

CITY OF SEATTLE

PROPOSAL FOR SECTION 108 LOAN

**TO FINANCE DEVELOPMENT OF
3333 RAINIER AVENUE SOUTH
(FORMER CHUBBY AND TUBBY)**

UNDER THE CITY'S \$10 MILLION SECTION 108 LOAN FUND

JULY 3, 2008

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I. LOAN SUMMARY

Borrower: SouthEast Effective Development (“SEED”).

Purpose: Acquisition and non-construction development costs of the residential portion of the property

Loan Amount: \$2,150,000

BEDI Grant Amount: \$430,000

Term: Loan Term expires in 2027

Interest Rate: HUD Section 108 floating rate based on 20 basis points over 90 day LIBOR (approximately 3% as of June 2008).

Principal Repayment: Principal payments for the project will be amortized over the loan term in the following amounts:

Year	Principal
2008	0
2009	0
2010	0
2011	45,000
2012	45,000
2013	45,000
2014	45,000
2015	45,000
2016	45,000
2017	45,000
2018	45,000
2019	45,000
2020	45,000
2021	45,000
2022	45,000
2023	45,000
2024	45,000
2025	45,000
2026	45,000
2027	1,430,000
	\$2,150,000

Security:

- 1) The City will take a subordinated interest in a real estate deed of trust for the Property
- 2) Reserves capitalized in the development budget necessary to meet OED’s debt coverage requirements. Reserves to be released after cash

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receipts verify the project has met debt coverage requirements for a period of three-consecutive years.

3) Unconditional guaranty from SEED

Loan Fee: \$21,500 (or 1% of the cumulative \$2,150,000 principal amount due at closing).

**Administrative/
Monitoring Fee:** \$3,000 (annual)

Financial Reports: Borrower shall provide the City of Seattle, Office of Economic Development with annual financial statements of the Borrower within 120 days of the end of its fiscal year and a rent roll and annual operating statement for the projects certified by the Borrower.

Environmental: All required environmental contaminant removal, remediation and disposal shall be undertaken in full compliance with applicable OSHA standards.

Conditions for Loan Disbursement Disbursement of the loan is conditioned on the following:
1) Confirmation that bond cap has been allocated to the project
2) Final commitments from all other financing sources including tax exempt financing and tax credit equity; and
3) Guaranteed maximum price contract from the general contractor

II. PROJECT DESCRIPTION

The Project is located in Southeast Seattle, an historically underinvested and low-income community. Southeast Seattle has a population of nearly 45,000 with a higher percentage of low- and moderate-income households compared to the citywide percentage (Southeast 61.5%; citywide 43.9%). Similarly, Southeast’s poverty and unemployment rates exceed the citywide rates (Southeast 17% poverty and 8.3% unemployment; citywide 11.8% poverty and 5.1% unemployment).

To help spur investment, the City received HUD approval to designate Southeast Seattle as a Neighborhood Revitalization Strategy Area (“NRSA”) and has directed a significant amount of CDBG resources to Southeast including capitalization of the Rainier Valley Community Development Fund (“CDF”). Investment of this proposed Section 108 Loan will help advance the City’s objectives/strategies identified in the NRSA to create rental housing at all income levels, including affordable rental housing (NRSA, p. 87).

The Project is located on 3333 Rainier Avenue (“Property”), at the site of the former Chubby and Tubby hardware store/warehouse and less than ½ mile south of the future Mount Baker light rail station. In 2005, SouthEast Effective Development (“SEED”) acquired the Property with bridge financing provided by the Enterprise Foundation and the CDF. SEED will demolish the existing building¹ and construct two buildings: one mixed-use building fronting Rainier Avenue with approximately 58 rental units and 5,700 square feet of commercial/retail space and a second

¹ Tenants currently in the building will move prior to the start of construction. These tenants are on month-to-month leases that include specific waivers of rights to relocation assistance.

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building at the rear portion of the Property with approximately 10 rental units. SEED has committed to make all 68 units to be affordable between 60% and 80% median income. Construction will commence by February 1, 2009 and will be completed by June 1, 2010.

SEED has requested a Section 108 Loan to finance residential costs of the project, including permanent acquisition financing and non-construction development soft costs². Loan funds will be drawn from proceeds of a City non-recourse note issued under a Contract for Loan Guarantee Assistance with HUD in the amount of \$10 million ("Section 108 Loan Fund"). BEDI funds in the amount of \$430,000 will be used for payment of a Section 108 loan loss reserve and certain project costs (as more particularly described in Section IV below).

III. PUBLIC BENEFIT

CDBG National Objective

Each project funded under the City's \$10 million Section 108 Loan Fund must meet one of three CDBG national objectives pursuant to 24 CFR 570.200(a)(2) and 570.208:

1. Benefit to low and moderate income families.
2. Aid in the prevention or elimination of slums or blight.
3. Activities meeting community development needs having a particular urgency because existing conditions pose a serious and immediate threat to health or welfare of the community and where other financial resources are not available to meet such needs.

The Project will meet the national objective of benefiting low and moderate income families through the creation of affordable housing. Pursuant to Section 570.208(a)(3) of the CDBG regulations, at least 51% of the residential units of the project must be occupied by low- and moderate-income households. The Project will exceed this minimum standard because all housing units (approximately 68 rental units) will be affordable between 60% and 80% median income.

108 Eligible Activity

In addition to meeting a national objective, projects funded under the Section 108 loan fund must meet an eligible activity. The Project will be eligible under 24 CFR 570.703(i)(2) and 570.204 as a community economic development project.

² The proposed 108 loan will not replace/refinance the loan previously made by CDF.

IV. DEVELOPMENT BUDGET - PROJECT FINANCING

The following represents a summary of the development costs, construction financing sources and permanent financing sources. A more detailed development budget is attached as an exhibit to this Loan Proposal.

DEVELOPMENT BUDGET

Total Development Cost = \$19,784,761

The following represents a summary of the development costs.

Cost	Total Project	Residential Portion
Acquisition	2,671,401	2,444,787
Construction	12,531,763	11,687,130
Soft Costs	1,075,283	990,855
Financing Costs	1,358,355	1,250,389
Organizational Costs	2,147,959	2,015,406
TOTAL	19,784,761	18,388,567

Construction Financing Sources

Financing Sources	Amount	Basic Terms	Status
Tax-Exempt Bond Financing – Tier A	3,582,566	17 year, 5.3% Interest	Proposed
Tax Exempt Bond Financing – Tier B (\$700,000 plus bridge of several permanent sources) <ul style="list-style-type: none"> • Bridge of \$3,773,137 tax credit equity) • Bridge of \$2 million State HTF • Bridge of \$500,000 King County • Bridge of \$483,000 OH 	7,456,137	24 months; 4.9% interest	Proposed
Section 108 Loan	2,150,000	Loan term until 2027 90 day LIBOR + 20 basis points	Proposed
BEDI	430,000	Companion grant to 108 loan	Proposed (Committed in same Council legislation as 108 loan)
City (OED) - CDC Equity Fund (CDBG)	149,533	0% interest; forgivable upon completion of lease-up	Committed
City – Office of Housing <ul style="list-style-type: none"> • OH committed \$3,953,000 • \$483,000 not disbursed during construction due to tax exempt bond rules to maximize use of 	3,470,000	50 year term; 0% interest	Committed

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tax exempt bond funds during construction			
EPA Grant	35,000		Committed
Seattle City Light Built Smart Built Green Green Communities – Enterprise	156,086		Proposed Proposed Proposed
SEED – Deferred Development Fee	980,025		Committed
SEED – cash	150,000		Committed
Rainier Valley Community Development Fund <ul style="list-style-type: none"> Prior loan of \$1,087,000 repaid except for \$275,000 to remain during construction 	275,000	4.5%; 10 years	Proposed
Commercial Construction Loan <ul style="list-style-type: none"> Same lender as providing tax exempt financing 	950,414	5%; 24 months	Proposed
TOTAL	19,784,761		

Permanent Financing Sources

Financing Sources	Amount	Basic Terms	Status
Tax Exempt Bond Financing – Tier A	3,582,566	17 year term; 35 year amortization; 5.3% interest	Proposed
Tax Exempt Bond Financing – Tier B	700,000	4.9%	Proposed
Low Income Housing Tax Credit Equity	3,773,137	Tax credit equity based on \$0.91 per credit	Proposed
State Housing Trust Fund	2,000,000	40 year term; 1% interest; Payments deferred until Yr 17.	Committed
Section 108 Loan	2,150,000	Loan term until 2027; 90 day LIBOR + 20 basis points	Proposed
BEDI	430,000	Companion grant to 108 loan	Proposed; Committed when 108 loan committed
City (OED) - CDC Equity Fund (CDBG)	149,533	0% interest; forgivable upon completion of lease-up	Committed
City – Office of Housing	3,953,000	50 year term; 0% interest	Committed
King County	500,000		Committed
EPA Grant	35,000		Committed
Seattle City Light Built Smart	156,086		Proposed Proposed

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Built Green Green Communities - Enterprise			Proposed
SEED – cash	150,000		Committed
SEED – Deferred Development Fee	980,025		Committed
Rainier Valley Community Development Fund <ul style="list-style-type: none"> • Prior loan of \$1,087,000 repaid except for \$275,000 to remain during construction 	275,000	4.5%; 10 years	Proposed
Rainier Valley Community Development Fund	950,414	5%; 10 years	Proposed
TOTAL	19,784,761		

NOTES:

- As noted in the tables above, SEED has not received final commitments for several sources in the development budget. The Project has not yet received bond cap from the State Housing Finance Commission but is expected to receive bond cap in September. SEED has obtained letters of interest from a potential lender of tax exempt bond financing and from a potential investor of housing tax credits. The terms of such financing are consistent with other recent projects. However, the 108 loan will not be disbursed until such financing commitments have been finalized.
- SEED has received a \$2 million commitment from the State Housing Trust Fund.
- SEED has obtained a funding commitment from King County in the amount of \$500,000, and has requested an additional \$700,000. It is unclear whether King County will provide such additional funds. If King County commits the additional \$700,000, SEED will use such funds as partial take-out financing for tax exempt bond financing after the completion of construction. Due to the uncertainty regarding these funds, OED’s underwriting analysis does not include the \$700,000 King County funds as a financing source.
- OED has already committed \$149,533 in CDC Equity Fund to the Project. However, these funds will not be disbursed unless and until the 108 loan is ready to be disbursed.
- If the 108 loan is approved, the City will receive companion Brownfields Economic Development Initiative (“BEDI”) grant funds in the amount of \$430,000 for use in this project. The City will use BEDI grant funds as a loan loss reserve (\$288,433) for the 108 loan and for project costs (\$141,567). Allocation for these two purposes will be as follows:
 - Loan loss reserve: the amount of BEDI reserved for loan loss has been determined according to a HUD approved formula of:
 - 2.5% of the loan 53,750
 - + 6 months of debt service &

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<u>operating expenses</u>		<u>234,683</u>
= Total Loan Loss Reserve	=	288,433

- **Project costs:** after the loan loss reserve amount has been determined, BEDI grant funds in the amount of \$141,567 may be used for project costs (\$430,000-288,433).
- The Rainier Valley Community Development Fund has been requested to keep \$275,000 of its current loan in the project and disburse a new loan in the amount of \$950,414 to finance the commercial portion of the project.

V. OPERATING BUDGET – ABILITY TO REPAY

Primary Source of Repayment

The primary source of repayment for the loan will be revenue generated by project residential rental income.

The appraisal and market studies conclude that the Project is located in a strong market due to the near completion of light rail construction. (Appraisal, p. 19; Market Study, p. 33). Moreover, the appraisal and market studies conclude that absorption rate should be between 10 to 30 units per month, which would result in the Project’s lease-up within 3 to 7 months. (Appraisal, p. 19; Market Study, p. 39). While OED agrees that the market position is generally strong, we are using a more conservative absorption rate of 6 units per month based on SEED’s experience with its Dakota Project. The Dakota (Rainier Court Phase 2) has 178 units between 50-60% AMI, and experienced an absorption rate of 7 units per month. Due to the close proximity of the Dakota to this Project and the similar affordability of the units, OED has decided to model the pro forma on the more conservative 6 units per month with lease-up lasting as long as 1 year.

With respect to vacancy, the appraisal concludes that the rate is currently 2.8%. (Appraisal, p. 19). This is consistent with SEED’s experience with the Dakota. To be conservative, OED’s analysis projects a 5% vacancy.

OED will apply a 1.15 debt coverage requirement for this Project. This debt coverage is lower than the 1.2 coverage required for mixed-use projects. Because the 108 loan will not finance the commercial portion of the project and will not rely on revenue from the commercial space, OED believes it is prudent to use a lower debt coverage of 1.15 which is consistent with what other lenders use for housing projects. According to rent projections in the pro forma, the project will not initially meet the City’s 1.15 debt coverage requirement. To satisfy the City’s underwriting debt coverage requirement, OED will require capitalization of a debt service reserve for the benefit of the City, in the amount of \$288,433 (Budget/ProForma p. 1 and 4). The debt service reserve will be released when project revenues are high enough to reach the 1.15 debt coverage ratio for a consecutive period of three (3) years. Based on projections in 2027, SEED should be able to refinance current debt (@1.25 dcr) and make the final payment on the Section 108 loan (Budget/Pro Forma, p. 5).

The Borrower has made a commitment to maintain the buildings in good condition. The pro

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forma includes an annual budgeted amount of \$465 per unit for repairs and maintenance. The pro forma also indicates replacement reserves in the amount of \$350 per unit. (Budget/ProForma p. 4) These amounts are consistent with reserves required by lenders in housing tax credit projects.

Secondary Source of Repayment

The secondary source of repayment is recourse to the project collateral as discussed in the section below entitled Collateral.

Tertiary Source of Repayment

The third source of repayment is the financial strength of SEED. Analysis of SEED’s financial strength is relevant to determine their ability to provide a guaranty for the loan. SEED has maintained solid financial ratios, including a healthy net cash balance and working capital (Budget/ProForma, p. 9).

VI. COLLATERAL

The 108 loan will be secured by a deed of trust on the Property. During the construction period, the 108 loan will be subordinate to “Tier A” tax exempt bond financing in the amount of \$3,582,566 and a portion of “Tier B” tax exempt bond financing in the amount of \$4,473,137. The remaining \$2,983,000 of the Tier B financing will be subordinate to the 108 loan. The total amount of senior debt during construction will be \$8,055,703. An appraisal on the Property confirms that the combined amount of the 108 loan and senior debt is less than 80% of the value of Property.

Loan to Value Ratio =	<u>Loan Amount</u> Fair Market Value of Collateral
Loan Amount =	Private Loan Amount (senior to 108 loan) = \$8,055,703 108 Loan Amount = \$2,150,000 Total Amount = \$10,205,703
Fair Market Value of = Collateral	\$15,180,000
Loan to Value =	$\frac{\$10,205,703 \text{ [combined loan amount]}}{\$15,180,000 \text{ [fair market value of collateral]}}$
Loan to Value Ratio=	.672

Following the completion of construction, the amount of senior private debt will decrease to \$4,282,566, resulting in a combined loan amount of \$6,432,566. The loan to value ratio after completion of construction will improve to .424 (\$6,432,566/\$15,180,000).

The City will also have access to BEDI grant funds in the amount of \$288,433. Under a loan to

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discounted value analysis, the combination of security in the CDE and cash security results is below the maximum 1:1.

Loan to Discounted Value (not to exceed 1:1)

Collateral	Value	Discount Rate	Discounted Value	Less Prior Liens	Net Value	Loan to Discounted Value
Security in the deed of trust	\$15,180,000	.80	\$12,144,000	\$8,055,703	\$4,088,297	
BEDI	\$288,433	1.0	\$288,433	0	\$288,433	
TOTAL:					\$4,376,730	.491

In addition to a deed of trust and BEDI reserves, the City will have a guaranty from SEED.

VII. DEVELOPMENT TEAM AND EXPERIENCE

SEED will serve as the project developer and has extensive experience developing affordable housing near the future Mount Baker light rail station. SEED recently developed Rainier Court Phases 1 and 2 (Courtland Place and the Dakota), located a few blocks south of the current Project. SEED will also handle property management for the Project, employing a live-in manager in charge of day-to-day management of the property and part-time staff to handle leasing and maintenance duties.

Architect

Diana Keys of Johnson Braund Design Group is leading the project design. Johnson Braund has a nearly 30-year track record of success in a variety of housing projects, including multi-family affordable housing and market rate condominium projects. SEED previously worked with the firm on the Rainier Court project. (Resumes attached)

General Contractor

Inter-City Contractors, Inc. is serving as SEED’s general contractor. ICC has extensive experience on a broad range of projects including construction of multi-family affordable housing, office and retail commercial projects. ICC has worked on several projects with Johnson Braund. Moreover, SEED has worked with both Johnson Braund and ICC on the Rainier Court project. (Resumes attached)

VIII. DEVELOPER/OWNER COMMITMENT

SEED has committed a significant amount of time and resources to bring the project through the predevelopment phase. SEED is contributing \$150,000 in cash and will defer development fees

of \$980,025. Finally, they have a history of community development projects and programs to revitalize Southeast Seattle.

IX. CHARACTER

Over the past 30 years, SEED has developed several projects in Southeast and currently owns 900 units of housing. Within the last 10 years, SEED has invested significant resources to acquire and develop property near the future Mount Baker light rail station, including Courtland Place and the Dakota. SEED has demonstrated a commitment to ensure the continued availability of affordable housing as the future Mount Baker light rail station encourages the development of higher income, market rate housing.

X. PROPOSED COSTS

The development budget has been prepared with the assistance of SEED's consultant Housing Resources Group, project architect Johnson Braund Design Group, Inc. and SEED's general contractor Inter-City Contractors, Inc. Based on the level of review and comparison of costs to other recent housing tax credit projects, OED believes that the cost estimates are reasonable. A guaranteed maximum price contract will be required as a disbursement condition of the 108 loan.

The development budget contains various contingencies to guard against any cost overruns. SEED has reserved a construction contingency of \$917,718, representing 8.6% of the hard construction costs. This contingency amount is consistent with customary underwriting requirements.

XI. COMMITMENT OF FUNDS

As described above, SEED needs final commitment from several of the funding sources. Due to the letters of interest already provided, OED believes that the commitments will be forthcoming at the projected loan terms/rates. However, the City's 108 loan will not be disbursed until all funding sources have been committed.

XII. NEED FOR PUBLIC ASSISTANCE

Due to the high cost of construction and relatively low rents, the Project cannot be constructed through private financing alone. The Project requires significant assistance from the City (OH and OED) to make development feasible. Without such support from the City (and other significant contributions from the State, County and CDF), the project would have a financing gap of several million dollars.