

**A FINANCIAL PLAN
FOR THE
CHINATOWN COMMUNITY DEVELOPMENT CENTER
2003-2007**

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EXECUTIVE SUMMARY

Introduction

This year, 2002, marks a tremendous milestone for the Chinatown Community Development Center. After twenty-five years, it has become a nationally renowned community development corporation, known for its innovative affordable housing developments and its grassroots community organizing affecting national, state, and local policy. However, as the organization celebrates its 25th anniversary, it must also take stock of its assets and plan for the future.

This Financial Plan will discuss Chinatown CDC's financial health in three aspects: (1) the annual operating budget, (2) the operating budgets of the property portfolio, and (3) the underlying financing structure of its properties. These three components comprise the organization's overall financial health and their cumulative impact is reflected in our financial statements. This financial plan seeks to identify not only the issues, but also the road we must take to resolve these issues, prepare for the future, and strengthen the organization financially.

The Annual Operating Budget

Chinatown CDC has grown tremendously in the twenty-five years since its inception in 1977. From our incarnation as the Chinatown Resource Center, an organization with a handful of staff and an annual budget of only \$86,000, we have grown to a staff of over one hundred employees and an annual operating budget of over \$4 million (excludes the operations of the property portfolio).

Over the next five years, it is projected that Chinatown CDC's annual operating budget will grow to \$6 million. Our ability to continue to generate revenue to support this growing budget depends on several key factors: the strength of the economy; our ability to cultivate new relationships and maintain existing relationships with key governmental officials and foundation staff; the success of our capital campaign – "Campaign for Communities"; and our ability to develop new affordable housing projects.

The Property Portfolio

Chinatown CDC provides property management services for all of the properties we have developed where we have sole ownership or where we are the general partner of a limited partnership. In addition, we manage two other properties for private owners. In the past five years, the portfolio has grown tremendously. In 1997, Chinatown CDC managed 13 properties, a total of 637 units. Today, there are 18 properties under management, a total of 1,145 units. This represents an 80% increase in the number of units managed. Most of this growth occurred in an 18-month period from mid-1999 to 2001.

The total budget for 2002 for the management operations of this sizeable portfolio is \$9.6 million. Like most community development corporations,

Chinatown CDC faces the challenge of keeping rents as affordable as possible while maintaining the long-term viability of the housing asset. One of the challenges is that operating expenses tend to increase faster than rental income. Experience shows that expenses increase 4 – 5% per year on average. However, rental income, which is regulated by our financing sources, only increases approximately 3% per year on average. Over time, expenses will exceed income, resulting in operating deficits.

The projections for 2002 indicate operating deficits of an estimated total of \$14,000. The projected five year (2003-2007) cumulative total of operating deficits for the portfolio is \$630,000. These estimates are worst case scenarios as Chinatown CDC is seeking to address these issues by refinancing/re-structuring the debt on some properties and applying for additional Section 8 rental subsidies.

Financing Structure – Deferred Loans

The long-term financial health of our properties (and therefore of the organization) is further complicated by the deferred loans from the City of San Francisco or the State of California used to purchase and rehabilitate the properties. The size of the loans, combined with the large amount of accumulated interest, creates a major repayment problem if and when these loans are called. Chinatown CDC has been working closely with the City to renegotiate these loans – to reduce the interest rates and/or to write off the accumulated interest.

Financial Health

All of the preceding issues – the growth in annual income and expenditures, the operating budgets of our eighteen properties, and the underlying financing structure of our properties (both the completed projects and the projects currently under development) comprise the overall financial health of Chinatown CDC and is reflected in the annual audit report.

Chinatown CDC's audited financial statements reflect a complex organization. The annual audit includes all operating income and expenses incurred by Chinatown CDC – both its programs and properties. Since many of the properties are owned by a limited partnership (of which Chinatown CDC is the general partner), only the percentage of Chinatown CDC's ownership is reflected in the audit. To complicate things further, the figures also include the deferred interest (which is shown as a liability) from the loans used to develop the properties. The deferred interest from the affordable housing loan structures from the City of San Francisco was over \$1 million in 2000 and dramatically reduced our net assets. In addition, the fluctuations from real estate development activities such as the timing of when developer fees are received, to the instances where Chinatown CDC "loans" a project funds until financing is secured, can also skew a financial statement. Therefore, it is quite difficult to decipher the true financial state of the organization from reviewing just the audits.

Keeping in mind the many underlying variables and complexity, our audited financial statements in 1998, 1999, and 2000 indicated that Chinatown CDC realized a net operating deficit in each of those years, between \$1.1 million in 1998 to \$1.8 million in 2000. In addition, the deferred interest and depreciation caused a sharp decline in the net assets of the organization, from over \$4 million in 1998 to just over \$500,000 in 2000. However, as stated before, these numbers do not tell the full story of our financial state. Chinatown CDC has taken some steps to reformat the audit to separate the housing and non-housing activities in order to show a clearer picture.

With a change in format and the conversion of a City loan (for 665 Clay Street) to a grant, the audited financial statement for 2001 showed a financially stronger organization. Chinatown CDC realized a net operating surplus of nearly \$1.8 million, which included deferred interest and depreciation. Excluding deferred interest and depreciation, there was an increase in net assets of \$3.7 million.

Another means to assess the financial health of the organization is through the application of some commonly used financial ratios (Current Ratio, Cash Ratio, Day's Cash Ratio, and Debt-To-Equity Ratio). Again, these ratios are skewed by our real estate development activities. However, using these ratios with a few caveats finds Chinatown CDC to be in good financial health, given its strong asset base and sufficient cash reserves. Deficits from the general operating budget or from properties in the portfolio and the accumulated deferred interest liabilities are beginning to have an impact on the organization's finances. However, as shown in the 2001 audit, Chinatown CDC is taking steps to reverse this trend.

Conclusion

The following Action Plan summarizes the major steps Chinatown CDC must take to strengthen the financial health of the organization:

Action Plan Summary:

- *Raise \$4 million through the Campaign for Communities for the International Hotel, Broadway Family Apartments, and program initiatives.*
- *Diversify our income base and attract new donors so the organization is less dependent on only a few funding sources.*
- *Increase multiple-year funding commitments from foundations to stabilize our revenue from year to year.*
- *Monitor the growth in expenditures to identify operating efficiencies.*
- *Restructure the existing debt on several properties in order to continue to operate the building for low-income residents and increase the net assets of the organization.*
- *Acquire one new affordable housing development each year to generate additional housing units and developer fees.*

The challenges that lie ahead for Chinatown CDC are a result of twenty-five successful years. Given our history, track record, and reputation, Chinatown CDC is poised to meet these challenges and continue as one of the best community development corporations in the nation.

PREFACE

The Chinatown Community Development Center was established as a nonprofit organization on April 1, 1977. It was formed as the Chinatown Resource Center, a coalition of Chinatown grassroots associations that were active in the areas of affordable housing, open space, transportation, community facilities, and public housing. In 1981, the Chinatown Resource Center established the Chinatown Community Housing Corporation as a subsidiary corporation to preserve and develop affordable housing in the greater Chinatown/North Beach area. The organizations, which were linked historically through overlapping boards and a common Executive Director, merged and became the Chinatown Community Development Center in January 1999.

With the merger that created the Chinatown Community Development Center, a new mission statement was adopted:

The mission of the Chinatown Community Development Center is to build community and enhance the quality of life for San Francisco residents. The Chinatown Community Development Center is based in the Chinatown neighborhood and also serves other San Francisco neighborhoods including North Beach and the Tenderloin. We are a community development organization with many roles – as neighborhood advocates, organizers and planners, and as developers and managers of affordable housing.

We believe in a comprehensive vision of community, a quality environment, a healthy neighborhood economy, and active voluntary associations. We are committed to the empowerment of low-income residents, diversity and coalition building, and social and economic justice.

Each of our programs is part of a holistic vision of a healthy working class neighborhood, including:

- Affordable Housing Development: Chinatown CDC develops all of the properties it owns, and also provides technical assistance to other non-profit organizations. All residential properties are developed for individuals and households with incomes below 80 percent of the area's median income, with most units affordable to households with incomes between 30 percent and 50 percent of median. Development work is accomplished through acquisition and rehabilitation of existing buildings or land acquisition and new construction.
- Property Management: Chinatown CDC currently oversees the day-to-day operations of 18 properties comprised of 1,145 units of affordable housing. Management services include the on-site physical operation of the property, the leasing of units, and the maintenance of the buildings.
- Tenant Services: Chinatown CDC's tenant services programs provide supportive services to low-income tenants, including translation assistance,

citizenship and ESL instruction, health and recreational activities, vocational services, and referrals to culturally and linguistically appropriate social services as well as appropriate supportive services, including mental health and substance abuse counseling.

- Community Organizing: Chinatown CDC works with tenant organizations to advocate for community involvement in public policy decisions and improves landlord/tenant relationships through counseling, educational seminars, and community events.
- Neighborhood Improvement: Chinatown CDC implements neighborhood improvement projects to enhance the transportation, streets and alleyways, and recreation centers and open space in the Chinatown neighborhood. It also serves as a “community watchdog” over land-use policies and projects.

These programs are supported by four departments: Executive, Administration and Human Resources, Finance, and Resource Development.

INTRODUCTION

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This Financial Plan will discuss Chinatown CDC's financial health in three aspects: (1) the annual operating budget, (2) the operating budgets of the property portfolio, and (3) the underlying financing structure of its properties. These three components comprise the organization's overall financial health and their cumulative impact is reflected in its financial statements. This financial plan seeks to identify not only the issues, but also the road we must take to resolve these issues, prepare for the future, and strengthen the organization financially.

THE ANNUAL OPERATING BUDGET

Since the organization was established in 1977, the annual operating budget has grown significantly. The Chinatown Resource Center began with an annual budget of \$86,000, primarily from a grant from the San Francisco Foundation. Twenty-five years later, the Chinatown Community Development Center's operating budget is over \$4 million (excludes the operations of the property portfolio). Today, revenue sources include government contracts, foundation grants, contributed income, project development fees, and property management fees.

Over the next five years, it is projected that Chinatown CDC's annual operating budget will grow to \$6 million. The future health of Chinatown CDC's budget depends on several key factors: the strength of the economy; our ability to cultivate new relationships and maintain existing relationships with key governmental officials and foundation staff; the success of our capital campaign – "Campaign for Communities"; and our ability to develop new affordable housing projects.

Both historic trends and these key factors affecting our future projections are further discussed below by income source.¹

Revenue

Government contracts: The affordable housing development, community organizing, neighborhood improvement, and tenant services programs all receive some government funding. In the past five years, government contracts have increased from approximately \$800,000 to \$1 million. Government contracts

¹ Appendix 1: 1997-2002 Projected Operating Budget; Appendix 2: 2003-2007 Projected Operating Budget

remain the largest source of income for the organization, ranging from 28% to 38% of total revenue.

Currently, Chinatown CDC receives about \$1.1 million from local government. We are fortunate that our contracts with the Mayor's Office of Housing (CDBG funds for housing development and housing counseling), and the Department of Human Services (for tenant services) have been put in the baseline of the City's budget, so these funds are highly likely to continue at their current level. Our ability to secure new contracts and/or to maintain other government contracts such as funding for services to families living in SRO's will depend on both the health of the local economy and our relationship with the next mayor and his/her administration.

At the state level, we have a three-year contract with the State Department of Mental Health for tenant services. Due to the strong lobbying from the supportive housing community, there is a strong possibility that these funds will continue past 2005 and Chinatown CDC will be able to renew the contract. In addition, with the new central subway project underway, Chinatown CDC is positioning itself to play a major role in Chinatown in providing community education and gaining neighborhood support for the project. A contract for these activities could be as much as \$250,000 per year.

Chinatown CDC has not received much federal funding for operating programs in the past. Currently the Office of Minority Health of the Department of Health and Human Services provides \$50,000 to support our senior services program. Based on conversations with DHHS staff, there is a strong likelihood that this funding will continue into the next couple of years. Chinatown CDC will continue to explore federal funding opportunities but the availability of federal funds is highly dependent on the national economy and the priorities of the Administration.

All in all, Chinatown CDC has probably maximized most of the potential funding from government sources. The income projection for the Government Contracts category is \$1,526,000 with 2-3% increases over the next four years. As a percentage of the overall budget, income from government contracts remains fairly stable at about 30%.

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Foundation grants: Chinatown CDC has historically had strong relationships with the philanthropic community. Income from foundations has averaged \$650,000 annually over the past five years. There has been a fair amount of fluctuation since this income is highly dependent upon foundation funding preferences and the strength of the economy.

In 2002, the projected total for foundation income of \$820,000 includes \$240,000 specifically targeted for the Campaign for Communities. The \$240,000 is intended to offset expenses directly attributable to the Campaign. Similarly, \$157,000 of the \$850,000 projected foundation income in 2003 is targeted to cover expenses for the Campaign for Communities. Therefore, the true amount

of foundation income supporting the annual operating budget in 2002 is \$580,000, and \$693,000 in 2003.

Fundraising for the Campaign will have some impact on the organization's ability to raise operating funds from foundations. Some of the foundations that have provided operating support in the past are being asked to make a substantial contribution to the Campaign. These Campaign funders may not make an operating grant to the organization during the Campaign period. Chinatown CDC will need to aggressively pursue additional foundation grant opportunities to support operating needs. In 2004, the first year after the Campaign, the projected foundation income drops to the level of \$600,000, which is consistent with the amount of foundation support the organization received prior to the Campaign. From 2004 – 2007, Chinatown CDC intends to increase the income from foundations to \$850,000 – a 42% increase.

While Chinatown CDC has historically been very successful in securing grants from various foundations, the key to increasing this level of support is to incorporate a cultivation aspect into our work with the foundations. Chinatown CDC will be taking a more active role in sharing our work, struggles, and progress with the philanthropic community so that they can feel that their work with us is truly a worthwhile partnership. In cultivating these relationships, Chinatown CDC is seeking to attract funding for multiple years based on our ability to develop more complete, longer-term visions and goals for each program area. Improved tracking and documentation of our program accomplishments will provide compelling information for our funders. Packaging our programs in a more comprehensive fashion and integrating many parts of our work together may attract funders to make longer-term investments in the organization by funding the entire program, or at least present them with the opportunity to fund some portion of the larger program. In addition, we will identify an "anchor funder" for each program area. This will most likely be an existing funder that the organization has a strong relationship with and who has a history of funding the program for several years. Cultivating the relationship with the "anchor funder" on a continual basis will help to secure longer-term funding commitments and facilitate gaining their assistance in identifying other funders.

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Contributed Income: Income from the Annual Dinner, direct mail appeals, and other events generate about 10% of the organization's annual budget. This has remained fairly consistent over the past five years.

The Campaign for Communities will strengthen Chinatown CDC's donor base by increasing the number of donors and their level of giving, thereby increasing the Annual Fund giving. The projections for contributed income nearly double from 2003 (\$350,000) to 2007 (\$655,000), and grow from comprising 8% of the total budget to 11%. Our most successful event, the Annual Dinner, continues to grow each year, and will likely increase by another \$100,000 over the next five years. Chinatown CDC will be organizing an additional annual event, targeted at community supporters rather than corporate giving. Because this will be a new

event beginning in 2003, it is anticipated that the revenue will start off at \$30,000 but will increase as the event becomes more established in the general community. Proceeds from the Campaign for Communities for the program initiatives are included in the 2006 and 2007 revenue estimates at \$50,000 per year. In addition, the Campaign will increase our overall donor base and generate more financial gifts from individuals.²

* * *

Project Development: Development revenue is earned through fees for projects developed by Chinatown CDC. All of Chinatown CDC's properties have been developed with financial assistance from the City of San Francisco, and are subject to a development fee schedule established by the City. Development fees can fluctuate significantly, depending on the financing structure and timing of a project. In the past five years, fees from development have ranged from a low of \$138,921 to a high of \$389,832.

Chinatown CDC's current development pipeline includes the completion of the rehabilitation of Notre Dame Apartments and 665 Clay Street in 2003, completion of the International Hotel in 2004, and the completion of the Broadway Family Apartments in 2005. These developments are currently underway and most of the financing has been secured for these developments. The fees generated from these developments are very likely to materialize unless cost overruns become excessive.

Chinatown CDC's housing development goals include acquiring a new project each year in order to continue producing affordable units at a reasonable pace. Therefore, we anticipate identifying one new project by the end of 2002 or the first quarter of 2003 and another by the end of 2003. These two housing developments would be completed in 2006 and 2007. The "Housing Pipeline and Fee Schedule"³ depicts the timeframe for each housing project in our pipeline and the associated fees from each project.

Several challenges confront Chinatown CDC in meeting its housing production goals. First, the northeast sector, on which the organization has historically focused its housing work, is very dense, with few vacant lots available for new construction. Much of the existing housing stock is comprised of SRO's and smaller units. Many of the current funding sources place a priority for family housing and larger (3-4 bedroom) units. Therefore, opportunities for rehabilitation do not match available funding opportunities. Second, San Francisco was recently rated the most expensive housing market in the nation. Identifying sites that are financially feasible in the current real estate market is very difficult. Third, public funding for affordable housing is scarce. At the federal level, the HUD budget has been decreasing and no new federal programs have been introduced for many years. State and local funds have also diminished, due to the slowing economy. The passage of the State and local

² Appendix 3: Schedule of Contributed Income

³ Appendix 4: Housing Pipeline and Fee Schedule

bonds for affordable housing on the November 2002 ballot will provide new funding for our work.

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Property Management: Chinatown CDC charges management fees to both Chinatown CDC and partnership owned properties. Because properties are developed with government funds, management fees are subject to annual approval by regulatory entities. Property management fees have increased over the past five years as the number of properties under management has grown. The income projections from 2003-2007 reflect a growth in income from the International Hotel, Broadway Family Apartments, and two new developments (approximately 50 units each) coming on line in 2006 and 2007. Revenue from property management fees is projected to grow from \$533,000 in 2003 to an estimated \$676,000 in 2007.

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Other Income/Miscellaneous: This category includes several different revenue sources, including investment proceeds from Wharf Plaza I and II, interest income from our various savings and operating accounts, bookkeeping fees, youth tour fees, tenant services site fees, and asset management fees.

The largest source in this category is from Wharf Plaza, where Chinatown CDC receives 29% of our net cash flow. Since Wharf Plaza I recently received approval from HUD to “mark up to market” and it is anticipated that the second building will receive approval very soon, these projections reflect an increase due to the additional HUD subsidy. The Project Bookkeeping Fees are similar to the Property Management Fees where each project in our portfolio is charged a bookkeeping fee based on the number of units. This income increases as new properties come under management and bookkeeping services are rendered. Tenant Services Site fees are also generated from the properties. Some properties are able to include in their budget a share of the tenant services expenses for the services provided to the residents. Other revenue from our portfolio are fees from managing the partnerships, asset management fees, and net cash flow from Notre Dame Apartments. The Youth Tour Fees are based on the growing success of the Chinatown Alleyway Tours and the revenue generated from these tours.⁴

Reviewing the past five years along with the projections for the next five years gives one the ability to analyze the longer-term changes in the various income sectors. Chinatown CDC seeks to further diversify its income basis, relying less on government and foundation funds, which are largely controlled by external forces, and grow its earned income (project development, and property management fees) and contributed income. However, one could also argue that Chinatown CDC’s services are a public service and should be supported by public sources (i.e. government contracts). The organization needs to find a healthy balance between its government, foundation, and earned income

⁴ Appendix 5: 2003-2007 Schedule of Other Income Sources

sources so that changes in government policies, politics, and fluctuations in the economy have minimal impact on its services and programs. Though the changes are gradual, the comparison between the 1997 and 2007 budgets (shown below) indicates that Chinatown CDC is moving towards a more balanced allocation of income.

(insert two pie charts: 1997 and 2007 income sources)

Expenses

Chinatown CDC's expenses have also increased over the past five years. The single largest expense is personnel, growing from almost \$1.6 million in 1997 to a projected \$4.6 million in 2007. The number of staff has increased as programs grow and new properties come under management. Today, Chinatown CDC has 112 regular positions compared to 85 positions four years ago. This represents a 32% increase in staffing since 1998. Also, in the booming Bay Area economy, Chinatown CDC has made conscious efforts to increase salaries in order to remain competitive in recruiting and retaining staff. Annual merit increases and regular review of the organization's salary schedule (implementing grade adjustments if necessary) enables the organization to maintain a strong and talented staff. Related to personnel is the rapidly increasing costs of health insurance and workers compensation. In addition, the rising costs of liability insurance and technology (computer infrastructure) are also adding to our annual budget. These are the primary expenses contributing to the growth in expenditures.

(insert two pie charts: 1997 and 2007 expenses)

While the proportionate amount of the different types of expenses has remained consistent over the years, the overall expenses continue to increase. Chinatown CDC should continue to carefully monitor these expenses and seek creative methods to operate as efficiently as possible.

Action Plan

- *Raise \$4 million for the Campaign for Communities for the International Hotel, Broadway Family Apartments, and program initiatives.*
- *Diversify our income base and attract new donors so the organization is less dependent on a few funding sources.*
- *Increase multiple-year funding commitments from foundations to stabilize our revenue from year to year.*
- *Monitor the growth in expenditures to identify operating efficiencies.*
- *Acquire one new affordable housing development each year to generate additional housing units and developer fees.*

THE PROPERTY PORTFOLIO

Chinatown CDC provides property management services for all of the properties we have developed where we have sole ownership or where we are the general partner of a limited partnership. In addition, we manage two properties for private owners. In the past five years, the portfolio has grown tremendously. In 1997, Chinatown CDC managed 13 properties, a total of 637 units. Today, there are 18 properties under management, a total of 1,145 units⁵. This represents an 80% increase in the number of units managed. Most of this growth occurred in an 18-month period from mid-1999 to 2001.

(insert bar/line graph depicting growth:
units vs. year- 1997-2002)

Within the portfolio, Chinatown CDC solely owns six properties and has an ownership interest in ten properties (through separately affiliated corporations and partnerships). We also manage two properties we do not own. The ownership interests are reflected in Chinatown CDC's consolidated financial statements.

The total budget for the management operations of the portfolio in 2002 is \$9.6 million. Like most community development corporations, Chinatown CDC faces the challenge of keeping rents as affordable as possible while maintaining the long-term viability of the housing asset. Most recently, the increases in utility costs, health insurance, workers compensation, and property insurance have generated substantial increases in operating costs.

Due to the government financing of these properties, there is generally a deferred loan on the property. Therefore, any surplus cash (after funding all operating expenses, debt, and reserves) from a property is used to pay off deferred interest. The only income to Chinatown CDC's operating budget from managing the portfolio is through management fees, bookkeeping fees, and partnership management fees. Like developer fees, these property management fees are subject to approval by regulatory entities.

In the long-term, it is a significant challenge for Chinatown CDC to continue to operate and manage these buildings as the operating expenses tend to increase faster than rental income. Experience shows that expenses increase 4 – 5% per

⁵ Appendix 6: Chinatown Community Development Center Portfolio

year on average, although certain expenses have risen much more dramatically (For example, workers compensation increased 35% from 2002 to 2003.). However, rental income only increases approximately 3% per year on average. Annual rent increases must still be approved by government regulatory agencies even though these properties are exempt from the local rent control ordinance. Therefore, although the early operating years of these properties are quite healthy, over time, expenses will exceed income. Due to the deferred loans on the properties, Chinatown CDC is unable to preserve the surplus in the early years to fund operating deficits in the later years.

As the properties in our portfolio get older, the operating deficits will increase. Operating deficits (excluding reserves) are funded by Chinatown CDC. Despite regulatory requirements, if properties cannot fund their operating and/or replacement reserves, these accounts remain under-funded. However, Chinatown CDC has always met its obligations in providing decent and safe housing. At times, the organization has taken funds from its reserves to make capital improvements to its properties.

The projections for 2002 indicate operating deficits for four properties: 523 Grant Avenue, 665 Clay Street⁶, Cambridge Hotel, and the Consorcia, for an estimated total of \$14,000. If no refinancing strategies are implemented or additional rental subsidies received (discussed later) then the increased costs of personnel (salaries, health benefits, workers compensation) and other operating expenses will increase the 2003 operating deficit for the portfolio to \$129,000.

The projected five year (2003-2007) cumulative total of operating deficits for the portfolio is \$630,000⁷. If operating and replacement reserve expenses are included, the amount increases to \$1.5 million⁸. Again, these projections are worst case scenarios, because the projections do not include any changes to debt structure or income sources.

⁶ The operating deficit is temporary, due to the rehabilitation process where one residential unit and a commercial space are vacant.

⁷ Appendix 7: 2003-2012 Portfolio Without Reserves

⁸ Appendix 8: 2003-2012 Portfolio With Reserves

Each property was developed with different sources of financing. An analysis of each properties financing structure must be examined to determine various strategies to reduce the deficit or bring the property to a break-even or surplus position. Properties such as 1370 California, Consorcia, Tower Hotel, and the Clayton have private debt which can be refinanced with more favorable terms. Chinatown CDC is also applying for Section 8 rental subsidies from the San Francisco Housing Authority to increase the rental income at the Swiss American, William Penn, 1370 California, and Larkin-Pine. And Chinatown CDC will pursue increases in the existing Section 8 contracts for the Hamlin and Cambridge Hotels.⁹

As Chinatown CDC considers various refinancing scenarios for our properties, we must also assess the longer-term impacts on our financial health. Refinancing extends the payment period and costs for another 30 years, or the length of the new loan. This process would start the whole imbalanced loan repayment process over again, in which the borrower pays mostly interest in the earlier years and little principal. This imbalance shifts in later years when the borrower's monthly payment is mostly principal and correspondingly little interest. Now, just as Chinatown CDC has reached a point after several years when more principal is being paid with each monthly payment, the organization would refinance and start paying mostly interest again.

In some of the buildings, Chinatown CDC has already refinanced one or more times. A long-term result of continuous refinancing, which Chinatown CDC seems to be experiencing, is an extended term of repaying original loans (35 to 50 years) and an enormous amount of interest. This practice may be fruitful in the short-term interest of cash flow, but the long-term costs are much higher.

Chinatown CDC should consider paying off or paying down the loans rather than continue to refinance, which would extend the term out further and cause us to continue paying high levels of interest. One way to break this cycle is for Chinatown CDC to refinance some higher-rate loans with a lower rate while maintaining the older, higher-rate level of monthly payments. The additional payment would help to pay down the principal more rapidly and the loan could be repaid more quickly.

It might be useful to try to get a lower rate for some of the buildings from a community development lender (e.g. Calvert Foundation, United Methodist Church, California Community Reinvestment Corporation) even though the term would be shorter. Chinatown CDC could then take advantage of the lower rate and make higher monthly payments as a way to lower the principal balance more quickly and then refinance again after a shorter term (5, 7, or 10 years, for example) with a much lower principal balance than would have otherwise been possible. Ultimately, the loans could be paid off faster, leaving CCDC with some better options for rents – lower rents and/or rents that increase more slowly than they would otherwise.

⁹ Appendix 9: Refinancing Strategies

However, there is little financial incentive for Chinatown CDC to do this now because cash flow (after loan repayments) goes to pay off the other, deferred public sector loans rather than remain with the organization. On the other hand, the buildings will be better off with faster repayment and Chinatown CDC can begin paying off the public loans. Alternatively, we might be able to negotiate with the public agencies to create an incentive where Chinatown CDC and the public agency would split the additional cash flow that would be created by refinancing.

Most lenders will include a prepayment penalty, making it difficult to refinance in the next eight years or so. However, rates are quite low now compared to rates in recent history. If Chinatown CDC plans to refinance, the present time is excellent for this purpose. Refinancing with a rate this low would also reduce the need in the future to refinance until the loan comes due again, unless we were to pay down the principal more rapidly than scheduled.

Chinatown CDC could take several loans to one lender as a package and try to negotiate better terms. We might be able to obtain lower closing costs because much of the underwriting paperwork would not have to be repeated. The lender may also be willing to negotiate the rate or other issues such as the prepayment penalty.

An additional approach to the negative cash flow situation would be the creation of sinking funds for those buildings that are generating positive cash flows in the immediate future. For example, the St. Claire, Tower and Clayton all show positive cash flow for one or more years in the future. CCDC could take the cash flow and put it into an interest earning account to help cover negative cash flows in later years. This would need approval of the funders, but it could be a compelling argument.

Action Plan

- *Refinance private debt on 1370 California.*
- *Seek refinancing from community development lenders for shorter terms and pay down the existing debt for the Consorcia, Tower Hotel, and the Clayton Hotel.*
- *Apply for Section 8 Rental Subsidy for the Swiss American, William Penn, 1370 California, and Larkin-Pine.*
- *Pursue increases in the existing Section 8 contracts for the Hamlin and Cambridge Hotels.*

Financing Structure - Deferred Loans

All of the properties developed by Chinatown CDC have deferred loans from either the City of San Francisco or the State of California (and in some cases, both). The loan terms range from 10 to 40 years, with the shorter terms being renewable. The interest is accrued during this period and ranges from 3-12%.

These financing terms have enabled Chinatown CDC to purchase and rehabilitate housing units for low-income residents. However, the size of these loans, in addition to the large amount of accumulated interest, create a major repayment problem if and when these loans are called. The potential rent increases needed to refinance the loans at higher rates in 10-20 years would create major hardships on the residents.

Many nonprofit organizations receiving deferred loans from public agencies are not concerned with repayment. They believe that the public agency will not actually collect the loan when it is due and convert it to a grant. Others believe that they will be able to refinance the loan when it comes due. These assumptions may be correct. However, these funds have been obtained as loans and the buildings themselves have been used as security for these loans. They are legally binding obligations for the organization.

The deferred loans impact Chinatown CDC in various ways. If Chinatown CDC believes that we will have to repay these loans, then we face the challenge of formulating a repayment strategy. If these loans are called, and assuming that refinancing funds are available at reasonable terms, Chinatown CDC would have several options. The buildings could be refinanced and rents could be increased if approved by regulatory agencies. However, the increases in rent would be a heavy financial hardship on the residents and likely create some displacement.

Because most of the buildings have greater debt than value, the buildings are not attractive to other buyers. There would be no proceeds from a sale, and the residents would likely end up with rent increases because the new owner would be in a similar position as Chinatown CDC. If the State demands repayment as these loans come due and Chinatown CDC does not have the funds to repay the State, the City could attempt to buy-out the loans. If the City does not have the funds, then the State will be left holding the property. It is difficult to envision the State becoming the landlord of hundreds of affordable housing units. In the past, when a nonprofit owner has defaulted, the State has stepped in to identify a new owner for the property. In these cases the properties remained affordable and the residents were not displaced.

It is important to renegotiate the loans with the City and State. Ultimately, it may require political activity to seek any changes from the State of California. Since the regulations governing the administration of these loan programs were written as legislation, it requires an act of the State legislature to amend them. The State legislature will need to be convinced to amend the regulations to allow for their loans to be converted to grants or to extend loan terms and write off interest payments in order to keep these housing assets affordable to low-income residents.

Chinatown CDC has been working closely with the City of San Francisco to restructure and renew organizational loans. In the past, the City has always renewed loans, extending them for ten-year periods upon renewal. However, they have not always been willing to write off the accumulated interest.

Therefore, the interest accrued for these loans continue to grow as the loans are extended, and are recorded on our financial statement as a liability.

As the deferred interest continues to grow, the liability erodes our net assets on our financial statements. Two years ago, funders were beginning to raise questions about Chinatown CDC's financial health. We became apprehensive that funders, who are unfamiliar with real estate financing, might get an inaccurate perception of the organization's financial health and withdraw their support. At the end of 2001, Chinatown CDC was able to convince the City to convert a \$2.85 million loan for the 665 Clay Street property into a grant. The grant was recorded as income on our financial statement and offset much of the liability of the deferred interest.

Chinatown CDC plans to work with the City to restructure several other loans with high interest rates¹⁰. The restructuring of these loans will decrease the amount of deferred interest, thereby reducing the annual liability on our financial statements. These actions will keep our net assets from declining at such a rapid rate. In addition, we are ensuring that the new projects we are developing do not have high interest rates on the deferred loans. The Broadway Family Apartments housing development financing has been structured so that \$6 million of the funds we receive is a grant and \$3.6 million is a 0% deferred loan from the City.¹¹

Action Plan

- *Work with the City of San Francisco to reduce the interest rate on the deferred loans for the William Penn, Hamlin, Bayside Apartments, Cambridge, and St. Claire.*
- *Ensure that the deferred loans on new housing developments carry no or minimal interest rates.*

FINANCIAL HEALTH

All of the preceding issues – the growth in annual income and expenditures, the operating budgets of our eighteen properties, and the underlying financing structure of our properties (both the completed projects and the projects currently under development) comprise the overall financial health of Chinatown CDC and is reflected in the annual audit report.

Chinatown CDC's audited financial statements reflect a complex organization. The annual audit includes all operating income and expenses incurred by Chinatown CDC – its programs and properties. Since many of the properties are owned by a limited partnership (where Chinatown CDC is the general partner), only the percentage of Chinatown CDC's ownership is reflected in the audit. To

¹⁰ Appendix 10: Deferred Loans

¹¹ Appendix 11: Estimated Net Assets

complicate things further, the figures also include the deferred interest (which is shown as an expense), from the loans used to develop the properties. The deferred interest from the affordable housing loan structures from the City of San Francisco was over \$1 million in 2000 and dramatically reduced our net assets. In addition, the fluctuations from real estate development activities such as the timing of when developer fees are received to the instances where Chinatown CDC “loans” a project funds until financing is secured, can also skew a financial statement. Therefore, it is quite difficult to decipher the true financial state of the organization from reviewing just the audits. However, it is the only financial report which consolidates all of the organization’s financial information and is commonly reviewed by lenders and funders.

The audited financial statements in 1998, 1999, and 2000 indicate that Chinatown CDC realized a net operating deficit in each of those years, between \$1.1 million in 1998 to \$1.8 million in 2000. However, these figures are somewhat deceiving because they include deferred interest and depreciation.

Without the deferred interest and depreciation, Chinatown CDC would show a positive net operating revenue (although as little as \$7,000 in 2000). In addition, the deferred interest and depreciation are also causing a sharp decline in the net assets of the organization, from over \$4 million in 1998 to just over \$500,000 in 2000.

In 2000, Chinatown CDC advanced approximately \$775,000 to cover expenses in developing Golden Gate Apartments and the Notre Dame Apartments. The impact of these advances is shown as a decrease in cash from 1999 to 2000. Chinatown CDC was reimbursed in 2001 through the proceeds of the bond financing for these two developments.

The audited financial statement for 2001 reflects several positive changes. Chinatown CDC realized a net operating surplus of \$1,793,376, which includes deferred interest and depreciation. Excluding deferred interest and depreciation, there was an increase in net assets of \$3,720,473, compared to approximately \$7,000 in 2000. The biggest factor for the increase was the conversion of the City’s acquisition loan of \$2.85 million to a grant. This single transaction increased our fund balance from \$552,869 in FY 2000 to \$2,346,245 in FY 2001.¹² (Appendix 12: 1998-2001 Financial Profile Summary)

In addition to the changes in our financial position, the format of the audit has been revised so that revenue and expenses associated with our programs and housing activities are separated into two main categories: “Low income Housing Operations” and “Other Programs”. “Low income Housing Operations” contains all information pertaining to the operations of our solely owned projects, including the buildings and related debt and depreciation. “Other Programs” contain all other organizational program-related items, including general overhead. Also, all forgivable debt and interest is separated from other debt. These format changes should give readers and funders a clearer picture of our financial position.

¹² Appendix 12: 1998-2001 Financial Profile Summary

Ratio Analysis

Another method of assessing the financial strength of an organization is through the application of some commonly used financial ratios. Ratios serve two main purposes: to show a comparison to industry standards or to identify trends within an organization. The following four key ratios demonstrate that Chinatown CDC is financially healthy, yet there are some indications that its financial strength is declining.

- One commonly used ratio is the Current Ratio, which measures the margin of safety an organization has through its ability to satisfy current liabilities with current assets. As a general rule, current assets should be at least 120% greater than liabilities. Chinatown CDC's current assets far exceed these standards, with current assets of two and a half times its current liabilities in 2000. This ratio declined through 1998-2000; in 2001 there is an increase, such that the current assets are nearly 300% of liabilities.
- A second liquidity measure is the Cash Ratio, which assesses the organization's access to cash. The calculation is the ratio of unrestricted cash and cash equivalents to the total of current liabilities. By this measure, Chinatown CDC is still very liquid. Our liquidity has decreased from 1998-99, though 2001 shows a slight increase.
- The Day's Cash Ratio measures the number of days the organization can fund itself with cash on hand. The industry standard is 90 to 180 days. Chinatown CDC's Day's Cash Ratio has decreased to the low end of the industry standard. In 1998 we had 205 days; in 2001 we had 135 days. This ratio varies dramatically depending on when we receive major grants and developer fees. The actual calculation is based on the amount of cash available on the last day of the year. For example, the sharp decline in 2000 is due to a cash advance Chinatown CDC made to cover expenses for housing development projects which were repaid in 2001.
- The Debt-To-Equity Ratio is used as an indicator of an organization's prospects for long-term solvency and indicates the extent to which organizational growth has been financed with debt. As a general rule, the lower the ratio, the sounder the organization. Because one of Chinatown CDC's primary activities is real estate development, the organization does incur large amounts of debt which increases its debt-to-equity ratio. In addition, the City's financing method of utilizing deferred and/or forgivable loans also increases the ratio. As shown below, without forgivable debt and interest, Chinatown CDC would have a much more favorable debt-to-equity ratio.

CONCLUSION

A number of challenges lie ahead for Chinatown CDC in order to strengthen the financial health of the organization and continue to serve tenants, constituents, and neighborhoods. We must diversify our income base and attract new funders and donors. We must restructure the existing debt on many of our properties in order to continue to operate the building for low-income residents. And we must continue to expand our wonderful programs and build more affordable housing units to meet the dire needs in the community.

These challenges are not unique to Chinatown CDC. In fact, these challenges are a result of success, and are faced by many other mature community development corporations across the nation. This financial plan seeks to identify not only the issues, but also the road we must take to resolve these issues and firmly establish ourselves as a community institution.

APPENDIX

- Appendix 1: 1997-2002 Operating Budget
- Appendix 2: 2003-2007 Projected Operating Budget
- Appendix 3: Schedule of Contributed Income
- Appendix 4: Housing Pipeline and Fee Schedule
- Appendix 5: 2003-2007 Schedule of Other Income
- Appendix 6: Chinatown Community Development Center Portfolio
- Appendix 7: 2003-2012 Portfolio Without Reserves
- Appendix 8: 2003-2012 Portfolio With Reserves
- Appendix 9: Refinancing Strategies
- Appendix 10: Deferred Loans
- Appendix 11: Estimated Net Assets
- Appendix 12: 1998-2001 Financial Profile Summary