NEW YORK CITY
HOUSING DEVELOPMENT
CORPORATION

MEMORANDUM

To: The Chairperson and Members

From: Marc Jahr
President
RJ for President Jahr

Date: November 18, 2013

Subject: Subordinate Participation in New Lending Facility for The Community Preservation Corp. ("CPC")

I am pleased to recommend that the Members approve the Corporation purchasing a subordinate participation ("Subordinate Participation") in the two or more Citibank, N.A. Revolving Credit Facilities (each a "Revolving Credit Facility" and collectively "the Revolver") to special purpose entities (each an "SPE") to be created by The Community Preservation Corporation ("CPC") in an amount not to exceed $20 million. The purpose of the Revolver is to provide financing for the CPC SPEs to facilitate the origination, or acquisition of, or participation in mortgage loans for the construction, rehabilitation, and refinancing of multi-family rental properties located in New York City's low and moderate income communities. In addition, HDC will not participate in a separate Citibank arranged working capital facility for CPC.

The entire Revolver is expected not to exceed $525 million ($350 million in new lending and $175 million in the takeout of existing debt). The following financial institutions have been considering involvement in the Revolver: Wells Fargo Bank; Morgan Stanley; Deutsche Bank; JPMorgan Chase Bank; Bank of New York Mellon; TD Bank; Bank of America; Capital One Bank; and HSBC Bank.

The Corporation's Subordination Participation will replace the Limited Guaranty to CPC Funding SPE 1, LLC, approved by the Members in April 2012. Subject to the Members' approval, the Corporation will purchase the Subordinate Participation in the Revolving Credit Facility in an amount not to exceed $20 million. Corporation Staff believes that the purchase of the Subordinate Participation furthers HDC's goals for the preservation and creation of affordable housing in New York City and provides important access to capital for the developers seeking construction financing or refinancing of affordable housing developments. The Subordinate Participation will further the production capacity for CPC, a primary private sector partner of the City's Department of Housing Preservation and Development ("HPD"), and is

consistent with HDC's mission to provide access to capital for affordable multi-family housing. This memorandum will provide a description of the Subordinate Participation economics, mechanics, and a discussion of the risks and mitigants.

Authority, Economics and Mechanics

Pursuant to the authority granted to the Corporation in subdivision 23-h of Section 654 of the Private Housing Finance Law, the Corporation may make loans to preserve, construct or acquire dwelling accommodations for people of low and moderate means. All of the mortgage loans which will be funded through this Subordinate Participation will satisfy the statutory provisions in the Private Housing Finance Law.

The HDC Subordinate Participation will be used to fund both new and existing mortgage loans on a loan-by-loan basis (and not on CPC's portfolio as a whole) in New York City. The mortgage loans funded with this Subordinate Participation will be underwritten in accordance with the State of New York Mortgage Agency ("SONYMA") Mortgage Insurance Fund or New York City Residential Mortgage Insurance Corporation ("REMIC") underwriting criteria and will be limited to loans underwritten in New York City. Additionally, at least fifty-one percent (51%) of new lending, tested by dollar amount, must be used to originate mortgage loans for projects where at least fifty-one percent (51%) of the units are affordable to tenants earning no more than eighty percent (80%) of the Area Median Income ("AMI"). HDC will take the first loss on those mortgage loans in which it participates, capped at 10% of each mortgage loan, and $20 million overall. CPC will not be able to use the Revolving Credit Facility for the origination of unsubsidized for-sale housing.

This Subordinate Participation will replace the Limited Guaranty to CPC Funding SPE 1, LLC approved by the Members in April 2012. The Limited Guaranty provided a guaranty equal to a 10% top loss of each mortgage loan up to a maximum of $10 million. In this Subordinate Participation, as noted, HDC will take the first loss on those mortgage loans in which it participates after CPC reserves have been depleted. HDC's exposure will be limited to 10% of each mortgage loan, and $20 million overall. In our current capacity as guarantor, HDC would take the first loss, whereas in this Subordinate Participation, HDC would take a loss only after CPC reserves are depleted.

It is anticipated that 83 existing mortgage loans will be rolled into the Revolver for a total loan amount of $101 million. Of these 83 loans, 55 are performing ($61 million) and 28 are non-performing ($40 million). Non-performing is defined as 90+ days past due. Approximately half of the non-performing loans (14) are construction complete and expected to convert shortly. Additionally, CPC forecasting expects a recovery of at least 90% of the value of the non-performing loans.

CPC has informed us that they have fully reserved for these non-performing loans and that they project that no losses will be passed on to the new lending group. CPC notes that they have never passed any losses onto its lending group and that they have been extremely accurate in projecting losses in the last few years, executing at approximately 99% of their mark-to-market values. HDC staff will continue a more detailed loan-by-loan review of the CPC portfolio prior

to executing the Subordinate Participation and will reserve the right to negotiate enhanced terms if HDC staff so determines. Additionally, Corporation staff will perform enhanced review of CPC's reserve levels and policies, and call upon CPC to increase reserves if staff is not satisfied with CPC's risk analysis.

HDC will earn an origination fee equal to 0.50% of each loan which is funded from the Subordinate Participation. Fees will be earned on a loan-by-loan basis. The approximate applicable interest rate for each loan shall be 30-day LIBOR plus 275 basis points. The expected term of the Revolving Facility is six years consisting of an origination period of two years, with the ability to earn into a third year of originations if certain performance thresholds are met, following the issue date of the Revolving Facility, and a three year maturity date from the date of the last mortgage loan originated by the Revolving Facility.

The Community Preservation Corporation ("CPC")

History of CPC and Its Work in New York City

Incorporated in 1974, CPC is a non-profit, lending institution that finances affordable multi-family housing. As a primary private sector partner to HPD, CPC has worked to support HPD's priorities over the last 39 years. Since inception, CPC has originated 700 HPD subsidized loans, accounting for $1.2 billion in subsidy and leveraging over $652 million in private capital. CPC is the primary lender for HPD's Participation Loan Program ("PLP"), which allows public resources to leverage both private capital and expertise in the origination of multi-family mortgages. CPC has served in this role since it was created specifically to represent the private sector in these transactions. On the servicing side, CPC services a $2.6 billion portfolio of mortgage loans, including $145 million of HPD-only construction loans and $196 million in HPD-only permanent loans.

Initially, CPC's focus was on restoring and rebuilding New York City's aging neighborhoods. During the early 1980s, CPC expanded to cover all the non-luxury areas of New York City, and in the late 1980s expanded into the Hudson Valley. In 1995, CPC merged with an upstate non-profit mortgage lender, The Community Lending Corporation ("CLC"), thereby becoming a New York State-wide organization. During the 2000s, CPC further expanded its geographic reach into New Jersey and Connecticut.

As CPC expanded beyond its original New York City market, it also diversified into more risky areas of lending, most notably condominium development lending. While CPC's initiatives served to bolster the troubled economies of upstate New York and surrounding areas, it moved away from its traditional core business and competency – affordable multi-family rental housing in New York City. Moreover, CPC chose to create a separate for-profit affiliate, CPC Resources, Inc., to undertake development activity for its own account. As a result, during the most recent economic recession, CPC saw its asset quality dramatically deteriorate.

As CPC's asset quality suffered, its ability to secure funding for its core business was badly compromised. Additionally, CPC's access to its existing revolving credit facility was curtailed

by its member institutions. In response, CPC underwent a structural reorganization in 2011, replacing its CEO, strengthening its risk management infrastructure, and implementing new risk management criteria. In early 2012, CPC announced that it had restructured its existing debt and secured an extension of its existing revolving credit facility from its member institutions allowing for up to $70 million in lending over the next two years.

Despite this recent, troubled history, CPC remains the private lender of choice for transactions with one or more of the following characteristics: occupied buildings; scattered site projects; not-for-profit sponsors; for-profit borrowers new to subsidy programs; and for private debt under $3 million. CPC's lending compliments banks by filling in market gaps not served by conventional lenders. Over the past 14 years, 85% of CPC's rental construction loans were under $5 million – a space rarely entered by conventional lenders. Equally compelling is CPC's ability to provide small ($1 million to $3 million) 30-year fixed rate mortgages with the support of SONYMA and REMIC; this fills a huge void in the multi-family mortgage market for small, fixed rate stable debt. For comparison, the average Fannie Mae or Freddie Mac loan is $8 million and $19 million, respectively.

CPC's Recent History

CPC is embarking on the first major recapitalization of the company since the existing debt was restructured in 2012. As part of this effort, in January 2012, the CPC Board of Directors made significant organizational changes to CPC, including the appointment of a new CEO, Mr. Rafael Cestero, former Commissioner of HPD, who in turn restructured the management team by hiring a Chief Risk Officer ("CRO"), establishing a formalized risk management function, and promoting a long-time employee to Chief Operating Officer. Over the past 20-month period, this new management team has taken aggressive measures to strengthen internal controls:

- CPC has incorporated Risk into its Executive and Board functions
- A Risk Committee at the Board level has been created to oversee the company and lending platform
- CPC updated and formalized Risk Asset Acceptance Criteria ("RAAC") ensuring the mortgage staff is consistent in its underwriting approach
- CPC improved upon its Mortgage Offering and Credit Committee process to coincide with the updated RAAC, which now appropriately addressed transaction risks and mitigants to those risks
- Quarterly monitoring of the portfolio is a renewed focus of the company
- The entire portfolio is now reviewed monthly by a committee, including the Chief Credit Officer and CRO
- CPC has aggregated and formalized its Credit Policies into a new Manual, which acts as a guide for the originations and servicing staff
- Since 2009, CPC has ceased lending outside of New York State and is focused on its core mission of affordable, targeted rental housing and subsidized homeownership

In addition to the changes in management and governance structure, CPC successfully sold the Domino Sugar site to Two Trees Management Company, deleveraged the company and raised new capital. The overall bank debt balance has shrunk from $404.9 million to $185 million

currently. The unpaid principal balance as of September 30, 2013 in the Special Assets portfolio has been reduced approximately 71% from $206.7 million to $59.5 million

As noted, despite CPC's diminished presence in the market over the last four years, there continues to be strong demand for CPC's core loan products. In fiscal year 2014, CPC estimates overall lending volume will reach $375 million throughout New York State, with $127 million of that in New York City, of which $87 million will be construction loans. Over the next five years, CPC anticipates originating $667 million, including $196.2 million of permanent loans originated in New York City, in new lending. CPC's five-year plan projects annual construction lending in New York City of $70 million to $80 million. These projections are supported by CPC's current production pipeline which includes over $150 million of applications in various stages of the approval process.

Risks and Risk Mitigation

The primary risks associated with the Subordinate Participation are construction risk, loan conversion risk, and the risk that CPC will file for bankruptcy. These risks and their mitigants are discussed below.

1. *Construction Risk*

The primary risk to HDC is the loan performance of the CPC loans during the construction period. CPC's "core" lending product is defined as construction loans on rental properties with rate-locked permanent loan takeouts.

The portfolio of core lending has traditionally performed well regardless of the prevailing economic conditions. As of September 30, 2013, the 60+ day delinquency rate among CPC's core portfolio was a manageable 8%, versus 67% on CPC's non-core portfolio. Backing out a loan which is near payoff and under contract, payment at par and expected by December 31, 2013, the 60+ day delinquency rate is 5.2%. Between 2004 and 2008 (prior to the most recent financial crisis), CPC's 60+ day delinquency rate on its core portfolio averaged 4.8%. On CPC/HPD rental construction loans, the current delinquency rate is 7% 60 days past due. This is on a total committed rental construction portfolio of $200 million ($74 million CPC share and the balance HPD PLP).

Underwriting standards for loans to be included in the Subordinate Participation have been established and are within the Corporation's programmatic underwriting standards. Additionally, HDC will have an ex-officio member on CPC's Risk Committee and will be able to monitor CPC's risk analysis and results.

2. *Conversion Risk*

Over the past two years, CPC's delivery of loans to the New York City Pension Fund was on average two years late. The majority of these deals were conversions of CPC-originated construction loans that were delayed due to construction and administrative issues. CPC has

recently increased its focus on portfolio management and has implemented several policies and procedures which are designed to improve the timing of deliveries, including pre-closing construction loan review, construction loan monitoring, new maturity extension procedures, weekly micro liquidity meetings, and a streamlined conversion process. CPC's Portfolio Services Group has increased its attention to driving HPD conversions by stationing a CPC employee at HPD one to two days a week to help with the HPD conversion process and backlog.

HPD has recognized the need to improve and accelerate the permanent loan conversion process and, as a consequence, over the last two years it has put renewed focus and attention on converting HPD/CPC loans as quickly and efficiently as possible to pay down CPC's existing credit facility and to help CPC deliver on future projects. In establishing regular conference calls with staff at CPC, HPD was able to designate and delineate responsibilities between HPD and CPC staff, enabling the teams to avoid overlapping efforts and provide more efficiency to the process. At the same time, HPD has significantly improved staffing for the loan conversion unit.

HPD has focused on managing the rent restructuring process and Section 8, HOME compliance, and tax exemption status, including J-51 tax exemptions. CPC has focused on identifying and resolving construction issues (a process CPC has supervised), and other items such as insurance, and re-underwriting. Over the same period, HPD has worked with CPC to be more proactive in sending default letters, including notices of default interest charges, and to motivate borrowers to complete the process of converting to permanent financing.

Since CPC's recapitalization in January 2012, CPC has made progress in converting its construction portfolio on a more timely basis. At January 31, 2012, CPC had 102 performing rental construction loans totaling $162 million of CPC dollars. As of September 30, 2013, CPC resolved and/or converted 56 loans totaling $130 million of CPC commitments. As of September 30, 2013, CPC now has 63 loans with a commitment of $110 million. The $110 million accounts for the remaining construction loans pending conversion as of January 2012, CPC's newly closed commitments, and participations of CPC's existing portfolio.

3. Bankruptcy Risk

With respect to bankruptcy risk, the CPC SPEs will each be a bankruptcy remote entity; although its bankruptcy is extremely unlikely. However, if a CPC SPE does file for bankruptcy, then by virtue of a repurchase structure Citibank would not be restricted by the automatic bankruptcy stay and could immediately step into the shoes of the CPC SPE as owner of the loans. With respect to the rights of CPC itself (not the SPE entities) as servicer for the loans, those rights may still be subject to the automatic bankruptcy stay so CPC might remain as servicer, but the loans themselves would be owned by Citibank.

Fees

The Corporation will earn an origination fee equal to 0.50% of each loan which is funded from the Subordinate Participation. Fees will be earned on a loan-by-loan basis. The approximate applicable interest rate for each loan shall be 30-day LIBOR plus 275 basis points.

Action by Members

The Members are requested to approve the funding of a Subordinate Participation in the Revolver in an amount not to exceed $20 million.