NYC HDC

NEW YORK CITY
HOUSING DEVELOPMENT
CORPORATION

MEMORANDUM

To: The Chairperson and Members

From: Marc Jahr
President

Date: September 18, 2013

Subject: HDC Limited Guaranty for Preserving City Neighborhoods

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I am pleased to recommend that the Members approve the Corporation providing a limited guaranty to the New York City Acquisition Fund LLC ("NYAF") on behalf of qualified non-profit organizations partnering with Preserving City Neighborhoods ("PCN"), equal to a 25% loss on acquisition loans up to a maximum exposure of $5 million ("HDC Guaranty"). The HDC Guaranty will allow non-profit organizations with affordable housing experience but limited balance sheets, to meet the recourse requirements of the NYAF lending program in order to secure loans to acquire and preserve distressed multifamily properties, in keeping with the goals of the Mayor's New Housing Marketplace Plan. The New York City Department of Housing Preservation and Development ("HPD") will work together with PCN to develop a pipeline with a particular focus on smaller buildings of fewer than approximately 30 residential units that have historically not generated interest in the open market.

The Corporation's staff recommends that the Members approve the HDC Guaranty to the NYAF on behalf of PCN. Staff believes that the HDC Guaranty furthers HDC's goals for the preservation and stabilization of affordable housing in New York City. The HDC Guaranty also provides important access to capital, in keeping with HDC's mission. This memorandum will provide a description of the HDC Guaranty economics, mechanics, and a discussion of the risks and mitigants.

Background

Through its Debt Program ("NYAF Debt Program"), the NYAF provides loans for the acquisition of first position notes as well as related soft costs. PCN was established as a new Housing Development Fund Company under Article XI of the New York State Private Housing Finance Law by Neighborhood Restore (described further herein) to partner with developers with an interest in acquiring overleveraged properties to preserve them as a long-term affordable housing asset. Developers who have been approved through HPD's Request for Qualifications ("RFQ") for the Multifamily Preservation Program will be eligible to partner with PCN. PCN will apply to the NYAF Debt Program on behalf of these qualified developers and will help guide the acquisition process, including subsequent foreclosure and procession towards securing and closing on construction financing. The HDC Guaranty will satisfy the NYAF Debt Program's 25% recourse requirement, allowing PCN, in partnership with the non-profit, to obtain financing up to 90% of the property's updated appraised value, with the remaining required equity to be provided equally by PCN and the non-profit.

In the aftermath of the recent economic crisis, landlords who purchased properties during market highs at inflated prices have since deferred maintenance, defaulted on debt payments and abandoned buildings throughout New York City. HPD has responded to this problem with a multi-pronged approach that includes monitoring building conditions and undertaking immediate repairs when necessary through Code Enforcement's Alternative Enforcement Program (AEP) and Emergency Repair Program (ERP), as well as working with lenders to reposition overleveraged portfolios and, when possible, to dispose of notes to acceptable developers identified by HPD.

In some cases, affordable developers have successfully stepped in to take over distressed multi-family properties, such as in the case of the Ocelot portfolio of approximately 14 buildings, containing over 400 units. Omni New York LLC, a for-profit affordable developer with experience in turning around distressed multifamily properties, successfully bid and purchased the Ocelot debt and subsequently completed an uncontested foreclosure in July of 2010 and closed on construction financing the following November. Construction and stabilization of the portfolio has been completed.

In another example, the Corporation provided financing in August 2010 for Workforce Housing Advisors (WFHA), another for-profit developer, to purchase the note for General Sedgwick, a 102-unit property located at 1520 Sedgwick in the Bronx and known as the "birthplace of hip hop." WFHA subsequently bid successfully at the foreclosure auction in November 2011 and the project closed on HPD Participation Loan Program ("PLP") financing in June 2012 for rehabilitation and paid off HDC's loan, including accrued interest, in full.

Unfortunately, many affordable housing developers, particularly community based non-profits with a vested interest in stabilizing their neighborhoods, do not have the ability to raise the capital needed in a timely manner to successfully bid on and acquire notes for distressed properties. Furthermore, foreclosure proceedings can be complicated and time consuming, adding risk and costs to an already difficult and expensive proposition. Finally, smaller overleveraged properties with fewer than 30 units are much more difficult to reposition and refinance. Lenders are less likely to pursue foreclosure actions on these properties as they are less likely to attract interested purchasers.

There remain a high number of smaller buildings that need to be repositioned. According to New York University's Furman Center for Real Estate & Urban Policy, annual counts of mortgage related *lis pendens* filings for multifamily buildings with 5 or more units continue to be high and the average number of units per building remains relatively low, with an average of 17 units per building for the 382 buildings filing in 2012 alone.

Many of these smaller buildings are located within areas that have already seen significant City investment and the buildings themselves have often incurred emergency repair charges. Within HPD's most recent AEP Round 6 buildings, 13% had a mortgage related foreclosure and 26% have Lis Pendens. These properties have an average of only 9 units per building. Within City Council District 37, which encompasses portions of the Bushwick, Cypress Hills, East New York, Ocean Hill, and Brownsville neighborhoods, 15 of the 27 properties in the AEP program had mortgage related foreclosures or have Lis Pendens with an average of 4.4 units per building and 11.5 B and C violations per unit. The 15 properties are still active in the AEP program and have a total of a balance of $235,451 due to the city.

While repairs undertaken through AEP often serve emergency needs, most of these buildings require a more comprehensive rehabilitation financing to more efficiently address capital needs. There is a gap in the marketplace as smaller buildings unable to attract the interest of private investors continue to languish, accruing expensive emergency repairs and destabilizing neighborhoods, while interested and able non-profit developers lack the financial capacity to acquire them. The HDC Guaranty will allow qualified non-profits that partner with PCN to access capital from the NYAF to acquire these difficult to finance buildings, addressing the market gap and ultimately serving the buildings' and community's needs.

New York City Acquisition Fund LLC (NYAF)

The NYAF offers acquisition and predevelopment loans to developers committed to the creation and preservation of affordable housing in the five boroughs of New York City. Made possible through an unprecedented partnership between the City of New York, major foundations and New York's public and private investment groups, the Fund provides loans of up to 130% loan to value for non-profit borrowers with loan terms of up to 3 years and limited recourse. The NYAF's Debt Program is a new initiative to enable transactions such as the note purchases contemplated within this memo. HDC's Chief Credit Risk Officer sits on the credit committee that reviews all NYAF loans and unanimous approval is required for any NYAF loan. HDC is no longer an NYAF originating lender and has never originated a loan through the Fund.

Neighborhood Restore

Neighborhood Restore was established in 1999 with the support of HPD, Local Initiatives Support Corporation (LISC), and Enterprise Community Partners (Enterprise) in order to transition buildings owned by the City through *in rem* foreclosure to new private ownership. Since its founding, Neighborhood Restore has assumed intermediary ownership of many of these troubled properties to address immediate health and safety needs and, primarily pursuant to HPD's Third Party Transfer Program, transferred title to new private owners to enable the preservation and ongoing responsible management of over 5,000 units throughout the city.

Salvatore D'Avola, the Executive Director of Neighborhood Restore, and Erica Sims, the Deputy Director, have both been active in the planning for PCN and it is expected that they would remain engaged. Neighborhood Restore employs a staff of approximately 15 people.

Preserving City Neighborhoods (PCN)
PCN was established as a new HDFC by Neighborhood Restore to partner with non-profit developers seeking to or with an interest in acquiring overleveraged properties to preserve them as a long-term affordable housing asset. The current principals of PCN's board are Lydia Tom, Jim Buckley and Denise Scott, who is also a Member of the Corporation's Board.

Authority, Mechanics and Guaranty Economics

Pursuant to the authority granted to the Corporation in subdivision 23-h of Section 654 of the Private Housing Finance Law, the Corporation may guarantee loans to preserve, construct or acquire dwelling accommodations for people of low and moderate means.

HPD and PCN will collaborate with non-profits to identify potentially at risk properties, prioritizing smaller distressed buildings with pressing physical needs that are, or could be, assembled into portfolios for refinance and rehabilitation, with an added focus within areas that have already seen significant City investment. HPD periodically receives lists of defaulted properties from banks including JP Morgan Chase and Capital One, which will help to inform PCN's pipeline.

Once an eligible non-profit is matched with an appropriate project or portfolio, PCN will apply to the NYAF for funds to acquire the related note or notes. As a condition to PCN obtaining 90% financing from the NYAF towards the purchase of such note, the Corporation will provide a guarantee of up to 25% of the principal amount of each such loan, subject to the requirement that the total of such guarantees outstanding at any time shall not exceed $5 million. The 10% equity contribution required for each note acquisition will be split evenly between PCN and the non-profit borrower. The PCN provided equity contribution would be repaid prior to the borrower equity contribution in any loss recapture scenario.

HPD has received authority from the New York City Office of Management and Budget to allocate approximately $3 million in available funds from the Battery Park City Authority ("BPCA") to create a working capital fund for PCN to cover its share of the equity as well as ongoing carrying costs.

The HDC Guaranty will be provided on a loan by loan basis and could be called on in an event of default under the NYAF loan documents. It is expected that NYAF, PCN and the Corporation will enter into a tri-party agreement that will detail related terms for the HDC Guaranty. It is further expected that PCN will execute NYAF's standard guarantee documents and the Corporation will separately execute a guarantee to NYAF for up to 25% on each loan. The Corporation's guarantee would cover losses, subject to a cure period expected not to exceed 180 days, after the NYAF typical credit enhancement reserves are allocated to reduce losses down to 50% of the subject properties' appraised value.

To compensate HDC for the risk that the Corporation's collateral guarantee might be drawn upon, the Corporation would receive an upfront fee of 0.25% of the loan amount and an annual fee of 0.10% of the loan amount, the latter which may be absorbed by the NYAF loan rate stack or separately capitalized as a soft cost.

As aforementioned, both HPD and HDC currently hold seats on the NYAF credit committee and review all proposed loans. HDC's vote is required for any NYAF loan approval. Thereby, HDC would review all PCN proposals prior to any NYAF financing and could decline a loan, if necessary.

NYAF requires a soft commitment letter from a third-party bank or government lender for a proposed takeout financing in advance of making its loan. It is expected that in most instances, HPD will be the proposed takeout and will provide a soft commitment letter for its proposed financing from a program such as the PLP or 8A programs.

After securing note financing through NYAF and closing on the note purchase, PCN would continue to partner with the non-profit to undertake any emergency repairs (to the extent practicable and allowed by the receiver) and to guide the property through foreclosure proceedings. PCN will be required to engage experienced foreclosure counsel.

PCN and the non-profit would work with HPD to position the property for rehabilitation and acquisition refinancing that would establish an affordability term of at least 30 years. Subsequent to the completion of any required foreclosure and concurrent with the rehabilitation financing closing, the related Corporation guarantee would be released and could be made available for another NYAF/PCN loan if approved by both the NYAF and HDC credit committees, so long as the overall aggregate HDC Guaranty obligation at no time exceeds $5 million. The NYAF loan terms will run concurrently with the Fund's authority to lend.

Risks and Risk Mitigation

The risks associated with the limited guaranty are delays and cost overruns, failure at foreclosure auction, closing on construction financing and borrower capacity. These risks and their mitigants are discussed below. To mitigate the risk of the Corporation making a payment under the HDC Guaranty, the guaranty will be made on a loan by loan basis and will be called upon only after a cure period to be outlined in the tri-party agreement between the Corporation, NYAF and PCN, but which is expected not to exceed one hundred eighty days.

Delays and Cost Overruns
Foreclosure actions in New York are often time consuming and costly. However, it is expected that HPD will fund a capitalized reserve using BPCA funds sufficient to cover any operating deficits throughout the foreclosure proceedings. HPD has agreed to work with only one bank portfolio at a time in order to limit the risk of managing the foreclosure process. PCN will be required to obtain experienced foreclosure counsel and has initiated this process. The Corporation will also retain the right of first refusal to purchase the note if the Corporation should so choose.

Failure at Foreclosure Auction
If PCN or the partner non-profit bids the value of the mortgage plus accrued interest at auction and still fails to win, HDC's guarantee would be extinguished. The property (or properties, as the case may be) may still be at risk, and alternative means of preservation might be necessary, but there would be no outstanding financial exposure to the Corporation.

Construction Closing
NYAF will require a soft commitment from HPD for proposed construction financing prior to closing on note purchase financing. Further, both HPD and the Corporation are on the NYAF credit committee and will be able to comment on and assess construction financing take-out prospects. The Corporation's vote is required for any NYAF credit approval.

Borrower Capacity
The purpose of PCN is to build borrower capacity, as Neighborhood Restore has successfully done through the HPD Third Party Transfer program. If, subsequent to the NYAF loan to PCN, it was determined that the partner non-profit did not have the capacity to proceed with the foreclosure or subsequent refinancing, another non-profit would be selected with HPD's input.

Fees

The Corporation will receive an upfront fee equal to 0.25% on each Loan and an annual fee equal to 0.10% of the outstanding amount of each Loan for providing the HDC Guaranty. The upfront fee to the Corporation will be paid at the closing of the NYAF loan and the Corporation's annual fee will either be added to the NYAF mortgage loan rate or will be separately capitalized as a soft cost.

Action by Members

The Members are requested to approve the HDC Guaranty to the NYAF on behalf of PCN for an exposure not to exceed $5 million and the execution by an authorized Officer of the Corporation of related documents and any other documents necessary to accomplish the HDC Guaranty.