ARLINGTON COUNTY, VIRGINIA

County Board Agenda Item
Meeting of October 23, 2010

DATE: October 1, 2010

SUBJECT: Consideration of the revised terms and conditions for conversion and re-subordination of three (3) existing County loans to AHC Inc. multifamily residential properties to a new ownership entity and a new first deed of trust to facilitate the substantial renovations of 103 affordable apartment homes at Ashton House, Key Gardens, Taylor Square Apartments and North Ashton.

RECOMMENDATIONS:

1. Approve the conversion of the existing Affordable Housing Investment Fund (AHIF) and Community Development Block Grant loans and deeds of trust on the Ashton House, Key Garden, and Taylor Square Apartments to a new ownership affiliate as detailed in the staff report and re-subordination of the County loans to a new primary loan in the amount of up to $13.0 million during the construction financing period and up to $9.0 million during the permanent financing period.

2. Authorize the County Manager to approve the new ownership affiliate and to execute, subject to approval by the County Attorney, replacement AHIF and CDBG loan Agreements and deeds of subordination, which will subordinate the County's existing loans for the Ashton House, Key Garden and Taylor Square Apartments to a new first deed of trust as detailed in the staff report and subject to the conditions set forth in the report and to amend or execute other related contract and loan documents, subject to approval by the County Attorney.

3. Authorize the County's Manager, with the concurrence of the County Attorney, to act as the County's representative in approving financing and revisions that are described in this report or are necessary to remove any ambiguity or inconsistency or which improves the County's financial security or financial position, or address any tax or regulatory concerns of the investor or lender, and which changes do not adversely affect the County financially prior to execution of the County's financing documents.

ISSUE: County Board action is needed to allow re-subordination of existing County loans to a new first deed of trust to allow the proposed refinance and renovation of AHC's North Ashton, Ashton House, Key Garden, and Taylor Square Apartments. There are no outstanding issues.

County Manager: BMD/GA

County Attorney:

Staff: David Cristeal and Anne Venezia, DCPHD

31. B.

SUMMARY: AHC is requesting that the County re-subordinate three existing AHIF and CDBG loans for Ashton House, Key Garden, and Taylor Square to a new first deed of trust for four properties (same three plus North Ashton) and provide a letter to the Virginia Housing Development Authority (VHDA) in support of the project to enable AHC to obtain an allocation of 4% Low Income Housing Tax Credits. The County Board previously approved the conversion and re-subordination of the loans at its February 20, 2010 meeting under a 9% tax credit structure. Due to anticipated competition in the 2010 tax credit round, AHC chose not to apply for competitive tax credits and pursued financing under a 4% tax credit deal. While the project's financing has been modified substantially, the affordable housing programmatic outcomes are unchanged.

The County is presently working with AHC to confirm a new loan document structure. Under the new deal, the four scattered site properties will be cross-collateralized and collectively pay down the total outstanding debt on the three outstanding County loans. The three outstanding County AHIF and CDBG loans, estimated to total approximately $1.0 million with accumulated interest as of the projected November 1, 2010 closing date, will be subordinated to up to $13.0 million in new primary financing during the construction period and up to $9.0 million during the permanent financing period. The refinancing will result in the substantial renovation of 103 committed affordable housing units (CAFs) of which 84 are currently income restricted. After renovation, all 103 units will be income restricted.

BACKGROUND: The sponsor for the proposed financing is AHC Inc., a Virginia not for profit 501(c) (3) corporation. Each property is currently owned by a separate AHC non-profit affiliate whose sole purpose is to own and operate one of the properties. Three of the four properties, Ashton House, Taylor Square, and Key Gardens are currently financed by a cross-collateralized, tax-exempt bond issue (i.e. they all serve as collateral for the bonds in the event that one of the properties defaulted). These three properties also have outstanding AHIF and CDBG loans with the County, totaling approximately $1.0 million. North Ashton is separately financed with a VHDA loan, which would be repaid with financing from this Scattered Site deal.

The current tenant population is predominantly households earning less than 60% of area median income (AMI) and AHC anticipates that a substantial number of the current tenants will continue to live at the properties after being required to temporarily relocate during renovation.

AHC acquired Ashton House, North Ashton, Key Gardens, and Taylor Square in separate transactions completed between 1983 and 1991 and completed minor renovations at the time of each purchase. On August 8, 1995, the Arlington County Board approved the issuance of $7.5 million of Revenue Bonds by the Industrial Development Authority (IDA) to refinance the primary debt of the cross-collateralized properties, which also initially included Key Boulevard and Jordan Manor. Jordan Manor was removed from the outstanding bond issue and is now being redeveloped as a stand-alone affordable housing project. Key Boulevard is also not included in this proposal and may be redeveloped under a separate initiative.

In 2003, the County approved an additional refinancing for these properties using bonds issued by the IDA. This refinancing allowed AHC to complete minor renovations (approximately $3,000 to $4,000 per unit). At that time, the County's AHIF and CDBG funds were re-subordinated to the new bond financing package and the affordable housing compliance period was extended for 25 years or until the County loans are paid in full, whichever is longer.

As a condition of both the 1995 and 2003 refinancing, AHC agreed to increase residual receipts payments that were expected to quicken repayment of County loans. To date, the cash flow and, therefore, the repayments of the County loans have not increased as anticipated. However, AHC did repay nearly $112,000 earlier this year, which reduced the outstanding amount of the County loans. AHC indicates that the high cost of centrally-metered utilities at these properties is the reason for escalating operating costs and, thus, lower residual receipt payments. The proposed renovations will replace the old central HVAC systems with energy efficient individual HVAC units and make numerous other upgrades that will improve the properties' operating performance and result in increased repayments to the County over time.

The County Board previously approved the conversion and re-subordination of the loans at its February 20, 2010 meeting under a 9% tax credit structure. Due to anticipated competition in the 2010 tax credit round, AHC chose not to apply for competitive tax credits and pursued financing under a 4% tax credit deal. While the project's financing has been modified substantially, the affordable housing programmatic outcomes are unchanged.

DISCUSSION: The balance of AHIF and CDBG loans on the properties is expected to be approximately $1.0 million at the projected November 1 closing date (see summary table that follows). While AHC does not require additional County funds for this renovation, loan repayments would be suspended during the 2-year construction period. Based on repayments made in FY10 (approximately $112,000), AHC's budgeted repayments for the FY10 operating year (approximately $195,000), and anticipated maintenance if these units were not renovated as proposed, staff estimates that the repayments during the construction period may have been $125,000 per year.

Anticipated Balances on County Loans on November 1, 2010*

Property	Funds	Principal	Interest Earned	Total Payments	Balance on 11/1/10
Ashton House	AHIF	$328,065	$79,960	-$71,590	$336,435
Key Gardens	CDBG	$354,783	$83,053	-$61,494	$376,342
Taylor Square	CDBG	$267,767	$63,879	-$45,303	$286,343
TOTAL		**$950,615**	**$226,892**	**-$178,387**	**$999,120**

* North Ashton, the fourth property in the Scattered Site deal, does not have an outstanding loan with the County.

AHC currently owns and operates Taylor Square, Key Gardens, Ashton House, and North Ashton though separate ownership affiliates. AHC established a new for-profit tax credit partnership to acquire and refinance the four properties. AHC is requesting that the County re-subordinate its existing loans on three of these properties and for a County Manager CEO letter of support to VHDA for the project to enable AHC to obtain an allocation of 4% tax credits.

Major elements of AHC's proposal are as follows:

- The new limited partnership, with an AHC affiliate as the general partner, will acquire the properties from the existing affiliates for approximately $10.5 million (this value assumes that the appraised value of the properties will equal the 2010 County assessments). The total development budget for the project is approximately $22.5 million or $218,000/unit). See the Sources and Uses table that follows.

Permanent Financing Sources and Uses

SOURCES AND USES OF FUNDS: PERMANENT FINANCING	9% Deal (Board approved in February 2010)	Proposed 4% Deal	% increase/ decrease
SOURCES			
Senior Permanent	$7,400,000	$8,700,000	18%
Tax Credit Equity	$9,912,306	$5,430,488	-45%
AHC Loan	$0	$763,562	-
Deferred Developer Fee	$1,179,846	$1,121,820	-5%
Seller Note	$6,516,357	$4,895,444	-25%
County Loan (AHIF and CDBG)	$1,157,589	$999,120	-14%
Interim Income	-$209,492	$525,959	151%
Total Sources	**$25,956,605**	**$22,436,393**	**-14%**
USES			
Acquisition	$11,031,300	$10,506,000	-5%
Construction	$9,335,700	$7,038,900	-25%
Soft Costs	$2,628,613	$1,470,321	-44%
Development Fee	$2,359,691	$2,039,672	-14%
Financing and Tax Credit Fees	$601,300	$1,381,500	130%
Total Uses	**$25,956,605**	**$22,436,393**	**-14%**

- AHC is requesting that the County recommit the current AHIF and CDBG loans totaling approximately $1.0 million and re-subordinate the projected balance to new senior debt of approximately $13.0 million during the construction financing period and approximately $9.0 million during the permanent financing period.

- Under the proposed deal, the four scattered site properties will be cross-collateralized and collectively pay down the total outstanding debt on the three outstanding County loans for Ashton House, Key Gardens, and Taylor Square.

- A County Manager letter of support for AHC's application for non-competitive 4% tax credits to help ensure that the project exceeds the minimum score required to obtain an allocation.

- Currently, nine units at Taylor Square, four units at Key Gardens, and six units at Ashton House are not currently income-restricted (though the rents are affordable). AHC would commit these 19 units to be income-restricted units at the 60% AMI level. AHC will commit all 103 units across the four properties to be income-restricted/committed affordable units for the next 60 years (this extends the existing affordability term by more than 35 years).

- AHC plans to spend approximately $62,000 /unit for renovations with a particular emphasis on improving energy efficiency. The renovations are designed to attain EarthCraft certification. The work will include full replacement of the existing plumbing, electrical, and roofing systems. The properties will be converted from inefficient, outdated centrally-metered heating and cooling plants to high-efficiency, individual HVAC units. Other renovations will include new kitchens, new appliances, upgraded baths, and other unit improvements. The renovations will also include the conversion of six units to full ADA-accessibility since none of the units are currently accessible. The renovations should enable AHC to achieve substantial savings in operating costs that will be used, in part, to pay off the County loan more quickly.

- Tenant relocation is necessary to complete the renovations. AHC intends to phase the renovations and has begun to implement the Tenant Landlord Commission-approved Relocation Plan to vacate the buildings targeted for the first phase of construction. The project budget includes approximately $2,300/unit to support tenant relocation. Most relocated tenants will move temporarily to nearby AHC properties.

- AHC proposes a development fee that equals 9% of the project's total development budget. Fifty-five percent of this fee will be deferred (i.e. paid over time from cash flow generated by operations).

AHC's proposal is similar to its Board-approved 1995 and 2003 requests to re-subordinate County debt in that one of the project objectives is to increase residual receipts loan payments to the County. In a staff analysis, however, average annual residual receipts saw little or no increase following either the 1995 or 2003 refinancing. Staff notes that the renovations completed following those refinances were minor in scope ($3,000-$4000 per unit) and did not address major operating systems and outdated building facilities. The substantial scope of the proposed renovations should enable the properties to finally operate so that they will generate greater cash flow resulting in higher repayments to the County. As a condition of this report, staff recommends that 15% of residual cash flow be used to repay the County loans until the deferred developer fee is paid-off. After the deferred fee is paid-off, staff recommends that the County's share of residual cash flow increase to 75%

Loan Terms and Conditions: Staff recommends that the County Board approve the conversion of the existing County loans on these properties to the new ownership entity, the re-subordination of the County loan under new subordination agreements and issuance of a County Manager CEO letter of support to VHDA, subject to the following terms and conditions:

1. The applicant shall execute a generally standard AHIF and CDBG Program Agreement and loan instruments for the County loan in a form acceptable to the County Manager and the County Attorney.

2. The County financing assistance will be in the form of a subordinated residual receipts loan, secured by the four Scattered Site properties, and repayable from the collective cash

flow from the properties. This loan will be made at an interest rate of 4%, compounded annually, over a term of 30 years. This loan will be subordinate to the primary mortgages in the aggregate amount of up to $13 million during the construction financing period and up to $9.0 million during the permanent financing period.

3. The County shall receive 15% of residual cash flow until the deferred developer fee is paid-off. After the deferred fee is paid-off, the County's share of residual cash flow will increase to 75% of residual cash flow until all the County loans are paid in full. These payments will be subordinate to any cash flow payments required to comply with Low Income Housing Tax Credit program parameters, including payment of the deferred developer fee.

4. The term of affordability shall be 60 years. However, if at any time in year 35 or later (but prior to the end of the full 60-year commitment period), AHC desires to refinance the property and is unable to refinance because the units are income-restricted, AHC may return to the County Board with a request to consider a recommendation to allow the units (or a portion thereof) to be rented at levels necessary for the financial feasibility of the refinance.

5. The applicant must comply with the affordable housing set-aside for the rental units as follows: All 103 or 100% of the units shall remain affordable at rents established in accordance with 60% AMI LIHTC rents as published annually by VHDA for the unit size, minus a utility allowance (if applicable) as per the schedule annually approved by HUD for apartments in Arlington for 60 years. In addition, all units which were previously committed at rents and incomes at or below 50% of the AMI shall remain committed at these levels through the duration of the affordability term.

6. Future payment on notes taken back by AHC for the acquisition proceeds shall be reinvested in future AHC-sponsored affordable housing projects in Arlington County. As with other loan terms, County staff will monitor use of these funds to ensure they are invested as prescribed.

7. The applicant, its designated ownership entity, heirs or assigns shall provide a purchase option including a right of first refusal to the County or its designee, if the developer decides to sell the property to an unrelated third-party purchaser any time prior to or at the end of the 60-year affordability term, wherein the County or its designee shall have the right, but not the obligation, for a period of up to 180 days, to purchase the property at 90 percent of its then-appraised fair market value. If the owner's appraiser and County's appraiser do not concur on the fair market value of the property, the two appraisers shall select a third appraiser using the industry-standard three appraiser method to determine the fair market value.

8. AHC agrees to work with the County's Department of Human Services (DHS) on including up to six (6) units for DHS supportive housing program consumers.

FISCAL IMPACT: Additional County funds are not needed to support this renovation; however, repayment of County loans will be delayed approximately two years until the renovations are complete. After the renovations are complete, the County will be entitled to a portion of available cash flow immediately and future annual repayment amounts are projected to exceed repayments made prior to undertaking the project.

Location Map