



REPORT

DATE: For the Agenda of December 13, 2002 **Item 104**

REPORT NO.: HCR02-098

SUBJECT: Extension of Trolley Court Loan (Council District 8)

SUMMARY

Issue: Should the Housing Commission extend the Trolley Court loan for a period of 20 years and modify the terms and conditions to amortize the loan at three percent interest for the 185-unit single room occupancy residential facility located at 940 12th Avenue?

Recommendation: That the Housing Commission approve the loan extension and modification of the loan terms and conditions.

Fiscal Impact: A modification of the loan terms and conditions would require the borrower to make monthly principal and interest payments generating an annual income to the Housing Commission of approximately \$32,410. The principal balance of \$488,213 (principal and add-on interest during construction period) will be reduced as each payment is made and should be paid in full in 20 years.

Affordable Housing Impact: An extension and modification of the loan term for 20 years will extend the affordability restrictions for the same term. Presently, 39 units are set aside as affordable units and rented to eligible tenants whose gross annual income does not exceed 40 percent of median area income (MAI).

Previous Related Actions: Please refer to Attachment 1.

BACKGROUND

In December 1987, the Housing Commission funded a \$480,000 development loan to THIC-Trolley Court, a California Limited Partnership (THIC) to construct a 185-unit single room occupancy residential apartment project at 940 12th Avenue. The project is a



five-level building (four full floors over a below ground parking garage). Amenities include: a common laundry room; 24-hour front desk; toilet and sink in each room; outdoor patio areas; a common room with vending machines; and parking for up to 20 cars in the underground secured garage. The average room size is 78 square feet. In exchange for the Commission's favorable financing, thirty-nine units were set aside and reserved as affordable units.

The Housing Commission's loan note bears a simple interest rate of three percent (known as "unconditional interest") and requires monthly interest-only payments. In addition to the unconditional interest, the borrower will pay the Housing Commission contingent interest representing a 14 percent share of net capital profits from the project upon the refinancing that would pay the Housing Commission's loan in full or cash-out refinancing, resale, mandatory payoff or foreclosure of the property.

The original term of the development loan matured ten years from the date the loan was funded. The borrower had the option to automatically extend the term of the loan for four additional successive five-year periods, provided that: 1) at the time of each extension no event of default had occurred; and 2) borrower agreed in writing to continue for the duration of each such period, the restriction on tenant and rental charges.

In August 1992, the first trust deed lender recorded a Notice of Default against the property. THIC had stopped making payments due the lienholder because of construction defects that caused the project to suffer a severe loss in rental income. The owners did file a lawsuit against the contractor and a judgment of \$140,000 was entered in their favor. In February 1993, the lender and THIC agreed to enter into a forbearance agreement. The Notice of Default remained in place until the loan was paid in full through the refinance with NationsCredit in 1999.

Due to the event of default, the borrower forfeited his option to automatically extend the term of the Housing Commission's loan. The Housing Commission's loan matured in December 1997 and the first trust deed loan was also due and payable. THIC actively searched for a lender to refinance the property. The pursuit began prior to the maturity date of the Housing Commission's loan. THIC was finally able to obtain a commitment from NationsCredit to refinance the project. Although the Housing Commission and the first trust deed loan had matured, THIC continued to make the monthly loan payments.

NationsCredit committed to provide a \$1,800,000 first trust deed loan for a term of seven years. The payoff of the existing lien (\$2,400,000) was substantially greater than the loan commitment from NationsCredit. The owners met the shortfall by obtaining a line of credit loan, collateralized by property other than Trolley Court. Once the financing was in place for the first trust deed, THIC requested a five-year extension of the Housing Commission's loan and subordination of the development loan to the refinancing of the

project by NationsCredit and a new first trust deed loan of \$1,800,000. Because the refinancing of the project did not result in cash-out to the owners nor did it pay the development loan in full, the payment of contingent interest was not due the Housing Commission. The Housing Commission Board approved the request on July 16, 1999.

The existing encumbrances against the property are as follows:

| | |
|---|--------------------|
| 1 st TD – NationsCredit | \$1,726,980 |
| 2 nd TD – San Diego Housing Commission | <u>\$ 488,213</u> |
| TOTAL ENCUMBRANCES | \$2,215,193 |

In November 2002, a summary appraisal report was completed that estimated the value of the property to be \$4,385,000. This results in a 51 percent loan-to-value ratio.

The Housing Commission's loan matures December 31, 2002.

DISCUSSION

On October 10, 2002, THIC made a formal request to: 1) extend the loan term for 20 years with fully amortized payments; and 2) extend the affordability restrictions for 20 years.

Since the development loan was extended in July 1999, the owners have made all interest only payments due the Housing Commission in a timely manner with two exceptions. The loan to NationsCredit has been paid as agreed and the property taxes are current. The NationsCredit loan has a balloon payment and maturity date of August 1, 2006. The Housing Program Lending Authority Policy 600.101 (Attachment 2) requires Housing Commission approval if a senior loan has a balloon payment in less than five years. The NationsCredit loan has a prepayment penalty of approximately \$54,000 in the event the loan is paid in full prior to the maturity date.

Staff believes that it would not be prudent to require the first trust deed to be refinanced at this time. It is recommended that the Housing Commission's loan be extended for 20 years at three percent interest with monthly payments of principal and interest amortized over the term of the loan.

The 20-year term extension of the Housing Commission's loan will preserve the affordability restrictions for the 39 set aside units. The following chart shows a comparison of the restricted rents to the average market rate rents for the units:

| <u>Unit Size</u> | <u>Restricted Rents</u> | <u>Average Market Rate Rents</u> |
|------------------|-------------------------|----------------------------------|
| Small Units | \$382 | \$500 |
| Medium Units | \$382 | \$530 |
| Large Units | \$430 | \$600 |

CONCLUSION

The Housing Commission's loan is well secured with a 51 percent loan-to-value ratio and, except as noted in the report; all other terms and conditions of the Housing Commission's loan will remain in full force and effect. This includes the requirement that the principals in THIC guarantee the Housing Commission's loan and profit participation/contingent interest agreement.

ALTERNATIVES

1. Extend the loan term for another five years with interest only payments.
2. Deny THIC's request for a loan extension. The effect of this decision would cause the owner to seek additional funds to pay the Housing Commission's loan in full or the filing of a Notice of Default by the Housing Commission. The payoff of the loan would also eliminate the affordability restrictions.

Respectfully submitted,

Approved by,

**Signature on File
with Original Document**

Jack D. Farris
Housing Finance and Development Manager

Elizabeth C. Morris
Chief Executive Officer

Monce (Trolley Court 2002.HC) 578-7491

Attachments: 1 – Previous Related Actions
2 – Housing Program Lending Authority Policy 600.101