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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: **Rebuild Durham, Inc. Loan Amendment**

Executive Summary
In June of 2012, City Council authorized the expenditure of $366,322.85 in housing bond Program income in the form of reimbursement to the U.S. Department of Housing and Urban Development as a result of non-compliance with the requirements of the Home Investment Partnership (HOME) program by Rebuild Durham, Inc. (RDI). Areas of non-compliance were the failure to keep HOME-assisted properties in a good state of repair and occupied and shortcomings in properly maintaining file documentation. At that time, RDI held 13 properties in its portfolio, four of which were vacant.

Although the HOME funds have been repaid, the loan agreement between RDI and the City continues to reference the HOME program and the original loan terms. The proposed loan amendment will defer the payment of the remaining City loan balances until the future sale of each property.

Since the loan amendment was last considered by Council, RDI has continued to make significant investments into the properties that it owns. RDI was able to do so as a result of a significant loan modification from the first mortgage holder (SunTrust) and utilization of rental income that would have otherwise been repaid to the City.

Recommendation
The Department of Community Development (DCD) recommends that City Council authorize the City Manager to execute the fourth amendment to Deeds of Trust and CHDO Loan Agreement with Rebuild Durham, Inc. and related documents for twelve RDI properties.

Background
Rebuild Durham was formed for the purpose of returning vacant properties in need of repair back to the available stock of affordable housing. Although having a worthwhile and noble purpose, the organization's financial model proved to be unsustainable to support the project. Put simply, a relatively small number of affordable rental units cannot generate sufficient income to cover debt service, organizational expenses and the maintenance and upkeep of those units. This was the case for the RDI project.

The City initially entered into a $410,000.00 loan agreement with RDI in August of 2000 for the purchase and rehabilitation of single family homes to be made available to renters having incomes at or below 60% of the area median income (AMI). Subsequently, in August 2003,

the City loaned RDI an additional $350,000.00 to enable them to cumulatively acquire and rehabilitate a total of 13 homes. The loans were structured such that upon completion of individual units, RDI would obtain a first mortgage loan from Central Carolina Bank (CCB) and repay the City an equal amount (typically around $35,000.00). The balance of the funds loaned on per unit basis (also around $35,000.00) became a second position loan at 0% to be amortized over 30 years.

By 2006, RDI had acquired and rehabilitated 12 properties. City Council approved an amendment to the original RDI loan agreement extending the timeframe for the acquisition and rehabilitation of the 13th property to March 2007. At that time, RDI was fully in compliance with the requirements of the HOME program, its properties were in a good state of repair and occupied and the organization had a full time Executive Director. Some months after the 13th property was completed in 2007, RDI dismissed its Executive Director and responsibility for day to day operations was left to the Board of Directors.

Project monitoring by staff in June 2008 found that RDI files continued to be in fairly good order with the only area of non-compliance being failure to recertify tenant income on an annual basis. Department staff offered and provided technical assistance. As less experienced Board members became increasingly involved however, non-compliance issues became more commonplace.

When HUD staff conducted a monitoring visit in April 2009, a windshield survey of the RDI properties found one of the properties to be vacant and open. As a result of that incident and the Department's concerns relative to capacity, HUD recommended that the Department develop a work-out plan with the Board of Directors. Later, after meetings with Board members which did not prove productive, the Department sent a letter to RDI in October 2009 requesting the non-profit sell its portfolio on the open market, convey the properties to another non-profit or contract for property management services with an entity having experience with federally-assisted rental property. The follow-up to that letter was a December 2009 meeting with the Board of Directors who agreed to have a work out plan in place by February 2010 that would involve either hiring a part time Executive Director or contracting for property management services. Finally, in the fall of 2010, RDI contracted with Ms. Edythe Thompson to serve as Part Time Executive Director.

Issues and Analysis

At the time that Ms. Thompson began her duties, she faced challenges on several fronts. After years without adequate funding of replacement reserves, a limited number of the properties had become unsuitable for occupancy and some had been cited for Minimum Housing Code violations. At the same time, RDI was struggling to remain current in loan payments to SunTrust and the City. (SunTrust absorbed CCB which was the original first mortgage lender.) Because of a high vacancy rate and substantial deferred property maintenance needs, one of Ms. Thompson's first actions was to secure a loan modification from SunTrust. What this modification did was to set aside 60% of RDI's outstanding first mortgage loan balance for approximately 30 years from the original loan date and reduce the interest rate to 4.5%.

In September 2011, RDI ceased making loan payments to the City. With the funds that would have otherwise been repaid to SunTrust or the City, Ms. Thompson began undertaking repairs to the non-profit's portfolio. In 2012, repairs totaling $17,598.58 were completed and in 2013, another $25,855.64 in repairs was completed. Through July 30, 2014, repairs totaling $6,285.11 have been completed.

With the transfer of 110 Chestnut Street located within the Southside project area to the City, RDI's portfolio now consists of 12 properties. Ten of those properties are in a good state of repair and occupied, in some cases by long term tenants. At the City's request, RDI did assess selling one of the un-occupied properties – 1508 W. Club Boulevard. The independent market analysis indicated that a likely sales price would be in the range of $40,000.00 to $42,000.00. Between SunTrust and the City, the existing debt on the property is $42,000.00 and RDI therefore opted to retain the property and undertake the needed repairs. Based on existing cash flows from other properties, RDI anticipates having needed repairs completed and the property re-occupied in approximately twelve months. A four-phased approach to completing the required repairs is attached. In the interim, RDI is keeping the exterior relatively well-maintained and the grass cut.

The other vacant property is 2534 S. Alston Avenue. When RDI bought the property, the home shared a private well with an adjacent property. That well has since failed and the extension of public water to that location is still a matter of years away. Nonetheless, that part of Durham is beginning to experience some development activity which could positively impact the property's value on the long term. In the interim, RDI is land banking the property and is keeping the exterior in a condition on par with and in some instances, better than other nearby properties. In addition to lacking water, the primary physical deficiency is the need for a new HVAC system. It should be noted that the property cannot be occupied until there is a water supply regardless of ownership. Based on information provided by RDI, the Department believes that RDI can handle the carrying costs associated with the S. Alston and W. Club properties.

The fourth amendment to Deeds of Trust and CHDO Loan Agreement with RDI will defer the City's existing outstanding loan balances until the future sale of each property. The expiration of the SunTrust deferral period is likely a trigger that would compel RDI to divest itself of its portfolio.

During the deferral period, RDI must continue to serve low to moderate income renters. Additionally, RDI will be required to demonstrate that funds equal to what would have been annual loan payments to the City are either being invested directly into property improvements or into a replacement reserve for future needs. The amendment also requires RDI to complete needed improvements to the Club Boulevard property within one year of execution. The Department will monitor RDI for compliance with these requirements.

Alternatives
Given that there are already loan terms in place with which RDI is default as a result of ceasing to make payments, one alternative, which the Department does not recommend, is to take no action. The proposed amendment recognizes that it is not feasible for RDI to resume loan payments to the City and formalizes the conditions under which RDI will continue to provide affordable rental housing in a compliant manner.

Financial Impact
If RDI was making loan payments to the City on the 12 properties it owns, that annual sum would equate to $13,968.00. The total City loan amount subject to the deferral is $308,526.10.

SDBE Summary
Not applicable.

Attachments
Amendment to Deeds of Trust and CHDO Loan Agreement
1508 Club Boulevard Building Assessment
PowerPoint – 12 RDI Properties