Section 108 Loan Guarantee Program Case Study

Mirasol Village Redevelopment – Using the Section 108 Loan Guarantee Program with LIHTCs

The Mirasol Village Redevelopment entails the new construction of 427 units of affordable housing in five phases to replace the now demolished 218-unit Twin Rivers public housing community in the River District of Sacramento, California. Twin Rivers was the oldest of the Housing Authority of the County of Sacramento's (HACOS) housing stock. In 2012, HACOS received a Choice Neighborhoods Planning Grant to determine how to revitalize the area and create a mixed-income and more connected neighborhood. The resulting Transformation Plan, completed and submitted to HUD in 2014, proposed replacing the obsolete public housing with a mixed-income community. HACOS obtained community input in the design and planning and a part of the plan is to have residents and resident-owned companies engaged in the construction. This was also envisioned as a green development and as transit-oriented housing, with improvements in the transit options for the community. The new development will have 427 units, including a one-to-one replacement of all 218 units from the original Twin Rivers project.

This case study will focus on how the City of Sacramento, HACOS, the Housing Authority of the City of Sacramento (HACS) and the Sacramento Housing and Redevelopment Authority (SHRA) used the Department of Housing and Urban Development's (HUD) Section 108 loan guarantee program to leverage resources to help fill the funding gap for this major redevelopment effort. This redevelopment is also utilizing the Low-Income Housing Tax Credit (LIHTC) program as a major source of financing. The LIHTC program is one of the largest and most competitive federal and state programs available to provide financing for affordable housing. Section 42 of the Internal Revenue Code outlines the program. Through the sale of LIHTCs, developments can raise equity to finance between 25- 50% of construction costs. It requires that the purchaser of the LIHTC enter the partnership as a Limited Partner investor, so projects are structured as limited partnerships or limited liability corporations. (For more information about the LIHTC program, see the website for the National Council of State Housing Authorities - ncsha.org – or check the website for the state housing finance agency in your state).

This case study will specifically detail the financing for Phases B and E, the first phase of this multi-phase development to begin construction. It is helpful to note upfront that the contract for the Section 108 Loan Assistance was entered into with the City of Sacramento, as the unit of local government, and with HACS, as the designated public agency (DPA) and the borrower. HACS and HACOS then entered into a Joint Powers Authority Agreement with SHRA to lead the transaction on behalf of all the parties. The chart below shows the relationships between all the parties involved with this transaction. McCormick Baron Salazar (MBS) is the developer and general partner, and they will work with a separate investor limited partner for each phase of the development.

Chart of Relationship of Organizations for Mirasol Village (Note GP= General Partner and LP= Limited Partner, owners of the LIHTC Project Partnership)

Additional Project Background and Timeline

In 2012, HACOS put out a Request for Proposals to select a master developer for the housing portion of the Transformation Plan.   McCormack Baron Salazar (MBS), known for its work with Housing Choice Neighborhoods and public housing redevelopment, was chosen.   HACOS signed a Memorandum of Understanding with SHRA to serve as the project manager for the redevelopment of the Twin Rivers public housing site.   SHRA was appointed as the lead for the entire transformation process and was charged with working with the City of Sacramento's Economic Development Department on the transit and homeless issues. HACOS is providing needed Project-Based operating subsidies, assisted with the relocation of the existing residents, and will retain ownership of the land – providing a long-term ground lease to each project partnership.

HACOS applied for and received a Choice Neighborhood Implementation grant from HUD in 2015 to assist with the costs of the construction, as well as costs of relocation, demolition, and environmental remediation.   MBS was charged with securing state and federal financing for all the new housing, undertaking all predevelopment activities, and constructing and then managing all phases of the development. They decided to obtain bond financing through the state of California to be able to access the automatic 4% LIHTCs as provided under Section 42 of the IRS tax code. Some of the phases will also include financing from State LIHTCs, and soft financing from other state housing programs. SHRA was charged with identifying the funding for and completing the infrastructure work. As detailed below, to do this, they collaborated with the City of Sacramento and HACS to obtain a $16 million Section 108 Guaranteed Loan through HUD.

Between 2015 – 2017, other sites were acquired, and entitlements and proposed plans were reviewed and adopted by local jurisdictions. In 2017, relocation of residents from the existing buildings was started and demolition of the Twin Rivers buildings began in early 2019. Meanwhile, MBS was applying for bonding authority from the state and SHRA was working to identify funds to complete the infrastructure work. All finally came together, and construction began on the first phase of the redevelopment in the 2nd quarter of 2020, with the second phase to begin by year end. MBS will then work to obtain financing commitments for the subsequent phases.

Why Use Section 108 to fill the gap on this LIHTC transaction?

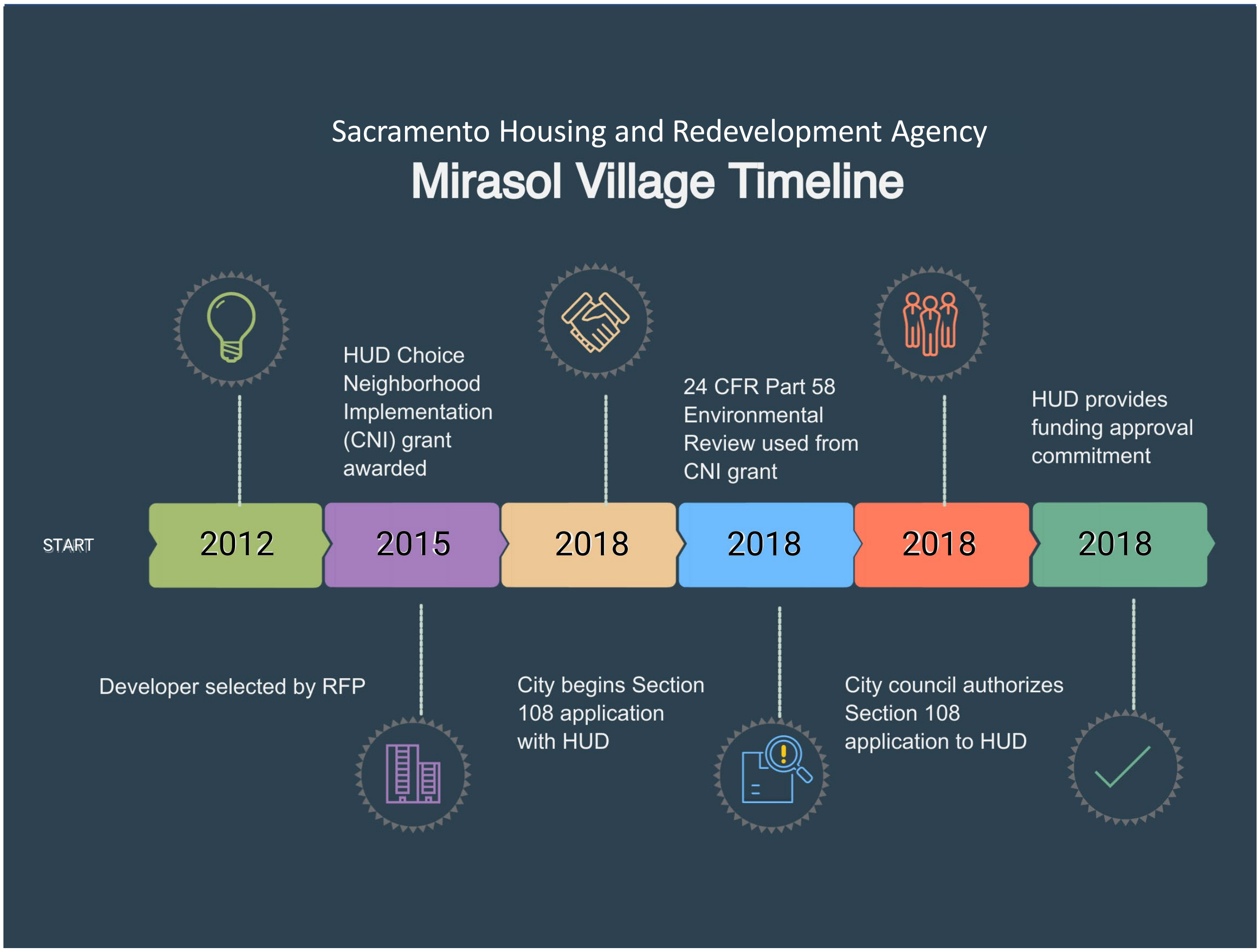
Untapped Resource. The SHRA was charged with finding $16 million to cover the needed infrastructure work for all phases of the Mirasol Village Redevelopment. This included site work, a public park, community garden, utility coordination, offsite permits, and oversight of all the improvements. Because the City had not always utilized its annual Community Development Block Grant ("CDBG") allocation, it was determined that a Section 108 Loan, allowing the City to leverage future CDBG allocations, would be the best way to fund these improvements. The City and SHRA initiated the discussion with HUD in 2017. The Section 108 program permits a CDBG grantee to leverage the annual allocation of a CDBG grant at a 5:1 ratio. For the City of Sacramento, this gave them the ability to access up to $24 million of Section 108 Loan capacity (see below).

Leverage of Section 108 Loan Guarantee – City of Sacramento, CA

2020 CDBG Allocation	5:1 Leverage Capability	Mirasol Village Section 108 Loan Amount	Mirasol Village Units
$4,800,000	$24,000,000	$16,490,000	427

Development and the Section 108 Timeline

The development of affordable rental housing, especially for public housing transformation projects, and those that use the LIHTC, requires resources from multiple sources. The timing of the submission of applications to a variety of funding sources requires careful calibration, and the rules of the various sources of funding require coordination between all the project partners and those sources of funding. While timing and order of processes will depend on individual projects and funding sources, the general process and steps initiated by the City of Sacramento and MBS for the project were as follows:



Supporting New Housing Construction with Section 108

Section 108 funding expenditures must follow the CDBG program rules, which have restrictions on the use of CDBG funds for the construction of new rental housing. Because of these restrictions, the Mirasol Village Redevelopment project required creative structuring of the financial resources.

The Developer of Mirasol Village, MBS, is a for-profit developer. The CDBG rules permit the lending of CDBG funds to a Community Based Development Organizations (CBDOs) for the new construction of rental housing but preclude loaning or granting CDBG funds to a for profit developer for this activity. However, there is flexibility with Section 108 funds to support new housing construction if used to fund infrastructure, site acquisition, demolition, or relocation costs if the work is performed by a CDBG Grantee and land is in public ownership. In this project, the land is owned by HACOS and will be leased to each project partnership, as each phase secures financing and starts construction. The $16 million Section 108 Loan proceeds for Mirasol Village will be used by SHRA to complete infrastructure improvements for the entire development including new sewer lines, roads, bike lanes, infrastructure costs, a community garden, and a public park. SHRA engaged a landscape architect and a contractor to complete the infrastructure work. The costs of the infrastructure improvements will be allocated to each phase of the development on a pro-rata basis and a reimbursement agreement will be signed between each project partnership and SHRA. Each project partnership will purchase the completed improvements with an Infrastructure Reimbursement Loan between SHRA and the project partnership. For the first phase under construction, the amount of the loan was $3,839,000. The infrastructure costs were then included in the budget for the project and allowable costs were included in the LIHTC basis.

Project Details – Phases B&E

The proposed development for this site will be located at 430 Dos Rio Street and 1390 Swallowtail Ave, Sacramento, California. Phases B and E include the new construction of 123 units targeted to families with incomes ranging from 30% Area Median Income (AMI) to 80% AMI, including one reserved for the on-site property manager.

The development plan includes the construction of playground areas and landscaped courtyards. Future phases will include a community park, resident community space, a fitness center, swimming pool and BBQ area. Amenities will be shared by all phases of the development through a shared use agreement. The total development will include 427 units. The units mix for Phases B&E will be as follows:

(44) 1-BR @ 619 sq. ft
(53) 2-BR @ 839 sq. ft
(10) 3-BR/2 Bath units @ 1,169 sq. ft
(8) 3-BR/2.5 Bath units @1,327 sq. ft.
(2) 4 BR/2 Bath units @ 1,385 sq. ft
(5) 4 BR/2.5 Bath units @ 1,385 sq. ft
(1) 5 BR unit @ 1,385 sq. ft

Common areas of 935 square feet

69 units will have Project Based Section 8 rental subsidy
22 units will be targeted to families making up to 80% AMI
The remainder (31 units) are targeted to families at 60% AMI


Mirasol Village Apartments (Rendering)

SOURCES AND USES
Mirasol Village Blocks B&E (first phase under construction)

Total Development Costs: **64,119,045**

Sources of Funds*:

Private 1st Mortgage Lender	$13,537,756
HCD (state) AHSC Loan	$12,933,015
HACOS Ground Lease Loan	$158,400
HACOS Choice Neighborhood Impl. Loan	$8,000,000
SHRA Infrastructure Loan (108 reimbursement)	$3,839,644
*LIHTC Equity Proceeds	$25,034,756
Deferred Developer Fee	$615,374
Total Sources:	**$64,119,045**

Uses of Funds:

Ground Lease from HACOS	$176,000
Infrastructure	$3,839,644
Construction	$41,539,770
Soft Costs	$9,086,935
Developer Fee	$2,702,296
Reserves	$1,112,518
Financing Costs	$3,600,325
Other	$2,061,557
Total Uses:	**$64,119,045**

*The equity proceeds referenced above are based on the sale of the 4% LIHTCs which came as of right with the allocation of bonding authority from the state of California Debt Limit Allocation Committee (CDLAC) for this development.

The California Department of Housing and Community Development (HCD) provided subordinate soft debt through the Affordable Housing Sustainable Communities Program (AHSC). This program supports infill development that reduces greenhouse gas emissions.

HACOS provided both a subordinate land lease loan and a loan funded through the Choice Neighborhoods Implementation Grant (CNI).

SHRA had a Reimbursement Infrastructure Loan with the project partnership. Infrastructure work was completed with HUD Section 108 Loan Funds. The SHRA Section 108 loan is in a subordinate position. The loan to the partnership is at an interest rate equal to the Applicable Federal Rate (AFR) at closing, with payments dependent on cashflow. Under the terms of the loan agreements, 50% of cashflow after the payment of the first mortgage debt service is paid to the deferred developer fee and the remainder used to pay soft debt based a specified formula in the documents.

Rendering of Mirasol Village

Mirasol Village Redevelopment Site Plan

Section 108 Loan Terms between the City and HUD

A summary of the Section 108 Loan provisions follows:

Amount: $16,489,000 Section 108 Loan guaranteed by HUD provided to the Housing Authority of the City of Sacrament, the designated public entity.

Principal and Interest: Funds will be requested from HUD as infrastructure costs are completed on a phase-by-phase basis. The loan term is 20 years. The initial interest rate is adjustable, based on the three-month LIBOR plus 20 basis points. Once HUD conducts its next public offering, it will market the note for sale in the capital markets which will result in a fixed rate of interest for the remaining term of the note. The principal amount of the loan will be paid based on a schedule attached to the Section 108 Loan Note signed by the City and guaranteed by HUD. It is projected to be paid from future year CDBG allocations. The annual principal payment ranges from 9% of the City of Sacramento's annual CDBG allocation up to 23% of the annual allocation, with an average of 16% through most of the term.

Collateral: The SHRA infrastructure loan is in a subordinate lien position to the permanent lender. Payments are from 50% of available cashflow, which is allocated per the documents between all the subordinate debt. HUD required a first lien position to meet requirements for note sale. Since that was not available at the project property level, HUD required that the City provide a first lien position on other City-owned real estate that was valued at an amount equal to 1.25x the loan amount. The City, therefore, had to obtain appraisals on other properties, and remove other liens. This took a few months, but they provided $21 million in real estate collateral in a first lien position to HUD as the collateral for the Mirasol Village Section108 Loan.

Section 108 Loan Provisions – Mirasol Village

Phase	HUD Rate to City	Section 108 Capital Cost	Source of HUD Capital	Payment Terms of City	Security
Used for Infrastructure Costs – drawn down on a Phased Basis.	Variable Rate Facility	Three Month LIBOR Plus twenty (20) Basis Points*; guarantee fee of 2.365%*	Money Market Funds	Quarterly Payment of Interest; Annual Payment of Principal	First Lien Position of other SHRA owned property equal in value to 1.25x the loan amount; Pledge of Future CDBG Funds.
Completion of Construction/ Operating phase	Fixed Interest Rate	Rate to be Based on Capital Cost in Bond Market; HUD Aggregates Multiple Section 108 Commitments Prior to Bond Sale	Bond Market Costs for 20 Year Facility/ Remaining Term at Time of Bond Sale	Semi-Annual Payment of Interest; Annual Payment of Principal	First Lien Position of other SHRA owned property equal in value to 1.25x the loan amount; Pledge of Future CDBG Funds.
*rate fluctuates based on market conditions					

The HUD guarantee fee is used to offset the credit subsidy costs of the loan and acts like a loan loss reserve for the federal government. The amount of the fee is modified annually based on HUD's projection of defaults and collateral recoveries on the Section 108 portfolio, as specified in the federal register. The City chose to finance the 2.365% fee from loan proceeds, alternatively the City could have paid the fee from its CDBG line of credit or used another available source.

Approval Timing Issues

In 2018, the City Council approved the Section 108 Loan Guaranty program with HUD. The closing, however, occurred late in 2019. Part of the delay was the time needed to provide the collateral needed by HUD, as described above. SHRA also had to identify a bank to be the account holder. Between that, and changes in required forms, the approval process took several months longer than expected. However, SHRA expressed that it was a positive process, and they would use Section 108 funds for housing again if needed.

Eligible Activity & National Objective

The use of the Section 108 funds was eligible under 24 CFR 570.703(f)(1), which allows for installation of public and other site improvement or facilities (other than buildings) on property owned by the recipient or its designated public agency. This eligible activity also met the CDBG program National Objective of benefiting low- and moderate-income persons by providing permanent residential structures, where at least 51% of the units will be occupied by low- and moderate-income households with incomes at or less than 80% of Area Median Income, pursuant to per 24 CFR 570.208(a)(3)(i).

Summary

The Section 108 Loan Guarantee program is a valuable tool for CDBG grantees to leverage gap financing that is critical to the development of much needed affordable rental housing. The ability to leverage CDBG allocations at a 5:1 ratio allows for CDBG grantees to maximize grant dollars to undertake large scale projects. The Mirasol Village Redevelopment provides one example of how a city can leverage its federal resources in a creative way to provide additional financing (here to pay for infrastructure improvements) to fill the gap in a locally supported redevelopment effort with the emphasis on providing affordable housing using the LIHTC.

Case Study Completed 12-2020