



CITY OF DURHAM | NORTH CAROLINA

Date: May 8, 2012

To: Thomas J. Bonfield, City Manager
Through: Keith Chadwell, Deputy City Manager
From: Reginald J. Johnson, Interim Director
Department of Community Development
Subject: Master Development Agreement with McCormack Baron
Salazar Development, Inc. for the Southside East Revitalization Project

Executive Summary

On May 2, 2011, City Council approved a commitment of funding in support of Phase I of the Southside Revitalization project located on the former Rolling Hills site. On June 30, 2011, the North Carolina Housing Finance Agency (NCHFA) announced the award of 2011 Low Income Housing Tax Credits (LIHTC) to McCormack Baron Salazar (MBS) for the Southside project. To comply with Internal Revenue Service requirements, Phase I must be completed no later than December 2013. In an effort to move predevelopment activities forward, City Council approved funding on September 8, 2011 for public and private predevelopment activities on the Rolling Hills site with the understanding a Master Development Agreement would follow for City Council consideration. The item was previously presented at the April 5, 2012 work session and City Council members requested that the item be held to a future meeting when infrastructure and construction costs have been received. Infrastructure costs have been received and are included in a separate agenda item and responses are due on May 11, 2012 that will include the costs to construct the 132 unit multi-family development.

Additionally, it was requested that MBS consider sharing in third party costs equally for Phase 2 predevelopment costs and MBS has agreed to the 50/50 split for any costs occurred prior to the award of tax credits for Phase 2.

The Master Development Agreement (MDA) sets forth the roles and responsibilities of the City and MBS and the structure of the development project. Concurrently the Department of Community Development is preparing additional agreements associated with (a) environmental remediation, site preparation and infrastructure improvements and (b) Phase 1 construction /permanent financing for City Council consideration.

Recommendation

The Department of Community Development recommends that City Council authorize the City Manager to execute a Master Development Agreement with McCormack Baron Salazar, Inc. (MBS) for the Southside Revitalization Project.

Background

In December 2007, City Council accepted the recommendation of a review panel to select MBS as lead developer for Rolling Hills and portions of the adjacent Southside neighborhood. In the fall of 2009, a community based revitalization planning process for the project area was begun and it resulted in a consensus master plan that identified three phases of rental development and three phases of homeownership development with the intent of serving a broad range of incomes while establishing the basis for future private investment. Subsequently, the Department was directed to craft a financing plan for the first two phases of both rental and homeownership development.

At the September 8, 2011 work session, City Council approved a Community Development Grant Agreement (CDBG) in the amount of \$550,000.00 with MBS to pay for design and engineering related predevelopment activities for the 20 acre site to include a phase I environmental assessment, geotechnical exploration and testing. The grant also provided funding for site design to include civil and landscape and the preparation of bid documents for demolition of the existing streets and infrastructure, sedimentation and erosion control, mass grading of the entire site along with site preparation and the design of new infrastructure improvements to serve the Phase 1 site. Additionally, at the September meeting, City Council approved a predevelopment loan in the amount of \$998,300.00 to fund the private predevelopment activities to include architectural, civil, mechanical, plumbing and electrical design of the 132 unit multi-family complex, the payment of water and sewer impact fees, legal fees and the payment of the NCFHA allocation fee. In addition, MBS committed \$510,000.00 of its own funds to funding these predevelopment activities. The work is underway both for the public and private predevelopment activities.

Issues/Analysis

The MDA defines the specific rights and responsibilities of the City and MBS for the redevelopment of the former Rolling Hills site which consists of approximately 20 acres located in the Southside community. For the Phase 1 development, the City will provide funding in an amount up to \$6,850,000.00 for environmental remediation, the demolition of the existing streets and infrastructure, mass grading for the entire site and new streets and related public improvements needed to serve Phase 1 (approximately 7 acres upon which the development of 119 multi-family rental units and 13 live work units will occur). The City will provide loans in an amount up to \$5,250,000.00 for the construction of the 132 units. There are multiple sources of City funding for the construction loans and the loan documents to include the financial structure with loan terms and conditions are being presented to City Council concurrently for approval.

For the Phase 1 development, the highest rated equity proposal was received from US Bank which will provide an equity investment of approximately \$11,500,000.00. In addition to the equity, MBS will be responsible for obtaining up to \$12,600,000.00 in private construction financing and approximately \$2,500,000.00 in private permanent first mortgage financing for Phase 1 (which will also be provided by US Bank), and will also be responsible for coordinating, directing and managing the construction of the units. At the financial closing for Phase 1 rental phase, agreements will be executed with all lenders and the equity investor and MBS will execute a guaranty of construction completion for the benefit of the City and will execute such further guarantees as may be required by the investor and the third-party lenders. These guarantees will include construction completion, development deficit guarantees, operating deficit guarantees, tax credit recapture guaranties and environmental indemnities. Additionally, NCHFA, along with the City will require that for a period of 30 years, 20 units remain affordable to families earning 30% or below of the area median income, 12 units remain affordable to families earning 50% or below of the area median

income and that 48 units remain affordable to families earning 60% or below of the area median for a total of 80 of the 132 multi-family units. MBS also will be responsible for entering into a Small Disadvantaged Business Enterprise Strategic and a Workforce Development plan with the City.

MBS will be responsible for preparing and submitting a tax credit application for Phase 2 which will consist of the development for the construction of 79 multi-family units on approximately 4 acres of the 13 remaining acres of the 20 acre site. If the tax credits are received, the City will be responsible for providing the public infrastructure improvements in an amount up to \$1,000,000.00 and construction financing in an amount up to \$3,500,000.00 for the development of the second phase. Numerous factors will drive the start date for Phase 2 construction, which would begin no earlier than 2015.

The decision on how to develop the 9 acres of the site remaining after completion of Phase 2 will be determined by the City. If a third phase of multi-family development is approved by City Council, MBS and the City will enter into good faith negotiations to come to similar terms on subsequent agreements to finance and complete the Phase 3 development.

The MDA defines the language if one or both parties decide to terminate their agreement and the process for arriving at the compensation that would be due to MBS upon termination.

Alternatives

The City Council could elect to not approve the MDA with MBS. Without an agreement on the mutual commitments between the City and MBS, the project would not move forward and the tax credits would be forfeited as tax credits are awarded to a developer not to a particular project or to a local unit of government. It should also be noted that if the City chose another direction which did not include MBS, it would result in the forfeiture of \$950,000.00 in NSP3 funding awarded to the project due to award being site specific to the redevelopment of the Phase 1 site.

Currently, general contractor responses to a Request for Proposals issued by MBS on April 3rd are due on May 11th and will include preliminary construction pricing for Phase 1 improvements. Those responses will be evaluated and MBS is expected to select a general contractor by no later than June 1st and then work with the selected general contractor to finalize construction documents and arrive on a final construction price and contract. If City Council does not approve the MDA with MBS, then all discussions with general contractors would cease and MBS would likely discontinue any further predevelopment work, significantly jeopardizing a summer closing/construction start needed to meet the December 31, 2013 placed in service date required by NCHFA.

With regard to the Environmental Remediation, Site Preparation and Public Improvements except for the installation of the new streets and infrastructure, the scope of work in the site preparation bid, which is being presented concurrently for approval, all other tasks that would be required to prepare the site for any future development with or without MBS being the lead developer for the site. The City could choose to manage the demolition and the mass grading effort and look at other future development options for the development of the site. This option would create a need to discuss compensation due to MBS, if any for their completed activities.

Financial Impact

The financial impacts associated with the mutual commitments between the City and MBS were reviewed at special City Council meetings on the Southside Revitalization project held on March 10th and April 7th of this year. On May 2nd, Council voted to authorize the City Manager to issue a commitment letter to MBS to provide up to \$5,486,468.00 in loan funds for the first phase of mixed-income rental development on the Rolling Hills site and up to \$3,887,410.00 in grant funds for the associated site preparation and infrastructure. As a result of identifying contaminated soil and rock on the site, the cost of removal has increased the funding required for the site preparation by approximately \$2.7 million dollars.

The total budget for the predevelopment tasks associated with the private development was \$1,508,448.00 with the City providing a predevelopment loan in the amount of \$998,300.00 in housing bond program income which is budgeted and available in the Rolling Hills CIP (Capital Improvement Program). MBS is providing the balance of the costs in the amount of \$510,148.00. The \$998,300.00 is part of the \$5,250,000.00 loan amount referenced above. Currently, the City is in receipt of invoices totaling \$643,162.00 of which \$412,526.00 is being charged against the predevelopment agreement and MBS funding the remaining amount of \$230,636.00.

As part of the 2011 NCHFA tax credit application process, a requirement is the submittal of a project budget for review. Upon review of MBS budget, NCHFA made downward adjustments on several line items with the largest adjustment in rent up reserves and attorney fees. This created a potential gap in the proposed budgets of \$673,664.00. The gap could be closed by higher equity pricing or by way of value engineering. Based upon proposals recently received, MBS has decided to move forward with US Bank to provide for construction and permanent financing as well as equity. The equity pricing secured is approximately \$1.6 million more than estimated in the tax credit application submitted in May 2011. Whether a financing gap exists will not be known until preliminary construction pricing is received and evaluated later this month.

SDBE Summary

The Department of Equal Opportunity/Equity Assurance has met with representatives of MBS and has approved a SDBE Strategic Plan that will govern the participation of City-certified firms in all aspects of the scopes of work in this project.