LOCAL GOVERNMENT

FINANCING OPTIONS

LOCAL GOVERNMENT FINANCING OPTIONS

In order for a jurisdiction to implement a hazard reduction program in its community, it is often suggested that the jurisdiction offer some form of financial assistance as an incentive. The problem of financing retrofit of hazardous buildings, however, is both critical and intractable. This chapter discusses the problems associated with financing retrofit projects, and lists sources of public funds which could possibly be used for this purpose.

This chapter focuses strictly on the issue of financing, implicitly assuming that the policy issues have been discussed at the local level and that the jurisdiction has made the commitment to provide financial incentives to owners of hazardous structures. In much of the discussion, this chapter takes the perspective of owners rather than of local government. This is because we assume the readers will be primarily public sector professionals who are conversant with the local government perspective while perhaps less so with private sector rationale. This approach is not intended in any way to minimize the importance of local governments' perspectives and responsibilities, comprising the health, safety and economic welfare of the public, which form the primary incentive for this *Handbook*.

THE SCOPE OF THE FINANCING PROBLEM: ATTAINABILITY, AFFORDABILITY, AND ECONOMIC INCENTIVE

Some owners are able to fund retrofitting projects with their own cash. For those owners, access to financing is not a problem. Most owners, however, are unable to fund retrofitting projects themselves and need to rely to a greater or lesser extent on outside sources of funds.

To be useful it is important that financing be not just available, but also attainable and affordable. Sources of funds can and do exist which might seem to be available for retrofitting projects but which in fact are not attainable. The Rosenthal Bond program illustrates this problem most clearly. Rosenthal Bond funds were designed to be available for retrofit projects if the projects, by virtue of the retrofitting, generate additional revenue and this revenue is available to pay off the bonds. As retrofitting usually is not revenue generating, few if any projects can meet the criteria established by the funding source. To our knowledge Rosenthal Bond funds have never been used. In fact, very few people are aware of the program and the way in which it is meant to work. Many local governments, which are supposed to administer the program, have never heard of it. Various other problems, including subsequent changes in tax laws, have rendered the Rosenthal Bond program virtually useless.

A common hurdle to accessing available sources of funds is the fact that the buildings in need of retrofitting often do not meet the criteria established for these funds. Bank and bond financing, for example, require that a specified loan-to-value ratio be present as a prerequisite to funding. Owners of highly leveraged buildings and buildings in depressed areas are often unable to meet these criteria and therefore do not have access to these types of financing. This problem is faced most acutely by owners of unreinforced masonry buildings (URMs) who are unable to obtain tenants because their buildings are considered hazardous. Subsequent to the Loma Prieta earthquake, the appraised value of URMs dropped precipitously because of their poor performance in that seismic event. Meanwhile, tenants began shying away from URM buildings, which had a negative impact on owners' cash flows. Owners in this situation would in fact see an increase in revenues as a direct result of retrofitting, as well as an increase in value to pre-quake levels. However, because these buildings generally carry a level of debt that is already based on their pre-quake values, their loan-to-value ratios are too high to permit the additional borrowing necessary for retrofitting projects.

Affordability of the project and its financing is the second major hurdle which trips up most owners considering retrofitting. As mentioned above, retrofitting is not necessarily revenue generating. It is also expensive. While it is commonly accepted that costs for post-earthquake repairs are significantly higher than the costs of retrofitting, owners have no mechanism allowing them to take into account the probability of their particular building being damaged in the next earthquake. Thus, owners who consider retrofitting out of concern about the safety and/or the long-term value of their property find themselves weighing the concrete expenses of retrofitting against perceived but unquantifiable benefits.

Owners must also consider the economic impact of retrofitting on tenants in their buildings. Few retail tenants can afford to interrupt their business for any length of time, and most feel that temporary relocation is impractical. Therefore, long-term retrofit projects causing major disruption would likely result in the loss of tenants. Increased lease rates required to pay for the project also are a concern. This is particularly difficult in the case of smaller buildings, where project costs per square foot are high because the fixed costs of retrofitting are spread over a smaller area. For all these reasons retrofit-only projects are uncommon. Retrofitting has mostly been undertaken in conjunction with larger remodeling projects, which are expected to result in revenues sufficient to compensate for the temporary loss of tenants as well as to at least pay for the project.

In many cases a major disincentive to retrofit is that it provides no net measurable economic benefit to owners. It has been argued that retrofitting property lessens liability exposure, rendering the decision to retrofit economically justifiable. This argument is weak for at least two reasons. First, although retrofit reduces liability exposure, it does not remove it entirely. The second reason relates to the way in which, as a practical matter, liability is handled by owners and insurers. (Note that we are discussing here liability insurance, not earthquake insurance which covers damage to property.) Owners who find themselves at increased exposure to liability as a result of the hazardous condition of their buildings generally can deal with the matter by purchasing additional liability insurance. The incremental cost of this additional coverage is minuscule in comparison to the owners' other costs of doing business and, of course, to the cost of retrofitting. Insurance companies will offer the liability coverage, typically finding it less expensive to risk the loss than to determine the type of construction of each of the buildings owned by the businesses which it insures. Exposure to liability turns out to provide economic incentive to retrofit only to those large businesses which are self-insured. (See: LIABILITY IMPLICATIONS AND CONSIDERATIONS)

The most compelling way that jurisdictions can make an economic case for retrofit-only projects is by passing ordinances which require that owners either retrofit their property or face demolition. However, some skeptical owners have questioned the efficacy of such ordinances, doubting the political will of jurisdictions to actually carry them out.

Even when faced with the ultimate loss of their property, many owners will not retrofit either because the money to do so is not accessible to them, as discussed above, or because they simply cannot afford to make interest and principal payments on the financings. In discussions with property owners rebuilding in Santa Cruz we found that all but one relied heavily on 4% 30-year financing from the Small Business Administration. (Note that this source of funds is only available for earthquake recovery, not for preventive retrofitting.) All of these owners indicated that they could not have rebuilt their properties without these funds, and even with this low-cost source of financing most found the expense difficult to bear. One owner commented that he does not ever expect to break even, let alone reap economic rewards; he was undertaking the project on behalf of his heirs. Owners who are losing money or breaking even, and who are unable to raise lease rates or rents to pay for the retrofits, are unable to comply with retrofit ordinances. In some instances owners may be willing to raise rents but tenants would be unable to pay; in the case of owners of residential property, jurisdictions may not want or permit them to do so for policy reasons, particularly where affordable housing is at stake. Owners comment that it is unreasonable for jurisdictions to enact tough ordinances without suggesting the means to comply.

It is worth pointing out that the attitude expressed in the above paragraph, while common, is not necessarily appropriate. In many areas of the State healthy aftermarkets are occurring for URM buildings. Some owners are selling their properties, albeit at a loss, while others are attempting to retrofit. Gentrification and revitalization are occurring in some areas. In still other areas, rents are sufficiently high as a result of other market pressures that owners can afford to absorb as overhead the cost of retrofitting. In the City of Los Angeles, two-thirds of the 8,100 identified URMs have been strengthened or are under construction; less than 20% have been demolished.

BANK LENDING

Faced with a project which needs financing, most owners turn to their local bank. In the case of retrofit projects, the banks are likely to be less than eager to lend. Obvious concerns are credit issues, such as loan-to-value ratios and debt service coverage (the ratio of funds available to make payments, to the principal and interest payments themselves). In a bank's view, retrofit projects are particularly difficult unless the owners have built up enough equity to support the additional loan.

For the most part, the banks look as much if not more at the owner's cash flow and ability to repay the loan; the value of the collateral is a secondary issue, as the bank wants never to have to collect on it. Further, the value of the collateral is, in the bank's eyes, not its cost but its market value. The market value of the property, and thus the bank's collateral, will not necessarily be improved by a retrofit project.

One might argue that the banks should be concerned with their potential for loss when the "big one" hits. We suspect that, as with the liability insurers discussed above, large banks in particular consider it reasonable to take the risk associated with hazardous buildings in their loan portfolio, planning to write off in the future such losses as are incurred rather than to spend money now to prevent potential losses. The banks' loss experience with the Loma Prieta earthquake did nothing to belie this argument.

New bank lenders, ones not already associated with a property, have an even stricter test of the value of the collateral. Until the seismic retrofit is complete, the banker considers that at any moment the earthquake may happen and the structure collapse. From a collateral perspective, then, unless earthquake insurance is available the banker really can only count on the value of the underlying land, <u>less</u> demolition/clean-up costs, <u>less</u> existing loans. It is a rare property that can withstand this form of analysis, and it is a rare bank which today will make such a loan.

The bankers' logic is derived primarily from the perspective taken by bank regulators. Bank regulators painfully scrutinize banks' portfolios and apply harsh tests to determine their creditworthiness. Regulators apply the logic outlined above to the analysis of banks' portfolios, and require that more capital be set aside in reserve against riskier loans. Riskier loans are therefore more expensive for the banks, which must then choose either to forego them in favor of cheaper loans or to pass the added cost onto the borrower. Adding to the borrower's cost, of course, makes it harder for the borrower to pay, debt service coverage deteriorates, and both bankers and owners find themselves in a frustrating position from which bankers extricate themselves by simply withdrawing from the market.

Note that the regulators make no allowances for Community Reinvestment Act (CRA) loans; CRA loans have to meet ordinary credit criteria. However, if the projects could stand up to ordinary criteria we likely wouldn't be relying upon CRA to get them funded. CRA turns out to be a very weak lever with which to pry loans out of the banking community.

SOME SOURCES OF FUNDS

Owners unwilling or unable to use their own cash or to get bank funding will turn to local government to provide the funds for retrofitting. As mentioned above, this chapter does not address the issue of whether or not local governments should provide any amount of financing. Assuming that the policy decision is made to do so, as a practical matter local jurisdictions are no more able, and in many cases are less able, than property owners and banks to come up with the funds. This section mentions several sources of funds available for retrofitting privately-owned properties. These sources, highlighted in bold, are outlined in more detail later in this chapter.

One source of funds available to some jurisdictions is the **Community Development Block Grant Program** (CDBG) administered by local jurisdictions and funded by the U.S. Department of Housing and Urban Development (HUD). As CDBG is a grant program, the funds need not be repaid to HUD. In its own way CDBG is a very flexible source of funds, allowing jurisdictions to design and administer local retrofit programs. Los Angeles uses CDBG funds extensively for its retrofit program. However, the projects using this funding must comply with strict criteria; generally, the projects must benefit low- and moderate-income individuals. Most large cities (over 50,000 population) and urban counties receive "entitlements" under the CDBG program, funds to which they are entitled and which they receive each year. These funds generally are committed to existing programs. Diverting them to retrofit projects is a matter of political choice.

Owners of properties providing low- and moderate-income housing have perhaps the widest array of financing tools from which to choose. Most can use long-term tax-exempt bond financing which, in today's market, offers an interest rate about two-thirds of bank lending rates. The tax credit program, wherein owners can take direct deductions from their tax bill, is a very powerful tool. At various times the State and Federal governments may offer programs providing financing, subsidies, and/or incentives to property owners to construct, remodel or rehabilitate low- and moderate-income housing. Two State programs, the **California Housing Rehabilitation Program** and the **Marks-Foran Residential Rehabilitation Act**, are particularly applicable to retrofit projects. Most of the previous Federal programs have been replaced by a single new program, dubbed **HOME**. Various other agencies, both public and private, are available to provide funding for low- and moderate-income housing.

The financing processes and requirements for funding low- and moderate-income housing are very complex. An industry of bankers and consultants is poised to help eligible owners seeking such financing. Most owners nonetheless suffer from both the attainability and the affordability problem. Simply stated, the fundamental difficulty is that in order to afford to finance new projects, even at relatively low interest rates, owners need to raise rents. This, of course, could defeat the purpose of the housing, and may render it ineligible for these sources of funds. Further, because of the complexity of the field, it is generally not economical to seek financing of this sort for projects costing less than several million dollars.

Other sources of funds are available for particular types of properties. **Marks Historic Bond Act** funding is available to aid in the rehabilitation of historically or architecturally significant structures. The **Small Business Administration** offers a number of programs, the most applicable being a loan guarantee program for owner/tenants in seismically hazardous buildings.

In addition to the Federal and State programs mentioned above, bond financing can be an option for local jurisdictions wishing to offer market-rate financing to property owners in their community. **Special Assessment District** financing has proven useful in at least two cities, and **Mello-Roos Community Facilities District** financing, a similar technique, should also be helpful. However, both attainability and affordability can be problems with these types of financing. Possible additional sources of bond financing are **Tax Increment Financing** (also known as Tax Allocation Bonds) available to properties in redevelopment areas, taxable **General Obligation** bonds, which must be approved by a two-thirds vote, and **Public Purpose Bonds** which must be issued primarily for other public capital improvements allowing no more than 5% of the bond proceeds to be used for the purpose of retrofitting privately-owned property. The latter three techniques have never to our knowledge been applied for the purpose of retrofitting privately-owned property. A great deal of study, particularly on the part of bond counsel, and especially with regard to public purpose bonds, would need to be undertaken before these techniques could be recommended as sources of funds for local jurisdictions.

On the following pages you will find more detailed descriptions of the sources of funds highlighted in bold in this section. These sources of funds, although limited, are tools available to local governments interested in promoting retrofitting.

(Winter, 1991)

STATE AND FEDERAL PROGRAMS

CALIFORNIA HOUSING REHABILITATION PROGRAM

(Propositions 77, 84 and 107)

(California Government Code - Section 8878.15 et seq.)

General: The California Housing Rehabilitation Program (CHRP) is administered by the California Department of Housing and Community Development (HCD) and is funded by General Obligation Bonds sold by the California State Treasurer. The program is divided into four categories, with funds allocated to each of those categories and split between rural and non-rural projects. The table below shows the project categories and the amount of funding available under each. CHRP is open to any individual or public or private entity capable of owning, rehabilitating and managing rental housing. Funds are allocated on a competitive basis.

Program Category	Rural Appropriated ($MM)	Rural Used ($MM)	Non-Rural Appropriated ($MM)	Non-Rural Used ($MM)
Seismic retrofit of Unreinforced Masonry Buildings (URMs)	4.0	none	16.0	13.65
General rehabilitation and acquisition of projects requesting seismic retrofit	4.0	none	16.0	13.65
Nonseismic general rehabilitation and acquisition	13.8	2.1	18.3	18.3
Single Room Occupancy (SRO) hotel/model rehabilitation and acquisition	6.8	none	10.2	9.375

Benefits: Through the CHRP program, HCD provides low interest loans directly to project sponsors. The interest rate on these loans is 3% calculated on a simple basis. The minimum term for rehabilitation-only projects is 20 years. The minimum term for refinance/rehabilitation or acquisition/rehabilitation is 30 years. Longer terms or 10-year extensions are sometimes available. Usually, annual interest-only payments are required with the principal due as a balloon payment at the end of the term.

Types of Properties: CHRP loans may be used for various types of rental housing developments to be occupied by very low-income and other lower income households, with some funds specifically targeted for SROs.

Jurisdiction's Responsibilities: The CHRP program does not require the participation of the municipality.

Owner's Responsibilities: It is the owner's responsibility to submit a complete application on a timely basis. Proposals at the most advanced stages are more likely to be funded.

Limitations: Under this program, loan limits for rehabilitation-only projects are $15,000 per SRO unit, $25,000 per 0-2 bedroom apartment and $35,000 per 3+ bedroom apartment. An additional $10,000 per unit is allowed when the project includes both rehabilitation and acquisition. New construction is ineligible.

After rehabilitation under this program a project must comprise a rental housing development with assisted units. Rent limitations apply to all assisted units for the full term of the agreement, regardless of prepayment, sale or transfer.

The CHRP program includes significant relocation rights and obligations. A URM must meet the following requirements to be eligible for program funds:

(1) At least 50% of the gross floor area will be used for residential purposes
(2) The building has been identified as "potentially hazardous" by the local building department due to the need for seismic reinforcement, and is located in a jurisdiction that has inventoried its unreinforced masonry buildings and has adopted a mitigation ordinance.
(3) The building contains at least 6 residential units, and at least 70% of these units will be assisted units.
(4) The assisted units could not be reinforced without also reinforcing the nonassisted units or nonresidential space.

For nonprofit sponsors, total after-rehabilitation debt may not exceed 100% of after-rehabilitation value. For for-profit sponsors, after-rehabilitation debt may not exceed 90% of after-rehabilitation value. HCD publishes a chart listing the maximum allowable initial gross rent by county and unit type.

Comments: Applications are accepted on an ongoing basis until all program funds have been committed. This program is very well suited for the rehabilitation of structures presently housing low-income residents, but remains limited in usefulness in many other aspects.

Property owners feel the requirements which must be met under this program are overly restrictive, particularly the percentage of residential units which must be reserved for low-income residents and the tenant relocation guidelines.

Contact: Department of Housing and Community Development
P.O. Box 952051, Sacramento, CA 94252-2051
(916) 445-6501

COMMUNITY DEVELOPMENT BLOCK GRANTS

General: Community development block grants (CDBG) provide Federal funding for programs that are designed and administered by local governments. CDBG funds flow through to municipalities in various ways dependent upon the size and location of the municipality. Large cities and urban counties, as well as some smaller cities, receive entitlement funds from this program on an annual basis. Municipalities under 50,000 in population, which are not qualified for entitlement funds, may apply to the State through a competitive process for funds in the "Small Cities" program.

The CDBG program is administered by the Department of Housing and Urban Development (HUD). Authorized under Title I of the Housing and Community Development Act of 1974 as amended, the primary objective of the program is to provide "decent housing and a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income." Activities funded through CDBG must also meet one or more of the three National Objectives: (i) benefit to low and moderate income individuals, (ii) aid in the prevention or elimination of slums or blight, or (iii) address other community development needs having a particular urgency because existing conditions pose a serious and immediate threat to the health or welfare of the community where other financial resources are not available to meet such needs.

Benefits: CDBG funds are among the most flexible sources of financing of eligible projects. Municipalities may design grant and loan programs tailored to their communities' needs.

Types of Properties: Many different types of properties can be served by CDBG funded programs. Designing a program which meets eligibility requirements may or may not be difficult, depending upon the complexity of the program being designed and on the activity and National Objective which the program is designed to meet. The table on the following pages, derived from HUD's *Guide to Eligible CDBG Activities*, outlines possible categories of programs for which a municipality might choose to use CDBG funds.

Jurisdiction's Responsibilities: Jurisdictions must design and administer CDBG-funded programs. Those jurisdictions which receive entitlement funds can use a portion of those funds for a seismic retrofit program. Non-entitlement municipalities must apply to the State through the State CDBG "Small Cities" program. Jurisdictions seeking to use CDBG funds for seismic retrofit programs should seek additional guidance from HUD.

Owner's Responsibilities: Owners need to meet the criteria established by the municipality for distribution of CDBG funds and must apply to the municipality for those funds.

Limitations: The National Objectives of CDBG are very specific for commercial and industrial buildings. Only certain activities are eligible under a CDBG-funded retrofit program. Under the "Small Cities" program, the maximum amount allowable per activity is $500,000.

Comments: Municipalities which receive entitlement funds generally direct most of those funds to ongoing programs. Retrofitting could be very expensive, requiring a large allocation of funds. Reprogramming funds from ongoing programs to a retrofitting activity could prove politically difficult. The "Small Cities" program for non-entitlement jurisdictions is very competitive. The program has $24 million to distribute annually, and receives anywhere from $35 to $75 million in applications. To have a reasonable chance of being accepted, "Small Cities" applications should address a number of CDBG objectives. Retrofitting alone is unlikely to be competitive.

Contact:
Housing & Urban Development Department
Regional Office - Region IX
450 Golden Gate Avenue, San Francisco, CA 94102
(415) 556-5900
or
Your regional office

Eligible Activity	Objective	Qualifies If	Example
Housing Rehabilitation: **Rehabilitation of any publicly or privately owned residential property, including the conversion of non-residential property for housing, provided such rehabilitation meets a national objective**	Low/Moderate Housing	The housing to be rehabilitated is occupied or will be occupied by Low/Moderate income persons. Rental units must be occupied at affordable rents	Conversion of non-residential structures into permanent housing for Low/Moderate persons.
	Slum or Blighted Area	Housing rehabilitation for households not known to have Low/Moderate incomes qualifies if: (1) the structure rehabilitated is located within a designated slum or blighted area; (2) housing deterioration is one of the conditions which contributed to the deterioration of the area; and (3) the structure to be rehabilitated is considered substandard under local definition before rehabilitation (such definition being at least as stringent as standards used in the Section 8 Housing Assistance program)	Correction of substandard conditions in housing units located in designated blighted areas exhibiting housing deterioration
	Spot Blight	Housing rehabilitation for households not known to have Low/Moderate incomes qualifies if: (1) the structure rehabilitated is located within a designated slum or blighted area; and (2) the rehabilitation is limited to the extent necessary to eliminate specific conditions detrimental to public health and safety	Elimination of faulty wiring, falling plaster or other similar conditions that are hazardous to all potential occupants

Eligible Activity	Objective	Qualifies If	Example
Special Economic Development: **Commercial or industrial improvement carried out by the municipality or a nonprofit, including acquisition, construction, reconstruction or installation of commercial or industrial buildings or structures and other real property equipment and improvements, or assistance for private for-profit entities for an activity determined to be "necessary or appropriate" (as specifically defined by the regulations) to carry out an economic development project.**	Low/Moderate Area Benefit	The assistance is to a commercial business which serves a Low/Moderate income residential area	Assistance to neighborhood businesses such as grocery stores and laundromats, typically qualify
	Low/Moderate Jobs	The assistance is directly linked to the creation or retention of permanent jobs, at least 51% of which are for Low/Moderate income persons	Assistance to a manufacturer in financing an expansion which will create permanent jobs, at least 51% of which are for Low/ Moderate income persons
	Slum or Blighted Area	The assistance is to a business in a designated slum or blighted area and addresses one or more of the conditions which contributed to the deterioration of the area	A low-interest loan to a business as an inducement to locate a branch store in a redeveloping blighted area

Eligible Activity	Objective	Qualifies If	Example
Clearance: **Clearance, Demolition, Removal of Buildings and Improvements, Movement of Structures to Other Site**	Spot Blight	Clearance is undertaken to eliminate specific conditions of blight or physical decay on a spot basis not located in a slum or blighted area	Demolition of an abandoned and deteriorated structure

Other categories of activities which might usefully be explored, always bearing in mind CDBG's national objectives, are Relocation: payments and assistance to individuals, families, businesses, nonprofit organizations and farms; Historic Properties: rehabilitation, preservation and restoration programs; and Commercial or Industrial Rehabilitation: for private for-profit businesses to the extent that rehabilitation is limited to improvements to the exterior of the building and the correction of code violations.

THE HOME PROGRAM

General: The HOME Program, a new housing assistance program from the Department of Housing and Urban Development (HUD), was created under Title II (the Home Investment Partnerships Act) of the National Affordable Housing Act of 1990. The general purposes of HOME include:

- To expand the supply of decent and affordable housing, particularly rental housing, for low- and very-low-income Americans. Such housing includes existing rental housing made affordable through tenant-based rental assistance.

- To strengthen the abilities of State and local governments to design and implement strategies for achieving adequate supplies of decent, affordable housing.

- To provide both financial and technical assistance to participating jurisdictions, including the development of model programs for affordable low-income housing.

- To extend and strengthen partnerships among all levels of government and the private sector, including for-profit and nonprofit organizations, in the production and operation of affordable housing.

HOME funds are available to States, cities, urban counties and consortia (contiguous units of local government). Funding for the HOME program includes a $25 million set-aside for technical assistance. HOME funds are allocated by formula, with 60% of these funds available for cities, counties and consortia and 40% for States. Each participating jurisdiction will be required to set aside 15% of its formula allocation for development of projects owned, developed or sponsored by community housing development organizations (CHDOs). HOME funds may be used for a variety of activities to develop and support affordable housing. Eligible activities include: tenant-based rental assistance, assistance to first-time homebuyers and existing homeowners, property acquisition, new construction, reconstruction, moderate or substantial rehabilitation, site improvements, demolition, relocation expenses and other reasonable and necessary expenses related to development of non-luxury housing.

Benefits: The HOME program is not a categorical housing program requiring a specific housing activity. Instead, the HOME program provides States and local governments flexibility to decide what kind of housing assistance, or mix of housing assistance, is most appropriate to meet their housing needs.

Types of Properties: Many different types of properties can be served by HOME program funds. The HOME program is structured to encourage States and local governments to use HOME funds most efficiently by requiring the smallest State and local matching contributions for the most cost-effective housing activities.

Jurisdiction's Responsibilities: Before receiving HOME funds, a jurisdiction must prepare (and HUD must approve) a Comprehensive Housing Affordability Strategy (CHAS), submit a notice of intent to participate, and provide a program description.

Owner's Responsibilities: The HOME program is specifically designed to meet the housing needs of low- and very-low-income residents, so the residents of buildings whose owners are applying for HOME program funds must meet HUD income guidelines if the project is to be eligible.

Limitations: HOME funds may not be used to pay for any administrative costs of a participating jurisdiction. Other activities prohibited under the HOME program include public housing modernization, tenant subsidies for certain special mandated purposes under Section 8, matching funds for other Federal programs, Annual Contributions Contracts (ACCs), activities under the Low-Income Housing Preservation Acts of 1987 and 1990, and operating subsidies for rental housing. Additionally, the funds cannot be used to create a reserve to undertake those activities at a later date.

Comments: As cities have not received HOME funds in the past, there are no established programs dependent on this source. Using these funds for seismic retrofit projects therefore will not require reprogramming, which may make the HOME program more accessible for seismic retrofit projects than established funding sources such as CDBG. However, as it is a new Federal program, we have no track record from which to judge the availability of HOME funds for this purpose.

Contacts:

Office of Affordable Housing Programs
U.S. Department of Housing and Urban Development
451 Seventh Street, SW
Washington, D.C. 20410
or
Housing and Urban Development Department
Regional Office - Region IX
450 Golden Gate Ave., San Francisco, CA 94102
or
Your HUD regional office

THE SMALL BUSINESS ADMINISTRATION (SBA)

General: The Small Business Administration (SBA) program most likely to be of interest to owners of seismically hazardous buildings is the Guaranty Loan Program. Loans are made by private lenders with a percentage of the loan amount (up to a maximum of $750,000) guaranteed by the SBA. Loan terms are dependent upon the use of the loan proceeds.

Benefits: Interest rates on SBA guaranteed loans range from prime rate plus 2.25% to prime rate plus 2.75%, depending on the term of the loan.

Types of Properties: This program is only suitable for small businesses that are owner/ tenants in seismically hazardous buildings. The proceeds from a loan through this program may be used for leasehold improvements.

Jurisdiction's Responsibilities: This program does not require the direct participation of the municipality.

Owner's Responsibilities: The owner must initiate this process by contacting the SBA. An applicant must have an historical earnings and cash flow record which demonstrates an ability to repay the loan. An acceptable tangible net worth is required to demonstrate that the business operates on a sound financial basis.

Limitations: The SBA requires sufficient assets be pledged as collateral. Although the SBA does not set minimum loan amounts, it is unusual to find a lender willing to participate in loans for amounts under $50,000.

Comments: A decision on a loan package is usually made within 10 working days after it is received by the SBA, not including the bank's processing time. A list of local lending institutions that participate in this program can be obtained from the SBA. This program can prove helpful to owners who can qualify for a loan but have been unable to find a bank willing to provide one. The Guaranty Loan Program will be of little help to owners who need some type of subsidy in order to afford a retrofit project.

Contact:
Small Business Administration
San Francisco District Office
211 Main Street, San Francisco, CA
(415) 744-6820
or
Your district office

BOND PROGRAMS

GENERAL OBLIGATION BONDS

(California Government Code - Section 43600 et seq. for cities)
(California Government Code - Section 29900 et seq. for counties)

General: AB 1001 (Chapter 658, Statues of 1991) allows the use of General Obligation (GO) bonds to finance the seismic retrofit of privately-owned hazardous structures. GO bonds are repaid from property and other general taxes levied throughout a jurisdiction so they must be used to finance projects with a public benefit.

Benefits: The funds from sale of GO bonds can be used to provide financing to owners of hazardous structures on any terms established by the municipality.

Types of Properties: A GO-funded loan program can be designed to finance retrofit of any type of property, assuming the project provides a public benefit.

Jurisdiction's Responsibilities: The jurisdiction must design and administer the program, issue the bonds, and make bond payments.

Owner's Responsibilities: The owner must agree to meet the requirements of the program.

Limitations: As with any GO bond, the issue must be approved by a two-thirds vote. General Obligation bonds are also subject to a jurisdiction's statutory debt limit.

Comments: To our knowledge, this financing mechanism has not been used by local governments to fund retrofitting of privately-owned structures.

Contact: Financial Advisor, Investment Banker, and/or Bond Counsel

MARKS-FORAN RESIDENTIAL REHABILITATION ACT

(California Health and Safety Code - Section 37910)

General: The Marks-Foran Residential Rehabilitation Act authorizes cities, counties, housing authorities and redevelopment agencies to issue tax-exempt revenue bonds to finance residential rehabilitation. The rehabilitation program should be based on a public improvement plan reviewed and adopted by a citizens committee. Any work pursued with funding from this program must comply with a municipality's rehabilitation standards. The funds from such a Marks-Foran bond issue can be used to provide long-term, low-interest loans to owners of residential property.

Benefits: Marks-Foran bonds provide loans at tax-exempt rates to property owners.

Types of Properties: Single-family and multi-family residential properties qualify for Marks-Foran bond financing. Commercial properties may qualify if located in a designated residential rehabilitation area.

Jurisdiction's Responsibilities: The sponsoring municipality must designate an area for residential rehabilitation, must design and administer the loan program, and must issue the bonds.

Owner's Responsibilities: Property owners must apply for funding and demonstrate ability to repay loans.

Limitations/Comments: Up to 20% of loans for absentee-owned property and up to 40% of loans for owner-occupied property may be used for general property improvements not required by such local rehabilitation standards. Funds can also be used for architectural, engineering, appraisal, origination and other fees.

Contact: Financial Advisor, Investment Banker, and/or Bond Counsel

MARKS HISTORIC BOND ACT

(California Health and Safety Code - Section 37600 et seq)

General: The Marks Historical Rehabilitation Act of 1976 allows a city, county, city and county or a redevelopment agency to issue bonds to finance the rehabilitation of historic properties. The project may comprise acquisition, relocation, reconstruction, restoration, renovation or repair of the historical property for any of four purposes, one of which is to provide for the safety of occupants or passersby. Prior to issuing bonds under this program, a municipality must adopt a historical rehabilitation financing program and designate historical rehabilitation areas.

Benefits: Provides tax-exempt financing to aid in the rehabilitation of historically or architecturally significant structures.

Types of Properties: Property must be "historical property" as defined by the Marks Act, (such as property listed on existing national, State or local historical registers or official inventories).

Jurisdiction's Responsibilities: A jurisdiction must adopt an historical rehabilitation financing program, setting forth the architectural and/or historical criteria to be used in selecting historical properties which may be eligible for rehabilitation financing. The jurisdiction's legislative body must designate historical rehabilitation areas using specified criteria. The jurisdiction must also allow affected citizens to participate in the planning and implementation of the historical rehabilitation financing program and in the designation of historical rehabilitation areas, providing for a maximum of citizen participation, including the establishment of a citizens advisory board.

Owner's Responsibilities: Owner must provide documentation that the structure meets the criteria for selection as an historically/architecturally significant building.

Limitations: Loans made under a Marks Historic Bond Act program must meet the following criteria:

(1) outstanding loans on the project property, including the loan for rehabilitation, cannot exceed 90% of the post-rehabilitation value of the property
(2) repayment period cannot exceed 40 years or 4/5 of the expected economic life of the property, whichever is less
(3) loan must be used only for historical rehabilitation work as defined in the Act.

Comments: A seismic retrofit program designed around historically significant buildings may be an appropriate option for a community with a traditional downtown area that contains a number of historically significant structures and a high concentration of seismically hazardous structures. A municipality's historical rehabilitation financing program may include a public improvement portion. Such infrastructure improvements must take place within a designated rehabilitation area. A rehabilitation agency can also buy historical properties with this financing.

Contact: Financial Advisor, Investment Banker, and/or Bond Counsel

MELLO-ROOS COMMUNITY FACILITIES DISTRICT
(California Government Code - Section 53311 et seq.)

General: The Mello-Roos Community Facilities District Act of 1982, subject to certain limitations, allows jurisdictions to provide market rate loans to private property owners to finance seismic retrofit work. Mello-Roos is therefore useful as an alternative to private financing mechanisms, particularly when private financing is limited.

Mello-Roos bonds are payable from and secured by a special tax on the properties in the district, so a jurisdiction is not legally liable for the debt incurred under this type of issue. The special taxes are generally collected with property taxes, and are in place only so long as they are needed to pay principal and interest on the bonds. The interest on Mello-Roos bonds issued to finance seismic rehabilitation of private properties is exempt from California State taxes but is subject to Federal taxation. Mello-Roos financings are similar to Special Assessment financings. (See: SPECIAL ASSESSMENT DISTRICTS)

Benefits: Mello-Roos bonds can provide financing at rates comparable to bank lending rates. Mello-Roos districts are geographically flexible, and can be designed to include all owners who are interested in and qualify for the financing. Depending on the guidelines for membership (e.g. value to lien requirements, etc.) Mello-Roos financing may be easier to qualify for than traditional financing.

Types of Properties: Mello-Roos bonds can be used to finance the retrofit of all types of privately owned, seismically hazardous structures.

Jurisdiction's Responsibilities: As a prerequisite to establishing a seismic retrofit Mello-Roos district, a municipality must adopt a mandatory retrofit ordinance which sets specific code requirements. The ruling legislative body of the jurisdiction must also adopt a resolution of intention to establish the district, levy the special tax, and issue the bonds. The legislative body must within 60 days hold a public hearing on the formation of the district and the issuance of bonds, and then must submit the matter to a vote. The issue requires a "yes" vote from all property owners included in the district. The jurisdiction generally assembles and works with a financing team to help establish criteria for allowing property owners to join the district, to help work with the owners of URMs and other seismically hazardous structures, and to bring the bonds to market. Once the bonds have been issued, the jurisdiction's responsibilities include monitoring of construction and administration of the district.

Owner's Responsibilities: Owners must decide to become members of the district and demonstrate their ability to meet criteria established for membership in the district.

Limitations: Some limitations to the use of Mello-Roos financing to pay for seismic safety work on privately owned buildings are:

(1) financing may be used to pay only for work necessary to comply with locally adopted seismic retrofit standards
(2) financing cannot be used to demolish, replace or repair a building unless it is located in the disaster area declared as a result of the Loma Prieta earthquake of October 1989
(3) all work financed on historical buildings must be done in accordance with the State Historical Building Code
(4) the district must be authorized by a 100% "yes" vote (i.e. the district may only include the properties of those owners who want to participate in, and who qualify for, the Mello-Roos program)
(5) Mello-Roos bonds may only be issued for this purpose prior to October 17, 1994

Mello-Roos bonds may be used to finance work on privately owned buildings. They cannot finance the retrofit of public buildings, because properties owned by government agencies are exempt from the taxes which are levied on properties in a Mello-Roos district.

Comments: Mello-Roos financings for the purpose of seismic retrofitting have generally been considered for use by general law cities and counties, although charter cities may use them as well. Membership in the district is voluntary so there are likely to be few compliance problems. To be certain a property owner is serious about joining the district, a jurisdiction may want to require potential members to submit preliminary plans, an engineer's estimate, and a sizeable non-refundable deposit, and make current all property tax payments. A Mello-Roos financing may require a significant amount of staff time, but there are few hard costs to the jurisdiction; all fees may be passed through to the district members. One of the more difficult efforts associated with a Mello-Roos financing may be determining the guidelines for membership in the district, such as setting value-to-lien ratios. The time necessary to establish a Mello-Roos district depends on the community and the commitment of the building owners. If the community has experience with Mello-Roos issues and the owners have already done engineering studies, then the bond can be issued relatively quickly. On the other hand, it is possible the establishment of a district could take several years. Proceedings to issue bonds can be concurrent with efforts to establish a district, which can shorten the overall timeline. An experienced municipality with a few well-prepared owners may theoretically be able to complete the formation of a district and issue bonds in 6 months or less. The legislation surrounding Mello-Roos financing is frequently updated; bond counsel should be consulted for the most current information. (See: CASE STUDY - CITY OF WEST HOLLYWOOD)

Contact: Financial Advisor, Investment Banker, and/or Bond Counsel

PUBLIC PURPOSE BONDS

General: Many communities issue bonds and other forms of obligations to finance projects which serve a "public purpose" such as construction or remodeling of public buildings. Subject to certain restrictions, tax laws permit up to 5% of the proceeds of such a financing to be used for unrelated private purposes. Financing the seismic retrofitting of a privately owned building theoretically could be one use of this 5% portion.

Benefits: These funds can be obtained without undertaking a separate financing, and would be available at the same low rate as the general issue.

Types of Properties: A funding program of this type can be designed to meet the needs of a jurisdiction for the retrofitting of any type of structure.

Jurisdiction's Responsibilities: The jurisdiction would prepare the financing as it would any other issue, working with its financing team and private owners to ensure that the financing is marketable and complies with tax laws. The jurisdiction will also be responsible for bond repayment.

Owner's Responsibilities: The owner must work with the jurisdiction and the financing team and meet the criteria established by the jurisdiction.

Limitations: Less than 5% of the proceeds of a public purpose financing may be used on private projects.

Comments: To our knowledge this technique has never been used. This type of program would be particularly well suited for communities which expect to issue a public purpose financing and which have a small number of structures in need of seismic retrofitting. Note that the 5% limit is not designed for this purpose; rather, it is a built in "buffer" in case a portion of a financing accidentally is used inappropriately. Bond counsel needs to be consulted about the appropriateness of using the 5% portion in a planned manner to finance seismic upgrade of privately-owned hazardous structures.

Contact: Financial Advisor, Investment Banker, and/or Bond Counsel

SPECIAL ASSESSMENT DISTRICT

(California Street and Highways Code - Section 5000 et seq., 10000 et seq. and 8500 et seq.)

General: Special Assessment District financing is similar to Mello-Roos Community Facilities District financing. (See: MELLO-ROOS COMMUNITY FACILITIES DISTRICT) Almost all Special Assessment proceedings are conducted under the Improvement Act of 1911, or the Municipal Improvement Act of 1913 used in conjunction with the Improvement Bond Act of 1915. The 1911 Act and the 1913 Act are general purpose acts that can be used, within certain limitations, by cities and counties to make market rate loans available to property owners to finance the seismic retrofitting of privately owned buildings.

Special Assessment financing presents an alternative to private financing mechanisms for owners of seismically hazardous buildings. Assessments levied on properties in a district are in proportion to the financing received for their retrofit projects. Bonds are issued based upon the total of unpaid assessments. A lien is created against each parcel with an unpaid assessment and the assessments are recorded in the county recorder's office. Assessments are collected in the same manner as property taxes and can be pre-paid in full within 30 days. The interest on Special Assessment bonds issued to finance the seismic retrofitting of privately owned buildings is exempt from California State taxes but is subject to Federal taxation.

Benefits: Special Assessment bonds can provide financing, at rates comparable to bank lending rates, to owners of seismically hazardous structures. Depending on the guidelines for membership, this financing may be easier to qualify for than traditional financing.

Types of Properties: Special Assessment bonds can be used to finance the retrofit of all types of privately owned, seismically hazardous structures.

Jurisdiction's Responsibilities: Prior to establishing a Special Assessment district, the governing body of a municipality must adopt an ordinance mandating seismic retrofitting of affected buildings and a procedural ordinance. The ruling legislative body also must adopt a resolution of intention to establish the district, levy assessments and issue bonds. An Assessment Engineer then prepares a report describing, among other things, the method used for determining the assessment to be levied against each property. After a 60-day notice period, the legislative body must hold a public hearing on the formation of the district and the issuance of the bonds. Unless owners of at least half the parcels protest, the legislative body can then adopt resolutions forming the district and authorizing issuance of the bonds. The jurisdiction generally assembles and works with a financing team to help develop guidelines for district membership. The municipality then offers district membership, in accordance with the developed guidelines, to all owners of seismically hazardous buildings. Membership can be voluntary.

Owner's Responsibilities: Owners must elect to participate in the district, obtain engineering and construction cost estimates, and demonstrate their ability to meet criteria established for membership.

Limitations: The following are some limitations applicable to any Special Assessment procedure:

(1) The money raised must be used for a public purpose, such as improved public safety.
(2) The total of the assessment cannot be greater than the sum of the cost of improvement and the expenses related to the bond financing.
(3) The assessment on any parcel must be proportionate to the benefit received by that parcel.
(4) The owner of a parcel assessed must be given an opportunity for a hearing on the extent of benefit his or her parcel is judged to receive.

Comments: Special Assessment financing for the purpose of seismic retrofitting has generally been considered for use by charter cities and counties, although general law jurisdictions may use this technique as well. As membership in a Special Assessment district may be voluntary, the jurisdiction should encounter few compliance problems. To be certain that a property owner is serious about joining the district, a jurisdiction may want to require potential members to make a sizable non-refundable deposit and to make current all property tax payments. A Special Assessment district may require a significant amount of staff time, but there are few hard costs to the jurisdiction as all fees may be passed through to district members. One of the more difficult efforts associated with a Special Assessment financing may be determining the guidelines for membership in the district, such as setting value to lien ratios.

In 1989, the City of Torrance established a Seismic Safety Assessment district to finance approximately $680,000 worth of seismic retrofit projects. Torrance used a combination of the 1913 and 1915 Acts to finance the retrofitting of 7 of the 40 privately owned structures in the city which were designated as seismically hazardous. (See: CASE STUDY - CITY OF TORRANCE) In 1991, the City of Long Beach used the same method to finance approximately $17.4 million worth of seismic retrofit projects on 307 parcels throughout the city. (See: CASE STUDY - CITY OF LONG BEACH). The interest rate on the Torrance bond issue was 10.75% while the rate on the Long Beach issue was 11.3%.

The time it takes to establish a Special Assessment district depends upon the experience of the community with such districts, the number of properties to be included in the district, and the commitment of the building owners. A smaller, experienced jurisdiction should theoretically be able to establish the district and issue the bonds in less than 6 months. By contrast the Long Beach financing took 18 months to complete.

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TAX INCREMENT FINANCING OR TAX ALLOCATION BONDS

(California Health and Safety Code - Section 33670)

General: Tax Allocation bonds are normally issued by redevelopment agencies to finance the revitalization of blighted and economically depressed areas. While to our knowledge they have not been issued for this purpose, Tax Allocation bonds theoretically can also be used to finance seismic retrofit projects. The "tax increment revenue" used to make principal and interest payments on the bonds is the portion of future property taxes that reflects an increase in the project area's assessed valuation due to the redevelopment work.

Benefits: Tax Allocation bond funds can be used for programs ranging from grants to low-interest long-term loans.

Types of Properties: These funds can be used to finance the retrofit of any structure located in the redevelopment district.

Jurisdiction's Responsibilities: The redevelopment authority of the jurisdiction must develop program guidelines for distributing funding, must issue bonds, administer the program, and make bond payments.

Owner's Responsibilities: An owner must qualify for funds under local program guidelines.

Limitations/Comments: Tax Allocation bonds have not, to our knowledge, been used to fund programs aimed at financing retrofitting of privately-owned seismically hazardous structures. The bonds issued to finance this type of program will likely be Federally taxable because of the emphasis on investment in privately owned buildings. It is unclear whether seismic retrofitting alone will generate sufficient tax increment revenue to cover bond payments.

Contact: Financial Advisor, Investment Banker, and/or Bond Counsel