DURHAM

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CITY OF MEDICINE

CITY OF DURHAM | NORTH CAROLINA

Date: **May 28, 2013**

To: **Thomas J. Bonfield, City Manager**
Through: **Keith Chadwell, Deputy City Manager**
From: **Reginald J. Johnson, Director**
Department of Community Development
Subject: **Approval of the Assignment, Assumption and Modification of the Loan to Preiss-Steele Place Housing, Inc.**

Executive Summary

Development Ventures Incorporated (DVI) a nonprofit subsidiary of the Durham Housing Authority ("DHA") was awarded low-income housing tax credits ("LIHTCs") by the North Carolina Housing Finance Agency (NCHFA) in 2012 for the rehabilitation of Preiss-Steele Place Apartments. Preiss-Steele Place Apartments, located at 500 Pickwick Trail, Durham, North Carolina 27704, is home to 102 elderly and disabled individuals whose incomes are at 60% or less than the area median income.

The current owner is Preiss-Steele Place Housing, Inc., also a nonprofit subsidiary of DHA. In order to take advantage of the tax credits, the current owner must sell the project to a for-profit entity to syndicate the tax credits. As of the date of the application for tax credits, the City had an existing loan to the project in the amount of $1,512,122.00, which loan continues to be serviced by the current owner. The estimated balance of the City's loan as of June 15, 2013 is $1,450,792.92. The Developer, DVI, is requesting the City to allow the new for-profit owner of the project to assume the existing City loan, as modified by an Assignment, Assumption and Loan Modification Agreement in a form substantially similar to the draft attached hereto as Exhibit A.

Recommendation

The Department of Community Development recommends that the City Council authorize the City Manager to execute the Assignment, Assumption and Loan Modification Agreement in a form substantially similar to Exhibit A.

Background

The existing City loan is re-payable by the current owner as follows: (i) the annual interest payment is equal to one-half of one percent (0.5%) of the outstanding principal balance and is paid monthly. As of the date of the application for tax credits, the outstanding principal balance is $1,512,122.00, and the monthly interest payment is approximately $7,560.61. Pursuant to the existing promissory note, the principal balance is re-paid by the current owner from the cash flow of the project. However, there has not been any cash flow for years. Nonetheless, the current owner, with funds provided from DVI and DHA, has been paying much more than required by the promissory note during the years of negative cash flow. The principal portion of the payment has been approximately $58,998.00 on average for the past few years. The amounts have been as follows: FY2008- $45,776.00; FY2009-

$49,193.00; FY2010- $63,310.00; FY2011- $66,696.00 and FY2012- approximately $70,016.00. The entire outstanding principal balance of the existing loan is due, as a balloon payment, on December 31, 2013.

DVI is proposing that the City re-finance the existing mortgage by allowing the new for-profit owner to assume the existing mortgage, as modified by the Loan Modification Agreement attached. The Loan Modification Agreement allows removal of the requirement for the balloon payment in 2013. It will require payments to the City and NCHFA, pro rata based upon the relative sizes of their respective loans, from the net operating income of the project. The combined payment amounts will be based on the lesser of a loan payment equal to the payment based on a 30 year amortization with a 0% interest rate or a payment which maintains a debt coverage ratio of 1.15. A copy of the operating pro forma for the project depicting the approximate distribution of the net operating income is attached as Exhibit B. The City's 0% loan will be in a first lien position and provides for a balloon payment on the outstanding principal balance at the end of the 30 year loan term.

It is anticipated that the project financing will close in July 2013 and will be placed in service by December 2014. DVI is requesting that the City allow the current payments to cease on the date of closing and to allow payments by the new owner to begin on or before April 1, 2015, and on or before April 1 annually thereafter. DVI will submit audited financial statements which set forth the information for the calculation of the debt service coverage ratio.

In accordance with DVI's tax credit award, the current owner will sell the project to a new for-profit owner for $3,750,000.00. At closing, the current owner will receive $2,334,975.00 in cash and a promissory note for the balance of $1,476,354.00. The current owner will use the cash from the sale as follows: (i) pay its closing costs; (ii) pay off its existing mortgage to Community Investment Corporation of the Carolinas (CICCAR); (iii) pay off its existing mortgage to NCHFA; (iv) satisfy its accounts payable; (v) reimburse DVI in the amount of $359,613.00 as described below; (vi) reimburse DHA in the amount of $508,870.24 as described below; and (v) the balance (estimated to be $598,941.00 less the above referenced closing costs and accounts payable) to capitalize DVI for use in providing guaranties and working capital for the rehabilitation of Preiss-Steele Place Apartments and other affordable housing developments as described below.

DVI has transferred funds to Preiss-Steele Place for several years to keep the project afloat when the occupancy rates plummeted as a result of changes in the market for affordable housing. DVI has made the following transfers to the project totaling $359,613.00: (i) $221,131.00 in 2007; (ii) $73,482.00 in 2008; and $65,000.00 in 2009. While the project continues to be a valuable asset to the City, DVI's resources tapped out in 2009.

In the year 2010, the DHA made a loan to the project in the amount of $82,350.00 in order to replace portions of the HVAC system that suffered a catastrophic failure. From 2009 to 2012, the project has continued to operate at a loss and DHA has used its unrestricted funds to keep the project afloat. The debt to DHA for these years is approximately $426,520.24 as of December 31, 2012, broken down as follows: $98,831.30 for 2009 and prior; $80,637.61 for 2010; $181,431.88 for $2011; and $65,619.45 for 2012.

DVI must have assets to use for guaranties related to the rehabilitation of the project and other affordable housing projects that it creates and maintains. DVI is required to have a minimum liquidity equal to 10% of the equity investment for this and other affordable housing deals. The equity investment in this deal alone is approximately $4,251,538.00, which means that DVI will need to show cash/liquidity in the amount of $425,153.00 in order to close on the equity with the equity investor.

DHA has recently been awarded a Rental Assistance Demonstration ("RAD") award from HUD for the rehabilitation of its Morreene Road public housing community. DVI will act as the developer of that project as well, and utilize the 4% LIHTCs to raise equity in the amount of $1,825,000.00. It is anticipated that the equity investor will have similar liquidity requirements, and if so, will require that DVI have $182,500.00 in liquidity.

In summary, the existing owner, Preiss Steele Place Housing, Inc., a nonprofit subsidiary of DHA, will sell the project to a new for-profit owner for $3,750,000.00. The current owner will receive $2,334,975.00 in cash and a promissory note for the balance of $1,476,354.00. The current owner will use the cash as follows: (i) pay its closing costs; (ii) pay off existing mortgage to CICCAR; (iii) pay off existing mortgage to NCHFA; (iv) satisfy its accounts payable; (v) reimburse DVI in the amount of $359,613.00; (vi) reimburse DHA in the amount of $508,870.24; and (v) capitalize DVI with the balance (estimated to be $598,941.00 less the above referenced closing costs and accounts payable) for use in providing guaranties and working capital for its affordable housing creation.

After paying its debts and winding up its affairs, the current owner will dissolve at the appropriate time. DVI will use the sales proceeds to develop other affordable housing in Durham for families earning 80% or less than the area medium income. DHA will use the $508,870.24 owed to it from the project primarily to house families in the City of Durham living below the poverty line.

Issues and Analysis

The new funding sources for the project will include the following:

Source	
City Loan	$1,450,793.00
RPP Loan (NCHFA)	$1,000,000.00
Seller Financing	$1,476,354.00
State Tax Credit Loan	$424,594.00
Equity (Tax Credit Syndication)	$4,152,662.00
Deferred Developer Fees	$47,652.00
Existing Replacement Reserves	$65,412.00
Total	$8,617,467.00

Since both the City and NCHFA will have loans on the project after rehabilitation, the City has required DVI to negotiate with NCHFA to make sure that the City's loan is treated at least as favorable as the RPP loan from NCHFA. DVI made such a request on February 18, 2013, and NCHFA agreed to do so on March 22, 2013. Copies of both letters are attached.

Alternatives

An alternative to the proposed assignment, assumption and modification would be the pay off of the City's loan at closing and the origination of a new loan to the new ownership entity.

However, this alternative would not provide for the distribution of sales proceeds desired by DVI.

Financial Impact
Based on a fixed amortization of the City's loan at 0% and a term of 30 years, the annual loan payment to the City would be approximately $48,360.00. With the loan structured as a cash flow loan, the annual loan payment to the City during the early operating years will be only slightly lower and then dropping to less than $40,000.00 annually in 2024 and less than $30,000.00 annually in 2031. Because of the original funding source, loan repayments will be considered housing bond program income.

Attachments
Exhibit A – Draft Loan Modification Agreement
Exhibit B – Projected Cash Flows
Request to NCHFA
NCHFA Approval March 2013