Neighborhood Stabilization Program

1. OVERVIEW

This exhibit describes the U.S. Department of Housing and Urban Development's (HUD) Neighborhood Stabilization Program (NSP) and outlines the proposed neighborhood stabilization strategies and programs for the City and County of Sacramento. Subject to direction from the governing bodies, this description will serve as the basis for the funding applications to be submitted to HUD by December 1, 2008.

Per the HUD regulations, the funding application requires a substantial amendment to the annual Action Plan and the Consolidated Plan. Because the Action Plans of the City and County are on a calendar year, these amendments are occurring at the same time as the Action Plan adoption. Key dates are summarized below.

Approval of Action Plan and Consolidated Plan (CP) Substantial Amendment Program Authorities	October 21
Action Plan Due to HUD	November 15
CP Amendment and NSP Application Due to HUD	December 1
HUD approves Application	December 31
Line of credit available	January 2
Deadline for any revisions to CP necessary for HUD approval	February 1

In addition, because of the truncated public process, SHRA intends to meet with the following groups in October to share this plan: Sacramento City/County Foreclosure Task Force, Sacramento Housing Alliance; Sacramento Association of Realtors; Sacramento Regional Partnership; Redevelopment Advisory Committees for Oak Park, North Sacramento, and Del Paso Heights, the North Highlands Vision Taskforce, and the cities of Galt and Folsom.

2. FEDERAL PROGRAM PARAMETERS

As part of the Housing and Economic Recovery Act of 2008 ("HERA"), Congress appropriated $3.9 billion in Community Development Block Grant ("CDBG") funds to state and local governments to purchase abandoned and foreclosed homes and residential properties. These funds create the Neighborhood Stabilization Program ("NSP"), which is intended to stabilize neighborhoods that are hardest hit by the foreclosure crisis. The U.S. Department of Housing and Urban Development ("HUD") has recently released the funding formula allocations and program rules which are summarized below.

Allocation of funding was based on state and local need measured by number and proportion of homes in foreclosure, subprime loans, and homes in default or delinquency. Each state receives, at a minimum, $19.6 million for use throughout the state. In addition, severely impacted entitlement jurisdictions whose proportional allocation equals at least $2 million receive their own funding. The State of California and jurisdictions within California will be receiving $529.6 million, or sixteen percent, of the federal grant.

In Sacramento County, the unincorporated County, the City of Sacramento and the City of Elk Grove all will receive grants directly from the federal government. The unincorporated County's grant (which can also be used in Galt and Folsom) is $18,605,460 and the City of Sacramento's grant is $13,264,829. Unincorporated Sacramento County is receiving the fourth largest allocation statewide, behind Riverside, Los Angeles and San Bernardino Counties, and the City of Sacramento is receiving the largest grant amount of any City in the State.

NSP funds are specifically focused on recovery and redevelopment of vacant, abandoned foreclosed homes. However, NSP regulations allow flexibility with use of the funds for rehabilitation, redevelopment, demolition, re-construction and land banking of vacant, foreclosed properties. The NSP funding is intended to complement larger redevelopment efforts, and to make a significant impact on distressed areas.

NSP funds have three purposes: to stabilize neighborhoods impacted by foreclosure, to remove significant blight from neighborhoods and to provide housing for low- to moderate-income households. Because of the anticipated condition of the properties, the acquisition price for land or property must be at a discount (at least five percent) below the appraised value. While all funding must be used for programs that house families at or below 120 percent of area median income (AMI), at least 25 percent of the funding must be used for families at or below 50 percent of AMI, and the jurisdiction must impose regulatory restrictions to ensure on-going affordability. Many nuances of these regulations, as well as their interplay with other HUD funding programs, and the short review timeframe, make interpretation difficult. The local strategy for the NSP funds is described in detail below; however, as more is understood about the regulations, proposed programs may be modified and new or alternative activities may be explored.

3. ELEMENTS OF A LOCAL STABILIZATION STRATEGY

Sacramento's neighborhoods have experienced many of the negative impacts of foreclosures: increased crimes due to abandoned and vacant properties, blighting influences as properties begin to deteriorate, and increased stresses on families and children.[1] NSP funding, however, presents an opportunity to return stability to some of Sacramento's hardest hit neighborhoods. Sacramento's local strategy responds to HUD's challenge to "carry out its NSP activities in the context of a comprehensive plan for the community's vision of how it can make its neighborhoods not only more stable, but also more sustainable, competitive, and integrated into the overall metropolitan fabric, including access to transit, affordable housing." While SHRA is proposing several programs as described below, all share similar goals, strategic elements and challenges

Sacramento's programs strive to achieve three goals:

- Return vacant foreclosed or abandoned residential properties to occupancy as quickly as possible;
- Revitalize neighborhoods through strategic redevelopment, rehabilitation and reuse of vacant properties; and
- Provide affordable homeownership and improved affordable rental opportunities to Sacramento families.

Critical Components of REO Programs

Programs will result in a variety of end uses from ownership to rental housing and may potentially include redeveloped uses, such as parks or commercial development when appropriate. REO programs share several key components critical to their success. Administration of these programs is complex.

- Property acquisition determines a program's success. Considerations include pricing, discount, flow, availability and quality. Acquisition processes must be quick and flexible.
- Rehabilitation systems should include well defined standards and specifications with contractors as partners. Contingencies must be budgeted to account for vandalism.
- Holding should be of limited duration to manage maintenance costs. While some market conditions permit more speedy recovery, the strategy recognizes that some areas and properties may require landbanking for a future use.
- Exit Strategies are necessary to ensure flow so that programs can operate at scale. For homeownership outcomes, this means strategies to create qualified buyer pools and evaluating ways to enlarge buyer pools, such as with downpayment assistance. Multiple disposition strategies may be required to return units to occupancy.
- Approaches should seek to maximize private financing and external leverage to the greatest degree possible.

[1] "Seven Ways Foreclosures Impact Communities", NeighborWorks America, August 2008

Geographic Targeting

Consistent with HUD's rules, the strategy seeks to operate in areas that are most severely impacted by foreclosures and in weaker housing markets that are not as readily able to recover without assistance. Staff believes that geographic targeting will focus activities in a way that achieves a visible impact in the City and County's most affected neighborhoods. Because weaker markets are targeted, home sales will be "naturally" affordable to families well below the 120 percent area median income (AMI) requirement, likely affordable to those in the low-income ranges (below 80% AMI). Rental units will be targeted more deeply to meet the very low-income requirements (below 50 percent AMI), consistent with market rents and incomes in the targeted areas. .

Geographic targeting is proposed based on the following criteria, as required by HUD regulations:

1. Foreclosure Rate – Top quartile of census tracts in Sacramento County by residential foreclosure filings per parcel, January 2007 through June 2008. (Source: DataQuick Information Systems)
2. Subprime Loan Percentage – Top quartile of census tracts in Sacramento County by percent of loans that were high cost, 2006. (Source: Home Mortgage Disclosure Act)
3. Likelihood of Increase in Home Foreclosures – Staff believes that it is reasonable to assume that areas with high rates of foreclosure and high rates of subprime lending will continue to have the highest foreclosure rate.

In addition to the areas chosen under the criteria listed above, the area around Lerwick Road in unincorporated Sacramento County will be targeted. While the entire census tract in which this area falls does not qualify under the criteria, the smaller area surrounding Lerwick Road has a high concentration of fourplex units with a very high foreclosure rate and a large number of low-income residents. The area has a history of problems, and the County has committed to revitalizing it. These funds would help to deal with the repercussions of foreclosures in the area and leverage other funds that will continue the revitalization process.

In addition to these criteria, SHRA compared the target areas with areas that were not included and found the following neighborhood characteristics.

- Investor activity is greater in the selected areas than in other areas of the County. While the percentage of homes purchased by investors countywide from August 2007 through July 2008 was 16 percent, the percentage of homes purchased by investors in the target areas was 28.5 percent over the same period.
- Declines in home prices have been steeper in the selected areas. From August 2007 to July 2008, home prices declined 28 percent on average

throughout the County. In the target areas, however, the average price decline has been almost 43 percent over the same period.
- The selected areas include the traditionally lower-income areas of the County. According to the 2000 Census, over 58percent of the households in these areas had incomes below 80 percent, and only 53 percent of households owned their homes.

Challenges

Sacramento's programs are designed in recognition of the funding rules and implementation challenges. Key challenges are highlighted and the descriptions below note program features designed to mitigate these issues.

Programs were designed with several key funding constraints in mind.

- All funds must be obligated at the property level within 18 months of the grant agreement. This means programs must be able to operate at scale.
- Acquisitions must be priced below appraised value. A systematic approach is more favorable than a case-by-case approach to this issue.
- Twenty-five percent of the funding must be targeted to households less than 50 percent AMI. Given other program requirements, rental housing is the only viable approach.
- Long-term covenants restrict eligible buyer pools, so flexibility should be sought relative to long-term restrictions.

Similarly, program design recognizes other implementation and administrative challenges

- Buyers are unable to compete directly with investors in today's market;
- Sacramento lacks capacity typically found in community development corporations that are able and interested in single family rehabilitation and ownership efforts. Getting to scale through existing partners is a challenge;
- Traditional affordable housing financing tools are largely unavailable for scattered site or smaller scale homeownership or rental housing;
- To be successful and truly transform neighborhoods, neighborhood stabilization strategies require broader tools and efforts, such as code enforcement, police and infrastructure, in addition to housing rehabilitation;
- As mentioned earlier, with tightened credit, attracting qualified buyers to the targeted areas will not be easy; programs must be proactive in this area; and
- Success requires skilled staff who are able to maintain a sustained and focused attention to these efforts.

4. LOCAL PROGRAMS

Vacant Properties Program

Modeled after the successful ‘Boarded and Vacant’ and the “Vacant Lot’ programs, the Vacant Properties Program is designed to return vacant and blighted homes and properties to owner occupancy. Partnering with local contractors and developers in targeted areas of the City and County of Sacramento, the Program provides a developer an incentive fee to be paid after homes are rehabilitated or constructed and sold to owner-occupants. In limited situations, demolition and reconstruction will be the preferred option.

Because the Program will be geographically targeted in lower-income neighborhoods, it is anticipated that prices will be affordable to families at 80 percent of median income. However, HERA regulations allow maximum sales prices up to 120 percent of median income. In no instance will a home be sold at a price that exceeds the total of acquisition, rehabilitation/construction, and disposition costs.

The program’s benefits include using private capacity and minimizing risk of owning properties. However, staff expects the scale to be relatively small.

Block Acquisition/Rehabilitation

High foreclosure rates and REO properties can provide a revitalization and intervention opportunity on a street-by-street basis. Developer-driven acquisition and rehabilitation efforts can substantially improve streets and block groups where foreclosures and vacant properties have magnified existing physical and social blight issues. These areas share many common traits, including:

- Poorly maintained half-plex and duplex homes;
- Prevalence of investor-owned properties;
- Heightened police and code enforcement activity; and
- Declining property values.

Building off the success of past and current efforts at Fruitridge Vista and Lerwick Road in the County and at Phoenix Park in the City, SHRA is crafting a Block Acquisition/Rehabiltation Program to help address some of the blighted conditions in specific targeted areas. SHRA will seek partnerships with private developers willing to acquire, rehabilitate (or demolish and rebuild) and maintain as common rental property, units in designated areas. Transformation depends not only on removing the physical blight, but also in stabilizing and securing the neighborhood; therefore, the program must be complemented by additional City and County efforts, including coordination of police and code enforcement efforts to reduce crime and nuisance activities and investment in public infrastructure.

Vacant, foreclosed properties in the following areas are eligible for acquisition and rehabilitation funding through the Neighborhood Transformation Program.

City
- Western Avenue
- Nedra Court
- Coral Gables Court
- Franklin Villa "Tip" – Properties in the Morrison Creek HOA, bounded by Shining Star Drive, Franklin Blvd. and Morrison Creek.

County
- Lerwick Road
- Norcade Circle
- Gigi Place and Della Circle
- Morningstar Drive
- Clover Manor Way

The Program will provide low-interest loans to developers who are able to demonstrate capacity to acquire at least 50 percent of the properties in one of these areas and make a significant investment for change in the area. Funds will be used to provide stable, affordable and safe housing units accompanied by strong property management as a vital component of this Program. Income targeting will contribute to the NSP requirement of 25 percent expenditure to very low income (50% AMI) households. Based on preliminary funding allocation, staff anticipates that up to two areas in each jurisdiction could be funded with NSP funds if a critical mass of foreclosed properties can be acquired.

Property Recycling Entity (PRE)

HUD's NSP contemplates local governments and intermediaries acquiring foreclosed properties for rehabilitation with rental, for sale, demolition, land banking and redevelopment as eligible activities. Other localities such as San Diego, Chicago, Dallas and now Los Angeles have private community-based entities to manage the tasks of acquisition, rehabilitation, rent or sale utilizing private capital from Community Development Financial Institutions (CDFI) and government sources. Sacramento does not have similar entities and there is limited local non profit capacity for this type of activity.

The Property Recycling Entity or PRE envisions an entity (government, affiliate or private) that can quickly acquire foreclosed properties and adjacent parcels, conduct the necessary rehabilitation or demolition, rent or sell and engage in redevelopment. Specifically the PRE could engage in the following functions:

- Acquire, rehabilitate and sell;
- Acquire, demolish and land bank;
- Develop land-banked assets in targeted areas, either separately or as a joint venture;
- Rent acquired assets and sell when market conditions improve

PREs would have a core staff to manage the process and contract as necessary to employ additional expertise and capacity. The PRE would also serve as a backstop or owner of last resort in those situations where other programs may not be applicable or cannot produce the necessary volume to achieve program goals. The PRE could take several forms; each have their own strengths and weaknesses.

- Agency ownership. SHRA, the Housing Authority or the Redevelopment Agency could all acquire foreclosed properties and adjacent parcels in the targeted areas using funds from the NSP. Using the governmental entities with their restrictions could delay the acquisition process and prevent the program from being competitive in acquiring key properties in impacted areas; however, these entities are readily available.
- Intermediary. A non-profit or forprofit entity could acquire, rehab, rent and sell the properties under an agreement with SHRA. A non-profit could also act as a subrecipient under CDBG rules. This structure allows for greater flexibility in acquiring properties; however the intermediary may not be subject to enough control to meet the Program's goals.
- Affiliated non-profit. SHRA could create an affiliated non-profit entity with the express purpose of acquiring assets in the same manner as an intermediary; however, this entity would be more tightly controlled and directed by SHRA. The board of the non-profit could be comprised of local elected representatives or members from the housing community.

Benefits and Advantages

A PRE would provide the foreclosure initiative with the flexibility and speed necessary to encumber the NSP funds within the mandated timeframe. Other programs contemplated in this initiative, while necessary to present a multi-faceted approach, are dependent upon outside vendors reacting to prescribed programs that may not produce enough volume to meet Program objectives. The primary benefits of a PRE include the ability to:

- Flexibly acquire a range of properties in short timeframes;
- Work alone as a nonprofit or joint venture with private entities;
- Quickly acquire properties where a clear exit strategy has not been formalized to take advantage of purchasing opportunities;
- Land bank and assemble properties for future development, waiting for market conditions to improve;
- Strategically acquire assets in coordination with larger revitalization efforts or where significant SHRA, City or County investment exists;
- Attract investment by providing lenders with CRA credits; and
- Serve as a community development corporation for the long term.

Challenges

For purposes of acquiring and rehabilitating properties, relying on existing government entities, using private entities or creating an affiliated non-profit present several challenges that will require a significant amount of start-up time, dedication of resources and expense. Some of these challenges include:

- Using an existing government entity would require the dedication of staff, setting aside funding and obtaining specific approvals for individual property acquisitions. These implementation challenges would impact existing Agency operations by diverting resources away from other activities even with the availability of administrative funding from the NSP.
- An existing intermediary would need to be placed under a program related development agreement for the intended activity. In addition to the Agency's requirements, this agreement would no doubt include a limitation of liability for the intermediary and some guarantee of fees and reimbursement of costs. An intermediary also may not be as responsive to working in targeted areas and may decline certain properties and projects due to liability and profitability concerns.
- A new entity would require a formation of a stand alone non-profit 501(c)(3) entity with an independent board, dedicated staff and funding for operations. The new entity would need capacity to manage the assets in the long term and have sufficient financial resources to hold and maintain the properties.

Volume and Scale

Based on past SHRA experience, historic activity, estimates of acquisition and rehabilitation costs, conservative leverage estimated, and conversations with potential partners, the following represents the best estimate of achievable units and the associated funding. Progress will be closely monitored in each activity and adjustments may be proposed through amendments. It is anticipated that a new non profit PRE would have some initial lag time due to formation and start-up activities.

<u>County Activities</u>

Program*	% Funding	Allocation	Units
Vacant Properties	20%	3,721,092	84
Block Acq/Rehab	40%	7,442,184	67
PRE	40%	7,442,184	84
Total	100%	18,605,460	234

*Administration is included in the program activities

NSP Substantial Amendment Summary Table

Activity Name	**Vacant Property Program**	**Block Acquisition and Rehabilitation**	**Property Recycling Entity**
Activity Type	Acquisition, rehabilitation, and sale of scattered site vacant single family properties to income eligible homebuyers.	Developer partner in tightly targeted areas for acquisition, rehabilitation, and to be operated as rental properties primarily for very low-income households.	Creation of government entity, affiliate organization, or existing nonprofit to proactively take on projects, including acquisition, redevelopment, land banking and rehabilitation; provides flexibility and speed to react to market, both scattered and block; allows for strategic focus for larger revitalization efforts.
National Objective	LMMH	LMMH, LMMA	LMMH, LMMA, LMMC, LMMJ
Projected Start Date	January 2009	January 2009	Formed January 2009, undertake activities by June 2009.
Projected End Date	January 2011	July 2012	December 2013
Responsible Organization	SHRA	SHRA	SHRA
Location Description	Target Areas	Target Areas	Target Areas
Activity Description **▪ tenure** **▪ duration** **- affordability range** **▪ cont. affordability** **▪ discount rate**	▪ Homeownership; ▪ One-time developer fee; ▪ In areas where affordability is presumed to naturally occur; ▪ Individual acquisition discount rate 5% / minimum average portfolio discount 15%.	▪ Rental; ▪ 30 year loan (w/ ability to be forgiven) with up to 4% interest; ▪ Length of affordability will follow HOME requirements dependent upon investment amount per unit; ▪ Individual acquisition discount rate 5% / minimum average portfolio discount 15%.	▪ Homeownership, rental, or any allowed redevelopment use; ▪ Grant or 30 year loan (w/ ability to be forgiven) with up to 4% interest; ▪ Either be in areas where affordability is presumed to naturally occur or will follow HOME per unit cost restrictions; ▪ Individual acquisition discount rate 5% / minimum average portfolio discount 15%.
Total Budget **▪ NSP funds** **▪ leverage**	▪ City – $3,389,901 Leverage – $13,600,000 ▪ County – $3,721,092 Leverage – $14,900,000	▪ City – $3,979,449 Leverage – $2,000,000 ▪ County – $7,442,184 Leverage - $3,700,000	▪ City – $5,895,480 Leverage – $9,000,000 ▪County – $7,442,184 Leverage – $11,000,000
Performance Measure **▪ by income group**	Housing Units ▪ City – 76 units (51-80% AMI) ▪County – 84 units (51-80% AMI)	Housing Units ▪City – 18 units (50% AMI and below); 18 units (51-80% AMI) ▪County – 27 units (50% AMI and below); 40 units (51-80% AMI)	Housing Units ▪ City – 27 units (50% AMI or below); 39 units (51-80% AMI) ▪ County – 33 units (50% AMI or below); 50 units (51-80% AMI)