

Memorandum



DATE November 18, 2008

TO Members of the Economic Development Committee: Ron Natinsky (Chair), Tennell Atkins (Vice Chair), Jerry R. Allen, Dwaine Caraway, Sheffie Kadane, Linda Koop, Mitchell Rasansky and Steve Salazar

SUBJECT **Community Development Block Grant Section 108 Loan Application Authorization**

On Thursday, November 20, 2008, the Economic Development Committee will be briefed on Community Development Block Grant Section 108 Loan Application Authorization. A copy of the briefing is attached

Please let me know if you have any questions.



A.C. Gonzalez
Assistant City Manager

C: Mary K. Suhm, City Manager
Ryan S. Evans, First Assistant City Manager
Deborah Watkins, City Secretary
Tom P. Perkins, Jr., City Attorney
Craig Kinton, City Auditor
Judge C. Victor Lander, Judiciary
Ramon Miguez, P.E., Assistant City Manager
Jill Jordan, P.E., Assistant City Manager
Forest Turner, Interim Assistant City Manager
David Cook, Chief Financial Officer
Jeanne Chipperfield, Budget Director, Office of Financial Services
Karl Zavitkovsky, Director, Office of Economic Development
Hammond Perot, Assistant Director, Office of Economic Development
Lee McKinney, Assistant Director, Office of Economic Development
Helena Stevens Thompson, Assistant to the City Manager

Community Development Block Grant Section 108 Loan Application Authorization

**A Briefing to the
Economic Development Committee**

Economic Development and Housing Department

November 20, 2008



Purpose

To brief Housing Committee and Economic Development Committee regarding Community Development Block Grant Section 108 Loan Program

The Need for Action

- Capital funding is less available
- Banks are not willing to loan as much against collateral
- Interest rates for available funding has increased
- This deteriorating financial climate leaves the City with the crucial decision
 - Should we wait it out on the sidelines, or
 - Develop creative solutions to keep momentum going in the growth prone areas and stimulate investment in more challenged areas

Ideas Worth Investigating

- While the focus of today's briefing is on HUD's Section 108, this program represents the first of several financing mechanisms staff is exploring that may assist projects in this difficult capital market
 - Emergency Housing and Economic Recovery Bonds
 - Public financing of major venues
 - Municipal Management District
 - More aggressive use of PID'S

Risks

- Greatest risk to the City's economic health is to do nothing
- As we pursue each of these programs, our goals will be to
 - minimize any exposure to the City, but there always will be some risk
 - enhance projects' fundability to create real projects, but these programs may not insure success
- What is certain
 - Our inaction will mean several projects contemplated for the City will not move forward

History of Intown Housing Program/ Section 108 Loan

- In 1995, City borrowed \$25M in mezzanine financing to implement the Intown Housing Program, which
 - Encouraged residential and economic development in and around the Central Business District and made available project financing assistance using Section 108 loan funds, tax abatements, infrastructure cost participation and development fee rebate incentives
 - Promoted the development of affordable housing in these areas with a 20% requirement for families at 80% of Area Median Family Income
- Seven projects were completed:
 - Kirby Building, Santa Fe Lofts, Majestic Lofts, and Davis Building – Downtown
 - Deep Ellum Lofts and Treymore at Cityplace – Deep Ellum/East Dallas Area
 - Eban Village – South Dallas/Fair Park Area
- January 2006, the \$25M was paid off

History of Intown Housing Program/ Section 108 Loan (cont.)

- Advantages to use of Section 108 loan funds
 - Accelerated the redevelopment of downtown bringing needed residential to the area
 - Produced 1,088 units and leveraged over \$114M in private investment of which 218 units were affordable to families at 80% of Area Median Family Income
- Disadvantages
 - 46% of Section 108 loan repayments were made from loans to developers
 - 54% of Section 108 loan repayments were made with CDBG entitlement grant funds
 - CDBG funds were required to fund repayment because of negative amortization of development loan payments

Section 108 Loan Overview

- Provides communities with a source of financing for economic development, large-scale physical development projects, public facilities and housing rehabilitation
- Eligible activities include:
 - Economic development activities eligible under CDBG
 - Acquisition of real property
 - Rehabilitation of publicly owned real property
 - Construction, reconstruction, or installation of public facilities
 - Related relocation, clearance and site improvements
- CDBG affordability requirements govern
- The maximum repayment period for a Section 108 loan is 20 years

Section 108 Loan Overview (cont.)

- The loan can be structured to match the needs of the project(s) and the City
- Interest rate
 - Each loan amount has a separate interest rate
 - Rates on interim borrowing is priced at 3 month London Interbank Offered (LIBO) rate plus 20 basis points (0.2%)
 - Rates on permanent financing are pegged to yields on U.S. Treasury obligations of similar maturity to the principal amount with a small additional basis point spread, depending on maturity, added to the Treasury yield
- Section 108 obligations are financed through underwritten public offerings
- The loan is secured through a pledge of current and future CDBG funds

Section 108 Loan Overview (cont.)

- Requires an affordability component that is in direct proportion of 108 funds used to total project cost which encourages mixed income developments
 - For example, a total project cost of \$40M that has a \$10M Section 108 loan would be required to have a 25% affordability requirement

Section 108 Loan Overview (cont.)

- Application Process
 - Made through the local Fort Worth HUD office for a due diligence and compliance review
 - Is then forwarded to HUD headquarters in Washington D.C. along with recommendation of approval or disapproval
 - HUD headquarters examines the requested loan terms and security offered above the required pledge of CDBG entitlement funding
 - If approved, it is forwarded to the Secretary of HUD for final approval and release
- The length of time the application process takes depends on the individual application

Proposed Strategy

- Use the Section 108 to provide project gap financing or mezzanine debt necessary to move projects forward in today's financial market
- Minimize (if not eliminate) the risk to the CDBG program revenue
- Set guidelines by which the funds would be used

Minimize Risk to CDBG Entitlement

- Match Section 108 loan repayments to repayments from City's borrower(s)
- Annual repayment of Section 108 loans to be credit enhanced to eliminate risk of City making payments from annual CDBG allocations
 - An additional credit enhancement will be required to provide additional collateral support, as required, to insure that interest and/or principal can be repaid in the event that the refinancing is insufficient to repay both the first and second liens
 - If the first lien mortgage financing doesn't include an interest reserve during the period construction, redevelopment and lease up, additional credit support will be required

Minimize Risk to CDBG Entitlement (cont.)

- Require total loan balance, including first liens, not to exceed 85% of the lower of total cost or appraised value of the completed stabilized project
- Use Section 108 funding as a mezzanine refunding piece
- Require 100% return of investment on every project within 3 – 5 years of initial loan with exit strategy:
 - 18 to 24 month mini perm for lease up
 - 3 – 5 years for project stabilization
 - City's equity is recovered when senior loan is refinanced into permanent project loan

Other Proposed Guidelines

- Identify, structure, and recommend only projects where there will be no use of CDBG entitlement grant to make Section 108 loan repayments
- Insure that 50% of the funding be included for the Southern Sector projects
- Must include an affordability plan for housing investment
- Projects can be mixed-use or housing
- Minimum private investment of \$30 M
- Must meet all HUD Section 108 requirements

Projects in Discussion

- Fair Park Area
- Lancaster Corridor
- North Oak Cliff
- Deep Ellum

Process

- Seek Housing Committee approval to move forward with Section 108 loan application process
- If approved, begin process, begin
 - Project plans development
 - Program Guideline development
 - Citizen Participation planning
 - Setting of Public Hearings
- Submit formal application to HUD
- Throughout process,
 - City will need to follow HUD's required public participation plan to provide public notice and public hearings to receive citizen input to the proposed plan and the final plan for use of funds for identified individual projects
 - City Attorney's office will be reviewing steps taken helping staff to ensure total compliance with HUD regulations

Recommendation

- City Council approve application to HUD for up to \$75M in Section 108 individual project loan funds

Next Steps

- January 5, 2008 – brief Housing Committee on
 - HUD's public participation process
 - Program guidelines
- January 28, 2009 – City Council Action Item approving City Manager to apply for up to \$75M in individual project Section 108 loans