

**CITY OF LAKEWOOD, WA**

**APPLICATION FOR SECTION 108 LOAN GUARANTEE**

**FROM**

**U.S. DEPARTMENT OF HOUSING AND  
URBAN DEVELOPMENT**

**FOR THE**

**ECONOMIC DEVELOPMENT LOAN FUND**

**IN THE AMOUNT OF \$2,890,000**

**January 16, 2012**

## A. Introduction

The purpose of this Section 108 application is to create a loan pool to assist with economic and community development activities in the City of Lakewood. The \$2,890,000 in 108 Guaranteed Loan Pool funding will be used for investment in key economic development projects located within the City of Lakewood. The Section 108 loan proceeds will be used as gap financing for development and as business loans to facilitate economic development.

Loan Pool funding will be made available to eligible applicants City-wide. Future targeting may focus on census tract 72000, Lakewood's most economically distressed census tract. Lakewood is currently exploring this area's potential as a Neighborhood Revitalization Strategy Area (NRSA) in an effort to turn the tide of community decline and economic disinvestment. As additional NRSA areas are developed, Lakewood will look to these areas for Loan Pool funding.

As each project becomes ready for commitment, the City of Lakewood will submit a loan proposal to HUD with a full description of the project, an explanation of the eligible activity and national objective to be achieved, and analysis of the project's compliance with the City of Lakewood's underwriting guidelines (as described in greater detail below). The City of Lakewood understands that such information will be required prior to release of funds for an individual project.

Because this application is for a loan fund, Section 108 loans may qualify under one of several eligible activities, including 24 CFR 570.703(a)(e)(f)(h)(i)(l). Similarly, Section 108 loans may qualify under one of several national objectives, including 24 CFR 208(a)(1)(2)(3)(4) and 24 CFR 208(b)(1)(2)(3). Projects funded under 24 CFR 570.703(i) will meet the public benefit test pursuant to 24 CFR 570.209(b)(3)(i)(A) or 570.209(b)(3)(i)(B) as applicable.

Following are descriptions of three potential projects representative of the type of projects the City of Lakewood expects to include into the Section 108 Loan Pool. Each of the following projects has completed initial and credible feasibility analysis and has already obtained or will not require any extraordinary permits or regulatory approvals. Any additional or replacement project selected by the City will meet the 108 underwriting criteria, including project readiness, and will be completed within a reasonable time frame from approval date.

- **Woodbrook Infrastructure Improvements** – Located in Lakewood's lowest income census tract, 72000 (80.6% LMI), Woodbrook boasts one of Lakewood's two concentrated industrial zoning districts. The project would foster industrial redevelopment through the replacement of failing and dilapidated roadway and utility infrastructure. The activity qualifies under 570.703(l) public facilities; and will meet a National Objective under 570.208(a)(1) low-moderate income area benefit.
- **Manufacturing Facility Upgrade** – This project would provide for the upgrade and renovation of manufacturing facilities for a construction related parts manufacturer. The construction would include the renovation of existing warehouse space into commercial manufacturing, including funding for machinery, utility upgrades and working capital. The activity qualifies under 570.703(i) economic development; and will meet a National

Objective under 570.208(a)(4) low-moderate income job creation. Because the project is expected to qualify under 570.703(i), it will also meet the public benefit standards under 570.209(b).

## **B. Section 108 Submission Requirements**

### **1. Community Development Objectives**

The Section 108 loan fund will result in lending for economic and community development in the City of Lakewood. In doing so the loan fund will further the City's Economic Development Goals as referenced in the City's 2010 – 2014 Consolidated Plan, including development of planned, coordinated approaches to economic development and job creation involving partnerships with bankers, realtors, developers and entrepreneurs.

In addition, the Loan Pool will support the following community development objectives as stated in the City's 5-year Consolidated Plan:

- Removing blighted and abandoned buildings
- Improving transportation options
- Providing infrastructure and utilities
- Encouraging housing renovation and more dense development in neighborhood business districts, including housing affordable to people who work in the community
- Increasing safety – actual and perceived
- Providing amenities to improve the local community – parks, quality schools, local opportunities for shopping.

### **2. Compliance with 24 CFR 570.208 - National Objectives.**

Section 570.200(a)(2) requires that all CDBG activities meet one of three National Objectives. Section 570.208 defines the three national objectives as: 1) benefit to low and moderate income families; 2) aid in the prevention or elimination of slums or blight; and 3) meeting other community development needs having a particular urgency because existing conditions pose a serious and immediate threat to the health or welfare of the community where other financial resources are not available.

Projects assisted with the Section 108 loan fund will benefit low and moderate income individuals by creating jobs, providing area benefit, providing affordable housing or serving limited clientele. The loan fund may also help eliminate conditions of blight.

### **3. Compliance with 24 CFR 570.703 – Eligible Activities**

Each of the projects to be assisted with the Section 108 loan fund will be eligible under 24 CFR 570.703. Because this application is for a loan fund, Section 108 loans will qualify under several eligible activities: (a) acquisition; (e) clearance, demolition, removal; (f) site preparation; (i) economic development activities or (l) public facilities.

None of the projects assisted with the Section 108 loan fund will be used for the ineligible activities provided in Section 570.207(a): buildings used for the general conduct of government, general governmental expenses, or for political activity.

#### **4. Section 570.209 Guidelines and Objectives for Evaluating Project Costs and Financial Requirements.**

All activities eligible under Section 570.203 and some eligible under 570.204 must meet the requirements of Section 570.209. This section outlines underwriting guidelines for ensuring that a proposed project carries out an economic development objective in an appropriate manner. These guidelines under 570.209(a) are not mandatory but serve as a framework for financially underwriting economic development projects. The City of Lakewood has developed underwriting guidelines consistent with 570.209 and described in greater detail in Section C below. Each project assisted with the Section 108 loan fund will comply with the City's underwriting guidelines.

All projects eligible under Section 203 and Section 204 will comply with public benefit standards in Section 570.209. Section 570.209(b)(1) establishes the standards for evaluating public benefit in the aggregate, Section 570.209(b)(2) applies those standards and 570.209(b)(3) establishes the standards for individual activities. All projects assisted with the Section 108 loan fund to which Section 570.209 applies will comply with the standards of subsections 570.209(b)(1), (2) & (3).

#### **C. City's Underwriting Guidelines**

**1. Project Management:** The City of Lakewood Community Development Department will administer the fund. The City of Lakewood will underwrite all loans with assistance provided by its consultant National Development Council (NDC) to advise on project feasibility. NDC has a more than 40-year track record of assisting local governments in structuring and implementing economic development and housing projects.

**2. Public Benefits:** The proposed project will clearly identify the public benefit(s) including CDBG National Objective to be achieved.

**3. Proposed Costs:** The analysis will compare estimated development costs to costs of similar properties. Also, the analysis will determine whether estimated development costs have been prepared by a credible third party such as a contractor or other cost estimator. Finally, the City's loan commitments will be conditioned on a final guaranteed maximum price contract for development within the proposed budget.

**4. Commitment of Funds:** Section 108 loans should have commitments of construction and permanent financing. If private financing includes a right to adjust the interest rate after a certain point in time, the analysis will describe the effect of such a change on the Section 108 loan. Loan documents should contain adequate lender protections (e.g., default and cure privileges) for the City, subject to reasonable conditions of other lenders having priority over the Section 108 loan.

**5. Need for Public Assistance:** The analysis will determine whether the project can be developed feasibly with private financing alone or, in fact, requires public financial assistance to make the development feasible. City staff will examine the reasonableness of a for-profit

developer's fee compared to market rates. If the for-profit developer has an ownership stake in the project, Staff will also examine the reasonableness of the developer's return under cash on cash return and internal rate of return ("IRR"). Cash on cash return measures the developer's cash return on a cash investment [i.e., cash flow ÷ equity]. IRR measures the rate at which the developer's investment grows over a long term period, taking into account periodic cash flows and property appreciation. As part of such analysis, an excessive developer fee/return will be reduced and put back into the project in the form of additional equity and/or additional reserves.

**6. Evidence of Site Control:** Eligible projects must demonstrate evidence of an executed purchase and sale agreement.

**7. Payments/Amortization:** Section 108 loans may be amortized over the full term of the loan (e.g., 20 year amortization for a 20 year loan); amortization greater than the term of the loan may be considered (e.g., 30 year amortization for a 20 year loan), if the anticipated financial condition of the project is sufficient to sustain a balloon payment at the end of the term.

**8. Ability to Repay:** The analysis will identify the primary, secondary and tertiary sources of repayment for the loan. A 1.2-projected debt coverage ratio is desired, however, a debt coverage ratio of 1.1 may be considered if the project's financial condition supports such a lower ratio (e.g., project has commitment of financially strong tenant(s) under long term lease).

Key repayment risks will be analyzed in detail, including an analysis of project financial assumptions compared to actual market conditions. The analysis will compare anticipated lease rate to similar properties. Also, the analysis will compare anticipated vacancy rates to similar properties. The analysis will also describe the projected leasing time frame to achieve project stabilization and whether reserves exist to guard against delay. If there is a balloon payment at the end of the loan term, the analysis will describe the financial condition of the property on the maturity date, the project's ability to make the final payment and efforts to mitigate risk (e.g., replacement reserves to maintain the physical condition of the property). Debt service reserves may also be required.

In addition, CDD will reference appropriate supporting documentation, such as a recent appraisal and operating pro forma to support our analysis.

**9. Collateral:** Section 108 loans should have a loan to value ratio not to exceed 80 percent at project stabilization. This value must be supported by an appraisal prior to funding. The City's security interest will typically be in the form of a deed of trust. The analysis will first determine whether the loan to value ratio exceeds 80 percent, using the property being financed as the sole source of value. If such calculation exceeds 80 percent, the analysis will then determine whether there is sufficient outside collateral to add as value, in order to meet the loan to value requirement. In certain cases, HUD permits outside guarantees to suffice for additional collateral, depending on the resources and financials of the individuals or entities providing such guarantees. The Loan Committee will decide whether to accept outside collateral and/or guarantees to meet the loan to value requirement. Consistent with customary underwriting practice, loan to value coverage will be determined at project stabilization (i.e., the point in time when the project has obtained the targeted debt coverage ratio). The analysis will also describe

how, prior to stabilization, construction risk and lease-up risk will be mitigated. The analysis will also identify key mitigation issues such as construction contingencies, reserves, guaranteed maximum price contract, and experience of the development team.

**10. Development Team Capacity and Experience:** Projects to be funded should have a development team that has both the capacity and demonstrated experience to complete the project as evidenced by past projects of similar size and scope, as well as financial strength. The analysis will include (i) resumes of development team members and (ii) a list of prior comparable projects completed by development team members with a description of project size and cost, and whether such projects were completed on time and on budget. Also, the analysis will describe development team members' experience with public funding sources and accompanying regulations as applicable (e.g., housing tax credits, Davis-Bacon).

**11. Developer / Owner Commitment:** Developer / owner commitment can take many forms. These commitments can include: developer / owner equity, guarantees of completion, guarantees to fund shortfalls or guarantees of minimum cash flow. The developer's financials will also be examined and analyzed.

**12. Character:** Projects to be funded should have developers with good credit histories, demonstrated integrity, and quality references.

**13. Proposed Costs:** The analysis will compare estimated development costs to costs of similar properties. Also, the analysis will determine whether estimated development costs have been prepared by a credible third party such as a contractor or other cost estimator. Finally, the City's loan commitments will be conditioned on a final guaranteed maximum price contract for development within the proposed budget.

**14. Loan Term:** (as permitted under federal regulations) Section 108 loans shall not exceed a loan term of 20 years, with no loan to exceed the overall 20 year term of this loan fund and in no event to exceed the useful life of the asset being financed.

**15. Interim Borrowing:** Interest rates on interim borrowing are priced at the 3 month London Interbank Offered (LIBO) rate plus 20 basis points (0.2%). Permanent financing is pegged to yields on U.S. Treasury obligations of similar maturity to the principal amount. A small additional basis point spread, depending on maturity, will be added to the Treasury yield to determine the actual rate. Interest rates on interim borrowing are priced at the 3 month London Interbank Offered (LIBO) rate plus 20 basis points (0.2%). Permanent financing is pegged to yields on U.S. Treasury obligations of similar maturity to the principal amount. A small additional basis point spread, depending on maturity, will be added to the Treasury yield to determine the actual rate.

**16. Interest Rate** Section 108 loans will carry a fixed rate pursuant to a HUD public offering; or floating rate based on HUD formula of 90 day LIBOR (London Interbank Offered Rate), as adjusted monthly, plus 20 basis points. The City may charge the borrower an interest rate that is higher or lower than the HUD floating rate. Any change in the interest rate will be discussed in the underwriting analysis.

**17. Origination Fee to City:** The City of Lakewood will assess a fee of up to 2% of principal amount. This fee shall be used to pay for the City of Lakewood's direct and indirect costs in underwriting and managing the loan program.

**18. Project Monitoring:** Throughout the duration of a project, the City will monitor fund recipients, including on-site visits as appropriate. The objective of monitoring activities will be to determine the status of funds and to ensure that projects are being administered properly and in accordance with the Loan Agreement, special program requirements, and applicable City, State, and Federal laws, rules and regulations.

**19: Interim Benchmark Measurements** For each of the projects to be funded, the City will set key interim benchmarks to measure performance in pre-construction, construction and post-construction stages.

**D. Pledge of CDBG Guarantee**

The City of Lakewood understands that if the participants in this Section 108 loan fund fail to make timely payments and the City of Lakewood therefore fails to make a required payment on its notes, HUD will deduct that payment from the City of Lakewood's CDBG Letter of Credit and in accepting this loan guarantee, the City of Lakewood will pledge its CDBG funds and all other applicable grants as security for the guarantee.

**E. Schedule for City's Repayment of Loan**

In requesting approval of this loan guarantee the City of Lakewood is requesting a commitment for a 20-year term. The City of Lakewood will act as the borrower and issue the guaranteed debt obligations, consistent with RCW 35.21.735. Please use the following principal repayment schedule. The sources of repayments will be payments on the loans from the proceeds of the guaranteed notes. The City expects to close on its first loan within 18 months of Loan Pool approval, with subsequent project-specific approvals every 12-18 months thereafter. Therefore City initially proposes the principal repayment schedule from 2014 through 2034 as detailed below for the Loan Pool.

### Loan Payment Schedule

<u>Date</u>	<u>Payment</u>	<u>Date</u>	<u>Payment</u>
August 1, 2014	0	August 1, 2026	144,000
August 1, 2015	31,000	August 1, 2027	151,000
August 1, 2016	63,000	August 1, 2028	159,000
August 1, 2017	93,000	August 1, 2029	167,000
August 1, 2018	97,000	August 1, 2030	175,000
August 1, 2019	102,000	August 1, 2031	184,000
August 1, 2020	107,000	August 1, 2032	193,000
August 1, 2021	113,000	August 1, 2033	601,000
August 1, 2022	118,000		
August 1, 2023	124,000		
August 1, 2024	131,000		
August 1, 2025	137,000		

**TOTAL**

**2,890,000**