Investing in Portland's Future

PDC PORTLAND DEVELOPMENT COMMISSION

Portland Development Commission Loan Review Committee Recommendation & Approval Form

Meeting Date: 5/8/2008

☒ I am the Project Manager
☐ I am NOT the Project Manager

Project Name: MLK-WYGANT

Business Name: MLK -WYGANT HOUSING, LLC

Address: 4606 NE Martin Luther King Jr, Blvd City: Portland Zip Code: 97211

Presenter: John Marshall Extension: 03232

Department: Housing Section: HDF

☐ **THIS IS A "NO ACTION" ITEM – INFORMATION ONLY**

ACTION REQUESTED: *(150 character limit)*
Approve amendment and restatement of Regulatory Agreement and recommend approval of extension of tax abatment to Planning Commission

The exceptions/special requests are found on Page: ________ ☒ There are no exceptions.

Approved Loan Deferrals **START** Date: ________ Approved Loan Deferrals **END** Date: ________

Department Director's Endorsement: Komi P. Kalevor
I support and agree this item should go forward to the Loan Review Committee.
Director *or* Division Manager signature required before submitting to LRC for review and recommendation.

Loan Committee Members – initial for recommendation *(3 members required before sending forward)*

☑ **Approval Recommended** to Executive Director – move forward for signature
☐ **No Approval Recommended** to Executive Director – move forward for concurrence
☐ **Defer to Next Meeting** – Amendments/Corrections to be completed – return to Presenter
☐ **Approval Recommended to Commission** – forward for signature

JVC ________ Julie V. Cody, Chief Financial Officer & Loan Review Committee Chair
________ David Elott, Interim General Counsel
BA ________ Bruce Allen, Sr. Development Manager (Special Projects)
________ Fred Atiemo, Business Finance Manager
________ Komi Kalevor, Interim Housing Director
AB ________ Alfred Bookman, Division Manager, Asset Management & Credit Administration

☑ **APPROVED** ☐ **NOT APPROVED**

Bruce A. Warner, Executive Director J. L. Jackley for Bruce A. Warner

Date signed: May 12, 2008

☑ *Check here if you are "Acting" for Executive Director.*

LOAN COMMITTEE APPROVAL FOR MLK- Wygant Housing, LLC
Submitted by: John Marshall

ACTION REQUESTED:

Approve amendment and restatement of regulatory agreement for MLK Wygant property if tax abatement extension is approved by City Council and recommend extension of tax abatement to Planning Commission

SUMMARY:

MLK -Wygant (Project) is a mixed use affordable rental housing project funded by PDC in 1996-97. It has 3 three-story wood frame buildings with 38 rental units focusing on families (71% are 2 BR or larger) and 1800 SF of commercial space. PDC's affordability agreements restrict 8 units at 50% MFI. The owner has voluntarily kept the project entirely affordable serving tenants with average incomes of 43% MFI at average rents of 47% MFI in a market where rents could be $200 to $300 higher per unit because of market gentrification.

The property's 10-year property tax abatement under the 3.104 Multiple Unit Program expires in June 2008. A city ordinance currently requires that new applications must be 100% affordable to be eligible for a 3.104 tax abatement. It is ambiguous whether projects must be completely affordable to be eligible to obtain an extension of the tax abatement. The likelihood of the City Council or the County Assessor denying the tax abatement extension is minimal if the project is fully affordable.

In light of this, the owner has agreed to make the housing entirely affordable for the remainder of the term of the POC loan (February 2027) to obtain an extension of the 3.104 tax abatement because the current rents can not cover operating expenses and property taxes. This will not require any new PDC funds.

FINANCE REQUEST:

Dollar amount – zero

PRIORITY TARGET:

Family	Yes
Special Needs	No
Mixed Income	Yes
Mixed Use/Commercial	Yes

PROPOSED UNIT BREAKDOWN
(Count and affordability)

One BR	11	8@ 50%; 3@ 60%
Two BR	14	14@60%
Three BR	10	12@60%
Four BR	2	2@60%
TOTAL UNITS	**38**	**30@60%; 8@ 50%**

COLLATERAL:
2007 assessed value $2,680,180
(Land/improvements)

RELATED DEBT

Number of Loans	2
Dollars outstanding	$811,600
Paid as agreed	Yes
Deferral/Restructure	N/A
# of projects on Watchlist	0

SPONSOR CAPACITY:
Very good – sponsor has managed the properties without issue

OWNERSHIP TEAM:

Senior Lender	State of Oregon Risk Share
Property Manager:	Self Managed
Owner:	MLK-Wygant Housing, LLC
Subordinate Lender:	PDC

Investing in Portland's Future

PDC
PORTLAND DEVELOPMENT COMMISSION

PORTLAND DEVELOPMENT COMMISSION
INTERNAL MEMORANDUM

DATE:	May 8, 2008
FROM:	John Marshall, HDF, Team 3
TO:	Loan Review Committee
SUBJECT:	Approve amendment and restatement of regulatory agreement to restrict all residential units and recommend extension of tax abatement to Planning Commission for MLK-Wygant located at 4606 NE Martin Luther king, Jr. Boulevard in the King neighborhood of Northeast Portland

PROJECT DESCRIPTION/BACKGROUND:

The MLK-Wygant (Project) is an affordable three story project consisting of three buildings with 38 rental units. The Project was built in 1997 and has 11 one-bedroom units; 14 two-bedroom units; 10 three-bedroom units; and 2 four-bedroom units. It has a laundry room, 1800 square feet of ground floor commercial space, and 25 onsite parking spaces. It is located on Martin Luther King Jr Blvd, which provides access to mass transportation.

The Project was built on land owned by PDC after a competitive RFP process to select a developer that would develop a mixed use housing project in partnership with the King Neighborhood Association. It should be noted that this market, which is still challenging in 2008, was a much greater risk twelve years ago when the Project was built.

The owner, MLK-Wygant Housing LLC is a for-profit business comprised of Jane Olberding, Chris Diloreto, and Mark Jacobs. Jane Olberding has 29 years of experience in housing development and management. She has built and managed several affordable rental projects in North and Northeast Portland and founded Fair City Housing in 1987. Chris DiLoreto is a local architect who has worked with Jane for years. Mark Jacobs is a general contractor who developed housing and retail projects in the Portland Metropolitan area.

The owner funded 9.2% of the development cost, much greater than the average non profit's contribution to affordable rental projects. The Project has an Oregon Risk Share loan of$1,630,000 with annual debt service of approximately $133,000, a PDC $450,000 loan with annual debt service of approximately $22,800, and a $361,600 Equity Gap contribution that is repaid from Excess Cash flow greater than a 1.15 DCR.

Property taxes on the improvements are abated until June 30, 2008 at which point they will begin at a minimum of$35,709 per year. The taxes could be substantially higher if the property is reassessed after it loses the tax abatement. Loan Review Committee MLK Wygant Tax Abatement Extension

FINANCIAL:

PDC coordinates with the Planning Bureau, which makes a presentation to the City Council after PDC completes a financial analysis when owners request a new tax abatement or extension. The threshold test is to ascertain whether the property needs the tax abatement and the tax abatement should not result in the owner earning more than a 10% Internal Rate of Return.

The 2008 proforma (Attachment 1) uses the 2008 budget developed by the owner and Oregon Housing and Community Services (OHCS), the senior lender. Minor adjustments were made (increasing replacement reserves from $163 per unit to $300 per unit-appropriate for a mature project with large bedroom configurations) and lowering administrative costs because rent certification costs will be less than initially estimated. The proforma has total operating costs of $163,093 or $4,292 per unit, which is slightly lower than the OHCS budget at $168,073. Proforma operating expenses of $4,292 per unit are comparable to reports to PDC from other mature affordable housing projects with large bedroom configurations. Future expenses are increased at 3% per year.

The income in the proforma is based upon the MLK-Wygant current rent roll. These rents average 47% MFI because the owner has voluntarily kept them low in spite of the ability to charge an additional $200 to $350 per unit on the unrestricted units because the market has gentrified and the Project is well maintained. The analysis is based upon income from 8 one bedroom units restricted at 50% and the remaining units restricted at 60% MFI.

The owner has agreed to make the housing at the Project 100% affordable for the remainder of the term of the PDC loan (February 2027), if the tax abatement extension is approved by City Council. Future income is increased at 3% per year rather than the standard 2%, because it is anticipated that higher rents will be implemented gradually at tenant turnover. If the owner raised the rents substantially in excess of 3% per year and stays below the maximum allowed rents for the restricted units a 10% internal rate of return could be exceeded. However, this will be ascertained by the annual reviews PDC is tasked with and could result in creating an accrued payment liability obligation by the owner, or an extension of the affordability period under an Extended Use Agreement. In addition, the County Assessor could terminate the tax abatement. A 4% vacancy is projected because MLK-Wygant has historically been very well managed with little vacancy loss upon turnover and low bad debt losses. This produces net operating income very close to the OHCS/owner budget (proforma at $174,682 compared to $175,891 in the OHCS/owner budget).

SUMMARY:

An extension of the abatement is necessary for the property to remain affordable and maintain its debt service payments. The internal rate of return analysis shows the return to the owner is 1.830/0 with the full tax abatement. This low return is caused by several factors:

1. MLK-Wygant has a larger capital investment ($250,180 =9.2% of total development cost) than most affordable properties;
2. In 2008 and 2009, the owner funded capital expenditures to complete major moisture repairs, which reduced cash flow to nominal amounts in the first two years;
3. MLK-Wygant services real debt to the state and PDC;
4. Rents are restricted/do not increase to market rents during the period of analysis because of the PDC Regulatory Agreement that restricts all housing units until February 2027;
5. Past history in Portland indicates that purchasers of restricted affordable housing are nonprofits with the selling price being the outstanding debt plus costs to ensure the seller does incur tax obligations.

In essence, the PDC and OHCS affordable housing restrictions depress appreciation and prevent the owner from recovering more than the cash return in year 10 of the analysis because the owner will not be able to sell the property at market value until the affordability agreement expires in 2027. In addition, the owner will most likely have to fund major repairs from cash flow or unsecured credit lines that reduce cash flow because Regulatory Agreements limit equity that would be used as collateral to refinance capital repairs.

Property taxes are based upon the assessed value of the property increased by 3%. This produces property taxes starting at $35,709 or $940 per unit. Since there is a possibility the property could be revalued if MLK-Wygant's tax exemption is terminated, the estimated taxes used for the analysis are at the low end of the potential range. Higher property taxes would result in even greater losses, which could jeopardize the status of the 8 units that are restricted at 50% by the POC Regulatory Agreement. By using the lower end of the property tax range, it increases operating expenses by a minimum of$35,709; or 21% above current operating expenses. To offset this increase, the owner would have to increase rents $99 per unit per month on the unrestricted units. It is more likely the owner will seek a greater return since they have voluntarily operated with minimal returns on their investment in previous years. The consequence is rents on the unrestricted units could be increased by another $70 per unit to approach a 10% cash on cash return. The combined pass through of the property tax burden and a recapture of a reasonable return on investment could increase rents by 21% if a 10% cash return were the objective. This would result in immediate turnover of the current tenants whose average income is 43% MFI.

If the tax abatement is not extended, and rents remained at the same level the internal rate of return is negative 15.8. There would be no expectation of a positive return until the existing affordability agreements expire in 2027. Thus, it is logical to expect there would be a dramatic rise in rents. The City would lose 30 affordable units for annual tax revenue that is 92% of the average subsidy needed to create a single unit of new construction for the MFI levels being served at MLK-Wygant. The net present value of the forgone property tax during the term of the tax abatement is $500,454.

Current Unit Mix and Affordability:			**Proposed Unit Mix and Affordability:**		
One BR	11	8 @50%	One BR	11	8 @ 50%, 3 @ 600/0
Two BR	14	Unrestricted	Two BR	14	14 @60%
Three BR	10	Unrestricted	Three BR	10	12 @ 60%
Four BR	2	Unrestricted	Four BR	2	2 @ 60%
Total Units	**38**	Unrestricted	**Total Units**	**38**	38 @ 60%

RELOCATION:

N/A - However many affordable families will be displaced if the tax abatement is not extended because the owner will raise rents to pay for minimum 21% increase in operating costs. It is likely that families living in rental units that have been kept voluntarily affordable will be forced to leave on short notice. *(Most tenants are on month to month tenancies, so the displacement could be very rapid.)* At a minimum, the City will lose 30 units of affordable housing and there is no requirement or funding to help the tenants relocate.

FEDERAL COMPLIANCE:

N/A - No federal funding exists and none is being requested.

Give and Receive:	**Get**
• Extend multiple unit tax Preserve eight affordable units and create abatement through 30 additional affordable restricted February 2027.	• Preserve eight affordable units and create 30 additional affordable restricted units for term of PDC loan – through February 2027. • Preserve successful mixed use project on MLK Jr Blvd. • Encourage efficient property owners/managers to participate in providing affordable housing.

CONDITIONS:

If the tax abatement extension is approved by City Council, the Borrower will execute an amended and restated regulatory agreement for eight one-bedrooms at 50% MFI and all of the other units at 60% MFI for the remainder of the term of the PDC loan. In addition, PDC will also require an Extended Use Agreement that is required for all tax abatements after December 8, 2006.

EXCEPTIONS TO GUIDELINES:

None

RECOMMENDATION:

PDC staff recommends:

1. Amending and restating the regulatory agreement with eight units at 50% MFI and the rest at 60% MFI, and
2. PDC recommend extension of the tax abatement for the period of the PDC loan (February 2027) to the Planning Commission.

ATTACHMENTS:

1. Proforma- Full Abatement
2. Internal Rate of Return with Full Abatement = **1.83**
3. Proforma - No Abatement
4. Internal Rate of Return with No Abatement = **-15.16**
5. Proforma- Partial Abatement for 8 units
6. Internal Rate of Return with Partial Abatement 8 units restricted = 21% abatement = **-9.18%**