

Proposed HUD 108 Loan Pool

The Section 108 loan guarantee is a provision of the Community Development Block Grant (CDBG) program. It enables the funding of particularly large scale projects for which there would otherwise not be sufficient funding on an annual basis utilizing CDBG. Through the program, an entitlement community, such as the City of Cincinnati, is permitted to borrow against future CDBG grant amounts for projects that are otherwise eligible for CDBG funding. As such, important and significant community and economic development projects can be implemented in the short term, but paid for on a long term basis.

As an entitlement community, the City of Cincinnati may, under HUD regulations, commit to projects of up to five times its annual CDBG amount. With the current grant level being at approximately \$11 million per year, the City may engage in financing projects through the HUD 108 program of up to \$55 million. In return for a commitment from HUD to this leveraged amount, the City must pledge from its annual CDBG, and other sources, a sufficient level of funding for all future principle and interest payments. For this reason, it is important to be mindful that use of the HUD Section 108 loan guarantee program is not a risk-free venture as the City will be responsible for any outstanding debt service payments throughout the term of the debt incurred by HUD to meet its commitment.

Jointly the Department of Community Development (DCD) and the Economic Development Division (EDD) is proposing that this tool be utilized to fund multiple projects in the City for which adequate funding would not otherwise be available. These projects are:

<u>Project</u>	<u>Amount</u>	<u>Dept.</u>
Homeless to Homes	\$ 7,000,000	DCD
Low Income Housing Tax Credit Bridge Loan	17,000,000	DCD
Community Development Loan Pool	2,000,000	DCD
Economic Development Loan Pool	11,000,000	EDD
Total	<u>\$37,000,000</u>	

Of the \$37 million in requested HUD Section 108 borrowing authority, \$7 million of the requested funds for the Homeless to Homes initiative do not have a source of repayment. As a result, the repayment of the \$7 million will come from the City's annual CDBG entitlement allocation. There is a projected annual debt service payment of \$532,000 based on a 20-year amortization schedule. The other \$28 million in Section 108 authorization funds are anticipated to be performing loans with private repayment sources.

In contrast, the Low Income Housing Tax Credit Bridge Loan project contemplates repayment to the City of all funds coming from the HUD Section 108 program. As such, while future CDBG funds would need to be accounted for in the guarantee part of the program, repayment from the project would provide program income to the CDBG program, which would require that all such funds be utilized by the City for other CDBG eligible program activities. In this way also, the Economic Development Loan Pool would be lent utilizing strict underwriting criteria that will assure repayment of its obligations to the City. In this instance, the loan repayment proceeds from the Low Income Housing Tax Credit Bridge Loan and the Economic Development Loan

Pool programs that come to the City will be available to fully repay HUD for those portions of the overall loan pool, which will minimize impact on the City's ability to continue other CDBG activities.

Homeless to Homes:

The developer for this project is 3CDC and it has an estimated total project cost of \$27 million. This project is consistent with the Homeless to Homes (HTH) plan approved by City Council in 2008 to improve and expand the services provided to single homeless men and women. The project encompasses the relocation of the City Gospel Mission, new construction of the YWCA shelter for women, and relocation of the Drop Inn Center (DIC). The City is seeking \$7 million from a HUD Section 108 loan to fund the development of the DIC and the YWCA. These funds will be structured as a 20-year forgivable loan for the development of the shelter(s). The City will pledge a portion of its future CDBG entitlements to repay the loan to HUD. HUD will also require collateral, such as a mortgage on the real property for the length of the loan, which is 20 years. Any real property used as collateral must have an 80% Loan-to-Value (LTV). A development agreement for the HTH project and subsequent funding was approved by Ordinance No. 15-2012, passed by City Council on January 25, 2012. Funding in the amount of \$3 million that includes CDBG and Capital has already been secured. The remaining \$7 million will come from this source.

Low Income Housing Tax Credit Bridge Loan:

The developer for this project is the Model Group. The HUD Section 108 loan will be used to bridge \$17 million of LIHTC equity for five years in a scattered site development throughout various City neighborhoods known as the Losantiville Apartments. During the 5-year period, the investors will make interest payments on the HUD Section 108 loan and pay off the entire balance at the end of year five in a balloon payment. Since the interest rate on the HUD Section 108 loan is significantly less than investor's required Internal Rate of Return (the developer is estimating that the HUD Section 108 loan at 1.5%), there is an interest arbitrage that accumulates in the fund which will then be invested in other housing projects. According to the developer, based on current investor hurdle rates and current HUD Section 108 rates, the developer estimates that this arbitrage would generate over \$3.5 million in equity. The City will get guarantees from the Tax Credit Investors for repayment of the bridge loan which significantly reduces the risk.

Community Development Loan Pool:

This loan pool of \$2,000,000 will provide financing for future community development related uses. With past cuts and potential future cuts to the Federal budget, the availability of these funds will be a valuable resource for future projects. Any potential projects to be funded with this 108 loan pool will be vetted to make sure that they are viable, eligible activities, and meet the appropriate national objective. It is also understood that any project under this loan pool will have to be reviewed and approved at the HUD level before any commitment can be made.

Economic Development Loan Pool:

The Economic Development Division wishes to create a new loan pool to increase its ability to stimulate job creation in the City. Funds will be used for projects that are feasible in the market, but require additional gap financing. Each project will be expected to generate sufficient cash

flow to repay the loan. The types of deals being considered will vary from business retention or expansion to commercial development, but the emphasis will be on job creation. Real estate acquisition and improvements are preferred because other assets are more difficult to collateralize. Every prospective deal will be subject to an exacting set of underwriting criteria. Each project must also follow CDBG program regulations, which includes meeting Eligibility, National Objective, and Public Benefit requirements. Deals will be expected to include an appropriate level of private funding, though EDD will remain open to deals that utilize the HUD Section 108 program in tandem with other public funding sources, such as historic rehabilitation tax credits, New Markets Tax Credits (NMTCs), Tax Increment Financing (TIF), and other conventional sources.

The asset being financed will generally serve as the collateral, and in most cases EDD would require 100% collateral coverage. EDD would be willing however in some cases to subordinate its lien, if appropriate. EDD will be flexible in accepting additional forms of collateral if the financed asset has insufficient collateral value.

Interest rate relative to the prime rate would depend on the particulars of each deal. The City's rate will generally be close to prime or slightly above prime, but open to negotiation. The repayment term will depend on each asset being financed. Loans will generally be self-amortizing with up to a 20-year term. Interest-only payments may be offered to the Principle Developer for up to two years after the completion of the project. For financings structured to leverage NMTCs or other complex funding sources, the City will consider adjusting the amortization schedule when needed to facilitate the other funding sources.

Applications will be underwritten on a case-by-case basis. Trained City staff and a National Development Council consultant will perform detailed underwriting. Minimally, the following criteria must be met:

- Project costs are reasonable.
- All funding sources are committed.
- HUD Section 108 funds are not being substituted for private funding.
- EDD performs thorough financial and risk analysis and determines that project is feasible.
- Return on owner's equity is appropriate.
- Project will produce sufficient cash flow to repay loan.
- Applicant has sufficient capacity and experience.
- City of Cincinnati will receive sufficient return on its investment.

Conclusion

The submission of the Section 108 Loan Pool application to HUD, and subsequent funding, is subject to City Council approval.