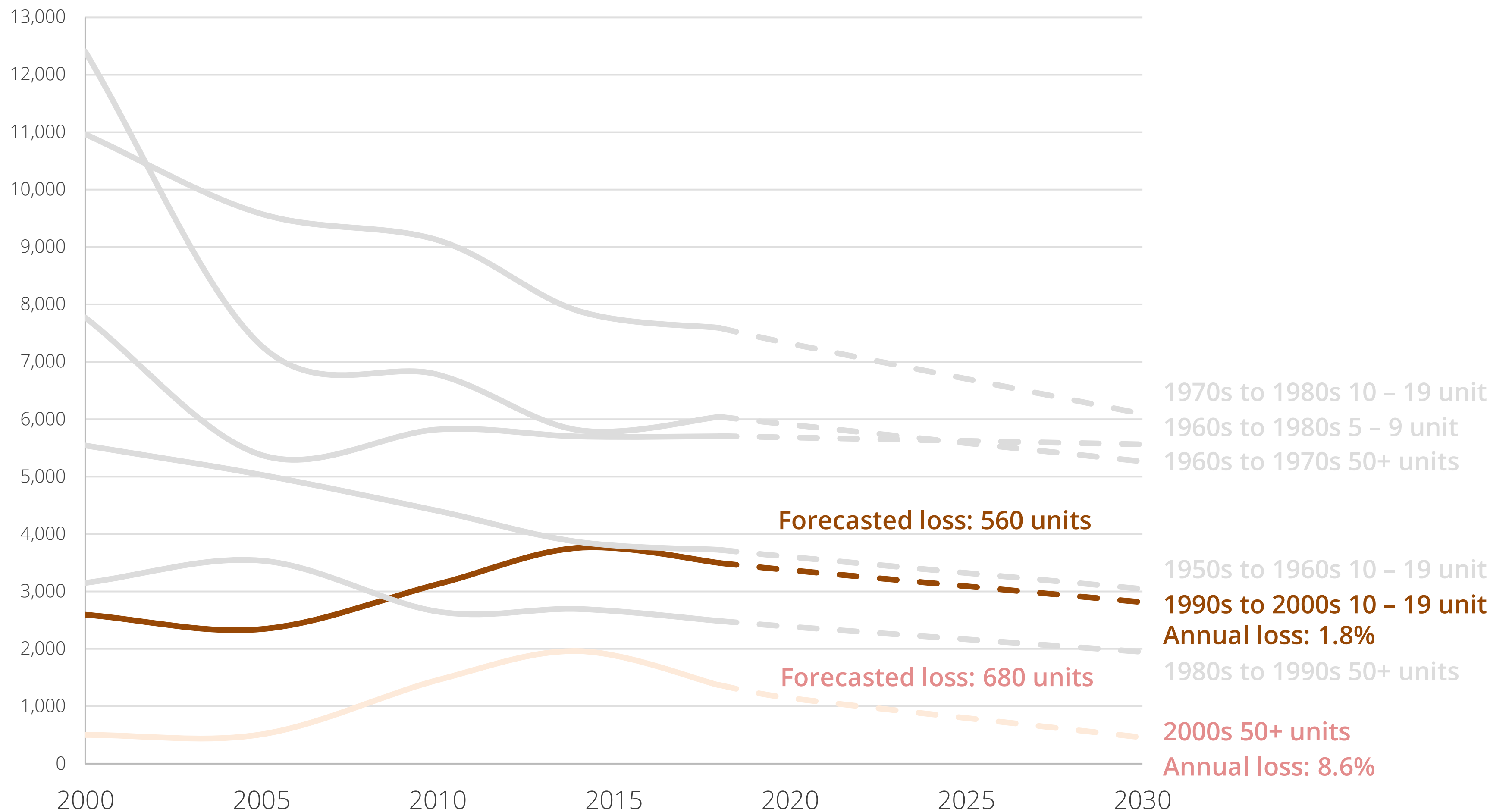
78% of units affordable to households earning up to 65% AMI were built before 1990.



Sources: DHCA, ACS 2018 1-year, CoStar

Future Trends by Building Typology

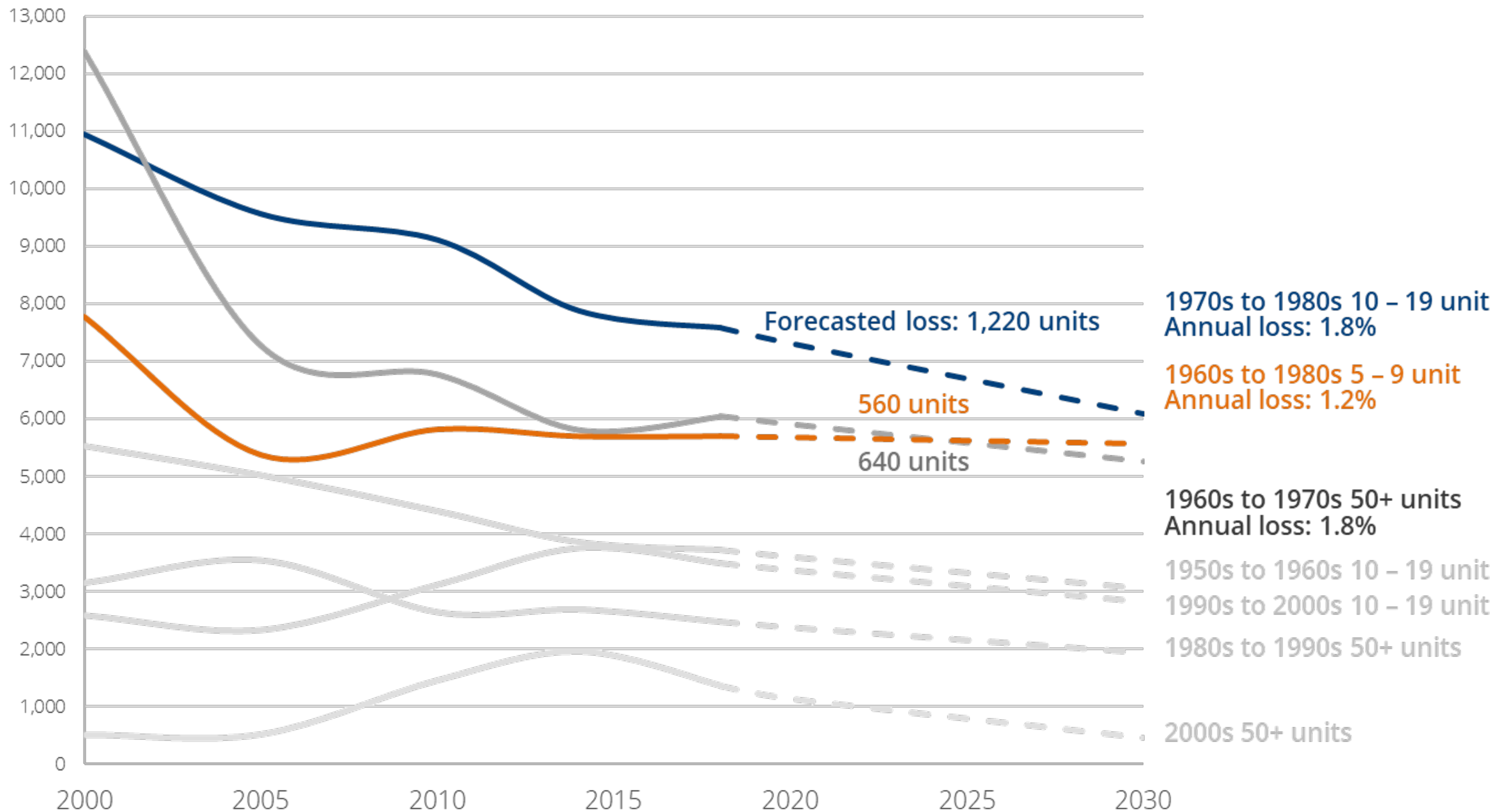
There are fewer newer NOAH units (built after 1990s), but they are losing units at a faster rate



Sources: DHCA, ACS 2018 1-year

Future Trends by Building Typology

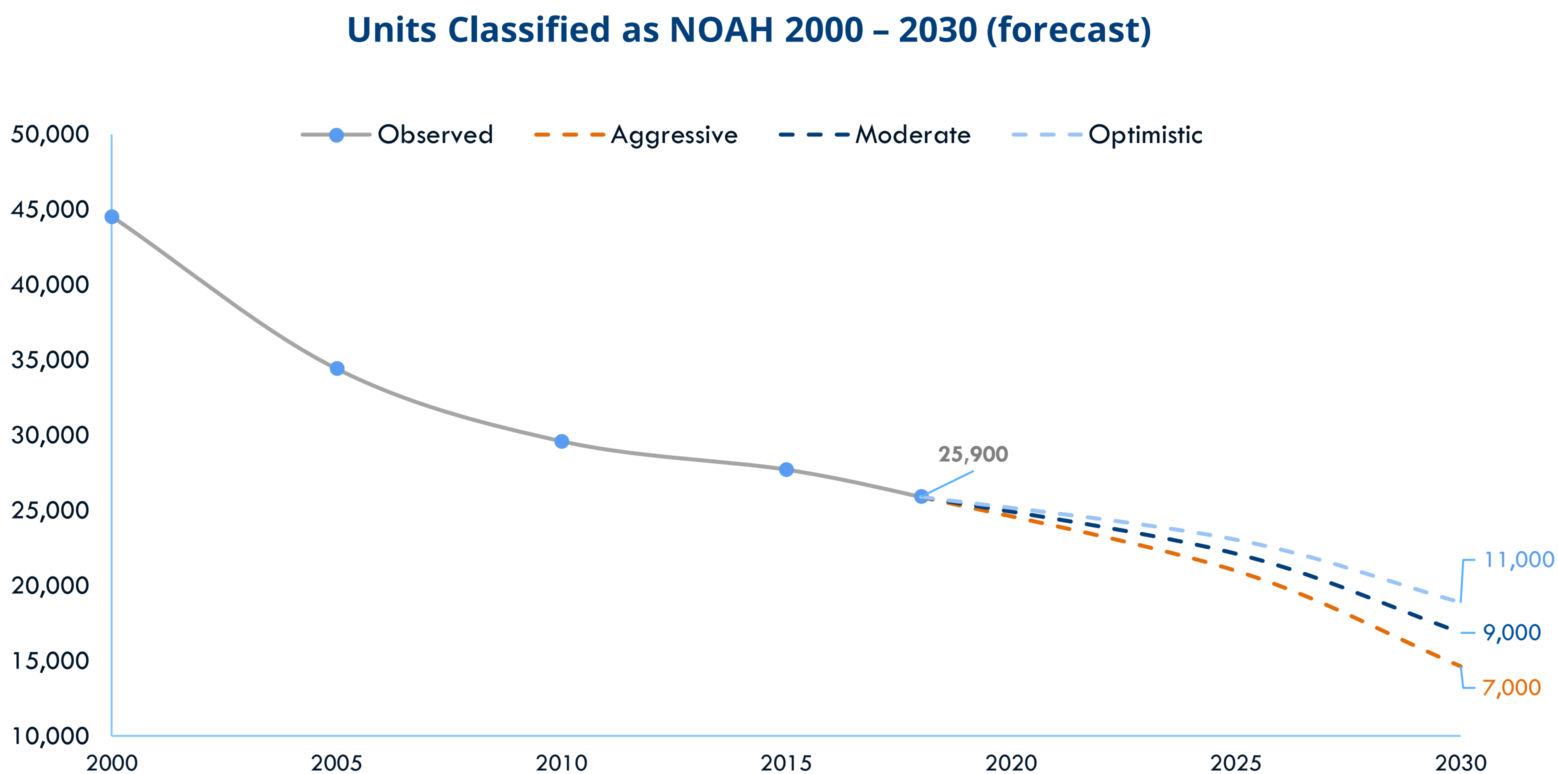
Older units built between the 1960s and 1970s are projected to be lost slower rate, but account for a larger share of lost units.



Sources: DHCA, ACS 2018 1-year

Projected Change

Based on these criteria, we forecast a loss of NOAH between 7,000 – 11,000 units by 2030.



Sources: DHCA, ACS 2018 1-year

Projected Change

Based on these criteria, we forecast a loss of NOAH between 7,000 – 11,000 units by 2030.

Common NOAH Property Typologies by Category
(sorted by projected loss of affordability)

Typology	Total Units <65% AMI	Estimated Loss (2020 – 2030)
1970s to 80s 10 - 19 unit	5,080	1,227 units
Post-2000 50+ unit	917	680 units
1960s to 1970s 50+ unit	4,046	650 units
1990s to 2000s 10 - 19 unit	2,342	560 units
1950s to 1960s 10 - 19 unit	2,493	550 units
1980s to 1990s 50+ unit	1,662	440 units
1960s to 1980s 5- 9 unit	3,817	120 units
Total	**20,357**	**4,200 units** (50% of total loss)

Sources: DHCA, ACS 2018 1-year

Preservation Framework| Unit Loss

There are four key ways in which a housing unit can be lost from the affordable stock. Each has different implications for how we approach preservation.

Physical Deterioration	As a NOAH or deed-restricted affordable property ages, there is insufficient investment in the property to maintain habitability, and the property is eventually removed from the building stock. This can result from insufficient cash flow from operations, poor management and/or intentional neglect.
Erosion of affordability via rent increase	If rents in NOAH properties increase faster than tenant incomes, eventually some rental units will no longer be considered "affordable," despite no other changes to the property, building, or business model.
Value-add Investment	In response to market demand from middle- and high-income rental properties, NOAH or expiring deed-restricted properties may undergo light-to-moderate rehabilitation to improve the property to be repositioned in the rental market or convert to for-sale condominiums. This process may be initiated by a transfer in ownership.
Redevelopment	In areas where the market can support redevelopment, an owner may completely redevelop a NOAH or expiring deed-restricted property, which can include a full rehabilitation, demolition and new construction, or a combination of both approaches. Such properties are generally targeted at the top of the market to offset the major investment in the property.

There are two primary conditions required to preserve a property:

1. Achieve a sustainable financial position.	The property must generate a net operating income (NOI) to sustain operations and repairs. If a property cannot sustain itself through NOI, it is at risk of being lost through lack of upkeep or be sold through a distressed sale.
2. Protected from exposure to market pressure.	There are a two key ways to ensure that properties are not exposed to existing market pressures: • A legal restriction, policy or loan agreement that regulates the increase of rent on the property; or • Transferring ownership to non-profit motivated owners (mission-oriented nonprofits, tenant ownership.)

There are three primary intervention points to preserve buildings: change in **ownership**, **recapitalization**, and **redevelopment**.
When a property is bought or sold, facilitating transfer to mission-driven ownership can restrict rent increases. The property must generate a net operating income (NOI) to sustain operations and repairs. If a property cannot sustain itself through NOI, it is at risk of being lost through lack of upkeep or be sold through a distressed sale.

Preservation Framework| Policy Categories

There are five key policy categories in which different permutations of preservation approaches can be combined to develop a sustainable preservation framework for Montgomery County.

Strategy and outreach	Analyzing preservation needs, opportunities, approaches, and interventions in the local context; and coordinating and executing efforts (often across agencies) to achieve identified goals and targets.
Land use and planning	Leveraging the rules governing or guiding development within a jurisdiction (including zoning codes and area plans) to incentivize or require preservation of affordability.
Tenants' rights	Leveraging the rules that govern how various stakeholders (owners, property managers, developers) participate in the market to preserve affordability and protect tenants.
Capital financing	Providing the financial resources necessary to undertake preservation interventions.
Operating subsidy and cost reduction	Operating subsidy/cost reduction: Offering incentives and resources that make it financially feasible for landlords/owners to offer reduced rents to lower-income tenants.

The most appropriate preservation approach and intervention is likely to depend on multiple factors, including but not limited to: the type of unit (NOAH, expiring deed-restricted); risk of loss; most likely loss type(s); property characteristics (scale, building typology, location, redevelopment potential); and priorities for resource allocation. **All these tools will be required for an effective preservation framework.**

There are five key policy categories in which different permutations of preservation approaches can be combined to develop a sustainable preservation framework for Montgomery County.

Category	Key Recommendations
Strategy and outreach	• Triage opportunities to preserve affordability, focusing on near-term opportunistic approaches such as COVID-19-related policies to bridge towards future comprehensive preservation efforts.
Land use and planning	• Allow or incentivize directly preserving existing NOAH as an alternative to MPDU compliance. • Consider a transfer of development rights program that builds off the County's agricultural TDR program to preserve priority existing affordability and continue to designate affordable housing as a public benefit.
Tenants' rights	• Consider expanding rent stabilization after the Covid-19 crisis following the 90-day rent relief bill. Rent stabilization needs to be designed carefully to ensure a healthy pipeline of new development along with preservation of residents at risk (especially in areas along the Purple Line expansion). Such a policy would need to balance and accommodate the necessary costs of property operations and maintenance.
Capital financing	• Explore opportunities to expand the Housing Initiative Fund to meet the needs of the preservation pipeline. • Adjust HIF administration guidelines to align with new LIHTC income averaging regulations. • Review allocation decisions to ensure that funding criteria promotes preservation, especially at lower income levels.
Operating subsidy/cost reduction	• Expand utilization of rental agreements through the County's PILOT provision. • Evaluate the previous County reduced rent program for elderly tenants and explore development of a new preservation property tax credit.