Section 108: Strategies for Financing Large-Scale Projects

EQUAL HOUSING OPPORTUNITY

COMMUNITY PLANNING & DEVELOPMENT

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Today’s Topics

- Section 108 basics
- Strategies for Funding Infrastructure Projects
- Structuring Assistance to Mixed-Use Projects
- Underwriting Best Practices
- Tips for combining Section 108 with other sources of financing
- NRSA’s as a Tool for Streaming Compliance

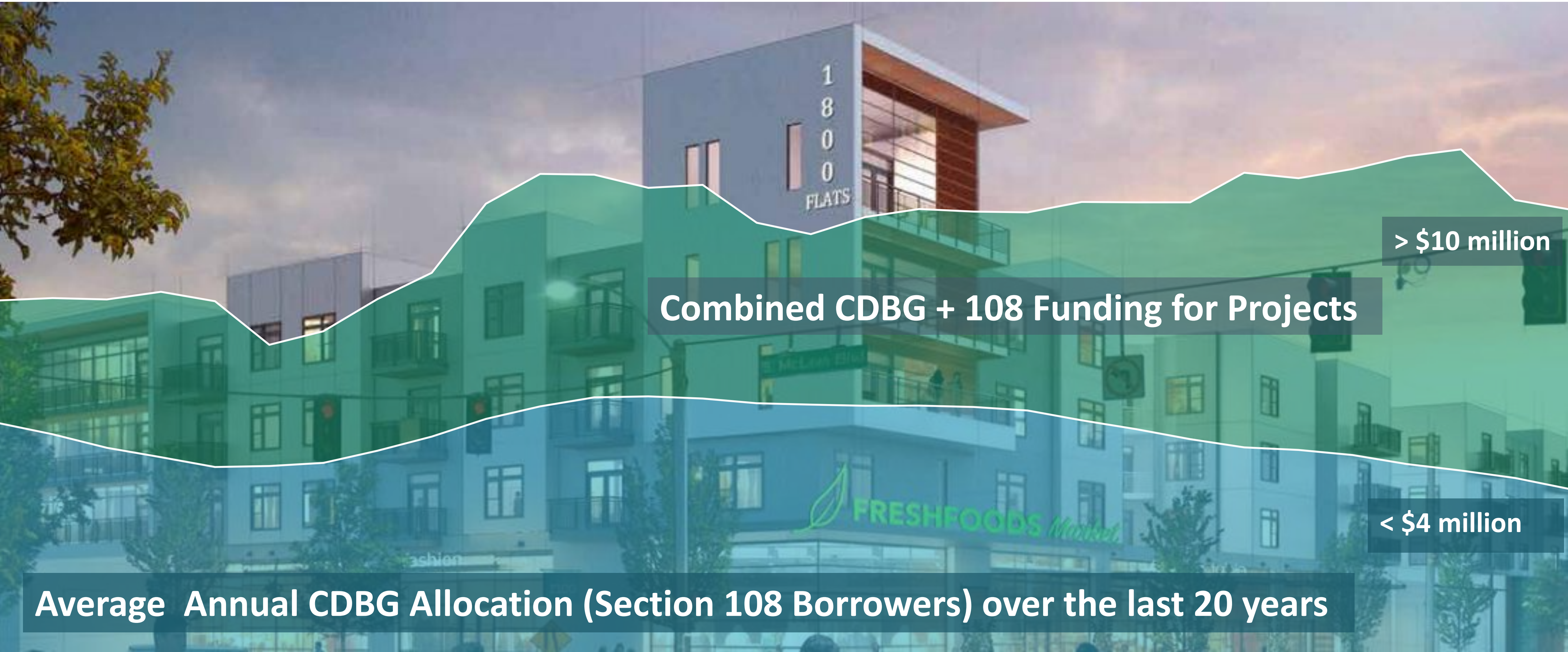
HUD’s Section 108 Loan Guarantee Program

- Provides *loan guarantees*, not grants
- Employs the framework of the Community Development Block Grant (CDBG) Program
- Offers recipients (states, cities and counties, and insular areas) a means of accessing the capital markets
- Low-cost, non-competitive money available on a rolling-basis

Section 108 Borrowing Capacity

Annual CDBG Allocation		$3,000,000
Max available borrowing capacity	x 5	= $15,000,000
Outstanding 108 commitments	-	$800,000
Outstanding 108 loan balance	-	$2,000,000
Available borrowing capacity		**= $12,200,000**

Using Section 108 maximizes the impact of grant funds



Stages in which CDBG & Section 108 funding can be deployed

Preparation/ Pre-development	Implementation	Ensuring Outcomes
Acquisition	Real estate project	Job training
Demolition	Machinery & equipment	Homebuyer assistance
Site prep & remediation	Working capital	Provision of public services
Relocation costs	Infrastructure + improvements	Technical assistance to non-profits

Flow of Funds: Project by the Applicant

HUD
(Guarantor)

2
Note with Federal Guarantee

1
Advance Request
&
Loan Documents

Lender
(Investor)

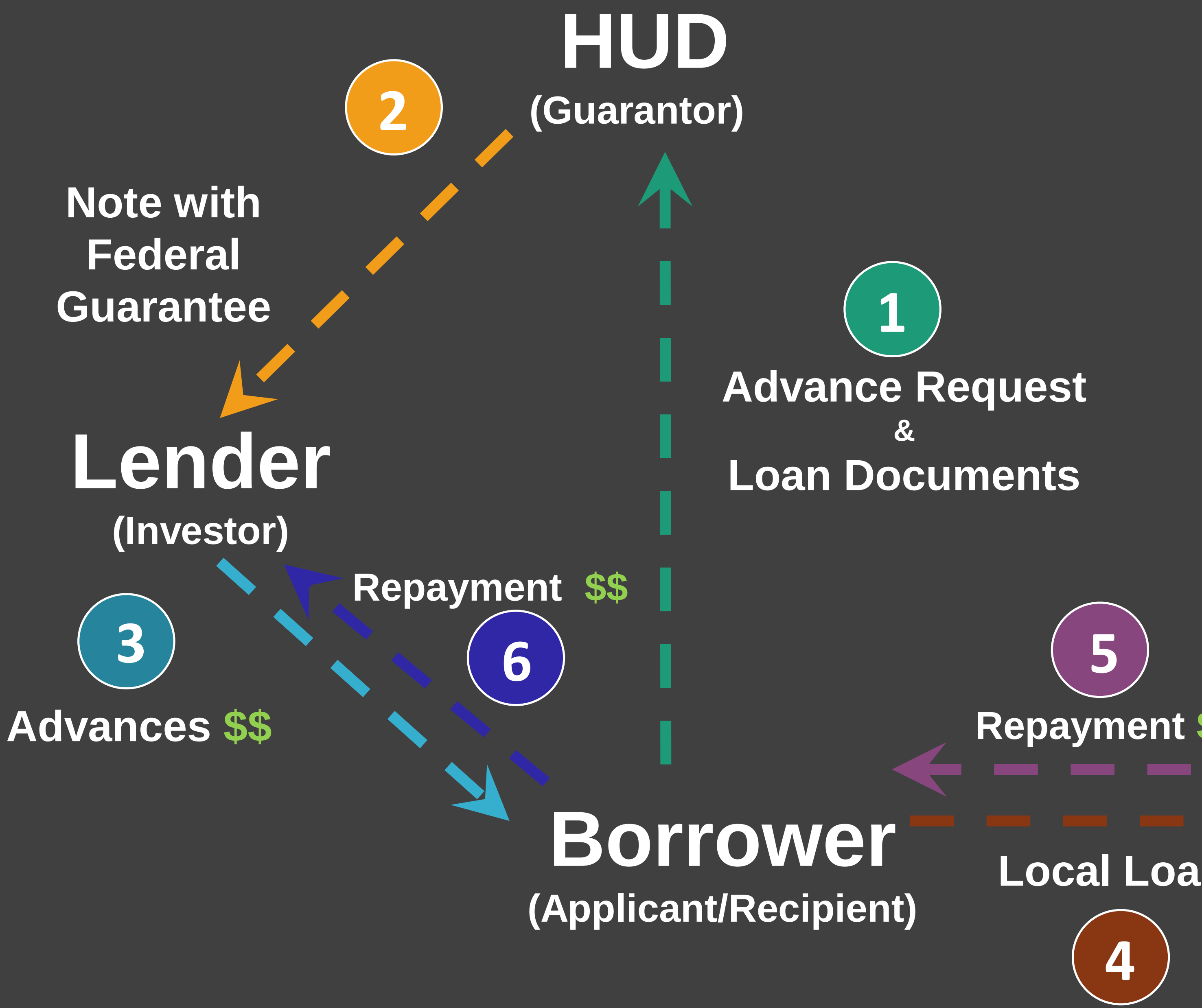
Repayment $$

4

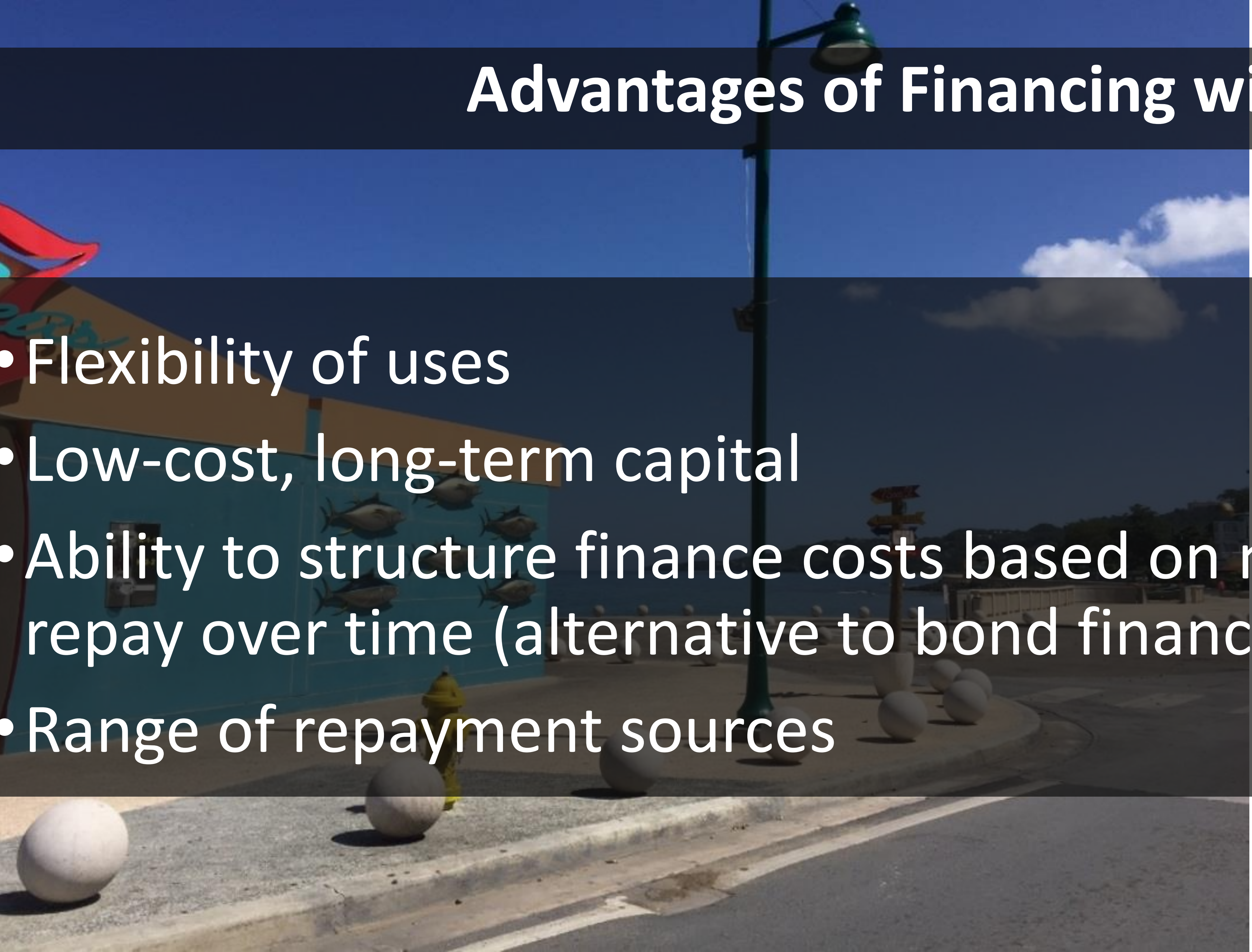
3
Advances $$

Borrower
(Applicant/Recipient)

Flow of Funds: Project by a 3rd Party



Advantages of Financing with Section 108



- Flexibility of uses
- Low-cost, long-term capital
- Ability to structure finance costs based on needs & repay over time (alternative to bond financing)
- Range of repayment sources

Approach to using Section 108

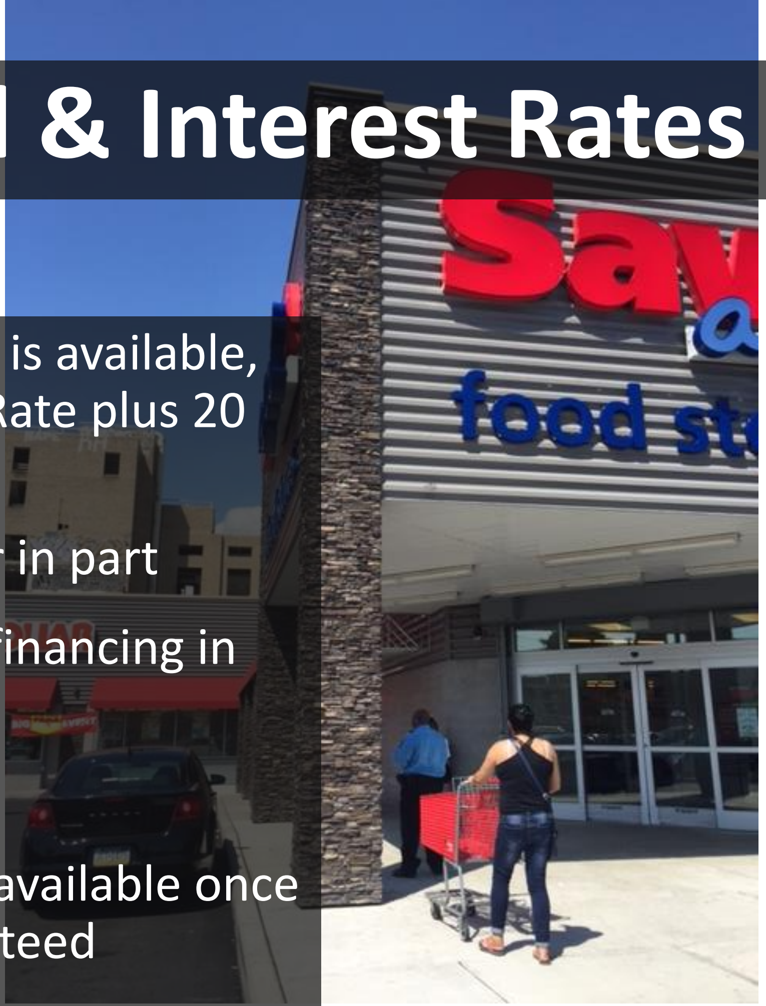
Project Specific:

- Approach used by majority of borrowers
- Application is for a specific project; requires detail & specificity
- After HUD approval, guaranteed loan would be used by the recipient or re-lent to a 3rd party borrower

Loan Fund:

- Better fit for when a pipeline of projects exists or community is target resources within a specific geographic area or with specific E.D. goal in mind
- Enables grantee to weight a portfolio of loans so there is a balance of large, solid loans and smaller loans designed for entrepreneurs and/or projects that are higher risk but have a high social impact value
- Streamlines Headquarters' underwriting process for each individual project (Field Office must first make a determination of program compliance)

Source of Capital & Interest Rates



Interim Financing: Variable interest rate financing between public offerings is available, Interest rates are based on the 3 month LIBOR (London Inter-Bank Offered Rate plus 20 basis points (.02%)

- These notes may be prepaid at any time without penalty, in whole or in part
- Variable rate interim financing is converted to fixed rate permanent financing in the next public offering

Permanent Financing: Competitive fixed interest rate financing is generally available once every 18 months, through HUD's public offering, which is the sale of Guaranteed Participation Certificates to the capital market investors

- For most recent public offering (May 2015), all-in interest rate for a 20-year loan with equal installments was 2.85%
- Option exists to pre-pay/defease and refinance loan, with certain restrictions

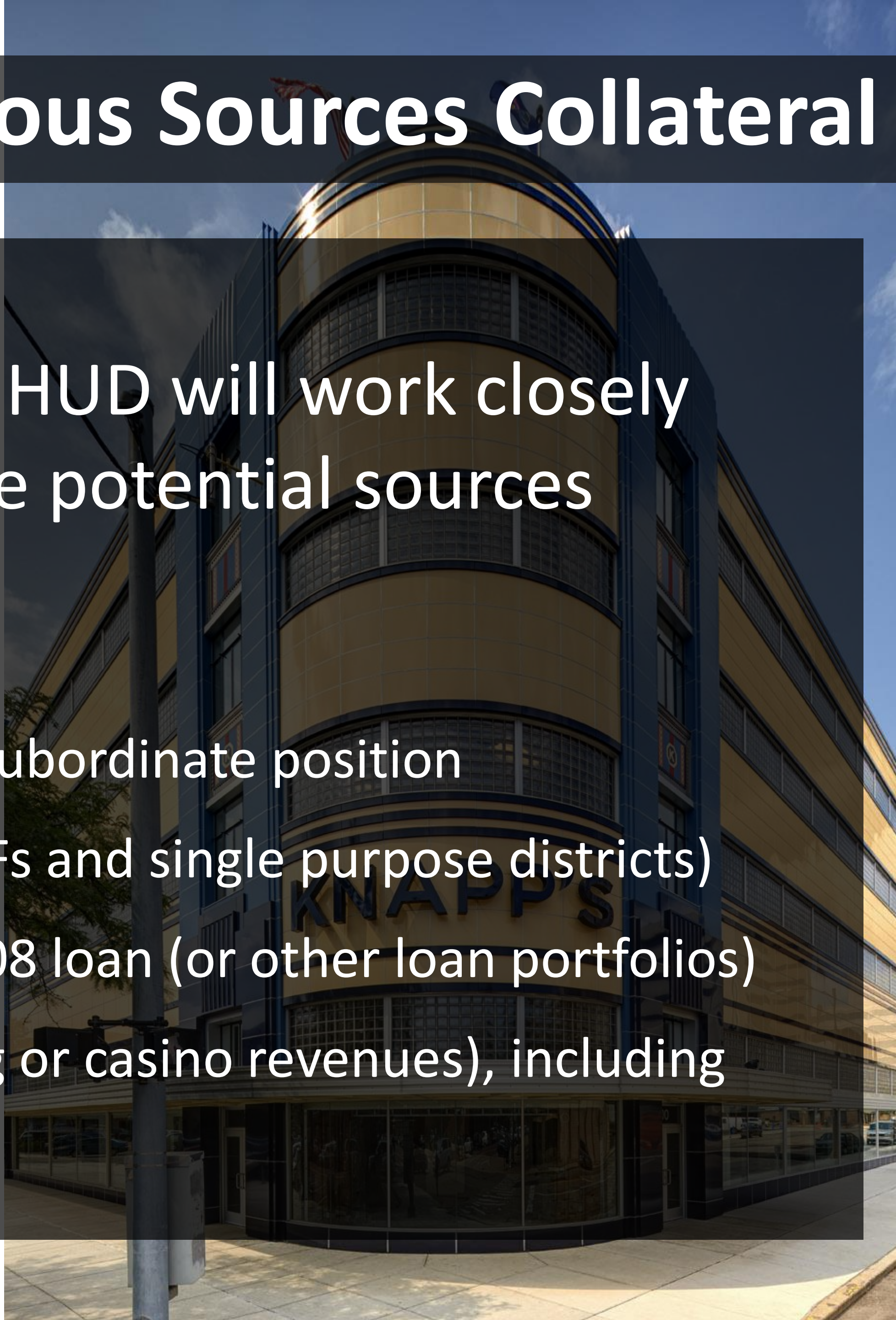
Repayment Sources

Examples of Repayment Sources:

- Current & future CDBG
- Revenues generated by special taxing districts (e.g. TIFs and single purpose districts)
- Parking revenues
- Casino revenues
- Repayment of 3rd party loans (those financed with Section 108 loan or other loan portfolios)
- General funds

Various Sources Collateral

- While additional collateral is also required, HUD will work closely with applicant to determine and underwrite potential sources
- HUD can accept many sources of collateral:
  - ➢ Unlike most conventional lenders, HUD can accept a subordinate position
  - ➢ Revenues generated by special taxing districts (e.g. TIFs and single purpose districts)
  - ➢ Repayment of 3rd party loans financed with Section 108 loan (or other loan portfolios)
  - ➢ Liens on other types of revenue available (e.g. parking or casino revenues), including those unconnected to project being financed



Section 108 Application Process

Notify HUD Field Office (& HQ)

Complete Pre-submission requirements

(including citizen participation)

Submit Application

Concurrent review HUD FO and HQ

Revise Application as needed

HUD approves Application & issues commitment

Strategies for Financing Infrastructure Projects

Flexibility of Uses

Examples of Infrastructure Projects

- Street improvements (sidewalks, stormwater management, bike lanes etc.)
- Community center, recreational center, or park
- Senior center
- Healthcare facility (senior or low/mod income population served)
- Flood mitigation
- Water/sewer
- Acquisition, demolition, remediation, or site improvements for economic development

Ability to finance costs of large-scale infrastructure & repay over time

Mount Vernon, WA:

Downtown Flood Protection & Revitalization Project

Mount Vernon, WA:
Downtown Flood Protection & Revitalization Project

- **Historic downtown constantly at risk of flooding from Skagit River**
- **Every 3-5 years a major effort to protect the downtown core:**
  - 1500 to 2000 volunteers working over 24 hour time period
  - 150,000 sandbags
  - Flood fight cost ~$300,000
- **Project occurring over 3 phases**
  - Phase I: Floodwall and river trail from Division St. Bridge north to Lions Park (completed 2010)
  - **Phase II:** Included floodwall engineered to protect historic downtown Mount Vernon, 1,650 linear ft. of floodwall, 24-ft wide riverwalk and trail connection to regional trail system, 30,000 square foot Public Riverfront Park (completed 2016)
  - **Phase III: Includes** 1.4 miles of floodwall and earthen levee and .9 miles of riverwalk and trail connection to regional trail system. (Construction underway/to be completed in 2017)

Mount Vernon, WA:
Downtown Flood Protection & Revitalization Project

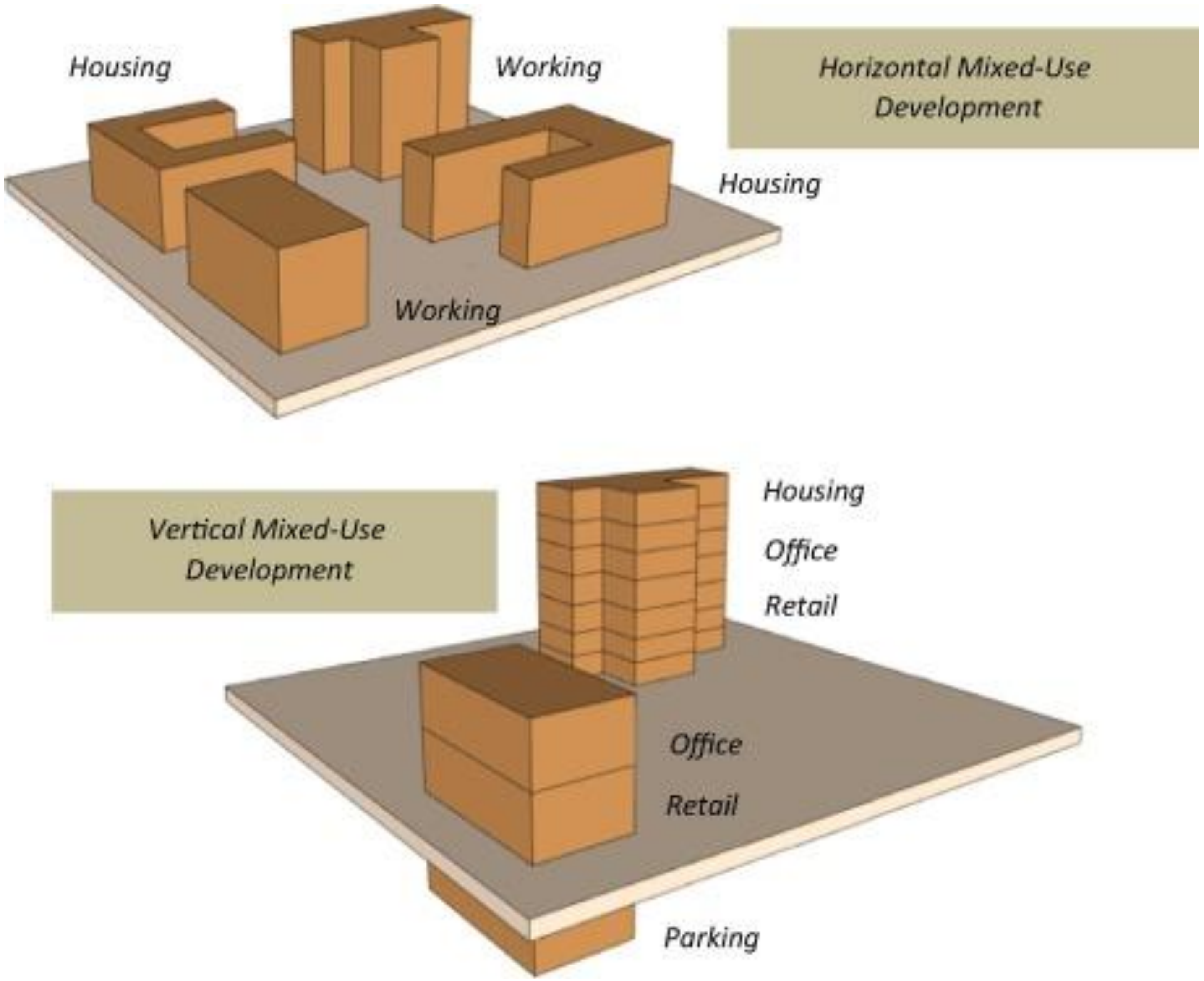
- Total Phase II development costs: $12.5 M
- Leveraged $292K in annual CDBG funds into $1 M in Section 108 assistance (repaid over 10 years)
- Section 108 used for acquisition of property, demolition of existing structures & construction of public improvements
- Portion of project assisted with Section 108 benefits an area that is primarily low- and moderate-income

Mount Vernon, WA:
Downtown Flood Protection & Revitalization Project

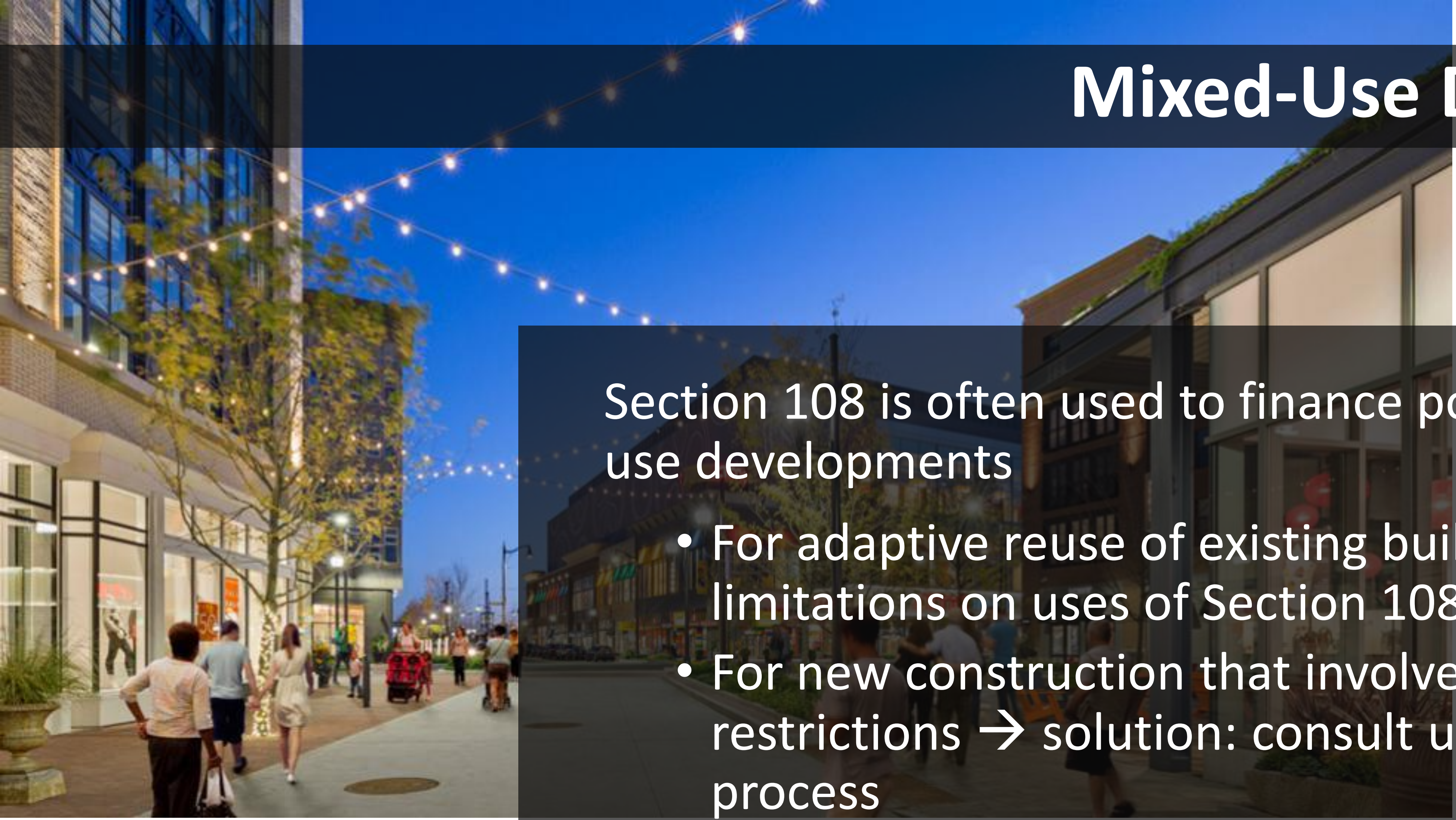
- When complete, will remove the downtown from the FEMA 100-year base flood elevation
- Enables redevelopment and economic revitalization of the historic downtown
- Provides a critical and attractive part of a regional shoreline trail system and link to community parks and a space for community events
- Projected economic benefits of new downtown development:
  - 626 new jobs in 5 years; 2,548 new jobs within 30 years
  - 125,000 square feet of new retail commercial over next 5-10 years
  - 55,000 square feet of new office over next 5-10 years
  - 200 units of high-density residential over next 5-10 years
  - Property tax will increase $9 million over next 30 years

Structuring Assistance to Mixed-Use Projects

Mixed-Use Development



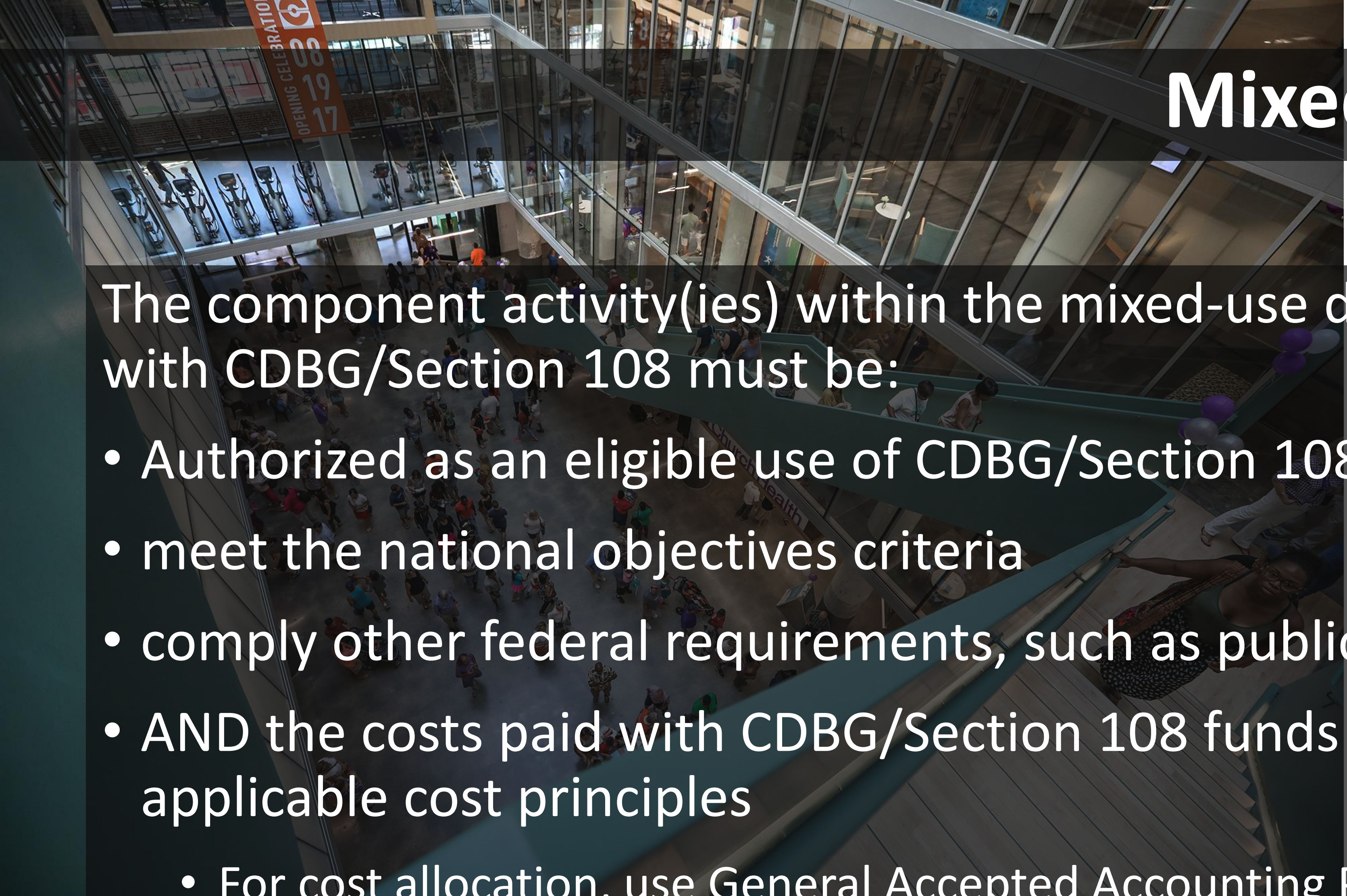
Mixed-Use Development



Section 108 is often used to finance portions of mixed-use developments

- For adaptive reuse of existing buildings, fewer limitations on uses of Section 108 funds
- For new construction that involves housing, more restrictions → solution: consult us early on in the process
- Generally Section 108 helps to fill a ‘gap’ in budget, so it’s about matching it to eligible uses

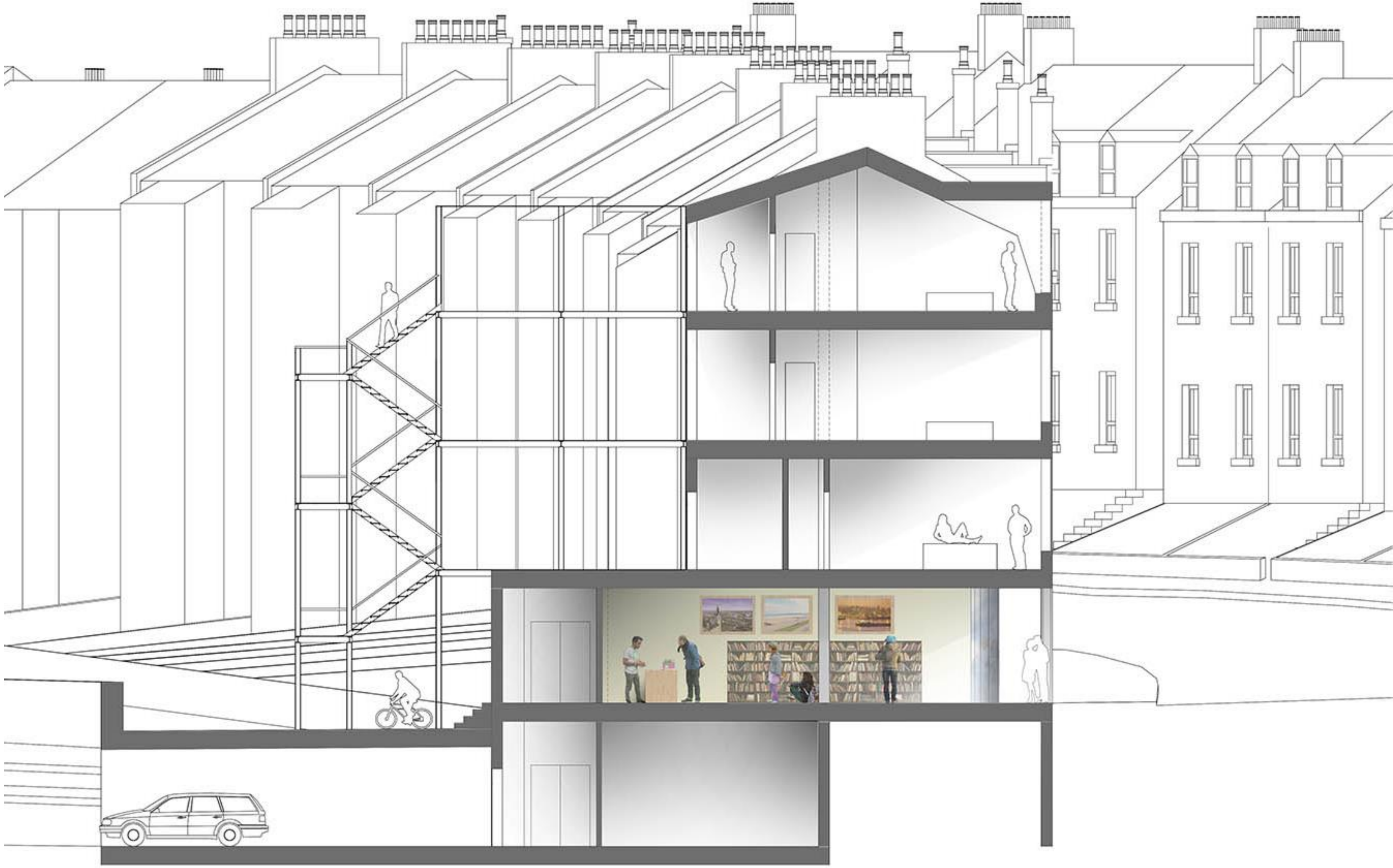
Mixed-Use Development



The component activity(ies) within the mixed-use development to be funded with CDBG/Section 108 must be:

- Authorized as an eligible use of CDBG/Section 108 funds
- meet the national objectives criteria
- comply other federal requirements, such as public benefit standards
- AND the costs paid with CDBG/Section 108 funds must comply with the applicable cost principles
    - For cost allocation, use General Accepted Accounting Principles (GAAP), most often involves cost allocation related to square footage of different uses
    - Don’t forget that portion of common areas costs can be assigned to specific uses

Need to fill a $1 million gap in $5 million project?

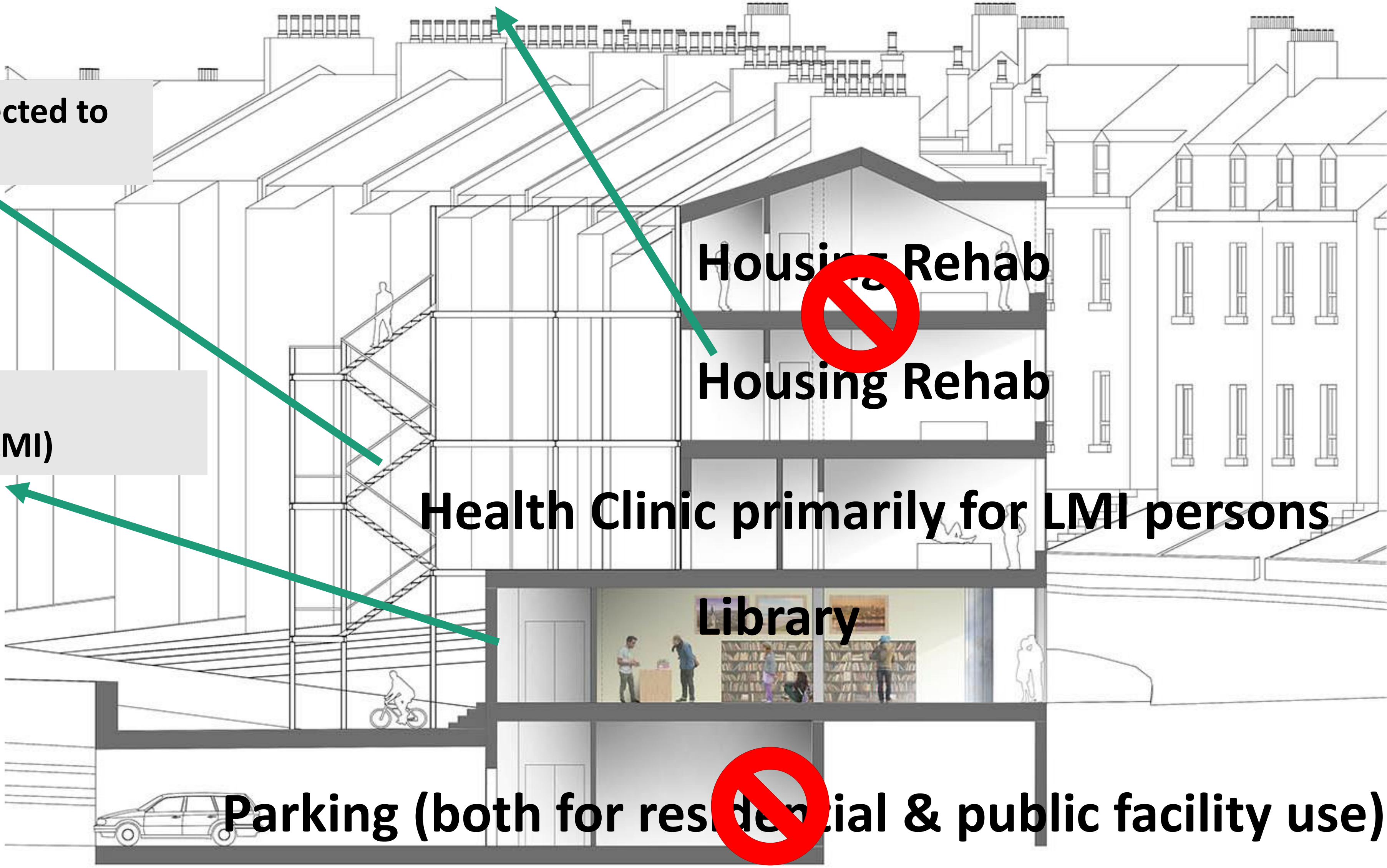


Scenario 1

Only 1 unit of LMI housing out of 4

$500K in Section 108 → Projected to serve 500 LMI clients/year

$500K in Section 108 → serves neighborhood residents (>51% LMI)

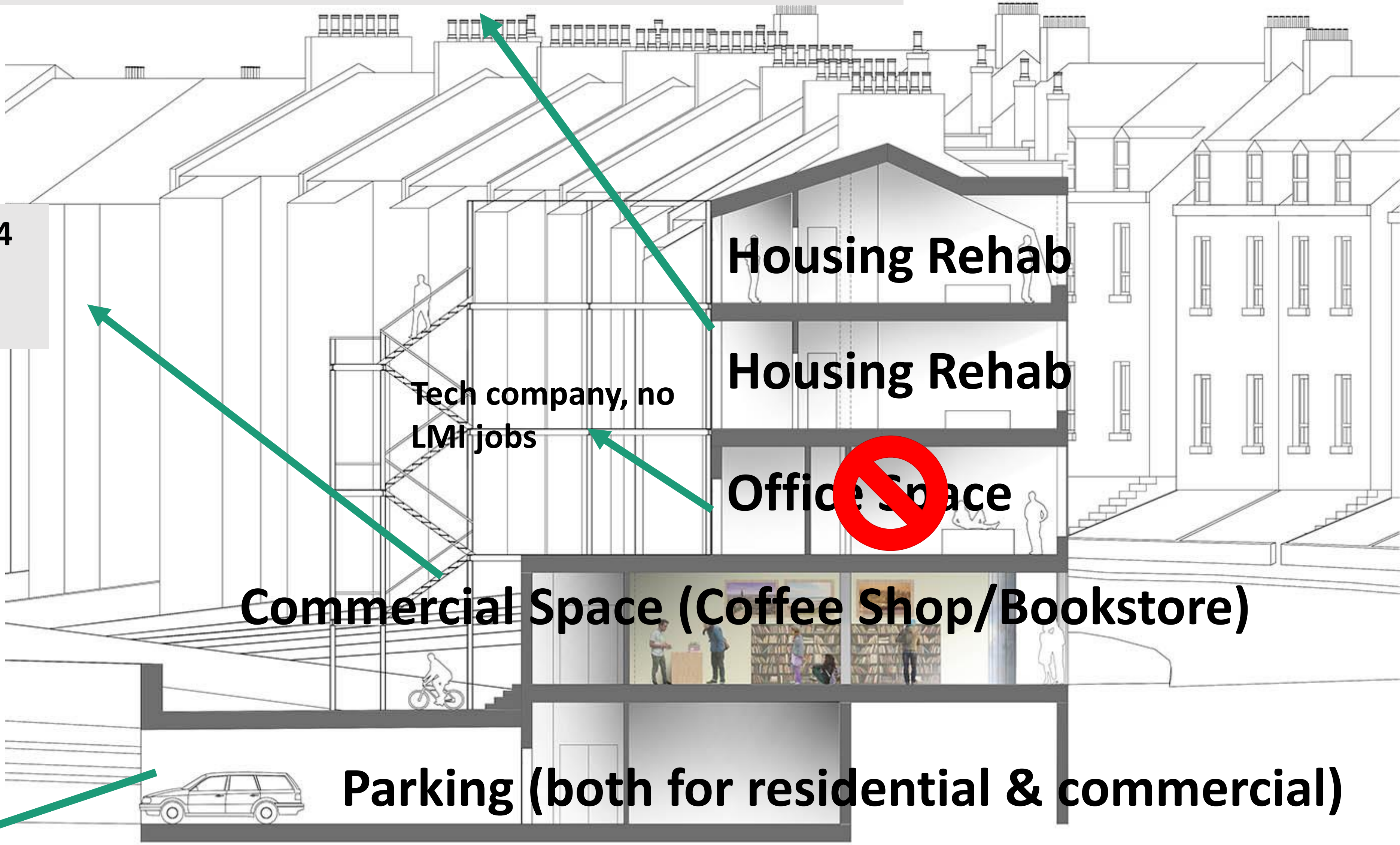


Infrastructure improvements

Scenario 2

$700K in Section 108 → 6 units (4 of which are for LMI households)

$200K in Section 108 → 4 FTE jobs (3 of which are held by LMI persons)



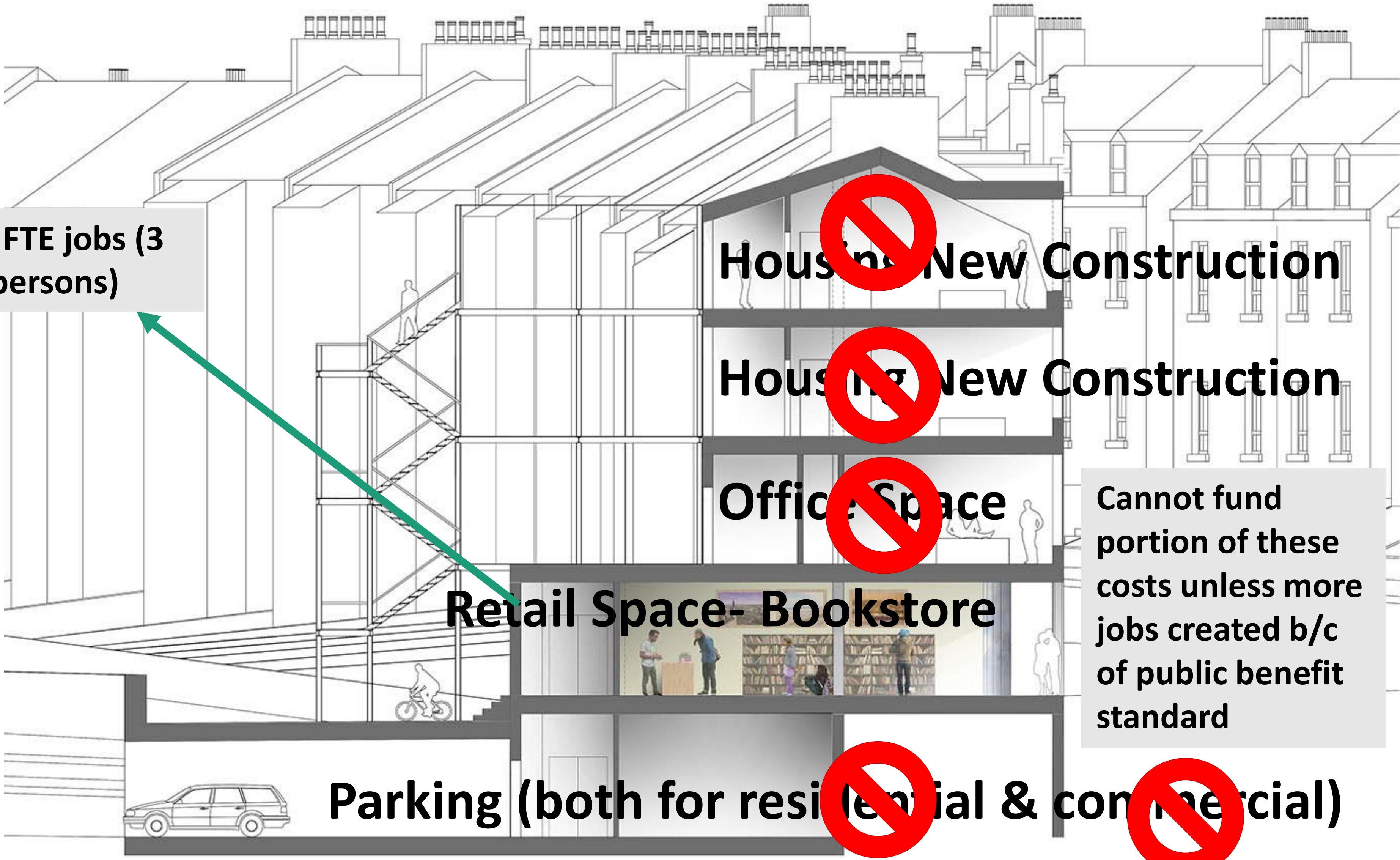
$100K in Section 108 for construction of parking lot rehab, except for portion for office space

For new construction (especially that involving housing), please contact us early in the process. Our program counsel often recommends that separate ownership structures be set-up.

Scenario 3

$200K in Section 108 → 4 FTE jobs (3 of which are held by LMI persons)

$800K of property under Slum/Blight Area



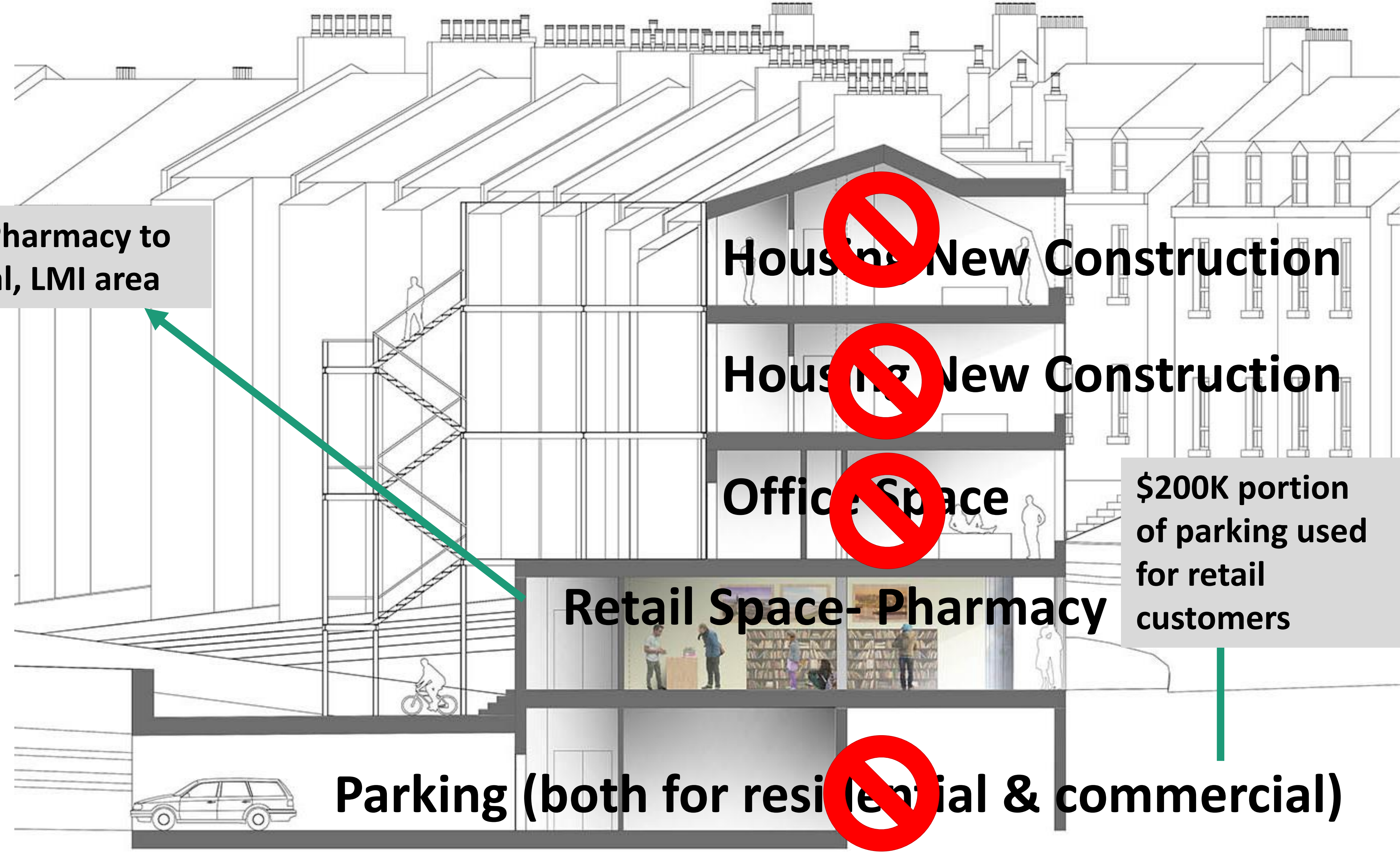
Cannot fund portion of these costs unless more jobs created b/c of public benefit standard

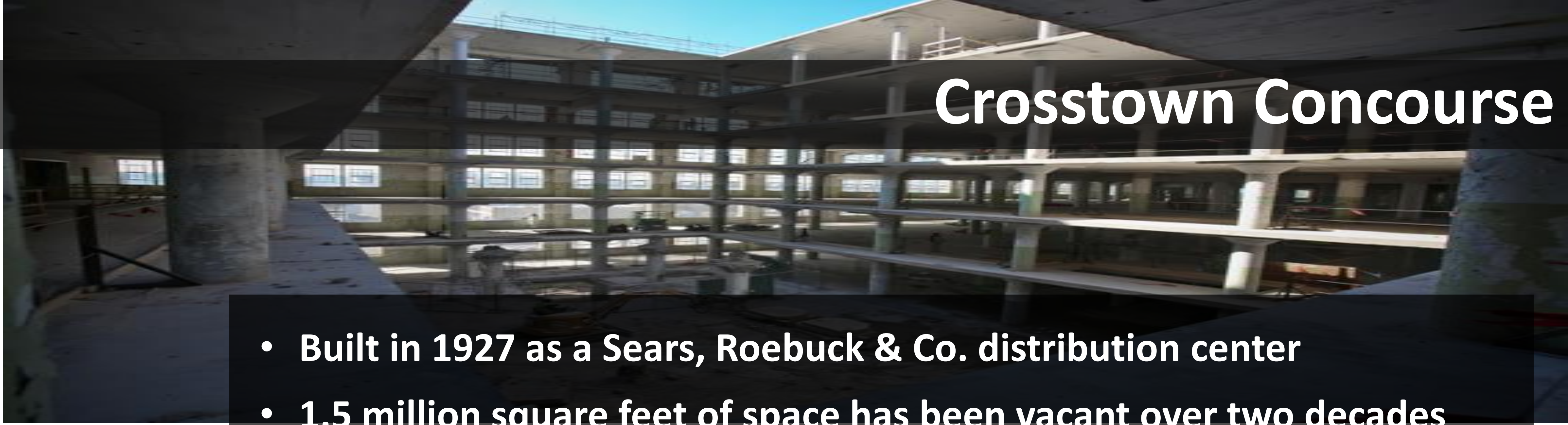
Acquisition

For new construction (especially that involving housing), please contact us early in the process. Our program counsel often recommends that separate ownership structures be set-up.

Scenario 4

$800k in Section 108 → Pharmacy to serve primarily residential, LMI area

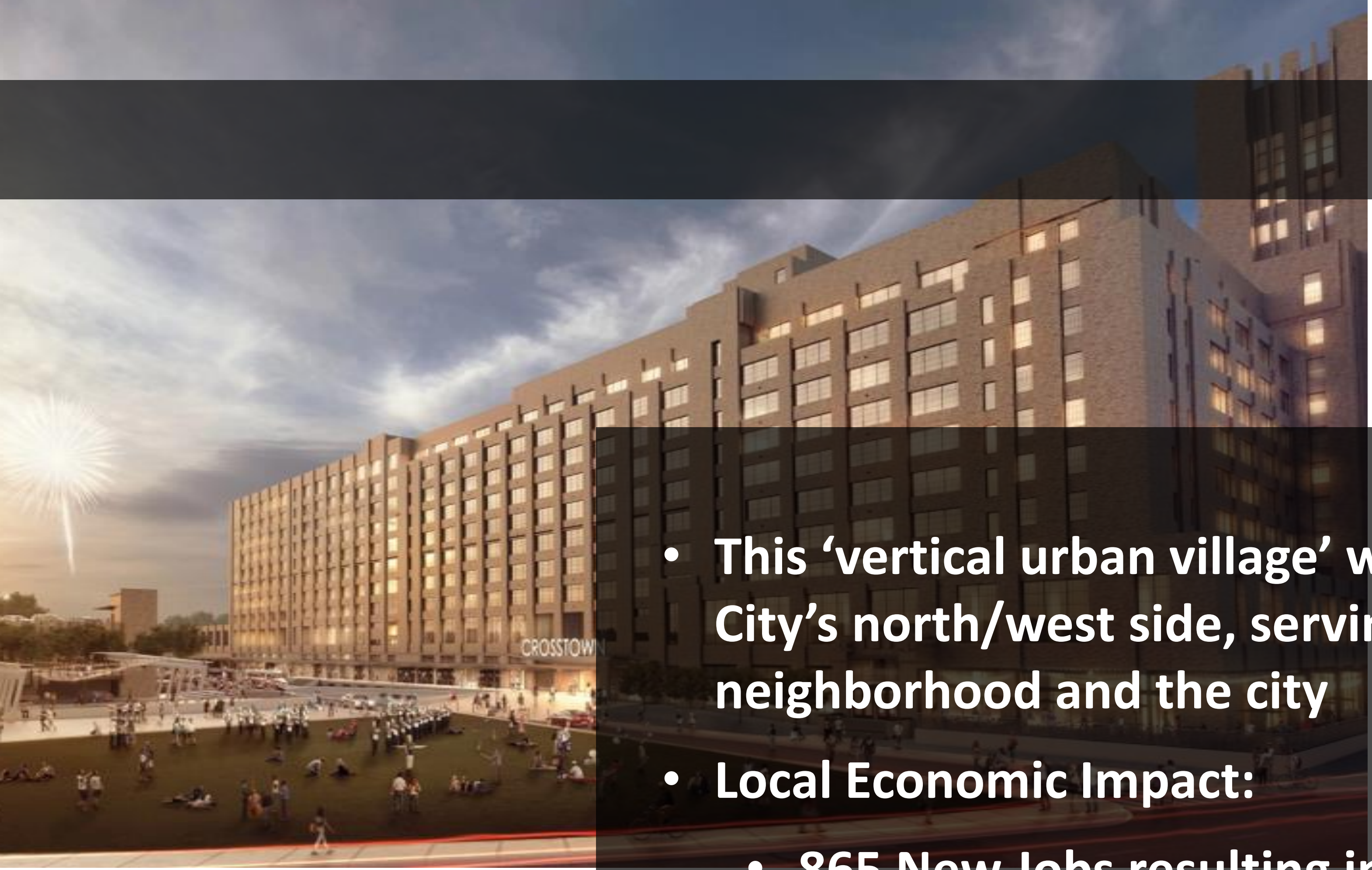




Crosstown Concourse

- Built in 1927 as a Sears, Roebuck & Co. distribution center
- 1.5 million square feet of space has been vacant over two decades (since 1993)
- Result of a partnership between eight arts, health, and educational institutions (St. Jude's, Rhodes College, among many others), which will occupy 600,000 of the sq. ft. of the development
- Multi-use development includes apartments, commercial space, and retail/restaurants

Crosstown Concourse



- This ‘vertical urban village’ will create a new anchor on the City’s north/west side, serving as catalyst for immediate neighborhood and the city
- Local Economic Impact:
  - 865 New Jobs resulting in $36.9M in new net annual wages
  - 997 New Construction Jobs resulting in $50.1M in annual construction wages
  - 1,503 New Indirect Jobs created

Memphis, TN: Crosstown Concourse

Sources of Project Financing:

$	4,000,000	HUD Section 108 Guaranteed Loan
$	2,000,000	HUD BEDI Grant
$	25,000,000	Private Equity
$	23,900,000	Historic Tax Credit Equity
$	45,000,000	New Markets Tax Credit Equity
$	91,600,000	Private Debt
$	16,150,000	City/County/State
$	207,650,000	*TOTAL PROJECT COST*

Underwriting Best Practices

Why is Underwriting so essential?

- Identifies risks involved in a particular loan
- Establishes suitable loan terms and conditions designed to mitigate those risks
- Minimizes risk to grant funds (both for CDBG & Section 108 projects)
- For Section 108 loans, underwriting is also essential to ensure HUD's acceptance of the grantee's loan to a 3rd party (business/developer) as collateral on the loan guarantee
- Currently, the underwriting guidelines at 24 CFR Appendix A to Part 570 <u>are required</u> for all 'special economic development' projects

Partnerships for Administering E.D.

CDBG/Loan Guarantee Recipient

- **In-House**: Internal staff, directly administered by recipient
- **Non-profit subrecipient**: Subrecipients – e.g. Community Development Corporations and CDFI’s
- **Other public entities**: Other public entities on behalf of recipient – e.g. Economic Development Authority or Redevelopment Authority

Real Estate Loans
(Income-Producing Properties)

- Borrower Evaluation
- Market Analysis
Property Appraisal
Project Readiness
- Project Financial Analysis
- Collateral Analysis

Business Loans

Borrower Evaluation

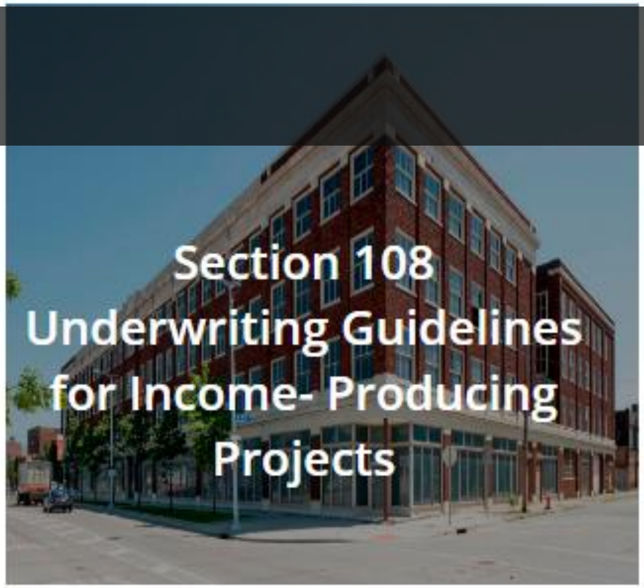
Market/Industry Analysis

Financial Statement Analysis

Projected Cash Flow Analysis

Collateral Analysis

Available Resources



The **Section 108 Underwriting Guidelines for Income-Producing Projects** assists Section 108 recipients in underwriting third party loans that finance the development of income producing properties.

The **Program Design and Application Process webinar** describes how Section 108 can serve as an important financing tool in targeting reinvestment for economic development, public facilities and improvements, and housing rehabilitation.

Section 108 Guides, Tools, and Webinars

Guides, tools, webinars, and other resources are provided to assist grantees and program partners in designing and implementing projects and programs.

View Section 108 Guides, Tools, and Webinars

HUD will publish additional resources on how to apply for loan guarantees and release new underwriting guidelines in early 2016. To receive information about upcoming webinars and the launch of new resource materials, please **join the Section 108 mailing list.**

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Tips for Combining with Other Financing Sources

Combining with Low-Income Housing Tax Credit (LIHTC)

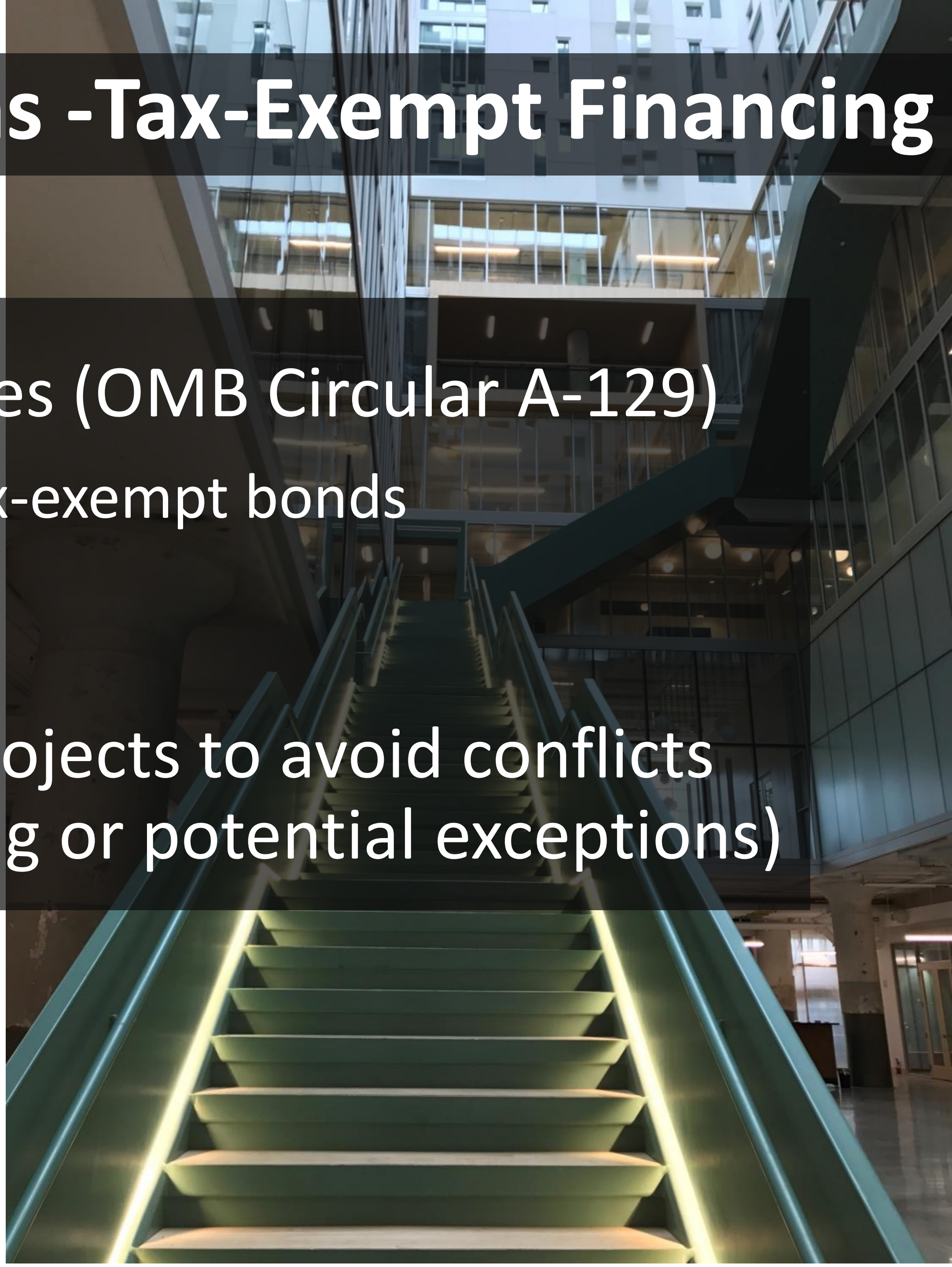
- Financing sources work well together, but recipients must comply with rules of both programs
  - Section 108 can accommodate deferred principal payments
  - LIHTC projects satisfy program objective to benefit LMI households
  - Potential Section 108 limitations on acquisition as well as on new housing construction (adaptive reuse of existing building is acceptable)

Combining with New Markets Tax Credits (NMTC)

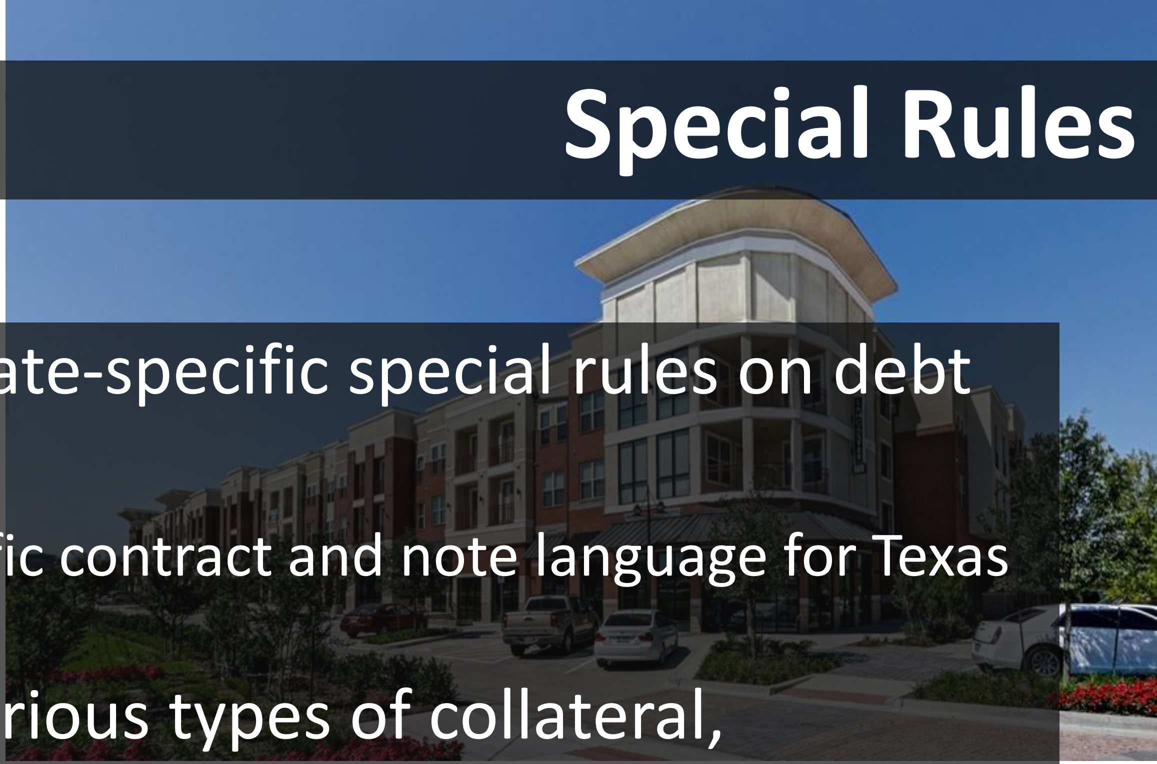
- Like LIHTC, rules of both programs apply & potential to defer principal
- Direct Loan to QALICB (the business/developer) OR
- Frequently part of “Leveraged Loan Structure” (increased equity investment in CDE→ increased tax credits)
  - All entities in the structure that ‘touch’ 108 funds must agree to 108 requirements
  - Typically requires assignment of membership interest in CDE and a collateral agency agreement
  - Section 108 collateral requirements can accommodate NMTC considerations (7-yr. compliance period, adjustment of collateral after unwind)
  - HUD & Section 108 recipient work through unwind together

Limitations -Tax-Exempt Financing

- HUD is subject to government-wide rules (OMB Circular A-129)
  - Prohibits direct and indirect subsidy of tax-exempt bonds
  - Affects repayment streams and collateral
- Our office can assist with structuring projects to avoid conflicts (e.g. identifying strategies around timing or potential exceptions)



Special Rules



- Contract flexibility can accommodate state-specific special rules on debt issuance
  - Program has adopted standard state-specific contract and note language for Texas and Alabama
- Program flexibility can accommodate various types of collateral, depending on state and local law
  - Full Faith and Credit and Moral Obligation
  - Liens on public property
  - Pledging future appropriations

NRSA’s

FORT SAM HOUSTON
PEARL BREWERY
GOVERNMENT HILL
PERSHING PARK
PERSHING ELEMENTARY
SUTTON HOMES
SAN ANTONIO MUSEUM OF ART
RUTH WOODWARD PARK
WHEATLEY MIDDLE SCHOOL
BOWDEN ELEMENTARY
FREEMAN COLISEUM
AT&T CENTER
WILLOW SPRINGS GOLF COURSE
AT&T CENTER PKWY
E HOUSTON ST
SUNSET STATION
FAIRCHILD PARK
CARVER COMMUNITY CULTURAL CENTER
SAN ANTONIO NATIONAL CEMETARY
LINCOLN PARK
E COMMERCE ST
N HACKBERRY ST
WALTERS ST
LINDBERG PARK
HEMISFAIR PARK
ALAMODOME
ST PHILIPS COLLEGE
PITTMAN SULLIVAN PARK
MARTIN LUTHER KING DR
IOWA ST
LEGEND
Eastside Promise Neighborhood
Choice Neighborhood
EPN/CN Overlap
Park

Neighborhood Revitalization Strategy Area

A locally designated area to undertake targeted revitalization efforts.

- 5 year designation
- Provides greater flexibility of CDBG & Section 108 requirements to facilitate deployment of these resources
- NRSA’s can be an option to consider when looking for flexibility for single activities

Benefits of an NRSA

- Single family housing units can be aggregated for an overall 51% low to moderate income benefit, not 100%
- Job creation/retention can meet the area benefit standard, avoiding income verification
- The aggregate public benefit standard is not required for economic development projects
- Public services undertaken by a community based development organization (CBDO) can be excluded from the 15% cap.

NRSA Approval Process

- Submit NRSA plan at any time
  - Best when submitted with new con plan so it runs the same 5-year time period.
  - If submitted later in plan cycle, the con plan is amended.

- Review is completed by local CPD field office
  - Grantee capacity
  - Stakeholder involvement
  - Performance Measures – Outcomes & Outputs
  - Likelihood proposed actions will result in housing and economic opportunities
  - Level of coordination
  - Ability to leverage funding

NRSA Specifics

Choice Neighborhoods & Promise Zones

- Neighborhoods within a Choice Neighborhood or Promise Zone may automatically qualify as an NRSA

Durham, NC

- 2012 Choice Neighborhood Planning Grant Awardee
- Choice Target Neighborhood: Southeast Central
- Neighborhood Revitalization Strategy Area: Southside

Southside Project Area

- Approximately 125 Acres
- Primarily residential area
- Residential vacancy rate of 28%
- Only 24 owner-occupied properties
- Poverty Rate approximately 29%

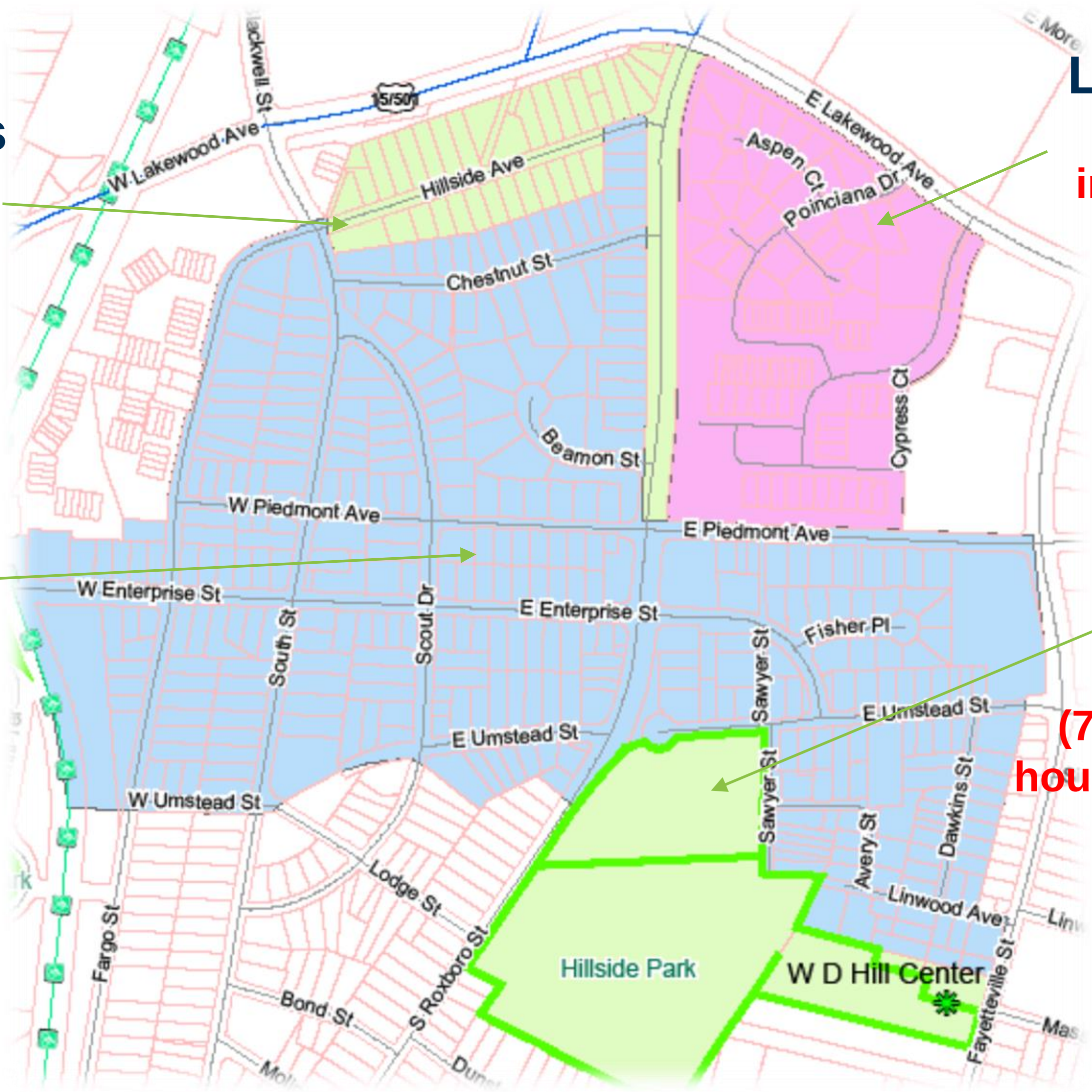
Southside Housing Conditions

- **Dilapidated: 113 (35%)**
- **Major Deficiencies: 148 (46%)**
- **Minor Deficiencies: 54 (17%)**
- **Standard: 7 (2%**
- **Vacant Lots (27% of total parcels)**

Key Elements of Southside Revitalization

New Single Family Homes
(48 in Phase I)

Piedmont Affordable Rentals
(9 total units)



Lofts at Southside
(132 unit mixed income units of which 80 are affordable)

Whitted School
(79 affordable senior housing units and Pre-K)

Southside Project - Infrastructure

- Water
- Sewer
- Curb/Gutter
- Street Pavement
- Grading of lots

More than Bricks and Mortar

Programs and Services for Southside Residents:

- Southside Neighborhood Association
- Southside Community Outreach Coordinator
- Southside Youth Leadership
- HUD Section 3 Employment Opportunities
- Durham Technical Community College Partnership
- Construction Training
- Culinary Training

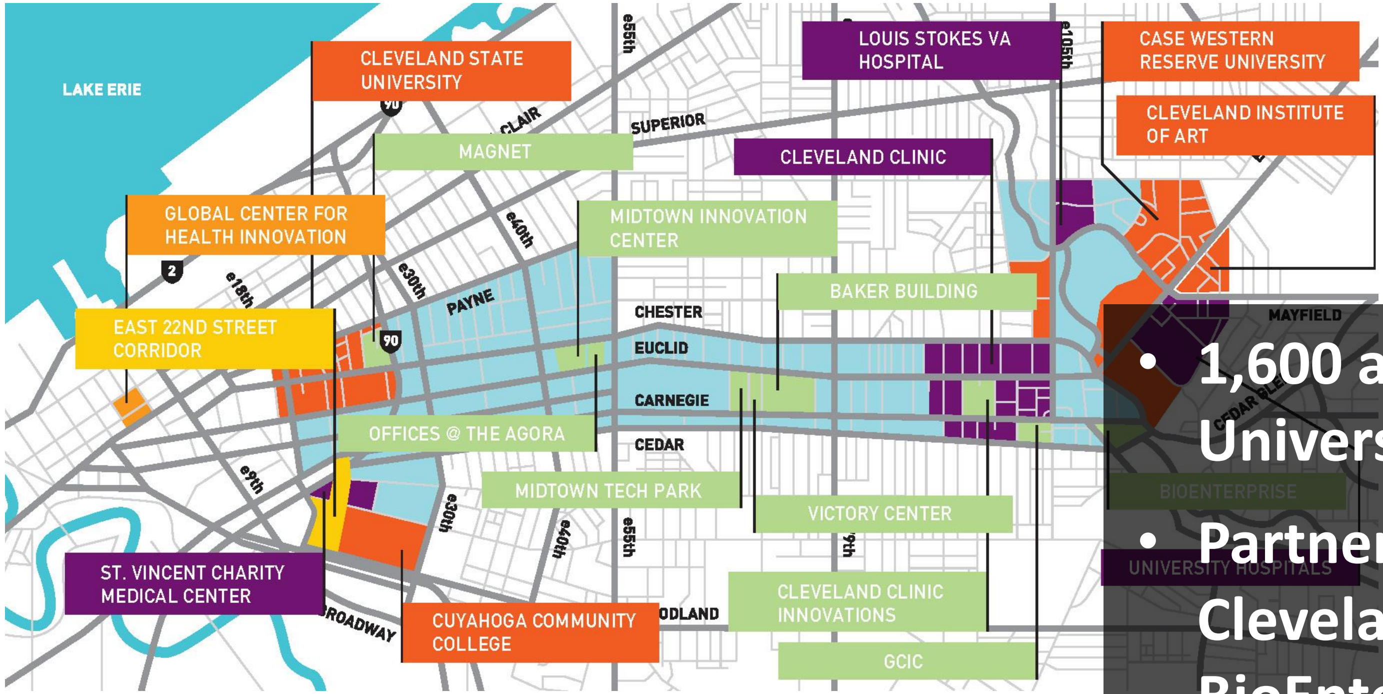
Southside Rehab Program

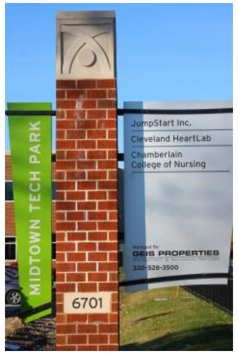
New Single Family Homes

Southside NRSA Leverage

Low Income Housing Tax (LIHTC) for the Lofts	**$12,000,000**
CDBG-Section 108 Loan	**$8,800,000**
Home Investment Partnership Fund	**$6,797,806**
Neighborhood Stabilization Program-3 Fund	**$500,000**
Whitted School	**$19,758,487**
Piedmont Rentals: City of Durham and Private Lending	**$678,000**
McCormack Barron Salazar equity	**$3,000,000**
Private Mortgages for 25 below 80% households at the Bungalows	**$2,500,000**
Market rate mortgages for 23 over 80% AMI households	**$4,025,000**
City of Durham below 80% AMI secondary & forgivable mortgages	**$1,000,000**
Purchasers' down payment from savings/NCHFA grants	**$216,000**
Duke University Incentives	**$20,000**
TOTAL	**$59,295,293**

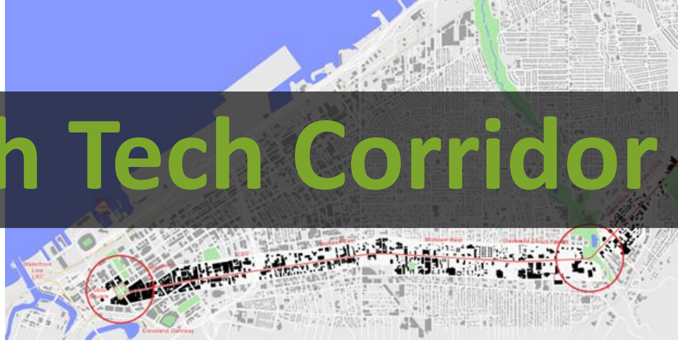
Cleveland, Ohio: Health Tech Corridor





- 1,600 acre area from Downtown Cleveland to University Circle area
- Partnership between the City of Cleveland, the Cleveland Foundation, MidTown Cleveland, and BioEnterprise
- Impact:
  - 1,800 new jobs
  - 500,000 square feet of new/renovated office and lab space
  - $4 billion of investment since 2008

Cleveland, Ohio: Health Tech Corridor



- Aimed to use presence of anchor institutions (hospitals & universities) to attract businesses
- New ‘HealthLine’ bus rapid transit route (BRT) on Euclid Avenue helped attract development
- Corridor was 86% leased in 2 years, showing growing demand
- HUD Neighborhood Revitalization Strategy Area designation streamlined documentation requirements
- **$41 million in Section 108 guaranteed loan funding** (out of a total $44 million in HUD funding) has helped finance projects in the HTC

Want more information?

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Section 108 Program:
https://www.hudexchange.info/programs/section-108/

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