2004 National Community Development Lending School
Commercial Real Estate Case Study
Eve Ryan

KEEPING MONEY IN THE COMMUNITY: COMMERCIAL REAL ESTATE LENDING

AGENDA

8:30 a.m.	Introductions
9:15 a.m.	Overview of concepts, terms, definitions and course outline
10:30 a.m.	Break
10:45 a.m.	Case study discussion ▪ Sources and Uses ▪ Financial Review ▪ Market Discussion
12:00 p.m.	Lunch
1:00 p.m.	Break out Group Sessions – case work
2:00 p.m.	Group Presentations
4:15 p.m.	Final Analysis – DOES IT WORK

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COURSE OBJECTIVE

The objective of the course is to familiarize you with the nuances of community development Commercial Real Estate lending focused on multi family housing projects with evolving market and funding demands.

- Understand the concept of affordable housing project financing to include use of tiered soft financing sources; balanced sources and uses; and financial review.

- Address the trend of developing mixed use projects including retail and/or office.

- Review urban issues that include development in proximity to transportation, services, schools, work place and the containment of urban sprawl.

Hollywood and Western
A Multi-Use Project Case Study
Construction Loan Request

BACKGROUND:

The project to be constructed project consists of 60 family rental units, 9,000 square feet of retail space and a 4,000 square foot child care center in the Hollywood area of Los Angeles, California. The project is located adjacent to the completed first phase project developed by the same development team.

BORROWING ENTITY:

The borrowing entity is a limited partnership comprised of two general partners: 1) a nationally known for-profit developer whose principals have been involved in IRS Section 42 Low Income Housing Tax Credit financing for over 10 years, Hope VI program funding, and market rate projects on multi-family, single family, retail and commercial real estate properties. They are well-known and held in high regard by numerous Housing Agencies and have had considerable success in obtaining Hope VI and 4% and 9% tax credit financing from numerous state finance agencies; and 2) a local-non profit developer, whose experience has been limited to and concentrated in the Hollywood community. They have partnered with this for-profit, and larger non-profits and have maintained a good reputation in multi-family housing management and social service delivery. The limited partner is a large national syndicator whose investors include Fannie Mae, Freddie Mac and many of the large banks in the US. They are considered premier providers of guarantees for less experienced developers.

BORROWERS' FINANCIALS:

For-Profit General Partner:

The for-profit general partner has provided audited financial statements for 2002 fiscal year (they operate on a calendar year) as well as unaudited statements for the period ending 3/30/04. Audited statements for 2003 will not be available until after your submission for approval.

For the period ending 12/30/02, they reported net equity of $4.7MM on total assets of $17MM and total liabilities of $12.5MM. Assets include unrestricted cash of $500M or 3% of total assets. Restricted cash consists primarily of two components: concentration cash account and proceeds from a $2MM foundation loan. The latter is restricted to provide financial assistance for housing development projects for low to moderate income residents in the Los Angeles area.

Liabilities of $12.5MM, of which $71% or $8.9MM were outstandings on a parent line of credit. Other debt totaled $1.4MM of which $145M was short-term debt and $1.2MM was long term debt. Accounts Payable and Accrued Expenses totaled $816M of which $330M was a provision for income taxes. Deferred Fee Income was stated at $803M from four projects.

The for-profit general partner provided unaudited statements as of 3/30/04 reflecting $728M in Net Income on Total Income of $12,722M and $11,602M in Total Expenses. FYE 2002 Income Statement showed $1,339M in Net Income.

Non-Profit General Partner:

The agency was formed in 1989 and is a 501c3 non profit community based organization. Unaudited financial statements as of 12/31/03 have been received from the non-profit general partner.

The balance sheet shows total Assets of $5,658M comprised of $968M in total Current Assets to include $546M in cash and cash equivalents; Fixed Assets of $2,160M to include land and buildings, and; Other Assets of $2,530M.

Liabilities equated to $4,835M with the largest portion attributable to Long Term Mortgage Payables of $4,542M. Resulting Fund Balance is reported at $823M.

The non-profit general partner has provided an Income Statement reflecting Net Income of $204M based on $900M in Total Unrestricted Revenue and $695M in Total Expenses. The largest component of income came from project development and management fees and the larges expense was Salaries and Related Expenses of $461M. Prior year's Income Statement reflected $70M in NOI

PROJECT DESCRIPTION:

General

The project will be 60 units of new construction family rental housing in the Hollywood area of Los Angeles, California on a 1.117 acre site. The u-shaped building will be four stories on top of a subterranean parking garage and the Hollywood-Western MTA subway station. The ground floor will consist of 9,000 square feet of retail space fronting the MTA station entrance at the corner of Hollywood and Western, and 4,000 square feet of child care space. In addition there will be a 1,000 square foot community room for the residents. The courtyard in the middle of the building will be open space, mainly for use by the child care center. Floors 2 through 4 will be the residential rental units. Two elevators will serve the building, with interior corridors on each floor.

The architecture of the building has been designed to integrate into the architectural design and artistic style of the MTA station. The MTA station, on the ground level, is designed with rightly colored tile and the artistic design "pays homage to the native Mestizo heritage and original European settlement" as well as the pan-ethnic backgrounds of more recent immigrants who constitute a large portion of Metro Rail users. Fossilized animal bones found when the site was excavated as well as 2 replicas of the old Pacific Electric Red cars are integrated into the station design.

Tenants of the family units will be income-restricted between 35% and 60% of AMI. Unit sizes will range from 509 square feet for a one-bedroom/one bath unit to 1,442 square feet for a four-bedroom unit. Unit features include central air conditioning, refrigerators and dishwashers. Washers and dryers will be included in the three and four-bedroom units.

There will be 45 parking spaces for the residential units (.75 spaces per unit) in a subterranean parking garage off Western Avenue, and 38 additional parking spaces for the retail space and child care space in a surface lot off Hollywood Boulevard.

This is a second phase of Hollywood 1, financed with tax-exempt bonds and 4% LIHTCs. Phase 1 contains 61 units and is income restricted to families at 50% to 60% of Area Median Income (AMI). Phase 1 is currently 100% leased and occupied.

The non-profit will provide a variety of service linkages between the residents of the project and a variety of service agencies, to include job training, after-school programs, free legal services, counseling and medical services.

Retail Space

The 9,000 square foot retail will be on the ground floor of the building and will face Hollywood Blvd and Western Blvd., wrapping around the plaza entrance to the train station. The retail storefronts will have a depth of 40 to 46 feet with unfinished ceiling heights of 15.5 feet. The storefront will be all glass. The retail component is designed for multiple tenants.

Child Care Center

The project includes a 4,000 square foot child care center on the ground floor, and can accommodate up to 70 children.

MARKET ANALYSIS:

Housing Market

Although you have yet to engage an appraisal, you have knowledge that vacancy rates for apartments in the area are very low. You believe demand is strong, especially for affordable units.

Retail Market

The project is located in an area of recently completed or soon to be completed new retail space, much of which is still in leasing. Street level rental rates for the corridor range from $2.25 per square foot, triple net to $3.50 per square foot, triple net for 5 to 10 year leases. Second floor space is leasing at $1.75 per square feet.

UNDERWRITING:

The borrower used the following assumptions to underwrite the project

- **Operating Expenses** - $3,600 per unit per year. The land is owned by the MTA and is exempt from property taxes. The residential improvements will receive a welfare exemption once the construction is completed.
- **Ground Lease** – the borrower has already entered into a 75-year lease with the MTA. The lease has capitalized Base Rent of $1,275,000 and an annual, residual receipts payment of 30% of the after-debt residential NOI and an annual, residual receipts payment of 40% of the after debt retail NOI.
- **Permanent Loan** – the developer needs to obtain a commitment for a permanent loan on the property.
- **Tax Credit Equity** – The 9% LIHTC project will generate $7,397,000 in equity based on the sale of the tax credits at $.82 per Allocation Dollar.

- <u>**Other Repayment Sources**</u> – ***The City of Los Angeles Redevelopment Agency (LACRA)*** has committed to a total loan amount of $3,726,000, of which $561,000 is earmarked for the childcare center. A 24 month predevelopment and acquisition loan in the amount of $1,790,000 has been executed and that loan, plus an additional $1,936,000 will become a permanent loan. LACRA will disburse their own loan funds. Terms of the LACRA loan will be 3% simple interest, residual receipts, and 55 years. Although LACRA has agreed to master lease the retail space for 20 years for $2 /s.f., the lease will not be in place before you close your construction loan. ***The Metropolitan Transportation Authority (MTA)*** and the borrower have entered into a ground lease for the subject property. A portion of the property has been developed with the entrance to a Metro Station (at ground level) and the train station itself is located underground. The developer is planning to apply for an AHP loan in the next round. The Syndicator is not requiring a rate lock on the permanent financing.

- <u>**Additional Underwriting Issues:**</u>
  - The MTA ground lease will not be subordinated to the construction or permanent loans.
  - The LIHTC award is predicated on 98% of the units being targeted to households with annual incomes that do not exceed 60% of AMI and as defined in the application as:
    14% of units targeted to 35% of AMI
    20% of units targeted to 40% of AMI
    38% of units targeted to 50% of AMI
    25% of units targeted to 60% of AMI
  - The Syndicator plans to infuse 60% of the Tax Credit Equity in upfront equity at closing.
  - Guarantees will come from the For-profit developer partner alone per pre-existing agreement between the partners.
  - Development fee will be $1,200M.

ENVIRONMENTAL:

A Phase I environmental report has been prepared for the borrower but conditions exist calling for a Phase 2 to be prepared.

INSTRUCTIONS

You've now reviewed all the information available to you. You have been given **Sources and Uses** based on a Site Acquisition – Phase I and Permanent Financing – Phase II scenario and Operating Scenario on the Multi Family aspect of the project.

You are considering financing this project and developing a financial proposal based on a thorough analysis to be presented to your Senior Management. Please consider the following and be prepared to discuss and fully support:

1. Are the sources and uses appropriate for this project? Numbers provided by the development team have been included in the Sources and Uses. Please consider the entire budget and use the assumption you will charge .90% loan fee and 5.75% interest for an 18 month construction/stabilization term. Then complete a balanced Sources and Uses.

Please note a Developer Fee Pay-In Schedule is at the bottom of the Sources and Uses. You will need to determine a pay-in schedule based on your final Sources and Uses balancing. The Estimated bank costs of closing the loan have been provided for you on the same page.

2. You have been provided a proforma on the Multi Family units. Use this consideration…..the Master Lease income has been capitalized in the development budget and the only ongoing lease expense is a residual receipts payment. Do you agree with the assumptions provided by the developer based on the facts you have?
3. What loan amount would you recommend as appropriate during construction for this project? Do you have a cushion? If so, how is it derived?
4. What extension option, if any, would you offer the developer?
    a. If offered, what conditions for extension would you require?
5. Assume the permanent lender will do two notes; one for the multi family and the other for the commercial with one mortgage on the property. What permanent loan amounts do you derive from your assumptions?
6. What guarantees should be required from the for-profit general partner?
7. List the key strengths and weaknesses of the project, development team and market.
8. How will you mitigate the weaknesses?
9. Do you support this loan request?

Attachments:
Exhibit #1 – Sources & Uses
Proforma – Multi-Family (to be handed out in class)
Phase I Environmental Study (to be handed out in class)

EXHIBIT #1: Sources & Uses

Hollywood Western
Los Angeles, Ca.

# Units:	60	Loan Amount:	$ -
Residential NRSF:	50,127sf	Loan Amount per Unit:	$ -

PHASE ONE: Site Acquisition & New Construction

11-Mar-02

SOURCES		USES				per unit
Bank Financing		Land Acquisition/Capitalized Lease Payment			$ 1,275,000	$ 21,250
LACRA	$ 3,165,000	Construction Cost of Improvements			$ 6,667,000	$ 111,117
LACRA - Child Care	$ 561,000	OnSite Improvements/Landscaping/Parking			$ 1,388,000	$ 23,133
Tax Credit Equity	$ 4,508,000	Offsites			$ -	$ -
60% #		General Conditions/Contractor OH & Profit			$ 990,000	$ 16,500
		Hard cost contingency		5.0%	$ 402,800	$ 6,713
		Payment & Performance Bond			$ 82,550	$ 1,376
Up-front Cash	$	Permits & Fees			$ 310,000	$ 5,167
		Architect/Engineer			$ 515,000	$ 8,583
		Soils/environmental testing/survey/inspection			$ 115,000	$ 1,917
		Title/Escrow/Recording			$ 51,000	$ 850
		Insurance/Taxes			$ 44,000	$ 733
		Legal/Accounting			$ 160,000	$ 2,667
		Marketing/Leaseup Costs			$ 60,000	$ 1,000
		Closing expenses (see tabulation, below)			$ 55,850	$ 931
		Loan Fee	0.90%	of loan amount	$ -	$ -
		Interest Reserve	5.750%	-- 50% AOB -- 18 mos.	$	$ -
		Permanent Loan Costs			$ 30,000	$ 500
		Common Area Furnishings/Equipment			$ 15,000	$ 250
		TCAC Fees			$ 90,200	$ 1,503
		Soft Cost Contingency			$ 138,000	$ 2,300
		Developer Fee			$	$ -
		Bridge Loan Fee/Syndication Costs			$ 99,000	$ 1,650
		Capitalized Operating Reserve			$ 73,000	$ 1,217
		G&A/Holding Costs			$ 40,000	$ 667
		Construction Mgt.			$ 45,000	$ 750
TOTAL SOURCES	$ 8,234,000	TOTAL USES		$ (4,412,400)	$ 12,646,400	$ 210,773

PHASE TWO: Permanent Financing

SOURCES		USES			per unit
Perm. Loan -	$ 1,750,000	Construction Loan Repayment		$ -	$ -
Perm. Retail Loan -	1,000,000				
Tax Credit Equity -	$ 2,989,000	Developer's Fee		$	-
TOTAL SOURCES	$ 5,739,000	TOTAL USES		$ -	$ -

TOTAL DEVELOPMENT COSTS:	**5,739,000**	**$ 12,646,400**
PER UNIT:		**$ 210,773**
Loan as a % of Total Development Costs:		0%
Estimated TAX CREDIT PROCEEDS:		**$ 7,497,000**
PROCEEDS per ALLOCATION DOLLAR:		**$0.82**

ESTIMATED CLOSING FEES:	
Appraisal - external	$7,500
Appraisal - internal	1,875
Costing (inc. inspections)	8,700
Environmental Review	1,275
Tax Service/Flood	1,500
Legal	35,000
Total CLOSING estimate	$55,850

DEVELOPER FEE PAY-IN SCHEDULE:		
Total Fee:	-- 9% of TDC	$1,200,000
Paid at Closing	$0	0% of total fee
Pmts during const	$0	0% of total fee
Paid @ close of perm	$0	0% of total fee
Deferred Developer Fee	$0	0% of total fee

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