



Date: December 7, 2012

To: Thomas J. Bonfield, City Manager
Through: Keith Chadwell, Deputy City Manager
From: Reginald J. Johnson, Director
Department of Community Development
Subject: Loan Subordination – Durham Hosiery Mill

Executive Summary

A request has been submitted by the Durham Hosiery Mill Limited Partnership for the City of Durham to subordinate two existing loans to allow for the refinancing of the property's first mortgage loan. The refinancing will result in a substantially lower interest rate and allow for the partnership to capitalize approximately \$330,000 for needed repairs. The lower interest rate will also allow for modest payments to the City on its cash flow loans to the project.

Recommendation

The Department of Community Development recommends that City Council authorize the City Manager to execute a loan subordination agreement for the Durham Hosiery Mill Apartments.

Background

As indicated in Exhibit A, the Durham Hosiery Mill Apartments is comprised of 151 one- and two-bedroom apartments serving the elderly in the historic mill building. The project was completed in 1987 and was financed with a FHA first mortgage loan in the amount of \$5,370,800.00 and two additional subordinate mortgage loans from the City of Durham in the amounts of \$2,265,000.00 and \$550,000.00. The source of City funding was a HUD Urban Development Action Grant (UDAG) which was a competitive program used primarily to promote economic development. Both of the City loans were structured as cash flow loans.

In 2002, the first mortgage loan was restructured to avoid bankruptcy. The restructuring involved the prepayment of \$2,627,583.00 utilizing assistance from HUD's Office of Multi-Family Housing Assistance Restructuring (OMHAR). The OMHAR loan in the amount of \$2,627,583.00 became a second mortgage loan and also payable solely out of surplus cash flow. At that time, the Partnership requested, and the City of Durham agreed, to subordinate its loans to the OMHAR loan. The agreed-upon distribution of surplus cash flows was 85% to the OMHAR loan and 15% to the City of Durham. Since that time, the project has operated on a generally break-even basis with little if any surplus cash being generated.

Issues and Analysis

Under the proposed refinance, the outstanding principal balance of the FHA first mortgage loan will be increased from its current balance of approximately \$1,869,655.00 to approximately \$2,274,700.00, resulting in net refinancing proceeds of approximately \$404,000.00. Of that amount, approximately \$330,000.00 will be escrowed pursuant to HUD

closing conditions and used to pay for needed capital improvements. The balance will be used to pay for HUD approved refinancing costs. No refinancing funds will be distributed to, or otherwise made available to, the Partnership or its partners.

The refinancing will lower the first mortgage interest rate from 7.650% to 2.800%, resulting in annual principal and interest savings of approximately \$78,718.00. This savings will allow for surplus cash resulting in projected 2013 payments of approximately \$61,787.00 on the OMHAR cash flow loan and \$10,904.00 on the City's cash flow loans.

HUD has given its consent to the subordination of the OMHAR loan. The City's consent to subordinate its loans will allow for the closing on the first mortgage refinancing which is currently scheduled for January 15, 2013.

As a prerequisite to requesting HUD's consent to the subordination, a physical needs assessment of the property was conducted. The assessment found that the property was in fair condition but that significant capital expenditures for repair and maintenance will be required in the near future. Those future expenditures will be drawn from the aforementioned escrowed funds.

Alternatives

If Council does not approve the subordination, the refinancing will not occur. As noted above, the benefits of refinancing include the funding of needed capital improvements, a stronger long term financial position for the project and modest payments to the City on its cash flow loans.

Financial Impact

The proposed refinancing will result in the generation of surplus cash allowing for modest payments on the City's cash flow loans. As noted previously, payments to the City of approximately \$10,904.00 in 2013 are projected.

SDBE Summary

Not applicable to this item.

Attachments

Exhibit A – Refinancing Summary (and transmittal letter)
Exhibit C – FHA Loan Worksheet
Subordination Agreement