SANTA BARBARA COUNTY
BOARD AGENDA LETTER

Clerk of the Board of Supervisors
105 E. Anapamu Street, Suite 407
Santa Barbara, CA 93101
(805) 568-2240

Agenda Number:	
Prepared on:	1/5/04
Department Name:	Housing and Comm. Dev.
Department No.:	055
Agenda Date:	1/20/04
Placement:	Departmental
Estimate Time:	1 hour
Continued Item:	YES
If Yes, date from:	1/13/04

TO: Board of Supervisors

FROM: Ed Moses, Director
Housing and Community Development

STAFF CONTACT: Patricia Gabel
ext. 3522

SUBJECT: Recapitalization of Housing Finance Loan Portfolio

Recommendation(s):

That the Board of Supervisors:

1) Approve Housing and Community Development Department's (HCD) request to solicit loan proposals of approximately $1 million dollars from local and national lending institutions to re-capitalize $3.2-3.4 million of its total loan portfolio, comprised of $1.259-1.330 million Housing Rehabilitation (HR) and $1.929- 2.091 million Down Payment Assistance (DPA) programs loans, to be used by HCD to "write-down" the cost of housing in the private market place to attainable levels for low-income and workforce families who live and work in the County of Santa Barbara.

2) Authorize HCD to return on or before February 24, 2004 with recommendations for most favorable offer for BOS review and approval.

Alignment with Board Strategic Plan:

The recommendation(s) are primarily aligned with Goals No. 7, Strengthen the Safety and Well-Being of Children and Their Families to Ensure a Strong Future for our Community, and Goal No. 5, Maintain and Enhance the Quality of Life for all Residents.

Executive Summary and Discussion:

The County's Department of Housing and Community Development (HCD) wishes to re-capitalize $3.421 million of its loan portfolio, comprised of $1.330 million Housing Rehabilitation (HR) and $2.091 million Down Payment Assistance (DPA) programs loans, to be used by HCD to "write-down" the cost of housing in the private market place to attainable levels for low-income and workforce families who live and work in the County of Santa Barbara. The County's total loan portfolio is $ 13,116,744. HCD has received a $1.1 million loan re-capitalization finance proposal from the Community Reinvestment Fund (CRF), a national not for profit organization.

At its meeting of November 5, 2003 the County's Debt Advisory Committee (DAC) reviewed HCD's proposal. As part of the DAC review, DAC members suggested that HCD solicit proposals from local lending institutions to compare to the CRF loan proposal. HCD is working with the Auditor-Controller's staff to solicit and review loan proposals. This will ensure that HCD receives the most favorable loan terms. Some of the local lending institutions to be solicited will include Hacienda Bank, Montecito Band and Trust, South Coast Community Credit Union and Mid-State Bank. Because of the proposed loan's unique nature, which makes it extremely difficult to analyze under the County's current debt review standards, the DAC referred HCD's re-capitalization loan request to your Board. ***It should be noted that one of HCD's loan conditions was that the General Fund was not needed to secure this loan transaction***

HCD has received one loan proposal from CRF (Attachment A) and Montecito Bank & Trust has declined to participate. If no other loan proposals are submitted, HCD will recommend selection the submitted proposal.

Use of Funds:
The recapitalized loan would provide capital to develop approximately 23 units of housing[1] that would be attainable for Santa Barbara families earning between zero to 200% of the Areas Median Income (AMI). This could serve families with 4 person households who have an annual maximum income level that does not exceed $121, 000.00. Seventy nine percent of the units (18) would be designated for families whose annual earnings do not exceed 80% of AMI ($48,480.00) and 21% of the units[2] (5) for families earning between 81-200% of AMI ($49,086.00-121,000.00). These loans would be made from the financial institution loan to the County. . Repayment of the loan will be made from the repayment cash flow of the secured portfolio over the term.

Using the following CRF loan proposal as an example, the Department would request a similar structure for the other loan proposals.

CRF Loan Proposal
The loan terms offered by CFR is a 6.40% interest rate over the term of 15 years. This rate is only 2.4% over the prime rate. Because of the uniqueness of HCD's loan portfolio, HCD cannot take advantage of the favorable interests rates now presently available, CRF's financial assumptions require a slightly higher interest rate (due to the size of the secured portfolio, variable and irregular repayment schedule on the $2.091 million DPA deferred portfolio, 15 year fixed-term and the tax liability of the financing); 6.40% as compared

---

1 **Assumes a $1.1 million loan and $ 44,000.00/Unit/Year For 5 Years. Cost Per Unit for new construction was calculated based on analyzing and averaging Housing Finance's: (1) total investment to subsidize the County's affordable housing development efforts over the last 3 years and (2) the actual amount the per unit cost was increased during the same time frame to make the programs work.**

2 **The ability to utilize 21% of the portfolio recapitalization funds to serve families up to 200% of AMI is based upon the fact that 21% of the portfolio is comprised of income from pre-1993 Community Development Block Grant (CDBG) loans. Income from these loans are not subject to CDBG regulations because "Revenue from 1992 grants, or earlier may not be considered program income if there has been a subsequent gap between open CDBG Grants"(Chapter 14 CDBG Grant Management Manual page 14-2). The gap occurred between open CDBG grants in the County of Santa Barbara in 1994.**

to 5-5.94% conventional market rates, to limit the increased risk they are assuming by entering into this transaction. CRF will receive a 2.0% transaction fee for originating purposes.

The CRF has also offered Santa Barbara County financing based on the formula of 325 basis points over the five-year treasury rate. Below are the variables used by CRF in calculating their interest rate offer of 6.4%:

1) The interest on this refinancing is taxable to the recipient at both the federal and state levels because the secured portfolio is not tax exempt.
2) The County is being offered 15-year fixed rate financing, which is expected to be prepaid in approximately ten years.
3) Band of Investment theory tells us the most creditable (least risky) borrower for fixed rate borrowing over a ten-year term is the U.S. Treasury. Currently, the yield on 10-year fixed rate U.S. Treasury securities is approximately 4.5%. The additional 1.9% (6.4%-4.5%) being charged by CRF reflects the risks associated with the basket of financed assets in our secured portfolio which includes amortizing 2nd trust deed loans and loans ($2.091 million deferred loans) for which there is no set repayment schedule. A 1.9% premium to the U.S. Treasury rate is very modest, given the underlying risk contained in the secured portfolio being financed.

The CRF has committed to lend the County these funds for a term of 15 years at an interest rate of 6.40%. This equates to 180 minimum monthly payments of $9,521 over the loan term. An additional term set for the loan is that the County must establish and maintain a "Debt Service Reserve" (DSR) in the amount of $85,000 to cover the potential short fall in our minimum monthly payments. On an annual basis, the County is required to replenish the reserve to its $85,000 level from the following sources: (1) Monthly cash flow from new loans originated with proceeds from this transaction, and; (2) Any other sources of funds available to the County, at our sole discretion. HCD will designate funds from its Housing Trust Fund (HTF), a $5.8 Million entity, to fill this purpose.

Finally, to limit the County's exposure, the loan proposal would requires the DSR to be backed (co-insured) by the County's HTF which must maintain an un-encumbered balance of $ 100,000 for the loan term. These dollars will be apportioned from un-restricted HTF funds which should prevent potential conflicts with any federal, state or local funds targeted for a specific economic strata being used for this purpose.

<u>Repayment</u>

As mentioned above, this loan would obligate the County to make 180 minimum monthly payments of $9, 521.00 over the term of the loan. This liability will be paid from the repayment proceeds of our $3.421 million loan portfolio used to secure this transaction. During the 2003 Calendar Year repayment proceeds for HCD's entire loan portfolio has average $118, 873.00 per month. This includes a one time negotiated loan pre-payment of $646,723.00 with the County's Housing Authority for its Sandpiper development. If this amount is subtracted the average monthly loan repayment for the 2003 Calendar Year is $47,015.00. We strongly believe that this performance will continue throughout the proposed loan term. In fact, CRF used our portfolio historical performance as an underlying basis in making its underwriting decision to enter into this transaction.

<u>New Policy Approaches</u>

HCD has implemented an aggressive policy of renegotiating existing deferred or residual receipts loans to get borrowers to prepay their loans for other considerations. This can be done by negotiating prepayment terms and conditions with each borrower. For example, if the County made a $600,000, 4% interest, 30 year term, deferred loan to a developer of a rental property in 1990 the County might not be repaid (principal and accrued interest) until the earlier of either resale of the property or in 2020 when the loan becomes due and payable (30 years from the loan's origination date) depending upon the cash flow of the project. The County could receive its investment from the project if the borrower could be convinced to prepay the loan prior to the due date. This might be accomplished by negotiating: (a) discounted rate on the overall loan repayment amount, (b) agreeing to commit a percentage of prepaid funds toward another planned affordable housing project of the borrower, (c) permitting the borrower to refinance the loan so they can take out some of their equity and pay off the County from some of the refinance proceeds or (d) obtaining an equity position in the project that will allow the County to share in the "cash flow". This is the strategy used to get the aforementioned $646,723.00 prepayment. Other projects are currently are under negotiation.

Lastly, as an incentive to borrowers to re-negotiate with the County, proceeds generated could be offered in a grant/loan mix. For example, 30% of County subsidy to a project could be given as a grant and the remaining 70% could be made available through a below market rate loan. Under this scenario, a subsidy of $ 44,000 per unit for new construction would be made available as a $13,220 grant (30%) and a $30,800 below market rate loan (70%).

Mandates and Service Levels:
There will be no changes in service levels.

Fiscal and Facilities Impacts:
There are no fiscal impacts. The funds to be re-capitalized are program income funds from HOME and CDBG funds. The administrative costs are removed as part of the loan. United States Department of Housing and Urban Development's: (I) HOME Investment Partnerships Program (HOME); 24CFR92.206(d)(2) and (6), and (II) the State Community Development Block Grant Program (State CDBG) sponsored under Title 25 HCD, Division 1, Chapter 7 Subchapter 2, Article 2, Section 7068; and HUD's 24CFR570.504(b) (2) (i) and (ii) sets the amount of administrative costs allowed. The Department will retain 7.5% of the loan amount for administrative expenditures.

Special Instructions:
None

Concurrence:
Auditor-Controller