DURHAM
1869
CITY OF MEDICINE

**CITY OF DURHAM** | NORTH CAROLINA

**Date:** **August 19, 2014**

**To:** **Thomas J. Bonfield, City Manager**
**Through:** **Keith Chadwell, Deputy City Manager**
**From:** **Reginald J. Johnson, Director**
**Department of Community Development**
**Subject:** **Award of Dedicated Housing Funds to Vermilion Homestead, LLC, a 60 unit Affordable Rental Townhome Community**

## Executive Summary

In response to the City of Durham's application for funding of CDBG, HOME, ESG and General Funds for FY 2014-2015, Workforce Homestead, Inc. submitted an application for a subsidized loan using Dedicated Housing Funds in the amount of $193,506.00 to provide gap financing for a 60 unit affordable townhome style community. These units will be constructed on Cook Road at Martin Luther King Jr. Parkway, comprised of two and three bedroom units and will be available to individuals and families whose income does not exceed 30%, 50% and 60% of the area median income.

On July 24, 2014 the City Council received a presentation from the Department and the Developer. In response to Council's request, additional financial information is attached to this item, along with the proposed loan documents. The following financial information is attached: Attachment "A" Project Development Costs, Attachment "B" Summary of Permanent Funding Sources, Attachment "C" Cash Flow Analysis and Attachment "D" Unit Mix and Rent Structure.

## Recommendation

The Department of Community Development recommends that City Council authorize the expenditure $193,506.00 in budgeted Dedicated Housing Funds for the purpose of creating 60 affordable housing units, and authorize the City Manager to execute a Construction/Permanent Loan Agreement and related legal documents for a period of 20 years at 1% interest with Vermilion Homestead, LLC.

## Background

The Annual Action Plan presented to City Council on May 5, 2014, included a recommendation by the DCD to fund the Vermilion project with a $193,506.00 loan using Dedicated Housing Funds. This funding was requested by Workforce Homestead, Inc. as a part of the competitive application process for CDBG, HOME, ESG and Dedicated Housing Funds. If approved by Council, the funding would leverage $7,651,325.00 in other investment.

The project developer applied for and received an award of 2013 Low Income Housing Tax Credits. At the time of the tax credit reservation, the developer anticipated obtaining a first mortgage loan in the amount of $2,412,000.00 from the Community Investment Corporation of the Carolinas (CICCAR). However, the appraisal prepared for CICCAR supported only a $2,160,000.00 first mortgage loan amount. CICCAR's lending guidelines limit their first mortgage loans for such projects to 75% of the restricted income appraised value. Also, since the time of the tax credit reservation, the equity pricing increased by $157,484.00, but additional site costs estimated at $150,000.00 resulted in a funding gap of approximately $298,546.00, which is shown on the Summary of Permanent Funding Sources as deferred developer fee. Should the project experience any additional cost overruns in excess of the construction contingency, the developer fee is the only source of funds available to cover any shortfall. Investors and syndicators are concerned that if the deferred developer's fee is too large, there may not be sufficient funds available to complete the project. Therefore, the developer requested assistance from the City of $193,506.00 (which was estimated at the time of application for City funding and prior to receiving all of the site development increased costs) to help close that gap and reduce the deferred developer fee to $105,040.00.

**Issues/Analysis**

The developer is maximizing all other available funding sources. In addition to the first mortgage loan, financing sources include an $800,000.00 Rental Production Program (RPP) loan from NCHFA, State Tax Credits of $694,174.00, LIHTC equity in the amount of $3,892,111.00 and a deferred developer's fee of $105,040.00. The proposed City loan and the RPP loans were initially projected to be at 2% interest, but NCHFA revised their interest rate to 1%, and since the City loan is not permitted to be at a higher interest rate than the RPP loan, we have adjusted the City loan interest rate to 1% to conform. Both loans will be repaid from project cash flow on a proportionate basis. Repayment of the City loan is projected to be $3,006.00 in year one, increasing to $5,092.00 in year 20, for a total of $89,914.00 repaid over the 20 year term. The reduction in the interest rate will not affect the annual repayment amount to the City, but the balloon payment at the end of the 20 year loan term will be reduced.

The project is located outside an area of low income or minority concentration and is therefore in compliance with the City's subsidized housing location policy. It is well located in terms of proximity to employment opportunities and commercial facilities. The location is served by DATA Route 5K and a sheltered bus stop is nearby.

Six units will be set aside to serve persons who are homeless, or who have disabilities. Vermilion will enter into a Memorandum of Understanding (MOU) with a local lead agency and will submit a Targeting Plan for review and certification by the NC Department of Health and Human Services (DHHS). Additionally, an MOU between the developer, lead agency and management agent will include: 1. A commitment from the local lead agency to provide, coordinate and/or act as a referral agent to assure that supportive services will be available to the targeted tenants. 2.

The referral and screening process that will be used to refer tenants to the project, the screening criteria that will be used, and the willingness of all the parties to negotiate reasonable accommodations to facilitate the admittance of person with disabilities into the project. 3. A communications plan between the project management and the local lead agency that will accommodate staff turnover and assure continuing linkages between the project and the local lead agency for the duration of the compliance period.

**Alternatives**
If the funding is not approved by Council, it will be necessary to increase the amount of the developer's fee that is deferred. Should the project experience cost overruns in excess of the construction contingency, the developer fee is the only source of funds available to cover any shortfall. Investors and syndicators are concerned that if the deferred developer's fee is too large, there may not be sufficient funds available to complete the project. In addition, any deferred developer's fee must be repaid from cash flow during the 15 year compliance period, or it can be deemed a "grant" by the IRS, not be eligible for tax credits, and result in a payback to the investors of forfeited tax credits. If the funding is not approved by Council, repaying the deferred developer fee, projected to be $298,546.00, from available cash flow, would place an increased financial strain on the project.

Another alternative is that Council could elect to provide a lesser amount of funding, but that too, would have a negative impact on the financial structure of the project.

**Financial Impact**
Dedicated Housing Funds specifically designated for the creation or preservation of affordable housing are budgeted and available for this project.

**SDBE Summary**
Goals for this project have been set by the Office of Equal Opportunity/Equity Assurance at 15% for minority SDBE participation and at 7% for women's SDBE participation.

**Attachments:**
Attachment "A" Project Development Costs
Attachment "B" Summary of Permanent Funding Sources -Revised
Attachment "C" Cash Flow Analysis
Attachment "D" Unit Mix and Rent Structure