CITY OF DURHAM | NORTH CAROLINA

Date: March 5, 2013

To: Thomas J. Bonfield, City Manager
Through: Keith Chadwell, Deputy City Manager
From: Reginald J. Johnson, Director
Department of Community Development

Subject: Loan Restructuring for Mutual Manor Apartments and Rockwood Cottages

Executive Summary

In 1994 City Council approved $691,000.00 in HOME funds and $260,000.00 in Bond funds for Woodland Associates, Inc. to develop 20 units of affordable senior housing on Rockwood Court, known as Rockwood Cottages, and $877,000.00 in Bond funds to develop 18 units of affordable senior housing on Fayetteville Street known as Mutual Manor Apartments. Woodland has successfully operated both complexes without interruption for the past 17 years. The original Low Income Housing Tax Credit compliance period has now expired and Woodland is requesting loan restructuring to be able to continue to maintain and operate both properties as affordable senior housing for an additional 13 years. All units at Mutual Manor will be affordable to residents whose household income is at or below 50% of Area Median Income, as determined by HUD and 14 units at Rockwood Cottages will be affordable to residents whose household income is at or below 60% with the remaining 6 units available to residents whose income is at or below 50% of Area Median Income (AMI).

Recommendation

The Department of Community Development recommends that City Council authorize the City Manager to amend the Loan Agreements and related documents for Mutual Manor and Rockwood Cottages.

Background

Both projects were originally funded in part through the sale of Low Income Housing Tax Credits with a 15 year compliance period. The compliance period expired in 2011 and both projects have been struggling to meet their financial obligations and adequately fund replacement reserves with the present rent and income limitations. The projects will not continue to be viable unless the rents and debt are restructured.

There are three areas that need to be addressed to get these properties back on solid financial ground, and they are: 1) decreasing operating deficits; 2) the ability to fund large capital improvements in excess of funded reserves and 3) restructuring existing City debt that is currently in excess of property value.

As we have seen recently with other similar projects, such as the Lincoln Apartments, without restructuring these loans to place them on firm financial ground, both projects are in jeopardy of not being economically viable. Jim Pou, General Manager of both limited partnerships has requested that the City review the financials for both projects and consider restructuring both loans.

Cash flow analysis provided for each project indicate that currently Rockwood is operating at a loss that is increasing on an annual basis by approximately $1,000.00. Additionally, it will be necessary to fund capital improvements from non-reserve resources. By reducing the interest rate to zero percent and raising the income and rent levels on the six units now restricted to 35% AMI rent limitations to 50% AMI, this property is projected to generate a positive cash flow, allowing it to be self sustaining over time. Capital improvements that are currently necessary will be paid from non-reserve resources, such as the developer. It is anticipated that the increase in operating cash flow over time will enable the ongoing funding of capital improvements as they become necessary.

Cash flow analysis for Mutual Manor indicates the property is operating at a loss of approximately $23,000.00 currently and increasing by several thousand dollars each year. By raising the income and rent restrictions from 35% to 50% AMI for new applicants and phasing in rent increases over time for existing tenants, the annual operating deficit will be reduced over the next several years. As the attached cash flow projections indicate, these increases will not be sufficient to provide enough operating cash flow to fund the necessary capital improvements now required by this seventeen year old property consisting of roof replacement, parking lot resurfacing and HVAC replacement. The owners have applied for funds to make these capital improvements under a separate grant request.

In addition to Rockwood Cottages and Mutual Manor Apartments Woodland Associates has completed the renovation of the former Mutual Heights Apartments, now known as Stewart Heights. This apartment community contains 147 units with one half of the units affordable to households whose income does not exceed 50% and the other half whose income does not exceed 60% of the Area Median Income. In addition, Woodland currently manages 400 affordable residential elderly and family rental units that were developed by the company's founder, James. W. Pou.

Issues and Analysis

Restructuring of the City loans is needed to reduce debt service, increase income and forgive principal repayment to allow Woodland to continue to operate these properties as affordable housing. If the restructuring of these loans is not permitted by the City, the projects will continue to operate at a loss which could potentially result in both properties failing. If that were to occur, the owner would have no incentive or ability to continue to operate these projects as affordable housing units. In addition, should these properties fail, the affordable senior housing stock in Durham would be decreased by thirty-eight units. Restructuring will allow for the continuation of affordable rents to households at or below 60% of Area Median Income for the balance of the loan term.

An in depth review of the financials for each property has been conducted by staff and the following recommendations are being presented for each project.

For Rockwood Cottages, consisting of 20 units, to remain viable and financially stable, the ownership entity need the ability to raise the rents for eligible tenants, for the remaining six units from the 35% to the 50% level of AMI. The other fourteen units are presently available to eligible tenants whose income does not exceed 60% of AMI. This can potentially increase rental income by approximately $10,000.00 per year, projected over a 5 year phase-in period. Rents will only be raised as the apartments are vacated and re-let to new tenants. Rents for existing tenants will not increase by more than $15/month, in any given year, which over a period of several years should bring the rent level up. Additionally, reducing the interest rate from 1½% to 0% will eliminate the project operating deficit. Project cash flows and the owners will continue to provide the funds to meet capital needs of the project. The current City debt on this project is approximately $951,000.00 that is far in excess of the County's current tax value of $763,200.00. When the indebtedness on a property exceeds the value, the property is "upside down" and there is no incentive for an owner to continue to subsidize the project. Typically they might abandon the property, or convert it to market rate units to increase the income enough to satisfy the debt and operating expenses. Woodland has indicated a very strong desire to preserve this project as affordable housing, but to do so they are asking for annual forgiveness to continue to support an affordable rent level for residents. Forgiving approximately $23,987.00 per year for the remaining thirteen years would leave a principal loan balance of approximately $639,169.00.

Mutual Manor consisting of 18 units has been operating at a deficit for several years and the ownership entity needs the ability to raise the rents by allowing eligible tenant income levels to rise to 50% of AMI, from the 35% they are currently at. Rent increases will only be raised as the apartments are vacated and re-let to new tenants. Rents for existing tenants will not increase by more than $15/month, in any given year.

The original City loan on this project was in the amount of $877,000.00, of which $66,200.00 was advanced for the acquisition of the property and the balance of $810,800.00 was for a construction/permanent loan. Loan forgiveness of $4,413.33/year for 15 years has enabled the acquisition loan to be totally forgiven. Loan forgiveness of $7,000.00/year for 16 years has reduced the balance of the construction/permanent loan to $698,800.00, that is still far in excess of the County tax valuation of $430,200.00. Woodland is requesting that the annual loan forgiveness be increased to $27,029.17/year for the remaining 12 years of the loan.

To address the capital needs of this aging property, Woodland has submitted an application to the Department of Community Development for $65,500.00 in FY13-FY14 General Funds designated for the preservation or creation of affordable rental housing. Those applications are currently under review by the Department. Specifically, the capital improvements needed are repaving the parking lots, replacement of HVAC units and a new roof. The financial viability of this project moving forward will require both a modification to the loan and a grant of General Funds to complete the capital improvements. Modifications to the loan allowing rent increases up to 50% AMI will not generate enough cash flow to enable the project to fund the capital improvements. The vacancy rate has historically been low and with low turnover, there is not much opportunity to raise the rents. Phasing in a small increase each year for existing tenants will likely not generate enough funds either.

Alternatives
City Council could elect not to allow Woodland Associates, Inc. to modify these loans and associated documents. This alternative would almost certainly ensure that the projects would not remain affordable to tenants at or below 50% to 60% of Area Median Income

Financial Impact
The financial impact on the City of reducing the interest only payments on the Rockwood loan is a reduction of $10,000.00/year income to the City and the principal loan forgiveness of $23,987/year will result in a loss of repayment of $311,831.00 at the end of the loan term, leaving a remaining balloon payment due of $639,169.00.

The increase in the principal loan forgiveness to $27,029.17/year for the Mutual Manor loan will result in a loss of repayment in the amount of $324,350.00 at the end of the loan term, leaving a remaining balloon payment due of $374,300.00.

SDBE Summary
N/A