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METRO

Agenda

MEETING: METRO COUNCIL WORK SESSION
DATE: August 4, 2009
DAY: Tuesday
TIME: 1:00 p.m.
PLACE: Metro Council Chamber

CALL TO ORDER AND ROLL CALL

1:00 PM	**1.**	**DISCUSSION OF AGENDA FOR COUNCIL REGULAR MEETING, AUGUST 6, 2009/ADMINISTRATIVE/CHIEF OPERATING OFFICER COMMUNICATIONS**	
1:15 PM	**2.**	**ADMINISTRATION OF AFFORDABLE HOUSING FUND PROGRAM: PRESENTATION AND DISCUSSION**	Steele/Gibb
1:45 PM	**3.**	**COUNCIL BRIEFINGS/COMMUNICATION**	
2:00PM	**4.**	**EXECUTIVE SESSION: COO REVIEW**	

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METRO COUNCIL

Work Session Worksheet

Presentation Date: August 4, 2009 Time: 1:15 Length: 30 minutes

Presentation Title: **Reconfigured Regional Housing Choice Fund**

Service, Office, or Center: Development Center

Presenters: Megan Gibb x1753; Meganne Steele x1736

ISSUE & BACKGROUND

With adoption of the 2009-2010 budget, the Metro Council appropriated $850,000 for a reconfigured regional housing choice fund. The program is to provide financing for land acquisition, pre-construction, or construction of affordable housing development. Staff were directed to secure the services of a third party loan administrator and to structure loans for repayment to the General Fund within two to five years.

In the initial steps of program design, Development Center staff interviewed Portland Development Commission (PDC) staff, the Network for Oregon Affordable Housing (NOAH) director, Metro's Chief Financial Officer, Metro legal counsel, and the One 19 Towers project developer. For additional detail please see the "Proposed Investment Strategy" section of Attachment A which describes eligible uses of funds, highlights underwriting and interest rate policies, and outlines a few alternative loan structures.

During the budget adoption process, it was anticipated that the Council members would approve specific project investments. However, after extensive discussions with the lending community it is apparent that private sector loan underwriting and lending processes cannot accommodate the delays related to scheduling formal Council action. The loan administrator must be provided with clear project selection criteria at the outset, and needs to be able to move forward quickly to close financing deals.

Council direction is needed regarding approach and project investment criteria in order to guide the processes used for loan administrator selection and project investment.

OPTIONS AVAILABLE

Three types of organizations could provide loan underwriting, origination and administration services:

1) a governmental agency such as the Portland Development Commission (PDC);
2) a non-profit Community Development Financial Institution (CDFI) such as the Network for Oregon Affordable Housing (NOAH); or
3) a commercial bank for a TOD Project such as the primary lender for a One 19 Towers.

For a detailed analysis please see the "Loan Administrator Alternatives Analysis" section of Attachment A which describes administrative processes, anticipated deal terms, and pros and cons for each alternative. The most salient findings are:

1. PDC would not charge administrative costs, loan origination fees, or loan interest provided Metro funding can be combined with PDC funding for the project. This option would preserve the most capital for investment into a project. However, given PDC's jurisdiction, projects would have to be located within the City of Portland to be eligible.

2. A Request for Qualifications (RFQ) selection process is required if Metro wants to consider using a CDFI because there are a number that may be interested. Terms would need to be negotiated, for example: NOAH's loan fees and interest costs would be in the range of $15,000-25,000 but projects could be geographically located anywhere in the region. Under an RFQ scenario PDC could still make a proposal. Respondents would be asked to list potential eligible projects. The option allows the most flexibility in selecting a loan administrator.

3. Using a commercial bank that is also providing primary financing for a project would be administratively easiest but would only be appropriate for separately approved Metro TOD Projects. This approach presents the highest risk to Metro, even if vacant land is provided as collateral. Weak market conditions could reduce the value of the property and/or make resale difficult; either of these events would adversely affect Metro.

IMPLICATIONS AND SUGGESTIONS

After discussions with the CFO, COO, and Metro Councilor program liaison, it is recommended that a Request for Qualifications (RFQ) process be conducted (option #2 above), applying the following general criteria for selection of loan administrator:

1. Proven expertise in loan underwriting, origination and administration.
2. Prospects for lending to project(s) that optimize Metro's project investment criteria.
3. Cost to borrowers and Metro.
4. Administrative ease for borrowers and Metro.

The loan administrator would select conforming projects in consultation with Metro's Development Center Manager. With the concurrence of Metro's Chief Financial Officer, the Development Center Manager would confer, informally, with the Chief Operating Officer, the Metro Councilor liaison for the Program, the Council President, and the Metro Councilor representing the area in which the project is located. Metro Development Center staff, with support from Metro legal counsel, would coordinate with the lender to review and approve deal terms and legal documents related to Metro's investment. The lender would provide regular reports to Metro on the project and loan status.

Regarding project criteria, proposed project investment criteria have been prepared based upon related Metro goals and strategies and Council discussion during the budget process. Please see Attachment B.

QUESTION(S) PRESENTED FOR CONSIDERATION

1. Does the Council concur with the staff recommendation to issue an RFQ?
2. Does the Council concur with the proposed criteria or requirements?

LEGISLATION WOULD BE REQUIRED FOR COUNCIL ACTION __Yes_x_ No

ATTACHMENT A

ADDITIONAL BACKGROUND

I. PROPOSED INVESTMENT STRATEGY

A. **Metro funds would provide financing for land acquisition, pre-construction, construction, or as bridge to permanent financing.** Metro would seek the second priority position in debt repayment, behind the primary bank lender, but ahead of other lenders and equity investors. Metro might wish to secure the loan with vacant land as collateral, but personal recourse loans are not recommended because of the difficulties of collection.

B. **Loan repayment capacity would be demonstrated by the project proforma and underwritten by the loan administrator.**

C. **Zero or low interest would be charged by Metro.** Metro funding would more effectively support production of affordable housing if the project loans were zero or low interest, with interest payments deferred until the time of principle repayment. If Metro as an agency wants to avoid the opportunity cost of foregone interest earnings on the $850,000 allocation, the estimated interest earnings could be prepaid by Metro at the time funds are transferred to a third party administrator, effectively reducing the amount of funds available for the loan.

D. **Alternative loan structures include:**

1. ***<u>Commitment of future equity proceeds from the sale of Low Income Housing Tax Credits (LIHTC).</u>*** Metro funds would be repaid when the LIHTC sale proceeds are received or at the time of permanent financing. This represents a relatively low risk approach, but would only be of use to projects already in the pipeline for LIHTCs.

2. ***<u>Financing a line of credit as a contingent loan guarantee</u>***. Metro funds would remain on deposit with the lender, earning interest, unless and until required. The risk level of this approach would depend on the construction loan terms and the performance of the project in the market. For example, if the project is leased-up more quickly than the primary lender has assumed, the lease-up period costs will be lower and the project may not need to tap into the line of credit. Meier Memorial Trust has used this approach in supporting community development investment projects financed by Shore Bank Enterprise Cascadia.

3. ***<u>Commitment of additional cash to be leveraged upon permanent financing</u>*****.** Metro funds could be repaid if projects earn-out added term financing, based on actual operating performance, pursuant to pre-approved term-lender earn-out conditions, or if the project is eligible to borrow more in permanent financing than is required to pay-off the construction loan. The risk level of this approach would depend loan underwriting standards and the performance of the project in the market. Current underwriting standards are at historic highs; it is conceivable that lenders who are now requiring 35% or more in equity will moderate back to more traditional 20% equity standards. Similarly, lenders and appraisers are currently estimating new apartment rental vacancies at the relatively high level of about 8%; a new project could lease-up quickly, providing permanent lenders confidence that the more traditional 5% vacancy rate is appropriate. By using a lower vacancy rate estimate, the projected net

operating income of the project increases. Under both of these scenarios, banks would be typically be willing to lend more on the permanent loan, which would provide the developer with cash to pay-off the Metro loan. Fannie Mae has used this approach by allowing projects to "earn-out" higher net operating income and providing an "additional tail" which allows increases in the permanent loan.

4. ***Commitment of vacant land as loan collateral***. Metro funds could be repaid at the time of permanent financing provided the project is eligible to borrow more in permanent financing than is required to pay-off the construction loan, as outlined above. Metro would have the recourse of taking the vacant land if there is loan default. Weak market conditions could reduce the value of the property and/or delay resale of the property, which would then increase administrative costs and create delays in the payment of funds to Metro. This scenario poses the most risk to Metro.

II. LOAN ADMINISTRATOR ALTERNATIVES ANALYSIS

A. Alternative types of loan administrators by selection method

1. ***Negotiated intergovernmental agreement (IGA)*** – An IGA could be directly negotiated with Portland Development Commission.

2. ***Open competitive selection of non-profit administrator*** - A request for qualifications (RFQ) process would need to be conducted if Metro wishes to enter into an agreement with a non-profit such as the Network for Oregon Affordable Housing (NOAH). There are several other Community Development Financial Institutions (CDFIs) operating in the region that may be interested in acting as loan administrator.

3. ***Developer-selected commercial bank*** – An inter-creditor agreement could be established with the bank the project developer(s) will be using for primary financing. This approach would be appropriate if there are specific project(s) the Metro Council wishes to fund, such as "One 19 Towers," which already has approval for TOD funding and has offered adjacent vacant property as collateral. One 19 Towers is the only project that would be eligible for funding under this scenario.

B. Alternative 1: PDC

- **Administrative processes:**
  - An Intergovernmental Agreement (IGA) and program guidelines would be negotiated at the staff level, and approved by the Metro Council and PDC Commission.
  - PDC would select conforming projects through its normal processes, in consultation with Metro's Development Center Manager. With the concurrence of Metro's Chief Financial Officer, the Development Center Manager would confer, informally, with the Chief Operating Officer, the Metro Councilor liaison for the Program, the Council President, and the Metro Councilor representing the area in which the project is located.
  - Metro Development Center staff, with support from Metro legal counsel, would coordinate with PDC to review and approve deal terms and legal documents related to Metro's loan.
  - PDC would request "draw-downs" of funds from Metro when project investments are approved.
  - PDC would provide regular reports to Metro on the project and loan status, pursuant to the IGA.
  - If the project were at risk of default, Metro would be relatively well positioned for repayment. PDC and any other subsidiary lenders are likely to have more invested in the project, and more institutional capacity to take action, which would allow Metro to be a "free rider" and recoup the Metro investment first.

- **Anticipated deal terms:** (As with the NOAH alternative below, these terms are conceptual until approved by Metro and PDC.)
  - Additional eligibility criteria: a requirement that projects be "PDC projects", so Metro funding can be combined with PDC funding to make a single loan, and avoid added administrative and processing costs.
  - Metro administrative costs are expected to be equal to or somewhat under the amount estimated during budget deliberations.
  - PDC would not charge administrative costs, loan origination fees or require an interest spread.
  - Metro's funding could be used as construction/mini-perm financing and be repaid prior to PDC financing.
  - Metro's debt could effectively be structured to be superior to PDC debt and, upon default and disposition of a foreclosed project, be repaid prior to PDC's debt.

- **Pros:**
  - No administrative charges or lending costs.
  - Excellent prospects for lending to project(s) that satisfy Metro's project investment criteria.
  - Low risk.
- **Cons:**
  - Projects would be geographically restricted to the City of Portland.

C. Alternative 2: NOAH or another non-profit lender

- **Administrative processes:**
  - A Request for Qualifications (RFQ) process would be conducted and a contract would be negotiated. The lender would select conforming projects in consultation with Metro's Development Center Manager.
  - With the concurrence of Metro's Chief Financial Officer, the Development Center Manager would confer, informally, with the Chief Operating Officer, the Metro Councilor liaison for the Program, the Council President, and the Metro Councilor representing the area in which the project is located.
  - The lender would request "draw-downs" of funds from Metro when project investments are approved.
  - Metro Development Center staff, with support from Metro legal counsel, would coordinate with the lender to review and approve deal terms and legal documents related to Metro's investment.
  - The lender would provide regular reports to Metro on the project and loan status.
  - If the project were at risk of default, Metro would benefit from NOAH's experience in loan servicing; of the more than 120 loans NOAH has made, none have defaulted but some have renegotiated for extensions of construction and/or mini-perm financing. In the event of default, Metro's recourse would depend on the terms of the multi-party risk-sharing agreement, but legal action could be required.
- **Anticipated deal terms:** (These are illustrative, based on initial discussions with NOAH, and may not be the same if another CDFI were selected.)
  - Additional eligibility criteria: NOAH is willing to work on any project.
  - Metro administrative costs are expected to be equal to or somewhat higher than the amount estimated during budget deliberations.
  - NOAH has indicated it would charge the borrower around 1% loan origination fees at the time the transaction closes and 1% additional interest on for loan servicing.
  - NOAH would need to be reimbursed for its legal expenses, which may range from $2 to 10k.
  - NOAH is willing to negotiate terms of a risk-sharing agreement, providing Metro with assignment of a portion of the collateral, if both Metro and NOAH are funders.
- **Pros:**
  - NOAH is willing to provide loan underwriting, origination and servicing for any project. It is working with a number of affordable housing providers, and has a project in Tigard that may be a good candidate: The Knoll has a 9% tax credit allocation authorized but needs capital to buy the land before the option expires this summer.
  - Projects could be geographically located anywhere in the region.
- **Cons:**
  - Project investment would be delayed because of the required RFQ process.
  - Tax credits are in low demand, significantly reducing the amount of revenue generated and extending the time required for the sale. This increases risk.
  - Metro administrative costs would be highest, reducing the amount of funds available for project investment.
  - NOAH's loan fees and interest costs would be in the range of $15,000-25,000.

D. <u>Alternative 3: One 19 Towers or another TOD Project</u>

- **Administrative processes:**
  - Metro Development Center staff, with concurrence of the Chief Financial Officer and support from Metro legal counsel, would negotiate the terms of a loan agreement with the developer and an inter-creditor agreement with the bank providing their construction financing.
  - Metro legal counsel would prepare the loan agreement to be processed concurrently with the TOD easement and construction financing.
  - The commercial bank would service the loan, under the terms of the inter-creditor agreement.
  - In the event of default, Metro would exercise its recourse to take title to the land which could then be marketed for sale. Depending on the market, Metro risks a financial loss on resale and delayed return of its funds.
- **Anticipated deal terms:**
  - TBD.
- **Pros:**
  - Metro administrative costs would be lowest of the three approaches. Funds could be directed more selectively to a Metro TOD project (approved or about to be approved) that would benefit from additional capital.
  - Most rapid process for selection of loan administrator since it would be pre-determined based on where the developer is getting primary financing.
  - In the event of loan default, Metro would take ownership of vacant real property.
- **Cons:**
  - A for-profit commercial bank may not be as intrinsically motivated to minimize public risk and maximize public benefits; therefore, this option presents higher risk to Metro.
  - Use of land as collateral is not consistent with the Metro Council's stated goal of a high degree of certainty of cash payback within a relatively short period. Weak market conditions could reduce the value of the property and/or delay resale of the property, which would then increase administrative costs and create delays in the payment of funds to Metro. This option presents the highest risk.

ATTACHMENT B

PROPOSED PROJECT SELECTION CRITERIA

THRESHOLD REQUIREMENTS

1. **Affordability –** Housing units are affordable to households earning less than or equal to 100% median family income.

2. **Diversity –** Housing choice is increased by locating projects in areas that do not have an existing concentration of poverty.

3. **Location –** Projects are located in 2040 regional centers, town centers, light rail stations or corridors.

4. **Design –** Projects have attractive building designs, durable materials, and pedestrian-oriented site plans.

5. **Repayment –** Independent financial analysis provides Metro a high level of confidence that funds will be repaid within 5 years.

DESIRABLE FEATURES

1. **Sustainable design innovations –** Project designs offer innovative approaches to sustainable development, such as compact form and green building methods, and could be replicated by others.

2. **Multi-modal connectivity –** Projects residents can conveniently access grocery stores and other urban living infrastructure by transit, bike and/or walking.

3. **Income mix –** Housing units will be rented/sold to households with a variety of income levels.

4. **Faster repayment –** Funds are likely to be returned to Metro within 2-3 years.