PHED COMMITTEE #2
June 22, 2020

M E M O R A N D U M

June 19, 2020

TO: Planning, Housing, and Economic Development Committee

FROM: Linda McMillan, Senior Legislative Analyst

SUBJECT: **Housing Opportunities Commission Housing Production Fund**

PURPOSE: Review Proposal and Recommendations

Expected for this session:
Roy Priest, Chair, Housing Opportunities Commission (HOC)
Linda Croom, Resident Commissioner, HOC
Stacy Spann, Executive Director, HOC
Kayrine Brown, Chief Investment and Real Estate Officer, HOC
Zachary Marks, Director of Development Real Estate, HOC
Shane Pollin, Vice President Development, Duffie Companies
McLean Quinn, President, EYA
Bob Youngentob, Chief Executive Officer, EYA

Background

The County Council has made a commitment to increase all housing with a focus on affordable housing as a part of the Council of Government's regional initiative to meet future housing needs. In February, the PHED Committee held a worksession on the Capital Improvements Program at which time it had discussions about new ways to leverage county funding and resources, to accelerate the production and preservation of affordable housing. The Committee was expecting to return to both the Capital Improvements Program and other proposals with current and new potential partners, but the COVID-19 health emergency required a dramatically different approach to Council sessions, including the temporary cessation of committee meetings.

PHED Committee Chair Riemer has been working with HOC to develop a proposal for a Housing Production Fund, which the Committee will be briefed on today. The most basic part of this proposal is that the County would make a payment of $3.4 million annually ($2.8 million in year one) to HOC to support HOC's debt service on a bond issuance of $50 million. These funds would be used by HOC for construction-period bridge financing for new, mixed-income housing developments. Once the project is complete and re-financed, the funds would revolve to give HOC capacity to continue with other new projects. This would not be county debt and would not be a commitment in the county's debt service budget.

As a part of its budget actions, the Council agreed to take $6.8 million from the Housing Initiative Fund operating budget loans and grants category and hold it in a designated reserve for affordable housing. This was to give the PHED Committee and Council time to consider whether these funds should be used to leverage and create other funds for new production and preservation or be appropriated to the HIF for the more traditional loans and grants. If the PHED Committee recommends and the Council agrees, $2.8 million of this reserved $6.8 million would be used in FY21 to make a payment to HOC.

CIP Amendment

HOC needs the county to include this Housing Production Fund and the expected county support in the CIP as a project as sufficient information for the issuance of bonds by HOC.

Council staff has drafted a PDF (first attachment) that is reflective of HOC's request. The PDF shows that loan repayments from HOC can be used as a source of financing the CIP project which reduces the need for Current Revenue. This is Council staff's recommendation for the use of loan repayments, but they could be allocated differently – which would then require Current Revenue for the full $3.4 million. Council staff believes that Current Revenue and loan repayments are the only two sources of supporting this payment, it could not be supported with PayGo. Council staff also notes that as is the case with other CIP projects, they show the intended and approved multi-year commitment but cannot bind a future Council. The full cost of the "project" can be shown and programmed but Current Revenue appropriations are annual. That said, Montgomery County has a strong history of annual investment through the CIP in the maintenance of deeply subsidized HOC housing and also has CIP projects that provide HOC access to county debt funding. While this is indeed a new proposal and strategy, the county has implemented many new proposals and strategies to increase production and preservation of affordable housing. Following this discussion, the PHED Committee will return to the proposal from DHCA for an Affordable Housing Opportunity Fund for preservation of housing that also proposes leveraging county resources in new and creative ways.

If the PHED Committee decides to recommend this project to the Council, it will require a CIP amendment and so would need to be introduced to the Council in early July if the Council is to act before recess.

Attachments

Draft PDF
HOC Presentation Slides

HOC Housing Production Fund – Housing Production ($50 million in revolving funds)

	Total	6 Years	FY21	FY22	FY23	FY24	FY25	FY26	Beyond
Expense									
Other	67,400	19,800	2,800	3,400	3,400	3,400	3,400	3,400	47,600
Funding									
Current Rev	18,337	6,737	1,237	900	900	900	900	900	12,600
Loan Repayment	49,063	14,063	1,563	2,500	2,500	2,500	2,500	2,500	35,000

Appropriation Request FY21	2,800
Appropriation Request FY22	2,800
Cumulative Appropriation	-
Expenditure/Encumbrance	-
Unencumbered Balance	-
Year First Appropriation	FY21
Last FY's Cost Estimate	-

Project Description

This project will provide payments to the Housing Opportunities Commission that will support the principal and interest requirements for $50 million in HOC-issued bonds to establish a revolving fund that will support the production of new affordable housing developments. The payments are based on an initial issuance of $50 million in bonds in FY21. The funds from the HOC issued bonds must be used to provide financing for no more than the first five years and may be used for project development, construction, and initial occupancy. Once permanent financing is in place, HOC will repay the fund for all draws associated with the development. At least 20% of all units must be affordable to households with incomes at or below 50% of area median income and another 10% at or below the income for a Moderately Priced Dwelling Unit. HOC is encouraged to access other sources of funding to increase the percentage of affordable units.

Project Justification

Montgomery County has a severe shortage of affordable housing and housing of all types. The Metropolitan Washington Council of Governments estimates that Montgomery County needs to add 41,000 housing units in the next years to meet demand, at least 75% should be in activity centers or near high-capacity transit, and at least 75% should be affordable to low- and middle-income households. Production of new housing must occur to meet these goals. HOC is the County's housing authority and its mission is to provide high-quality affordable housing. HOC has a pipeline of potential projects but needs additional short-term financing capacity to move all its projects forward.

Other

HOC estimates that it can create nearly 5,500 units of new housing on properties it owns, controls, or is controlled by the County and could be transferred to HOC.

Fiscal Note

Future loan repayments are expected and will be used to fund a portion of this project.

REVOLVING HOUSING PRODUCTION FUND

FUNDING, STRUCTURE, AND LOGISTICS

HOC

Stacy L. Spann, Executive Director

Kayrine Brown
Zachary Marks

June 22, 2020

Executive Summary

Highly Efficient

- For $3.4MM in annual appropriated funds over a period of 20 years[1], Montgomery County creates a permanent, revolving $50MM Housing Production Fund ("HPF") that:

Produces new, mixed-income communities	Becomes permanent after 20 years of appropriations	Revolves every four-to-five years yielding $250MM in investment[2]
Provides committed capital for part of HOC's 5,500-unit pipeline	Uses the model of existing revolving MPDU/Property Acquisition Fund	Yields an average of 100 MPDUs per transaction

Self Sufficient

- Without the HPF, these HOC pipeline of new units would need significant upfront HIF investment. So, the HPF *increases* the availability of the HIF for other projects.
- The HPF allows HOC transactions to proceed without using other limited affordable housing resources like LIHTC equity and volume cap, leaving these resources to other worthy projects.

Ready to Execute

- The HPF structure is fully and immediately executable. The first transaction would close in December 2020.

Scalably Designed

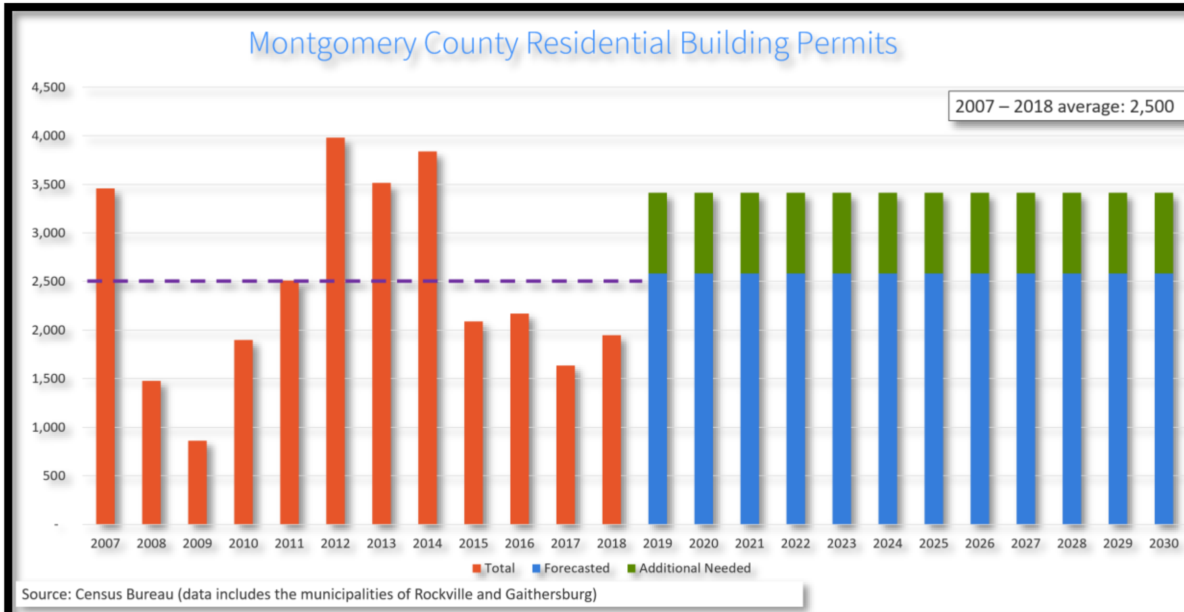
- At $50MM, the HPF will fund roughly 3,500[2] units over the 20-year life of the bonds.
- The HPF creates a timely and efficient avenue for private developers and private non-profits to participate in this expansion of housing in the County.
- The HPF can easily be increased by additional appropriations and bond issuance.

[1]If annual project interest paid is sent back to the HIF (as described later in this presentation), the annual net use of the HIF would be only $900,000.
[2]Should Council decide to send project interest paid back to the HPF, construction production increases by $127M during the 20-year life of the bonds, resulting in a total of approximately 4,375 units would be produced over the 20-year life of the bonds.

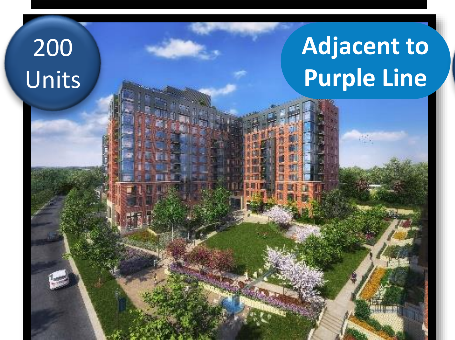
Primary Goal & Delivery Channel

HPF Focus

- Catalyze County pursuit of COG goal of 41,000 units over next 10 years (i.e., 1,000 additional units per year).
- In 2019, the County fell short of the COG-based target for the year by 275 units.
- HOC pipeline expected to grow to 350 units per year starting in 2021.



The Lindley



Started: 2016

Fenton Silver Spring (900 Thayer)

Started: 2017

Upton II

Started: 2018

Elizabeth House III

Started: 2019

Primary Goal & Delivery Channel

HPF Channel

- Accelerating HOC's mixed-income housing development pipeline.
- Utilizing public-private partnership ("P3") collaborations for co-investment, risk sharing, bandwidth, and talent diversity.

HOC Identified Pipeline (5,445 Units)	
First Five Years	Second Five Years
Total Units 3,447	Total Units 1,998

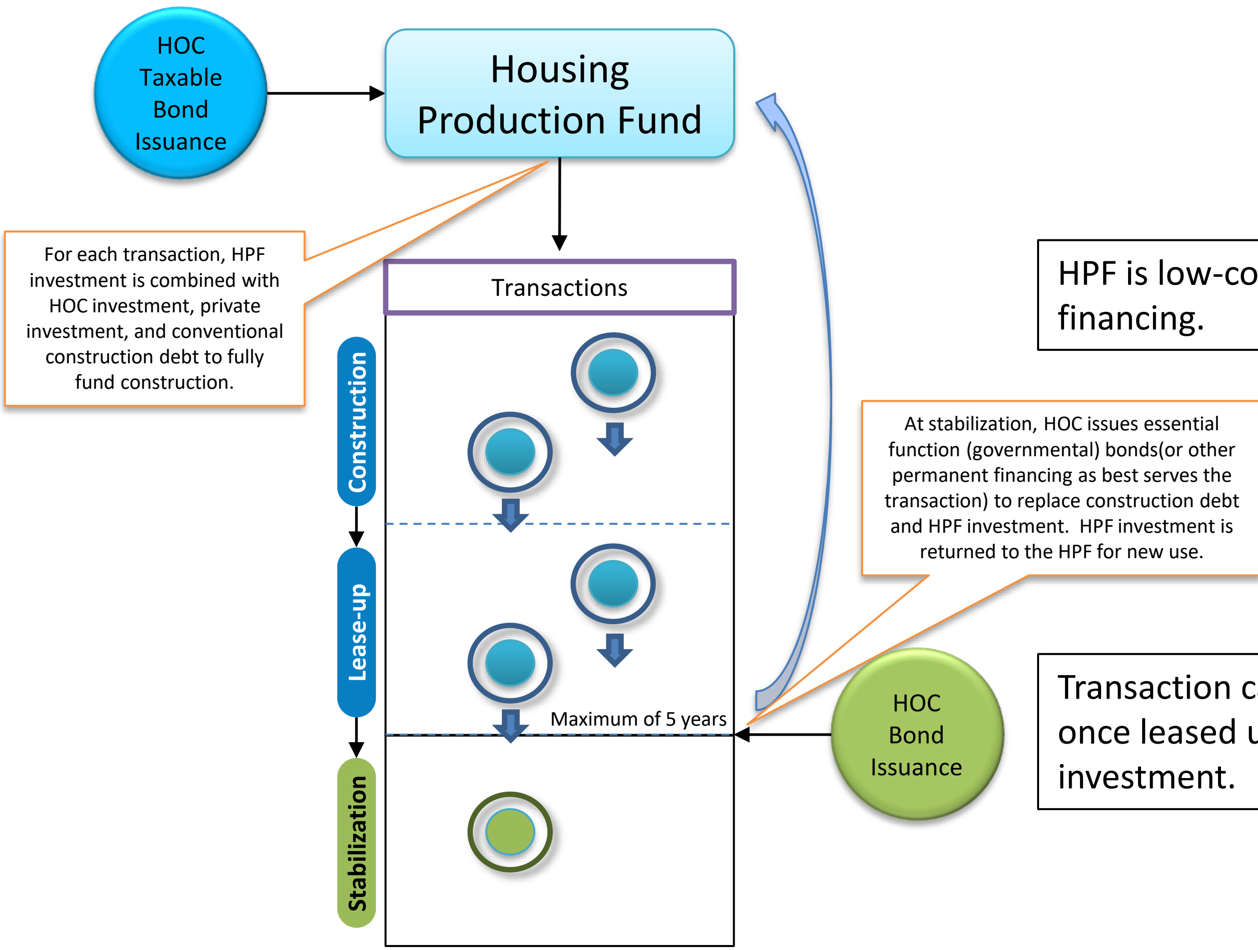
- Dedicated, revolving construction equity financing funded with County-serviced bond issuance.
- At $50MM, approximately 1,750 of 5,445 units in HOC's identified pipeline would be funded with the HPF.
- HOC has two P3 developments starting in FY21 that would fully utilize all of first $50MM.
- Availability of HPF allows HOC to add to the identified pipeline as funding resources are expanded; HOC has another 2,500 units it could secure reasonably quickly but hasn't pursued for insufficient resources.

HPF: First $50MM

Starts: 2020

Starts: 2021

Production Fund Mechanism



HPF is low-cost, construction-period bridge financing.

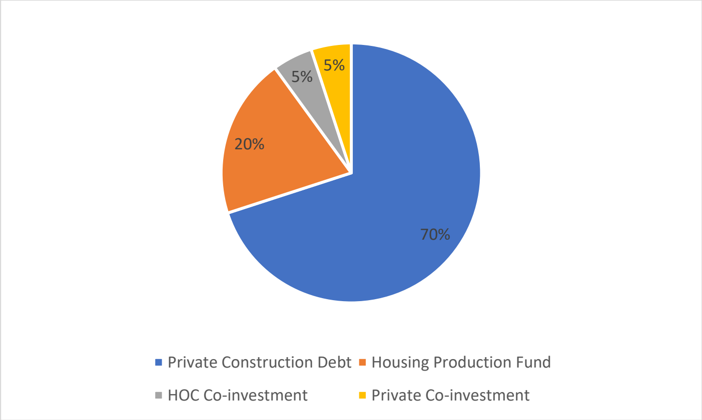
Transaction can support greater senior debt once leased up removing need for HPF investment.

Production Mechanism: Structure

P3 Ownership

Construction (Years 0-2)

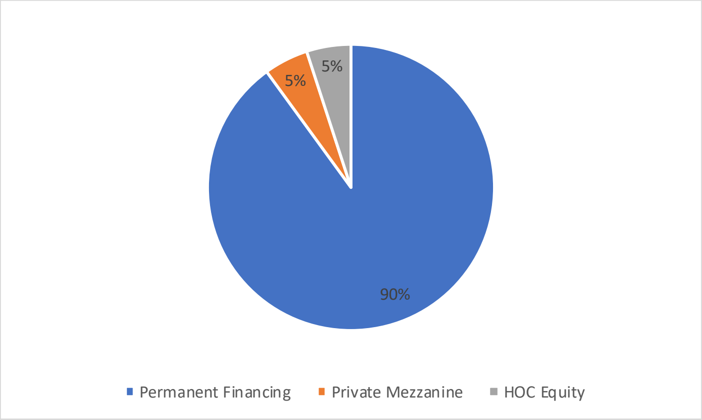
Lease-up (Years 2-4)



- Production Fund contributes five-year, low-cost (5%) construction equity.
- Upon stabilization, HOC takes ownership, issues governmental bonds (or other permanent financing as advantageous), and repays the Production Fund loan in full.
- New projects can be invested in upon repayment.

HOC Ownership

Stabilized Operations (Years 4+)



- No HIF required (but can be involved to buy down MPDUs to lower affordability)
- No LIHTC required (which makes for a fast, HOC-controlled process in which takeout funding is unlimited).
- Private development partner can either exit upon conversion to HOC ownership or can convert equity to subordinate debt.

Issuance, Interest Capitalization, & the HIF

- With an initial $50MM funding, approximately $250MM in project loans can be issued over the 20-year life of the bonds.
- The developments that use the Fund will pay 5% annually on the loan amount (and can be paid current because interest is capitalized for the construction and lease-up period).
- The $250MM does not include any reinvestment of project interest paid.
- Interest could be paid to the HIF to offset portion allocated to HPF.
- As with the existing MPDU/Property Acquisition Fund in the County's CIP, the Production Fund will continue to serve at this level and frequency after the bonds are paid off.

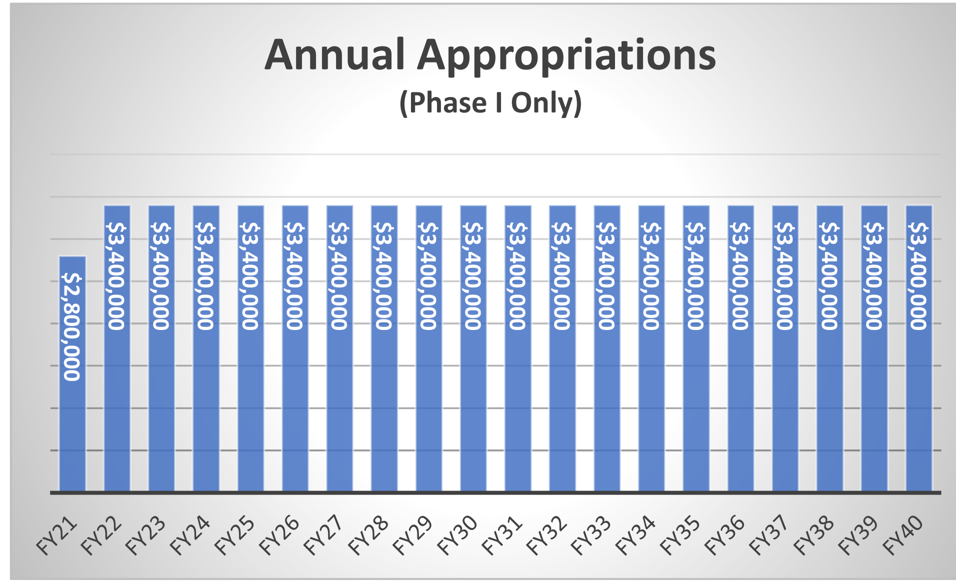
Leveraging of County Funds

25-to-1

HPF @ $50MM (Project Interest to HIF)

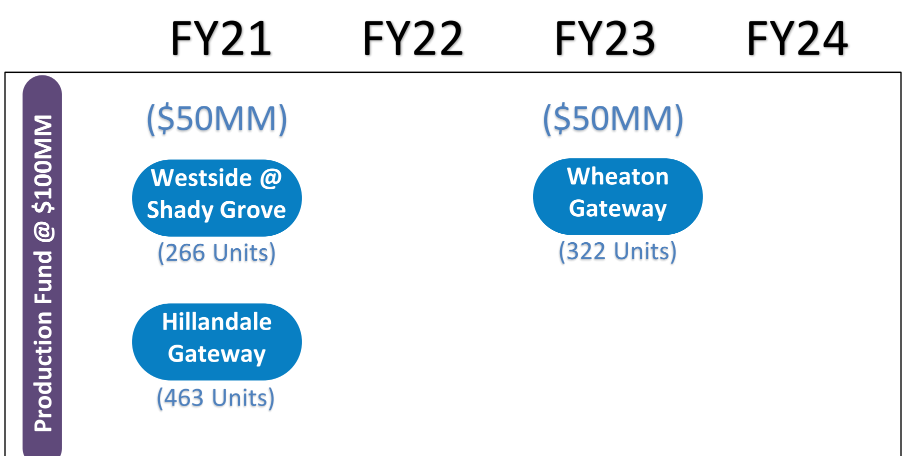
	Bonds Issued	*Bond P+I*	*Project Loans*	*Interest Paid*
FY21	$50,000,000	$2,800,000	$50,000,000	$1,562,501
FY22		$3,400,000		$2,500,000
FY23		$3,400,000		$2,500,000
FY24		$3,400,000		$2,500,000
FY25		$3,400,000	$50,000,000	$2,500,000
FY26		$3,400,000		$2,500,000
FY27		$3,400,000		$2,500,000
FY28		$3,400,000		$2,500,000
FY29		$3,400,000	$50,000,000	$2,500,000
FY30		$3,400,000		$2,500,000
FY31		$3,400,000		$2,500,000
FY32		$3,400,000		$2,500,000
FY33		$3,400,000	$50,000,000	$2,500,000
FY34		$3,400,000		$2,500,000
FY35		$3,400,000		$2,500,000
FY36		$3,400,000		$2,500,000
FY37		$3,400,000	$50,000,000	$2,500,000
FY38		$3,400,000		$2,500,000
FY39		$3,400,000		$2,500,000
FY40		$3,400,000		$2,500,000
			$250,000,000	**$49,062,501**

HPF Cost & Scalability



Phase I - $50MM

Portion of County HIF covers principal and interest for $50MM HOC bond issuance.

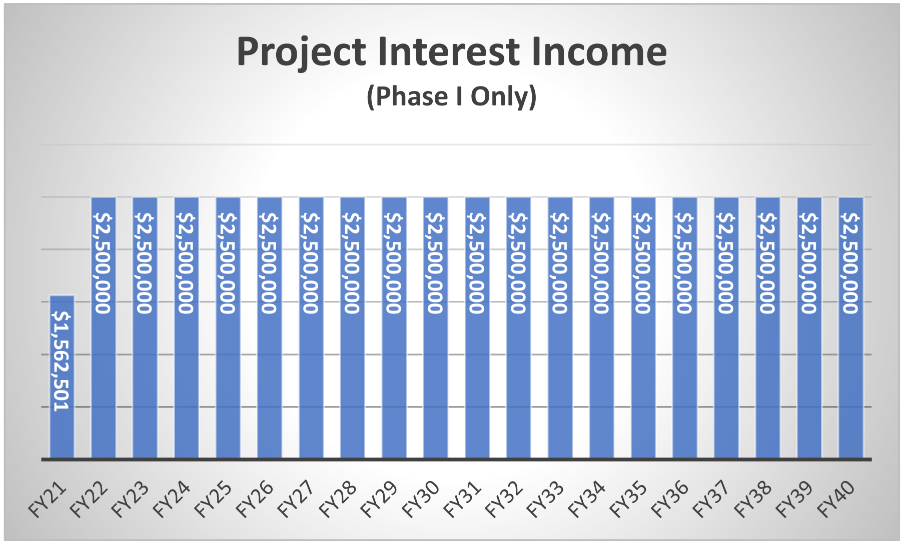


Phase II - $50MM

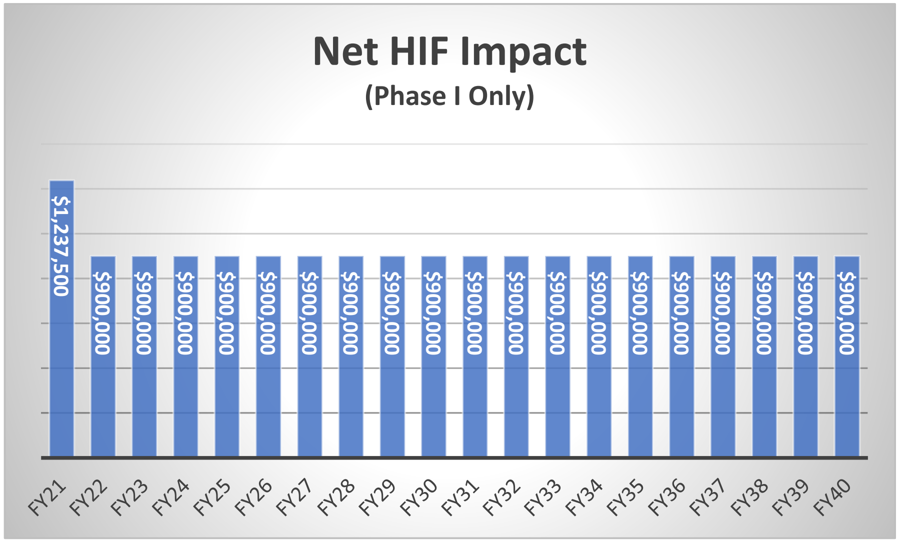
A second $50MM issuance could cover at least a third transaction with an increase in annual appropriations to ~$6.8MM. It may be advantageous to the HPF for this issuance to occur in FY22 to ensure it is done in the current low interest rate environment.

HPF Project Interest Income – Paid into HIF

Projects using the HFP pay 5% annual interest back to HPF for use. These funds could be used to offset HIF impact or increase HPF.



If used to offset impact to HIF, net impact to HIF is less than $1MM annually (other than the first year).



HPF Project Interest Income – Reinvested in HPF

Were project interest (at 5%) reinvested, the initial $50MM would result in $377MM in loans.

Leveraging of County Funds

37-to-1

HPF @ $50MM (Project Interest Reinvested in HPF)				
	Bonds Issued	***Bond P+I***	***Project Loans***	***Interest Paid***
FY21	$50,000,000	$2,800,000	$50,000,000	$1,562,501
FY22		$3,400,000		$2,500,000
FY23		$3,400,000		$2,500,000
FY24		$3,400,000		$2,500,000
FY25		$3,400,000	$60,539,063	$2,902,214
FY26		$3,400,000		$3,026,954
FY27		$3,400,000		$3,026,954
FY28		$3,400,000		$3,026,954
FY29		$3,400,000	$72,911,733	$3,498,023
FY30		$3,400,000		$3,645,586
FY31		$3,400,000		$3,645,586
FY32		$3,400,000		$3,645,586
FY33		$3,400,000	$87,813,069	$4,212,931
FY34		$3,400,000		$4,390,654
FY35		$3,400,000		$4,390,654
FY36		$3,400,000		$4,390,654
FY37		$3,400,000	$105,759,865	$5,073,949
FY38		$3,400,000		$5,287,994
FY39		$3,400,000		$5,287,994
FY40		$3,400,000		$5,287,994
			$377,023,730	**$73,803,182**

Legacy of Mixed-Income Success

107 Units | 53 Aff

Timberlawn

1989

305 Units | 122 Aff

Alexander House

1992

202 Units | 51 Aff

Strathmore

1996

308 Units | 92 Aff

Metropolitan

1997

173 Units | 53 Aff

MetroPointe

2008

200 Units | 40 Aff

The Lindley

2018

HOC originated the mixed-income model in the County and continues to be the leader in mixed-income development.

Channel Strengths

Size of Existing HOC Pipeline: HOC has identified nearly 5,500 units of new construction potential in properties it owns, controls, or are controlled by the County (and could be transferred to HOC). HOC has another 2,500 units it could reasonably secure quickly but hasn't pursued for insufficient resources.

Revolvability: HOC is particularly adept at financing stabilized properties. Its ability to secure high-LTV permanent financing will allow HOC to repay Production Fund monies upon stabilization (within 4-5 years of construction start). This certainty of take-out/repayment within a relatively short term is a core distinction from typical uses of the HIF.

Uses Existing Talent, Resources, and Precedent: HOC already has the track record of delivering the mixed-income model, experienced staff, housing advisors, developer relationships, and capital partners to deliver housing in volume. The Fund structure follows, nearly exactly, that of the MPDU/PAF revolving fund that the County established decades ago: 1) funded via bond issuance (long since paid off), 2) interim in nature, 3) replenished through HOC permanent financing, 4) available on demand, and 5) HOC controlled.

Permanent Governmental Ownership: Take-out financing that repays Production Fund draws also leads to HOC ownership/control of the properties upon stabilization.

Project Self-sufficiency: Unlike typical uses of the HIF, these projects would reliably refund the HIF after five years. HIF loans are typically outstanding for decades.

Production of Mixed-income Communities: Projects that use the HIF are typically 100% or near-100% affordable. HPF-funded communities would provide total affordable units per project similar to the high end of typical HIF transactions but in a fully economically integrated setting.

Value of P3 During the Construction Phase

Expertise & Bandwidth: HOC typically partners with the private sector on new construction developments to gain access to the best expertise in the market and to prevent staff capacity from being an obstacle to increasing housing production.

Aligning Risk: HOC requires that its partners co-invest and bear risk in these transactions to ensure our partners do not have incentives that compete with the best outcomes for the County, HOC, and its mission.

Leveraging Private Funds: HOC's partners help bear the cost of predevelopment expenditures such that capital resource availability is not an obstacle to increasing housing production.

Spurring Additional Opportunities to HOC: Private developers are more likely to afford HOC participation in their pipelines if a predictable P3 framework exists. The HPF creates a timely and efficient avenue for private developers and private non-profits to participate in this expansion of housing in the County.

Sizing & Logistics of the Bond Issuance

- The Bond Issue: Bonds would be taxable in nature to maintain maximum flexibility of ownership of housing development during the construction phase. Tax-exempt financing for housing, with private ownership would require an allocation of state ceiling private activity volume cap. Montgomery County is allocated approximately $38 million annually, by formula.
- Security for the Bonds: The bonds would not be a general obligation of Montgomery County or HOC and security for the bonds would be subject to annual appropriation by the County, which the bond market understands and prices accordingly.
- Bond Amortization: Full amortization of the bonds over 20 years based on a level debt payment; therefore, annual debt service payment from the HIF is known and constant.
- HOC and Trustee Management of Funds: HOC management of the bond issuance would also aid in both maintaining financing efficiency and accounting at the point of permanent financing/HPF repayment. All funds and accounts are held by a Trustee and utilized in accordance with the governing documents under the indenture.
- Governing Documents: Production Fund would be drawn by HOC on demand and in accordance with provisions of the indenture. An agreement between HOC and the County pledging debt service payments and detailing program parameters would be created. This would include annual reporting to Council.
- Timing: Bond issuance can proceed within 90-120 days of Council approval.
- Debt service payments: Semi-annual payments are made to the Trustee for benefit of bondholders on January 1 and July 1.

Notes on Further Efforts

<u>Leveraging Private Funds</u>: HOC is talking with private capital providers that operate in the affordable housing realm to provide funds to pair with Production Fund loans. While the returns required by the private capital providers are a little higher than the Fund 5% rate; when paired with the Fund loan, the blended rate is still supportable. This would lower the amount of capital required as a Fund loan for each transaction (and increase the number of transactions that could be served by Fund loans).

<u>Additional Opportunities</u>: This structure will be attractive to many private developers with active developments. It is likely these developers will commit their developments to future HOC ownership/control in exchange for the ability to access the Production Fund.

<u>Base Affordability</u>: Projects accessing this fund will typically have 25%-30% of units set aside as affordable at or below MPDU limits.

<u>Deeper Affordability</u>: Among potential options to discuss, decreasing the 5% project interest rate in exchange for deeper affordability or reinvesting some of annual interest sent to HIF back into a project for the same purpose. HOC will also use other resources toward deepening affordability on a deal-by-deal basis.