Funding solution to Mayor Garcetti's Earthquake Retrofit Initiative

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Item No.: 8
~~Deputy~~ Communication from the Public

March 6, 2015

Dear Harold:

Thank you for the opportunity. Here is an outline to the solution to fund the Mayor's Earthquake Retrofit initiative.

~~TENANTS:~~

I urge that the Council remove their gaze from the solution I've heard phrased as "charge the tenants $70/month to recover the retrofit costs." Such resources are not at the tenant level. If the tenants had $70/mo., we'd be referring to them as Home Owners, and not tenants. Although the tenants would benefit from increased safety and reduced potential of housing disruption, still, funding resources are not at the tenant level.

APARTMENT OWNERS:

It is the apartment owners who would reap a large portion of the benefits of such a retrofit, in the form of reduced or eliminated interruption of rent, because damages or deaths would be reduced or eliminated. *However, many of the apartment owners are not affluent or are depending on the rental income flow for retirement income.* In many cases, there really isn't the cash flow or the resources to substitute for the lost rental income while the tenants are displaced, or fund the type of major repairs that such a retrofit would require. Many apartment owners are small business owners with a fragile income stream.

~~TAX CREDIT to Apartment Owners:~~

The AAGLA discussion raised the idea of a tax credit to the Apartment Owners to help solve the funding problem for the cost of the retro-fit. A tax credit is not a substitute for the cash flow required to pay for the repairs, and replace the lost rental income of displaced tenants. Such a tax credit only provides benefits AFTER the cash outflow has taken place, so therefore presumes the apartment owner already has the funds to make the repairs.

INSURANCE COMPANIES ARE STAKEHOLDERS of a Retrofit program:

Insurance companies are DIRECTLY benefited by the proposed earthquake retro-fit program. Insurance companies will benefit in the form of:

1) Reduced casualty and death insurance claims payouts from retro-fitted apartments.
2) Reduced business interruption from "the big one" because the disaster magnitude of the event has been mitigated by the retrofit.

THE FUNDING SOLUTION THAT SOLVES THE CASH FLOW ISSUE:

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The discussed Tax Credit should be targeted to insurance companies and/or banks, to incent these institutions to provide the cash flow for the retro fit. In exchange to qualify for the Tax Credit, the insurance companies or banks would provide retrofit loans to apartment owners, with extended terms of 15- or-more- years. The apartment owners would use the funds from the loans to make the repairs. The loan to the apartment owner, collateralized by the retrofitted property, would provide the cash flow necessary to make the repairs. The mechanism of the loan would spread the burden of the repairs over 15-30 years, smoothing out the cash outflows. The institutions (insurance companies or banks) who extended the loans, would receive a tax credit.

<u>Qualification for Retrofit loans:</u>

The qualification for such a retrofit loan would be different from the normal qualifying procedure, which examines the capacity to repay the loan. Therefore for this reason, the loan payback periods would probably need to be extended, since the motivation for the Retrofit loan is different than for the presently-existing real estate loans, which are entirely based on ability-to-pay.

<u>Amount & timing of Retrofit Tax Credit:</u>

The insurance companies or banks which make the Retro fit loans would be compensated by

- ✓ the normal mechanism of the interest on the loan, *and*
- ✓ the Retrofit Tax Credit.

The retrofit tax credit could be calibrated to be higher in the beginning years of the program, and after perhaps [7 years, etc.—-as calculated by of the Tax Credit Allocation Committee budget], taper back somewhat, to encourage "early adoption" of the retrofit program. The Retrofit Tax Credit would compensate the lenders for the increased lending risk of the Retrofit loan program.

<u>LIMITATIONS:</u>

1) **<u>Amount:</u>** A principal limitation to this project would be the amount of tax credit made available by California Tax Credit Allocation Committee. This credit would compete with the Low Income Housing Tax credit. Investors directly benefit from the Low Income Housing Tax Credit, which intends to stimulate Home Ownership by means of Affordable Housing development.
   The proposed Retrofit Tax Credit would also directly benefit Investors, such as insurance companies or banks, but the stimulus target would be different: finance repairs to the vulnerable apartment stock/mitigate earthquake destruction.
2) **<u>Construction resources vs Compliance deadlines</u>**: It would be beneficial if there were a phase-in mechanism, and if the program had a more extended run time than just a few years. I worked briefly in the Los Angeles Unified School District New Construction division, in 2005-2006, when LAUSD executed a multi-billion dollar school bond program to build schools. The New Construction Division experienced political pressure to "deliver schools", and so LAUSD ended up being in the position of essentially bidding against itself for finite regional construction resources, since the scope of the building program was so enourmous. LAUSD was heavily criticized for its outsize "cost per square footage," which was an unfortunate, but predictable result of the enormous accelerated construction program. This retro fit program, could have a

similar effect, of bidding up the retro fit construction resources, unless some effort is focused on the compliance deadlines to "manage" the increased demand on construction resources.

Compliance approaches:

In addition the issue of how to secure an allocation to a new "RetroFit Tax Credit" from the California Committee, attention should be applied to the compliance /actual timing of the construction to minimize the "bid-up" effect of such a project. The compliance schedule could look like:

"3-story+ structures with more than 8 units, built before 1935 qualify for the highest Retrofit Tax credits between 2017-2019."

"3-story+ structures, with more than 8 units, built before 1940 qualify for the best tax credits between 2018-2020." Etc.

Such a "staged compliance" program would incent the banks to offer the best rates to the most vulnerable/targeted structures, and therefore incent these owners to take early action, and ideally "space-out" the demand on construction resources, seeking to minimize the "self-bidding" effect on local construction resources.

Successful campaign to secure Tax Credit Funding/ Scope of Benefit/Grant/Lottery:

In order to secure such a Tax Credit Allocation from the California Tax Allocation committee, the first question that would be posed is likely to be:

- ✓ How much [tax credit] would a successful remediation program cost?

So I assume initial funding would need to be secured for a "pilot" program to *define an Earthquake Retrofit, and to distinguish from slum-lord style deferred maintenance.*

Lottery for retrofit pilot program to quantify costs:

There could be a lottery to select a test property, to be able to effectively project retrofit costs. The entrants in the lottery could be selected by attribute, such as "4-story, 18-unit apartment building built before 1935." The property entrants should include some of the most vulnerable building attributes, but also present attributes that would be typical to buildings targeted by the program. Further, the property entrants could be additionally limited by Owner attributes, such as "that building which is owned by an owner owning less than 3 buildings." The Mayor could determine the impartial mechanism to blindly select a "winning property" to be test- retrofitted, or at least be the subject of a very detailed Retrofit Cost Estimate, so that reasonable costs for the Mayor's retrofit program can estimated.

The City should probably fund a Study to obtain a "census" of the number of apartment buildings older than [what year was the last residential earthquake code enacted], and cross-qualify such a census of target properties against the LA County Tax Assessor records, to determine the degree of concentration of ownership of the targeted class of apartment buildings. The degree of concentration of ownership of the targeted class of buildings could be a political factor in securing the Tax Credit, and should be previewed. The degree of concentration of ownership, if characterized as extreme, possibly could control the verbiage and application of Retrofit Tax Credit, to control for this effect. The test lottery entrants could be selected after the census is performed.

This same approach could be extended to the Retrofit Contractor population. The status of those Contractors educated and prepared to perform the earthquake retrofit would require some analysis, and possibly there should be separate licensing/ accreditation to perform this Retrofit work, since it would be mandated and funded with public tax revenue.

<u>California-wide application, and therefore economic stimulus:</u>

This Funding proposal, in addition to providing the safety benefits envisioned by the Mayor, would be an economic stimulus. This funding solution, by addressing the cash flow problem, could expand this solution, to make the earthquake retro fit available to the entire state, since this program could be scaled up to apply to multiple cities.