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COMMUNITY FACILITY DEVELOPMENT

Community Economic Development Toolkit

REAL ESTATE SERIES

CCEDA California Community Economic Development Association

Disclaimer

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COMMUNITY FACILITY DEVELOPMENT

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HOW A PROJECT PROCEEDS

Most projects –– whether physical development or business development –– follow a similar planning track. They go through planning and predevelopment, and then face a GO/NO GO decision. Each stage carries financial implications and require a set of skills. The following table summaries the stages of a project, and their financial (the size of the financial commitment is signified by the number of dollar signs) and skill needs.

As you read the following Tool Kit, keep in mind the Project Steps outlined below.

PLANNING	PREDEVELOPMENT	DEVELOPMENT Go/No go decision	PLANNING
ACTIVITIES Form project idea Examine community plans Do preliminary needs analysis	**ACTIVITIES** In-depth analysis Secure financing Finalize project team Attain site control	**ACTIVITIES** Construction or start up	**ACTIVITIES** Ongoing administration
MONEY IMPLICATIONS $	**MONEY IMPLICATIONS** $$	**MONEY IMPLICATIONS** $$$$$	**MONEY IMPLICATIONS** $$
SKILL/ ORGANIZATIONAL NEEDS Planning Community Outreach Funding Fund Raising Legal	**SKILL/ ORGANIZATIONAL NEEDS** Architectural/ Engineering coordination	**SKILL/ ORGANIZATIONAL NEEDS** Project Management Administrative	**SKILL/ ORGANIZATIONAL NEEDS** Asset Management Property Management

Use of this Guide: An Overview

COMMUNITY FACILITY DEVELOPMENT

THIS GUIDE SHOULD BE USED FOR THE FOLLOWING TYPES OF PROJECTS:

Projects may vary as to use, size and scope but will include the following:

1. Facilities for community uses:

a. Senior, Youth or Child Care Facilities (including Head Start)

b. Health Care Facilities and Clinics

c. Recreation, Meeting, Performing Arts Centers

2. Development of an office building for your corporate headquarters, programs and possibly other nonprofit services

3. For commercial (retail and office) and possibly industrial facility development (new construction or acquisition rehabilitation) which will have business tenants that cannot reliably make monthly space (rental) expenses. This may include micro-businesses or social enterprises.

4. Development of a job training, health, child or senior center and charter schools (if the tenant cannot afford market or near market rents, but provides essential services to the community).

5. Development of a business incubator. NOTE: Incubators typically rely on ongoing subsidies to lower common services and space costs incurred by the 'incubated' businesses. The source of subsidy (if needed) must be reliable if the sponsoring organization is willing to take the development risk of owning and managing a commercial facility and its associated financial obligations.

INTRODUCTION

This guide is intended for use by community development practitioners considering becoming developers of a community development facility. It is similar to the Commercial (Office and Retail) and Industrial Facility Guide. The key difference is that community facilities are financially structured to have very little to no debt. Many of the projects will fall between the two categories and this guide will help you if you are undertaking debt free projects or projects with a very small amount of debt. In most community facilities the tenant cannot afford to pay much or their cash flow is not reliable. This guide will focus will be on equity sources to make up the majority of the development costs. Much of the equity raised for these projects are achieved through capital campaigns or through large public or private grants focused on meeting a very important community need.

This guild includes projects that can generate some cash flow to support small loans with small debt service. Projects that do not have debt will have operating and management expenses that must be paid by the tenant or building owner, so in all cases ongoing cash flow is needed. In many geographic regions, heating or cooling costs can substantially increase expenses.

The newest, exciting trend supporting Community Facility Development is the use of New Markets Tax Credits. Community Facility projects have become highly desirable because there is little to no debt in the project , and the investor (institutional buyer of the credits) will have less risk. Additionally, their investment is leveraged against the grants and donations. This investor equity will stay in for the required period that the investor uses the tax credits (credits applied against tax liability over 7 years). After the 7 year period the investor will leave the partnership and the equity will remain in the project. The net result is an added $1.75 million in an $8 million dollar project.

This guide will help organizations understand the complexities of development and the commitment needed to proceed. It will also detail the degree of support needed by community, local government, and public and private sector partners.

Most importantly, this guide will take you through the key steps in the development process. As non-profit developers, it is important to minimize unnecessary costs. To assist you, we have divided the development process into phases. The first phase can be accomplished with existing staff interested in community development. Staff time must be dedicated to conduct the preliminary work required to make a sound decision on whether or not to invest funds to take the project through an extensive development process. Much of the initial preliminary analysis describes a process that, once

INTRODUCTION

learned, could apply to most real estate development.

In the second phase, we have detailed steps needed to complete a project. This will require your organization to invest predevelopment funding to conduct the necessary "due-diligence" to ensure the project is feasible. The second phase will also detail what needs to occur to complete development.

Projects might be designed to provide added benefits by including "green" or other energy-efficiency measures. Projects could incorporate service programs and include added features such as child care facilities, learning centers or libraries. Most of these uses may not have the ability to pay ongoing "market rents" and may impact the feasibility of your project. These added community benefits may incur additional development costs that you or your partners will need to consider.

For experienced developers, this guide could also be used as a checklist to remind you about key issues and provide a refresher on the process for this type of development.

Because of the need for significant equity it takes more creativity to structure financing. When structuring financing, we need to determine maximum debt based on market rents, vacancies, operating expenses, etc. We work backwards to determine the amount of equity needed. At this point any additional equity reduces the need for debt, creating a financing cushion that can be used to lower rents, subsidize other services, or generate income for your organization.

Your organization or proposed tenants will likely need subsidized or below market rents, so there will be a need for more equity. This guide includes some of the key sources of "equity" and other lower cost financing needed to create viable successful ventures that benefit both your organization and the community.

Remember, you are the landlord! You must make sure that the tenants you select are successful and will make lease payments however small it might be. There are operating expenses and the need to make reserve payments for future building needs.

This project type represents one of the simpler development step undertaken by nonprofit community development organization, especially if they are going to occupy the space with offices or programs. The developing organization is already familiar with space needs and expenses. They also understand the local real estate market and local lease rates and terms.

Community facility projects can be simple or very complex depending on the size and number of uses in the project. Similar projects are being developed by nonprofit community development organizations. Your tenant (whether it is your organization or not) must be able to reliably pay its share of the rent needed for operating expenses and for any debt. The amount of debt that the project can reasonably afford determines the amount of "other equity" needed. The lower the levels of debt, the lower the rents and the lower the leasing risk is to you (the developer).

Development is a team effort. This guide describes the development team members, what partners should be included in the process, and identifies ingredients and steps that are essential for a successful project.

This guide includes the following sections:

1. Use of this Guide: An overview of what types of Community Facility projects can be developed with assistance from this guide.
2. First Phase: Initial Development Steps. This section includes the steps needed for an organization to clarify its development concept and to determine if a project is possible. It explains who you should initially talk to and what information you would need to decide to proceed with your project. These are the steps needed to clarify what you want to do and gather the data needed to clearly explain your project in the hopes of garnering interest by project funders and partners. In many ways, this is the basic information needed to develop your concept paper. Once you decide to proceed, we will retrace many of these activities to include greater details needed for project and financing approvals.
3. Go/No Go: This is the point where you and your organization would use the data collected to decide if you should proceed. If you do proceed, you will know what resources or assistance are needed. This guide suggests

ways to keep costs minimal prior to the Go/No Go decision (main resource will be staff time). The next phase entails more time and financial commitments by your organization. You will incur predevelopment expenses (a great portion will be funds used for consultants that will verify many of the development assumptions such as market demand, development cost, and appraised value)

4. Second Phase: Detailed Development Process: These are the steps that outline the development process, key development steps, and important project resources. This section will provide insight into the essential steps needed for the successful completion of your project.
5. Financing: This section will provide some detail on the sources of financing and how they are used in the development of affordable housing.
6. Development Notes: These are some "tips" that we have compiled from experienced developers that highlight important considerations.

First Phase: Initial Development Steps



FIRST PHASE: INITIAL DEVELOPMENT STEPS

If you and your organization decided to explore the feasibility of developing a commercial or industrial project, this section outlines key items you need to know before spending predevelopment funds that will not be recovered unless the project is completed. You will need to invest staff time to investigate initial feasibility, but in the long run, it will save time and money. It is likely that you will look at several projects before one has the right attributes needed for success. Most of the general data gathered in this process will allow you to complete a concept paper that your organization can use to decide whether to invest the time and financial resources to move forward. It will also be used to generate support from future financing and development partners.

1. Determine the market need by target population: The first step is to make sure there is a need for your facility and the services or products your tenants are providing in the targeted community. This is your initial understanding of the scope and needs in your community. This can initially be verified by various sources including:
   a. Community Plans
   b. Community Planning Meetings: Local business or chamber of commerce.
   c. Local Government
   d. Community Organizations: Business development assistance or financing organizations.
2. Is there local government funding available? Local government funding will be needed unless there are other sources of project equity. Government equity includes grant funds or deferred/residual receipt loans from local government that could be anywhere from 40% to 75% of the total development costs. Deferred/residual receipt loans are structured so the payments are not due unless there is residual cash flow that the project can afford to pay. Additionally, these loans are usually at a very low interest rate. As with most community facilities, the tenant's ability to pay rent is not strong and you will need to increase any sources of equity. In some cases, a locality might commit funding over two budget periods.
   a. Funding Sources include:
      i. CDBG (Community Development Block Grants): Federal funds passed to local governments and counties (above 50,000 populations). For smaller jurisdictions, counties may be the funding entity and in some rural cities and counties the state will be the entity. These are grant funds and can be used for all types of CED real estate development efforts in low and moderate income communities. The funds are competitive and traditionally fund many ongoing public sector programs and initiatives.
      ii. Redevelopment Agency: Redevelopment Agency (RDA): Local redevelopment agencies generate their own funds from project area generated tax revenues. In California, a portion is mandated for low and moderate income communities (projects).
   b. Key departments that administer funds include:
      i. Economic Development Department
      ii. Redevelopment Agency
      iii. Community Development Dept

   Local government and federal pass–through funding require significant levels of public benefit, meaning that the funding is minimally targeted to meet the needs of low and moderate income individuals, families and communities. The more public benefit your project generates the greater likelihood of support.
3. State, Federal and Other Funding Sources: These sources are needed to complement, augment and sometimes replace funding from the local level. The funding will look similar to local government funding: residual receipt or deferred payment loans. In some cases it may be a substitute source for local support; however these sources vary significantly from state to state. It is not uncommon to have local sources augmented by state or other sources.
   a. Federal Sources: Equity (See added Funding Sources section for details on these sources)

i. US Department of Health and Human Services, Administration for Children and Families, Office of Community Services (OCS CED): The purpose of the CED discretionary grant program is to promote and support projects that address economic self-sufficiency for low-income persons and distressed communities to create employment and business development opportunities.

ii. US Economic Development Administration (EDA): Public Works and Economic Development investments help support the construction or rehabilitation of essential public infrastructure and facilities necessary to generate or retain private sector jobs and investments, attract private sector capital, and promote regional competitiveness, including investments that expand and upgrade infrastructure to attract new industry, support technology-led development, redevelop brownfield sites and provide eco-industrial development.

iii. US Department of Agriculture: For rural markets, the USDA has a competitive grant program for facility development.

iv. Congressional Earmarks: Your congressional representative (senator or congressperson) will entertain requests for earmarks for your project (some actively use earmarks for their constituents and some do not).

v. Private Investment: New Market Tax Credits (NMTCs): The credits are allocated from the Department of Treasury to qualified lending entities on a competitive basis (banks, loan funds, local governments and some development entities are eligible). These qualified entities will in turn allocate credits to projects that meet certain low and moderate income guidelines (location) and create jobs.

b. Sources: Debt: If some debt is needed and can be supported. (See Funding Sources section for more detail)

i. Conventional: Conventional financing for community facilities is very tough. It is important to locate potential lenders and insure they understand the project and the development team (the non-profit and its support team). Smaller regional banks may have a close relationship with you and support your effort. Your deal must be "solid". There will be significant weight put to the strength and capacity of the developer (experience and balance sheet) and a solid repayment source (strong tenants and strong cash flow).

ii. New Markets Tax Credits: Another structure for NMTCs are debt products created by financial institution that internally purchases the NMTCs and use the proceeds to lower interest rates on conventional debt products. The loans are generally for 7 years and rates will be 2 basis points lower that market rates. Loans will be made in NMTC eligible projects and locations.

iii. Other Lending Institutions and Community Development Financial Institutions (CDFIs): These loan funds are usually supported by the public and private sector. These are pooled funds that target a certain industry or market and these institutions have become very strong and successful in their niche market.

iv. CDBG/Section108: The local government entity would provide loans to projects. The local governments 108 loan funds are secured by future CDBG grant funding, and the loan made to you is secured by the project). The loan terms are determined locally and use is similar to CDBG requirements.

v. US Department of Agriculture: For rural markets, the USDA provides loans for the development of facilities.

vi. Owner Carry-back / 501c3 Bond Financing: Owners may be willing to carry-back financing to make the deal work. If you (or your programs) are tenants the building, this "value" and can work for you. The owner's financing is tax exempt adding a strong incentive to provide carry back financing.

c. Other Sources: Foundation and corporations may want to support an important local project and can provide grant funding (equity). Some Federal Home Loan Bank (FHLB) regional banks have grants available for economic development projects.

d. Confirm Funding Cycle: For all sources, make sure you recognize the timing for each funding cycle. The "art" in many of these developments is having the right application ready for each of the funding cycles. Sources may have requirements of prior approval from other funding.

e. Confirm Eligibility: Is your organization eligible for the targeted assistance? Is your location and project eligible?

For all of these potential sources, make sure you know the timing for each funding cycle and know when proposals are due. The "art" in many of these developments is having the right application ready for each of the funding cycles. It is also very important that you confirm that your project is eligible. Some sources may require approval from other funding prior to being eligible to apply. Is your project in the right location and do you meet all of the organizational eligibility requirements?

4. Locating a Site: Locating a site is a key step and should be initiated about the same time as you research funding resources. When looking at a site you will need to research:

   a. Zoning/Allowable Use

   b. Restrictions: Check the deed and planning restrictions for the site.

   c. Use Compatibility: Is the project compatible with neighboring uses?

   d. Availability/Ownership: Is the site available? If it has been available, why? (Issues include cost, environmental concerns, development constraints, etc.)

5. Preliminary Development Team: The informal development team is tasked to investigate and define the project. In some instances the same members might participate in project development. The team will represent the organization and its activities may be bound by board or organizational approvals. In this preliminary phase, your organization is trying to minimize costs by looking for volunteers and friends to provide estimates.

   a. Project Manager: The project manager might be a hired professional or a member of management. The manager must have adequate time to investigate the project. If the manager does not have development skills or experience, a development consultant, interested volunteer, or board member should be recruited to support and offer guidance to the manager.

   b. Architect/Contractor: The architect/contractor could be a board member or friend of the organization who can provide some input and insight into project design and development issues, and can provide rough cost estimates. Local contactors can also provide a rough cost per square foot estimate based on design and use.

   c. Consultant (If needed for financial structuring, development and planning): At this early stage the consultant could be a volunteer, board member or someone who might be interested in supporting the project and would have development and finance experience and skills. If the organization has an experienced project manager, a development consultant would not be needed.

   d. Attorney: At the outset, certainly in the planning stage, you should consult an attorney. He or she might also be a board member, but it is important that the attorney have experience in working with SEC.501(c)(3) organizations and in real estate development. There are unusual tax issues presented when non–profits engage in for–profit real estate development. Also, there are many land use issues (zoning, height/density/use, etc.) which may call for legal analysis.

6. Preliminary Feasibility of the Project: Now that you know the resources are available to develop a project and you have the team to support your efforts, the next steps will help you clarify the scope of the project and determine work tasks. By the final steps your organization should be able to make an

informed decision to proceed with the project (or to proceed by meeting certain conditions).

Remember, this analysis is for you to determine if you should proceed and if so under what conditions. Any issue or potential problems that you have identified will need a solution to allow you to continue. These steps include:

a. Planning:
   i. Local Plans, General Plan: How is the intended use reflected in local/ community plans? Is it consistent with the general plan?
   ii. Previous Development Efforts: What has happened to the proposed site? Why is it available? Has anyone else attempted similar development activities?

b. People: You must identify the supporters and opposition. What would they want to see in the project if you were to proceed? Community support is essential. Organized "Not in My Back Yard (NIMBY)" efforts can end or significantly delay your project. Talk to:
   i. Local Planning Staff
   ii. Local Elected Officials
   iii. Community (business associations, chamber of commerce, neighborhood councils, community organizations and key community leaders)

c. Preliminary Design: Your project team and the data gathered will enable you to determine the following:
   i. Facility size, office/retail unit configuration
   ii. Parking
   iii. Amenities
   iv. Density: What densities are allowed? What makes sense for your community?
   v. Local Design Standards: What must be included in design?
   vi. Funding Design Requirements: What do the funding sources require?

d. Preliminary Financial Feasibility: Financial feasibility is the most important step in your preliminary project analysis. Here you will begin to make adjustments based on resources and what you can afford to develop.

Now that you know what you are building and where, this is your initial attempt at determining project costs, sources of financing and ultimately the overall feasibility of your project. Your lenders will always ask for sources and uses: who is paying and what are they paying for. Our analytical steps will look at uses (costs) first and then look at what sources you have to pay for it.

i. Uses (Costs): Together, the two following cost items will equal your project's development cost.
   1. Hard Cost / Construction Cost Estimate: Based on square footage and uses, your development team will be able to estimate construction hard costs (what it costs to build the project). You also will be able to estimate the offsite costs (curbs, gutters and utilities).
   2. Soft Cost Estimate: These are all of the other costs that are not part of the actual construction. This includes some consultants, reserves and fees.

ii. Sources: This is your estimate of what funding sources might be available to you, how much you may be able to obtain and what the financing terms are. Sources will need to match uses and any debt (loans) must be able to be repaid from the project's cash flow.

   You should also check the funding requirements for these sources. Do you and the project team qualify for the tax credit or financing? Does your project meet the requirements and financing guidelines for all other sources?

   This is your preliminary analysis, so be CONSERVATIVE. Do not use lower estimates just to be eligible for a funding source. Ultimately, development expenses will usually be higher due to unforeseen events. Additional expenses will be harder to support after you have already been approved at a lower amount.

1. Debt: The maximum conventional loan a lender is willing to provide to a project is based on the cash flow generated by the project. For a construction loan, this would be the maximum loan (ultimately "taken–out" or "repaid" by the permanent loan). In many instances the construction lender is willing to provide "bridge financing", e.g., financing to bridge other funds such as City financing or tax credit equity that will not fund during construction.

   There are two measures used by banks and lending institutions to determine the maximum loan they will provide a project. The bank will use the loan size equal to the lower of the two following standards. They are:

   - Loan to value (LTV) is a ratio (percentage) used by banks to determine the maximum loan a project could receive based on its calculated value. A 75% LTV would mean that the maximum loan for project valued at $1 million dollar project would be $750,000. A 75% LTV is typical for projects.
   - Debt Service Coverage Ratio (DSCR) is a ratio of what the maximum loan for a project would be based on its ability to make loan payments. A DSCR of 1.20 would mean that a project would need total income per month (less expenses) to be greater than 120% of the monthly debt payment. You would have 20% extra cash available after you make your monthly payment to the bank. DSCR might be as low as 1.15 in some economic markets.

2. Equity: Includes "soft debt" from government. The CDBG, RDA, EDA, HHS/OCS sources are equity grants or may be debt a low interest and/or repaid on a deferred basis (when there is cash flow). This is included in equity and is generally "valued" as equity by the appraiser and/or lending institution to determine loan to value. Remember, more equity is needed if the goal is to reduce rents to the tenants.

3. Gap: This is the additional amount for which you have not been able to identify a source. As a result, you will need to go back and locate "other equity" sources or seek increased commitments. You might also look to cut costs by reviewing materials and amenities. More square footage or higher rents can also be part of your analysis.

7. Securing Preliminary Support: Based on this more in–depth analysis, you will need to loop back and conduct additional meetings to ascertain the level of support and level of funding commitments from the sources noted below. This is the phase of work where your organization will maximize its local community support, political connections, board connections and goodwill to obtain commitment from key sources of financing. You will need support from:

   a. Organizational Support (Board, Staff)

   b. Local Community

   c. Local Government

   d. Federal Government

   e. Debt, Equity, and Gap Sources

GO/NO GO/MODIFY

This is the point where the organization can determine if it is willing to spend the funds to start project predevelopment. Remember, to this point have committed some staff time and incurred very little expenses. The information you have gathered will give you an indication of whether or not you have a feasible project that you would be willing to invest predevelopment expenses on.

Second Phase: Detailed Development Process



SECOND PHASE: DETAILED DEVELOPMENT PROCESS

Now the work begins. The following steps will help you and your development team and partners proceed through the development process with the intent of closing financing and developing the project. You will need a technically competent development team and partners who will conduct the detailed analysis and work. Project details will be researched and completed. Designs will be finalized. Costs will be confirmed. Loans and grants will be approved by lenders, public and private sector funders. Agreements will be consummated. Construction will start and the project will be completed.

8. Predevelopment (Refine Assumptions)
   a. Site Control: Begin the process to gain site control.
      i. Letter of Intent: The letter of intent (LOI) is your written offer to the seller that outlines the terms and condition of the sale. This is drafted with your broker or real estate specialist and will include clauses to ensure your deposit is refundable and that there is ample time to conduct the studies needed to proceed. These projects take an enormous amount of time (negotiating multiple sources of financing where many have a long approval process). It is critical that ample time is negotiated. If there appears to be strong interest from a funding source, it might be prudent to allow payments to be made to the owner (portions of the deposit going "hard").
      ii. Negotiations: Site acquisition is a negotiation with offers and counteroffers. The actual sales price will usually be determined by the appraisal (most local governments cannot pay for a site above the appraised value). In some cases when the appraisal is lower than the seller is willing to accept, other costs borne by the seller might be paid by you.
   b. Site Due Diligence: Most of the following items are required by lenders and investors and will require predevelopment funds to engage these 3rd party studies.
      i. Title Report
      ii. Appraisal
      iii. Soils
      iv. Environmental
      v. Seismic
      vi. Flood
      vii. Noise
      viii. Traffic Studies
      ix. Historic and Local Public Development Requirements
   c. Entitlement/Planning: The planning department will confirm that your project meets all local planning restrictions, code and utility easement requirements.
   d. Market Assumptions (Market Study): The market study is a very important analysis that will help you assess the risks of this project. It is especially important if you are building a retail/office project and relying on attracting businesses and services into an underserved community.

Your project should have a market advantage due to the low debt burden associated with community facilities. Other market advantages might be the services and resources provided to the tenant. A major "anchor" tenant in the project (it might be your organization) is desirable and can financially support the project and allow for lower lease rates for businesses and services you are growing or attracting.

The market analysis will provide you with both expected income and expenses. This analysis will also include common area expenses: What is the local market paying and how the rate is calculated.

The analysis will determine what income and expenses are if this was a project designed to attract tenants in an open market (without subsidies or targeted assistance). This is the data that the appraisal will verify for lenders.

   e. Design: Design and site plan work should begin.
   f. Confirm Construction and Operating Assumptions: Based on the more formal plans, you will be able to confirm construction costs.

g. Appraisal: You may need to engage an appraiser to determine the sales price of the land or building. If it is not absolutely needed it is a cost that could be avoided and be included in the appraisal commissioned by the lenders. The appraisal will be needed if you have predevelopment funds that are to be used for site acquisition (funding from another source, usually local government).

9. Refine Development Team: This is the project development team who will close the financing and build your project. The team will consist of professionals who are hired to assist in the completion of the project. Bids will usually be taken to decide on key project participants such as the contractor and engineer.

   It is incumbent on you to do your due diligence (homework) to ensure that the parties have the skills, experience, time and financial capacity to complete the work. You may also want to talk to your lending sources (public and private sector) to make sure the team members meet their requirements (license and bonding). They may also have recommendations and provide insight from past experiences. Key members of your team include:

   a. Architect: Will move from design to working drawings and specifications

   b. Contractor: Your lenders will have certain bonding and insurance requirements for the contractor.

   c. Engineer

   d. Attorney: Make sure they have experience with LIHTCs.

   e. Accountant

   f. Energy Consultant: Especially if you are trying to meet certain energy efficiency goals.

   g. General Partners (Ownership Structure): (This item will apply only if your project is using New Markets Tax Credits as a source of equity. See the New Markets Tax Credit Section.) The attorney will structure the limited partnership that brings the equity investor (buyer of the tax credits) into the project. The investor becomes the limited partner and your organization will become the managing general partner. At this early stage, you will want to talk to several investors. All have different terms (how much and what they require when they leave the partnership in 10 years).

   h. Funding Sources: This would include all of the sources of debt and equity needed in the project. These sources must in agreement about the project; its cost, who is paying for what, when the funding occurs, the development time frame and in the case of debt and bridge–loans), when they will be repaid.

10. Financing

   a. Review Debt, Equity and Gap Financing Application: Each source will have specific requirements for approval. There are separate checklists of forms, documents and studies that are needed for each lenders approval. Be aware that any unforeseen condition will likely trigger the need for more information and may create additional financing requirements or contingencies. Also note the timing requirements for the sources of financing, some may require a prior commitment from other sources before they can approve or consider your application.

   b. Refine Development Pro Formas based on funding source requirements and conditions: Each source will determine the size of their commitments and the conditions of their funding. There is a possibility that many of the conditions will not be in sync with others, and there will be a need to negotiate a solution. In addition, the loan amounts will typically be less than anticipated and/or additional funds may need to be set aside to meet unanticipated conditions. There may be a need to locate additional sources or request more funds.

   c. Commission Appraisal: The appraisal is usually commissioned by the first trust deed lender and might be shared by other participating lenders and funding sources. Make sure you check to see how this process could be combined to save costs. The appraiser will determine an "as is" appraisal, the value upon completion of construction, and a value upon lease–up. If you have a mixed use project, they will need to value each segment and determine an overall value (appraisal costs will be higher).

   d. Obtain Conditional Commitments: After review of the application and underwriting the project, the lenders will make a "conditional commitment" subject to a number of items that can include but not be limited to: appraisal, review of environmental, review of architectural design and specifications, approval from participating lenders, approval of related entitlements, and conditions as a result of other findings from 3rd party reports.

11. Site Acquisition: During this process (preferably early as possible), you should have an approved letter of intent (purchase agreement) and have opened escrow.

12. Project Entitlements: Project entitlements include:

   a. Preliminary Plans: Your architect will submit preliminary drawings to the City for initial review. The City will note changes and other requirements

   b. Plan Check: Plan review undertaken by the planning department

   c. Design Review: Local or community review or review by lender(s).

   d. Building, Utility, Public Safety, Public Works Requirements

   e. Community Input/Approval

   f. Finalize Plans, Specifications

   g. Final City Approval (community hearings and approval from the Land Use and Planning Commission and from the City (Council)): You must know beforehand that approval is likely. If there is opposition, you should be ready to "prove your case" for project approval. This may include bringing a busload of seniors or supporters and have them call the council or commissioners offices.

13. Additional Construction Loan Requirements: These are the key items outlined by lenders as a condition of closing

   a. Final Working Drawings: This includes drawings and specifications

   b. Construction Contract: Lenders or investors may require certain types of contracts (cost or cost plus). Note on Construction Bids: The bid process begins when the working drawings and specifications are ready. Check with participating lenders on their requirements for the contractors bidding on the project (credit history, bonding capacity, prevailing wage compliance, insurance, etc.)

   c. Architect Agreement: Usually standard American Institute of Architects form

   d. Property Management Contract: This is the firm that will lease up and manage the project. In many cases the lenders have specific requirements. If your organization is interested in building this capacity (especially if you are providing additional services such as after school programs, senior nutrition, health and family care or youth programs), you may want to work with an experienced provider while gaining the experience.

   e. Leases: Lenders will require preleases for your key tenants whether or not it may be your own organization. The conventional lender will underwrite these key leases to determine the viability of the tenant to make its lease payments.

14. Syndication: The process of syndication began in Sep 9 (when you determine the ownership structure). You can locate a syndicator (investor who purchased the tax credits) using the following steps.

   a. New Market Tax Credit (NMTCs) Investor Solicitation (if you are planning to use NMTCs): The (tax credit) investor market changes based on economic conditions and the appetite of lenders. Demand from lenders and financial institutions are partially based on their desire to meet Community Reinvestment Act (CRA) requirements. Purchase of tax credits has proven to be a very safe method of meeting CRA investment requirements. Lenders are incented to invest in certain low and moderate income communities that are part of their service areas. This has driven up the market demand for tax credits (they will pay a higher price for tax credits). Check with any lender and they will know which investors are active in any region.

Besides financial institutions, insurance companies, utilities and some larger corporations are active in the tax credit market. There are also syndicators that purchase credits on behalf of corporate investors.

b. Negotiate Terms (Pricing, Amount, Pay in Schedule and Other Requirements): These items and the terms thereof are very important to your project. Two years ago the purchase price of credits ranged from 75 cents for a dollar worth of credit to over one dollar per credit. Post economic crash has dropped pricing down to as low as 67 cents, with very few investors in the market. In some high CRA demand areas, the pricing is back up to the 70 cent plus range. The pay in schedule is important because the investor does not accrue value in the credits until the project completes construction. However, equity is needed during construction (it is the cheapest source of funds during construction versus a conventional construction loan that charges interest over the period of the financing).

c. Finalizing Ownership Structure: Once terms are agreed, the attorneys will finalize the limited partnership. This document will outline the conditions of the equity investment, how the partners need to perform and how they could be removed or replaced.

d. Execution of Partnership Agreement: The actual execution usually occurs at the close of the construction loan.

15. Construction Loan Closing

   a. Fulfill Other Funding Conditions

      i. Escrow Account/Instructions: The escrow instructions are critical and include all of the documents, exhibits and approvals that must be presented before closing and recording of the documents. Escrow also manages the funding process (from lenders, investors and other grant sources) and payments to participating parties and consultants.

      ii. Other: Signed construction contracts, approved drawings, permit approvals and funded reserves.

   b. Documentation: All of the loan documents, funding agreements, inter–creditor agreements, partnership agreements and deeds are drafted by respective attorneys and reviewed by you and your attorney. Note: The permanent loan provider will provide a commitment to fund based on meeting conditions related to construction completion and lease up. The take out (or permanent loan provider) will require specific documentation. In some cases the construction lender will also be the permanent loan provider. There is a strong desire to close the construction loan since the interest rate on a construction loan is higher than the rate on the permanent loan.

   c. Negotiations: Representatives of every source of debt and equity participates in negotiations while closing the financing. You (the project), bear the cost of all attorney fees. It is essential to manage your attorney to ensure their fees are not being generated by insignificant negotiations. Business decisions should be the center of negotiations.

   d. Execution: Signing by all parties and subsequent recording of documents.

16. Start Construction: Construction cannot begin until the documents are signed and approval to proceed is given. In some cases, demolition and site preparation might be approved under a separate contract and funded outside of the construction financing.

17. Construction Period Management

   a. Monthly Draws

      i. Inspections: There are usually monthly meetings with all participating entities (various lenders, architect, contractor, building inspector, and the owner). Your participation might be through a hired construction manager who has experience in all aspects of construction. All parties should agree on the percentage of completion and how it matches the completion schedule. Your construction manager will help ensure that costs and change orders are justified.

ii. Architect Sign Off: See above

iii. Change Orders/Clarifications: Your construction manager is important in managing change orders and approving clarifications (between contractor and architect). All parties must agree on any change order.

iv. Draw Request: As part of the inspection meeting, the draw request is reviewed. Construction progress is agreed upon, bills reviewed and change orders examined and approved (signed by all parties).

v. Lien/Lien Releases: Upon completion of work by various trades and suppliers, lien releases are issued, signed and forwarded for recordation.

b. Pre Leasing: Each funding source (including the tax credits) may have restrictions on types of businesses and services (if the project is targeted for non–profit uses, micro businesses, start–ups or restricted by geography (local business only) .

c. Payments: Per the loan agreement, funds are released by the construction lender and participating lenders (city and/or state sources) to the construction account managed by your organization. You will subsequently transfer funds to the contractor. The agreement also defines the turn–around period for funding by both the bank and by you to the contractor.

d. Construction Completion: Tax credits require that a project must be placed into service by a specified date or the credits will no longer have value. Additionally the equity investor has estimated their equity investment into the project based on what the placed–in service date is (the partnership agreement will include monetary "penalties" if days are missed.

e. Tenant Improvements: The construction budget will allocate funds to support tenant improvements however the tenant will bear some of the expenses. The degree of this split is determined by the projects goals: to what degree is the project designed to assist new start up businesses or to provide incentives to have businesses locate in the community?

f. Architect Sign Off: Final completion sign off

g. Building Inspection Sign Off: Completion and issuance of the Certificate of Occupancy is by the city building inspector.

18. Leasing/Move In: This will likely be coordinated by you.

19. Project Stabilization (Construction Lender): The construction lender will be repaid by the permanent lender upon meeting certain agreed upon leasing goals (project lease up stabilization). The terms of the lease up are requirements of the permanent lender, per your loan agreement. In most cases the interest rate for the construction loan is higher than that of the term loan, so it is beneficial to meet the lease up requirement as soon as possible.

20. Conversion/Closing of Permanent Financing: Stabilization is the main trigger for the conversion however there are a number of items that are outlined in the permanent loan agreement (clear title, occupancy certification, approval of participating lenders, etc.)

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COMMUNITY ECONOMIC DEVELOPMENT — REAL ESTATE SERIES

Financing

COMMUNITY FACILITY DEVELOPMENT

FINANCING

1. New Market Tax Credits:
    a. These are tax credits that are federally allocated to Certified Development Entities (CDE's) in most cases these are financial institutions, experienced lenders and in some cases, local governments or developers.
    b. Each CDE has its own allocation plan based on geography and or lending activity. These include many small business lending, industrial development, commercial real estate or business expansion. All projects must be located in eligible low and moderate income census tracts defined by the US Treasury.
    c. NMTC's can be used by the CDE to lower interest rates, or can generate equity by being sold to investors for a specific business or commercial/ industrial facility. The goal of the program is to support job creation.
    d. For specific details on NMTCs, please refer to the following section of Equity and Debt financing sources.
2. Conventional Debt:
    a. Loan term can range from 5 to 10 years, and amortized over a maximum of 25 years. Debt Service Coverage (DSC) is usually around 1.20–1.25.
    b. If the proposed tenant(s) are not financially strong, the lender may request that your organization become the master tenant and that the space be sub–leased to your tenants. This structure will provide more comfort to the lender, but you are now on the "hook" to make sure the space is leased. This may be a solution if your organization can move its programs or offices into the building if the need arises.
    c. Since loans are based on DSC the permanent loan amount will not cover the remaining financing need, thus the need for other local, state or federal funding.
3. Gap:
    a. Residual receipt loans provided by government sources (local and state funds)
    b. Direct federal and state grants and foundation support. NOTE: the various grant sources (especially federal) have very strict job creation requirements and the developer will need to monitor and report its success in meeting these goals.
    c. Terms usually about 55 year terms at 3%–5%, along with restrictions
    d. Possible gap loans from CDFI, owner carry or Section 108 if there is cash flow available.
4. Predevelopment:
    a. Hard to get unless you have a strong balance sheet or have an extensive successful track record
    b. Local government is your best source
    c. Intermediary sources such as Local Initiatives Support Corporation, Enterprise or the Low Income Investment Funds are cheap but may take some time to approve
    d. Commercial Bank lines of credit. Many institutions offer lines using investment funds in the form of equity equivalent loans. These are based on organizational financial strength.

EQUITY AND DEBT SOURCES

The following is a short summary of some sources for equity (grants) and debt (loans) for community economic development projects developed by nonprofit community development organizations. We have added some comments and thoughts under "NOTE", reflecting what we are seeing in the marketplace. This analysis does not reflect "official" funding guidelines and developers need to review the guidelines and funding requirements of each program or lending institution.

Some of the key suggestions of emphasize are:

1. "Be ready to have an early discussion": Have your concept paper ready that defines the project as best as you can and have numbers ready (they need to know how much you need). Explain how the project meets the goals of the targeted funding program and let them know about all of the local partners

that already support the project. Have your development team lined up as best as you can with the understanding that things will change.

2. "Set up a meeting": If the funding source is local, have your local council offices or supervisor's office make the appointment for you (in their offices is a plus). This is helpful for local government funding and is helpful if you are targeting a foundation or corporation that is represented by a local or regional community development officer. This shows that your project has the support of not only the community but support from local government. For state or federal programs, your assemblyperson or congressional representative is your best partner. If it makes sense, a prominent board member at these meetings never hurts.
3. "Understand the process": Make sure you understand the requirements and the process for obtaining funding. Note the deadlines and the deadlines for items that you will need from third parties to make your application complete.

EQUITY RESOURCES

1. US Department of Health and Human Services, Administration for Children and Families, Office of Community Services (OCS CED): The purpose of the Community Economic Development discretionary grant program is to promote and support projects that address economic self–sufficiency for low–income persons and distressed communities by awarding funds to community development corporations (CDCs) to create employment and business development opportunities.

   Each year approximately 40–45 grants are awarded with a maximum grant award level of $800,000. Grants are awarded to cover project costs for business start–up or expansion and the development of new products and services. The grants serve as catalysts for attracting additional private and public dollars; for every CED dollar awarded, $3–5 is leveraged. Types of projects funded include business incubators, shopping centers, manufacturing businesses and agriculture initiatives. Funded projects are to create new employment or business opportunities for low–income individuals.

   NOTE: These grants become equity in projects. The current round is due in the beginning of July and occurs annually. You would essentially need a full detailed business plan to be able to complete the application process. More and more, programs are being integrated and projects that create jobs, with strong "green" elements. We also understand that access to healthy food will be of interest.

   For Guidelines and more information: http://www.acf.hhs.gov/programs/ocs/ced/

2. US Economic Development Administration (EDA): Public Works and Economic Development investments help support the construction or rehabilitation of essential public infrastructure and facilities necessary to generate or retain private sector jobs and investments, attract private sector capital, and promote regional competitiveness, including investments that expand and upgrade infrastructure to attract new industry, support technology–led development, redevelop brownfield sites and provide eco–industrial development.

   NOTE: These are substantial grants into projects. In prior years, job training facilities and incubators have been financed (they have high job creation numbers). Again, jobs, green and food are the current "buzz" trends. If you are close to your congressperson, and they support your project, have them coordinate the initial meeting with the local EDA representative. Grant amounts will usually match a local contribution (public and private).

   For more information: http://www.eda.gov/InvestmentsGrants/Programs.xml

   For some examples of their activities: http://www.eda.gov/NewsEvents/NewInvestments.xml

3. Department of Housing and Urban Development Community Development Block Grant (CDBG): These are federal funds passed to local governments and counties (above 50,000 populations). For smaller jurisdictions, counties may be the funding entity and in some rural cities and counties the state will be the entity. These are grant

funds and can be used for all types of CED real estate development efforts in low and moderate income communities. The funds are competitive and traditionally fund many ongoing public sector programs and initiatives.

NOTE: Again, these are grant funds so try to get as much as possible. These funds are very "political" and controlled by local government, so your local community development department and local council or supervisor's office is a good start.

4. Congressional Earmarks: Your congressional representative (senator or congressperson) will entertain requests for earmarks for your project (some actively use earmarks for their constituents and some do not). If they do, they will usually have a short form that you will submit to their office, and if they support it, will tie the request into a spending bill. This is a very political process, and it is essential the representative know your organization and is familiar with your project.

   If approved, the funding process will be assigned to one of the federal agencies that will administer and monitor the grant.

5. Redevelopment Agency (RDA): Local redevelopment agencies generate their own funds from project area generated tax revenues. In California, a small portion is mandated for low and moderate income communities (projects). This is another local source of CED grant funds.

   NOTE: Similar to local CDBG funds, RDA funds are controlled locally by the redevelopment agency and local political support is very important.

6. Foundations and Corporations: A quick source of small grants would be financial institutions, especially if your organization has a good relationship with a lender (on your board, or if they are your "bank"). Grants and corporate support can range from $1,000 to $50,000 or more depending on the size of your relationship (what institution you do business with).

   NOTE: Generally, it is more difficult to obtain financing with "cold" applications or requests. It is important to develop a relationship by having a community development representative meet you and see your activities and projects. A good way to locate the right contact person (the community development lender, Community Reinvestment Act officer or community relationship officer), is to talk to the Federal Reserve Bank community development representative for your region. Similar to a foundation, you need to nurture this relationship. Although the Federal Reserve Bank does not have funding, they know who to talk to at financial institutions and will invite you to key meetings and events.

7. Private Investment: New Market Tax Credits (NMTCs): If your project's development costs are greater than $8 million you may want to consider NMTCs. The credits are allocated from the Department of Treasury to qualified lending entities on a competitive basis (banks, loan funds, local governments and some development entities are eligible). These qualified entities will in turn allocate credits to projects that meet certain low and moderate income guidelines (location) and create jobs. For a $8 million project you may be able to "sell" the credits to investors (corporations and syndicated funds) for approximately $1.75 million (estimate based on market conditions in July 2010, and will change based on corporate demand for tax credits). The credit buyer becomes a limited partner in the project for a 7 year period and will exit the partnership, typically at a nominal cost.

   The funds generated by the NMTC become equity into the project. The $9 million threshold is based on very high fixed costs related to the legal and technical expenses and the lower market price investors are willing to pay for the credits. The equity remains in the project for 7 years (the investor uses the credits over this period) and this limited partnership will expire with the investor exiting the partnership.

   NOTE: In our current economic climate, it is increasingly difficult to find an investor AND a conventional lender for these projects. In most cases, the same institution provides both, however the market for financing commercial projects is very tough. The allocations for NMTC are also "hit and miss". You need to have a Community Development Financial Institution (CDFI, see next section) who covers your local geography and they need to be a successful applicant for the credits in the year that you need them. In addition your type of project needs to be a priority for them (some specialize in only business financing, some for charter schools, etc.).

Another structure for NMTCs that benefits community development projects are debt products created by financial institution that internally purchases the NMTCs and use the proceeds to lower interest rates on conventional debt products. Because the tax credits are expended by the investor in 7 years, the loans are generally for 7 years and rates will be 2 basis points lower that market rates. Loans will be made in NMTC eligible projects and locations.

LOAN SOURCES (DEBT)

1. Conventional: As noted in the previous section, conventional financing for commercial projects is very tough. It is important to locate potential lenders and insure they understand the project and the development team (the non-profit and its support team). In some cases, the smaller regional banks may have a close relationship with you and support your effort. Once you get past this hurdle, your deal must be "solid". There will be significant weight put to the strength and capacity of the developer (experience and balance sheet) and a solid repayment source (strong tenants and strong cash flow).

2. Other Lending Institutions and Community Development Financial Institutions (CDFIs): These loan funds are usually supported by the public and private sector. These are pooled funds that target a certain industry or market and these institutions have become very strong and successful in their niche market. CDFI's are loan funds that are 'certified' by the US Department of Treasury and can become eligible for federal grants to support their loan funds.

   In our current markets, these loan funds are the most active financial institutions.

   NOTE: Every loan fund specializes. The fund may be geographically targeted and will target certain niche markets such as small businesses, micro businesses or affordable housing development. They could be targeted to individuals, businesses or in some cases, nonprofit organizations. An added difficulty is that each has their own lending guidelines and limits, so one must locate the right loan fund and hope they have the right product for you.

3. CDBG/Section108: Another lesser known resource is the use of Section 108 loans by local governments that received CDBG grants (see CDBG above). The local government entity would provide loans to projects. The local governments 108 loan funds are secured by future CDBG grant funding, and the loan made to you is secured by the project) . The loan terms are determined locally and use is similar to CDBG requirements.

   NOTE: This is debt and must be repaid much like a conventional loan. There is likely a long approval and closing process since most localities do not have a set program for this financing. Use of this funding would likely be somewhat swayed by local politics, so talk to your councilperson or supervisor along with your community development department.

4. Owner Carry-back / 501c3 Bond Financing: In this very tough real estate and financial markets some opportunities exist for innovative structures that are available to potential buyers that have access to capital. Many larger developer/investors may be motivated to sell properties that are vacant and are in very poor markets. Owners may be willing to carry-back financing to make the deal work. If you (or your programs) are tenants the building, this "value" and can work for you.

   As a qualified 501(c)(3)organization, the buyer is eligible to use tax-exempt bond financing as the main source of acquisition financing. Based on the exemption of the interest on the bonds from both federal and State taxation, the resulting mortgage rate derived from the sale of the bonds is generally 1% – 1.5% below conventionally available rates. For example, if the bond rate is set at 5%, the taxable equivalent to the investor in the 35% federal and 9.3% State bracket would be 8.977% (they do not pay taxes on the interest income they receive as part of their financing to the project).

The bonds can be sold either to investors through public sale (based on underwriting by a lender who would guarantee repayment of bonds); or directly to a lender through private placement based on a negotiated rate. With a public sale, the transaction costs are higher than a private placement (bank or the seller)

In the case of a seller financing, there would be three possible advantages available to the seller:

1. Tax–exemption of interest(both federal and State)negotiated under the note;
2. Exemption from capital gain taxation during the period of interest only payments; and
3. Reduction of taxable income through charitable donation depending on the seller's particular situation. Also, in case a purchase price is smaller than appraised value, the difference can be deducted as a charitable deduction.

The bond issuance process usually takes a few weeks following two events:

1. Issuance of financing commitment by the lender/seller; and
2. Approval by a public body in which the project is located

However, since we are not authorized to provide tax advice, it is recommended that the seller consult his accountant and/or tax advisor to see if any of the above would provide an advantage under his particular situation

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COMMUNITY ECONOMIC DEVELOPMENT — REAL ESTATE SERIES

Development Notes



COMMUNITY FACILITY DEVELOPMENT

DEVELOPMENT NOTES

1. Although most community facilities attempt to be debt free, you must remember that there are operating expenses that must be paid that will cover maintenance, insurance, reserves and common area expenses.
2. Use real estate brokers experienced in similar commercial transactions.
3. Be aware that land costs will be restrained by local government sources which are typically limited by the appraised value.
4. Don't fixate on the first site or project you find or focus only on one project. In most instances you will find one possible project out of several that you investigate.
5. Negotiate ongoing fees with local gap lenders (with residual receipt financing), to ensure that excess cash flow does not go to repay the gap loan (instead of going to management fees or project services).
6. Make sure there is cushion in the development budget. You will never have too much money, and expect the most unexpected reasons for cost over–runs. It is difficult to go back to equity and grant sources for more funds.
7. Keep architect in check for cost purposes.
8. Keep lawyers in check for cost purposes.
9. Keep consultants in check for cost purposes.
10. Do not build for cash flow or developer fees, benefits to the community will always be greater than any financial returns you will generate.
11. The stronger the development team, the stronger the project and its ability to find solutions when problems arise.
12. If there is excess cash flow generated by the project it would be beneficial to add this into the pro–forma (to cover your management expenses), versus using excess cash flow to pay back differed loans from the city.
13. If you do not have experience, consider partnering with someone with extensive experience and with someone you like. You will be with them for many years, working closely in stressful situations leading up to the closing of the financing and managing the units once they are occupied.
14. Make sure you have staff designated to be the point person or "quarterback" for the project. He/she will be responsible for communicating with staff and management and with all of the project development team members. They must be responsible and have the ability to multi–task assignments.
15. Negotiate hard with your investor. If you do not have this skill, use a consultant. Total purchase amount, terms, dates/time of equity payments and exit terms are all negotiable.

FINAL NOTE

Development of community facility projects is not easy and requires a strong commitment from the organization and the members of the development team. The goal can be accomplished with the support of the community, local government and interested financial institutions. It is most important to have staff dedicated to the project and if they do not have the expertise, locate resources to support and guide the effort.

This document is intended to be a guide that outlines some of the key issues and identifies possible solutions and steps. It is not intended to be your source since every project has its own issues, concerns and peculiarities and its own unique solutions. The document is not intended to encourage any organization into project development but only to lay out some of the key steps and issues once the decision is made to proceed.

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