

CITY OF PORTLAND, OREGON

**PROJECT-SPECIFIC APPLICATION
FOR SECTION 108 LOAN GUARANTEE**

FROM

**U.S. DEPARTMENT OF HOUSING AND
URBAN DEVELOPMENT**

FOR

**LOS JARDINES APARTMENTS
5530 NE 60TH AVE, PORTLAND, OR**

**IN THE AMOUNT OF
\$400,000**

JULY 5, 2011

I. Project Description – Los Jardines

The property was built in 2002 and consists of nine (9) residential apartment buildings housing 43-units and one (1) two-story community building containing the leasing office with a 22-space garage and 21-surface parking spaces. This request is for one (1) residential building only (bldg F; 6-units). The remaining funding for the other nine (9) buildings is expected to be from current litigation between Hacienda Community development Corporation and Seabold Construction. The Portland Housing Bureau (PHB) has recommended that the sponsor develop a comprehensive financing plan that includes all of the existing lenders to repair the remaining nine (9) buildings. The project is in an existing low income housing tax credit (LIHTC) tax credit structure, with first tax credits drawn down in 2002 and its compliance period expires in 2017.

This funding request was made because the property requires rehabilitation due to alleged substandard construction practices for construction work performed by the project's general contractor, Seabold Construction and its subcontractors. The property received a certificate of occupancy in Fall 2002 and Hacienda initiated legal proceedings for \$4.4M in monetary damages against Seabold and its subcontractors in 2010. Hacienda's counsel, Ball Janik LLP (legal firm), is expecting a settlement offer in the \$2.2M range which is expected to net, after fees, \$1.95M to Hacienda, and could well be lower. The case is scheduled to begin arbitration through the American Arbitration Association in October 2011.

Ball Janik provided a legal time-line with associated fees to be completed in four phases:

- Phase 1 Summer 2010: Initial evaluation/research: legal expense incurred \$15,000
- Phase 2 Spring-Summer 2011: Pleadings/Discovery: legal expense incurred \$25,000; estimated legal expense to complete Phase 2 is \$84,000
- Phase 3 Summer-Fall 2011: Negotiation/Arbitration: Estimated legal expense \$210,000
- Phase 4 (if necessary) 2012: Trail: Estimated legal expense: \$130,000
- Potential Legal fees: \$477,000 plus percentage of settlement

Hacienda wishes to pursue work on one building pending the settlement of litigation on the entire project.

The project carries existing debt from the Network for Oregon Affordable Housing (NOAH) with a remaining balance of approximately \$1,454,666 that will have its maturity adjusted to be coterminous with the new Section 108 loan. In addition, the project has two existing subordinate loans from the Portland Housing Bureau:

Loan #	Orig Date	Orig Amt	Source	Int rate	Maturity	Payment	Collateral	Current prin bal
38268-02 ¹	8/17/01	346,793	HOME	3	1-1-33	1478/mo plus cash flow split	Trust deed	263,679
38269-02	8/17/01	344,562	HIF	0	Until repaid	Cash flow	EGC	344,562
		691,355						608,241

¹ This note was executed by Hacienda CDC and then loaned into the partnership, partnership is not the PHB Borrower
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These existing PHB loans will either be merged into one cash flow dependent unsecured note and carry a 0% interest rate, or left as separate, subordinate cash flow dependent notes. If left separate, the existing cash flow note may or may not experience an interest rate change, and changes to interest rate and structure of the existing amortizing note require the investor’s approval. The investor’s approval of the structure is at minimum a condition of closing; however the timing of obtaining the investor approval may not precede the HUD approval. Both existing PHB notes will subordinate to the Section 108 loan.

HACIENDA CDC

Hacienda CDC is a mission-driven nonprofit organization formed in 1993 “to improve the overall livability of low-income Hispanics by developing a permanent resource of decent and affordable housing, educational, economic development and related activities that benefit low-income Hispanics and others in the State of Oregon.” In addition to housing, Hacienda provides culturally-specific supportive services to enhance the lives of the residents and the surrounding community. Hacienda’s programs, provided by bilingual/bicultural staff, include afterschool programs for youth, adult education, healthy living classes, homeownership & foreclosure prevention counseling and economic development opportunities.

Hacienda currently owns and operates 400 units serving 2,000 low income individuals, 80 percent of whom are first or second generation immigrants including a large population of Somali Refugees. Residents typically earn far less than 30-60% of family median income for the area and 60% are school-aged youth. Hacienda also provides safe, secure and supportive housing for victims of domestic violence and their children.

DEVELOPMENT TEAM

The development team for the acquisition and remodel of the property will include: Catherine Kes, Hacienda’s Housing Development Director; Carleton Hart Architecture, a firm whose principals have years of experience as architects on numerous affordable housing and mixed use commercial projects; Forensic Building Consultants as the expert building envelope and waterproofing consultant. The recently selected general contractor is Horizon Restoration. A performance bond will be required.

II. Sources and Uses

A. Use of Proceeds:

USES	Permanent
Acquisition Costs	0
Construction Costs ²	304,382
Development Costs	62,618
Developer fee	33,000
TOTAL USES	400,000

² Includes 12% contingency
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B. Sources of Proceeds:

SOURCES	Rehab/Permanent
PHB Section 108 loan	400,000
TOTAL SOURCES	400,000

III. Conditions of Approval: Conditions of any commitment will include:

- **Verification of costs** – PHB will review an updated development budget based on the final rehab cost estimate for Building F and on the terms and structure of the final financing package.
- **Debt Coverage Ratio (DCR)** – PHB will confirm that the total amount of debt service from the permanent loan remains within an acceptable debt coverage ratio relative to the project’s stabilized Net Operating Income (NOI). DCR is measured as NOI/Total Debt Service.

IV. Conditions prior to funding:

- Completion of HUD Environmental clearance – completed August 16, 2010.
- Completion of second public meeting – completed July 19, 2011 (comment period expires July 27, 2011)
- Any required building permits.
- Approval of construction contract.
- Subordination of existing PHB amortizing debt.
- Approval of the investor for the additional debt and restructure.
- Approval of NOAH for additional subordinate debt
- Recording second position Mortgage Deed of Trust
- Relocation Plan

V. Section 108 submission requirements:

A. Community Development Objectives

The Portland Housing Preservation Fund is the HUD Section 108 Guaranteed Loan Pool created in 2008 to further the City of Portland's affordable housing preservation and permanent supportive housing goals. This project-specific application meets the goals of the Preservation Fund and is consistent with the City’s 2005-2010 Consolidated Plan and the 2010-2011 Action Plan including the following specific goals relating to providing affordable housing and ending homelessness:

Priority 1a: Provide stable, decent, affordable housing for households with the greatest

need.

Priority 1e: Preserve existing housing stock for low- and moderate-income individuals and families (0-80% MFI).

The project-specific application is also consistent with the City's Housing Preservation Policy, which established three major priorities. Specifically, the proposed rehabilitation of Los Jardines meets the second priority – preservation of expiring LIHTC properties.

B. Description of how the Proposal meets one of the Criteria in 24 CFR 570.200(a)(2) - National Objectives and is an eligible activity under section 570.201.

Section 570.200(a)(2) requires that all CDBG activities meet one of three National Objectives. Section 570.208 defines the three national objectives as: a) benefit to low and moderate income families; b) aid in the prevention or elimination of slums or blight; and c) meeting other community development needs having a particular urgency because existing conditions pose a serious and immediate threat to the health or welfare of the community where other financial resources are not available.

This project-specific application for the Los Jardines Apartments provides direct benefit to low and moderate income households and thus meets National Objective 570.208(a)(3). All of the tenants of the Los Jardines Apartments have incomes at or below 60% of area median income (AMI), with the majority earning 40% to 50% of AMI. Income certification will be required to ensure that the affordability and income targeting restrictions are maintained in the leasing of units for an affordability period of 60 years as required by the City's preservation policy. Incomes will be reviewed and certified on an annual basis in accordance with policies and procedures prescribed by HUD and PHB.

C. Eligibility under 24 CFR 570.200 CDBG activities.

Each project assisted with Section 108 guaranteed loan funds must meet one of the eligibility requirements listed in 24 CFR 570.703. The use of Section 108 guaranteed loan funds to assist in the financing of the Los Jardines qualifies as eligible under 570.703(h) – housing rehabilitation as permitted under 570.202. Specifically, the Los Jardines rehabilitation meets the requirements at 570.202(a)(1) as eligible rehabilitation and preservation of “privately owned buildings and improvements for residential purposes.” The project owner is a private non-profit limited partnership. In addition to meeting the requirements of 202(a)(1) concerning the type of building and improvements Los Jardines Apartments meets the requirements under 570.202(b)(1) for type of assistance: “Assistance to private individuals and entities, including profit making and nonprofit organizations, to ... rehabilitate properties ... for residential purposes.

D. Eligibility under 24 CFR 570.703, Section 108 eligibility and criteria

Each project assisted with Section 108 guaranteed loan funds must meet one of the eligibility requirements listed in 24 CFR 570.703. Each of the projects to be assisted with the Preservation Loan Fund will be eligible under 24 CFR 570.703. Because the original application was for a loan pool, the individual loans will qualify under several eligible activities: 703(a) acquisition; (c) payment of interest; (d) relocation; (e) clearance, demolition, removal; (f) site preparation; (g) payment of issuance or underwriting services related to 108; (h) housing rehabilitation; (i) economic development activities; (k) debt service reserve or (l) public facilities.

D. Underwriting Standards for Section 108 Assisted Projects – Project Evaluation

1. Project Underwriting - While section 570.209 Guidelines for evaluating project costs and financial feasibility do not apply to this project, the City of Portland has chosen to broadly follow the guidelines in evaluating the application for Los Jardines.

a. Reasonableness of the Proposed Project Costs

Staff and consultants to the City have reviewed the proposed project costs. The extensive remediation scope of work was developed by the project sponsor in consultation with the project inspection team and LMC Construction. The development budget is based on a detailed estimate by the contractor and third party quotes. Total cost per unit for the rehab scope is approximately \$66,666 per unit. This figure includes financing costs and \$1,100 per unit in temporary (likely intraday) relocation expense. The project costs include a developer fee of \$33,000, a portion of which may serve as additional contingency in the event of cost overruns. The per unit hard cost conforms closely to the litigate per unit damages amount.

b. Commitment of all Sources of Funds.

The sole source of funds at this time is the Section 108 funding. The remainder of anticipated rehabilitation costs for the rest of the buildings is expected to be paid for from proceeds of litigation.

c. Feasibility of the Project.

The project's feasibility was evaluated by the City using the underwriting guidelines adopted for the loan pool and determined to be feasible with the financing structure proposed. The two key underwriting parameters are Loan to Value (LTV) and Debt Coverage Ratio (DCR). An updated appraisal dated September 10, 2010 did not inform a lending decision because the valuation was made on a market basis, not an income restricted basis, and may place the LTV in excess of 80% depending upon

certain adjustments considered (see Collateral, p. 7). Because additional collateral may be necessary for the 108 loan the City will use its full faith and credit guarantee to provide the necessary security in accordance with the resolution passed by the Council in June 2008.

The project's debt capacity was also reviewed. Because it is a project targeting households at or below 60% of Area Median Income (AMI), the project's 43 units generate a fairly low Net Operating Income (NOI) as compared to similar market rate projects of this size. A review of the pro forma financials shows that the restructured project's NOI is projected to be about \$149,000. The current NOI provides a 1.16 DCR on the first mortgage but it is insufficient to fully amortize the Section 108 loan during a 20 year term, given increasing operating expense ratios over time and eventual declining NOI as a result. Therefore, the amortization will run thirty years although the maturity is twenty years, resulting in a balloon in year 20 requiring a refinance. PHB will retain the right to review the project operating pro forma prior to funding in order to re-confirm that the funding terms proposed here are still reasonable.

d. Return on owner's equity.

As a nonprofit housing provider, the project sponsor has limited resources to contribute as equity into the project. Hacienda will contribute any proceeds from the pending lawsuit to rehabilitating the other project buildings, and will be applying for Energy Trust funds related to energy efficient window replacement for this and other project buildings. The Energy Trust fund amount is uncertain, but estimated to be \$15,000 once applied for as to building F.

The project generates a modest cash flow from operations when the 108 repayment requirements are taken into account. Because the sponsor's contribution is negligible, any positive NOI has the capacity to falsely reflect an infinitely high return. In this case, the ROE measurement is probably not effective. There is no remaining deferred developer fee and NOI eventually turns downward, chilling the prospect of any long term returns.

e. Collateral

The City's Section 108 loan will take a second-position deed of trust in the real estate behind the NOAH first mortgage loan. As mentioned above, the combined loan to value for both loans may exceed 100% and therefore additional security is required.

An updated appraisal dated September 10, 2010 valued the property at \$4,100,000 if unrestricted and assuming no deferred maintenance. The 7% cap rate reflected in the updated appraisal appears aggressive, and

when applied to NOI produces a value of just under \$2.4 million for the entire project, presuming no deferred maintenance, which clearly exists given the litigation.

The entire Portland Preservation Loan Pool carries a full faith and credit guarantee from the City of Portland and this guarantee will be used to provide the necessary collateral for this project.

f. Development Team Capacity and Experience

The development team includes Hacienda's Housing Development Director who managed the development of their most recent project, Miraflores. The project's architect is Carleton Hart Architecture, a Portland firm with extensive green building design experience including seven of Hacienda's existing properties. The general contractor is Horizon Restoration. Horizon Restoration's construction projects range from minor emergency water damage to restoration projects exceeding \$5 million whose services include structural repair, content cleaning and storage, emergency mitigation and remodeling. Horizon is familiar with all phases of construction and has the ability to service both large and small claims.

g. Developer Commitment

The project has the commitment of the Hacienda CDC, which currently owns and operates the project as part of the limited partnership. Hacienda has a long-term interest in the project and the client community that it serves.

h. Character of the Principals

As a mission-driven nonprofit organization, Hacienda exists to "develop a permanent resource of decent and affordable housing, educational, economic development and related activities that benefit low-income Hispanics and others in the State of Oregon." Specifically, Hacienda develops and operates affordable rental housing and provides a broad array of supportive services to enhance the lives of the residents and the surrounding community. It has over 15 years of experience in the creation and preservation of affordable housing in Oregon and maintains a staff of highly experienced development and property management specialists to carry out its projects.

i. No Substitution of CDBG funds for Private Sources

Based on the review of the project's operating projections by staff and its consultant, the project's sponsors have accessed all reasonably attainable funding for the project. Given the very low rents, the project has very limited capacity for debt.

j. To the extent practicable the Section 108 funds should be disbursed on a pro rata basis

Section 108 funds are the only source for this rehabilitation work.

2. Standards for evaluating public benefit

Los Jardines is qualified as eligible under Section 570.703(h) – housing rehabilitation as permitted under 570.202. Specifically, the project meets the requirements at 570.202(a)(1) and (b)(1) as eligible rehabilitation and preservation of “privately owned buildings and improvements for residential purposes.” Therefore, the public benefit standards at 570.209 do not apply.

E. A Description of the Pledge of CDBG Guarantee

The City of Portland understands that if the participants in this Section 108 loan fund fail to make timely payments and as a result the City fails to make a required payment on its Section 108 obligation, HUD will deduct the missed payment from the CDBG Letter of Credit and in accepting this loan guarantee, the City of Portland has pledged its CDBG funds and all other applicable grants as security for the guarantee. (Please refer to Attachment A - Certifications.)

F. Schedule of Principal Repayment

LOS JARDINES		BALANCE	\$400,000
August 1, 2012	\$17,000.00	August 1, 2022	\$20,000.00
August 1, 2013	\$17,000.00	August 1, 2023	\$20,000.00
August 1, 2014	\$17,000.00	August 1, 2024	\$21,000.00
August 1, 2015	\$17,000.00	August 1, 2025	\$21,000.00
August 1, 2016	\$18,000.00	August 1, 2026	\$22,000.00
August 1, 2017	\$18,000.00	August 1, 2027	\$22,000.00
August 1, 2018	\$18,000.00	August 1, 2028	\$23,000.00
August 1, 2019	\$19,000.00	August 1, 2029	\$23,000.00
August 1, 2020	\$19,000.00	August 1, 2030	\$24,000.00
August 1, 2021	\$19,000.00	August 1, 2031	\$25,000.00