


City of Alexandria, Virginia

MEMORANDUM

DATE: FEBRUARY 6, 2008

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: JAMES K. HARTMANN, CITY MANAGER 

SUBJECT: CONSIDERATION OF CITY GUARANTEE TO THE ALEXANDRIA HOUSING DEVELOPMENT CORPORATION (AHDC) TO FACILITATE LOW INCOME HOUSING TAX CREDIT FUNDING FOR THE STATION AT POTOMAC YARD

ISSUE: Provision of a completion guarantee by the City to facilitate funding of low income housing tax credit equity for the Station at Potomac Yard project.

RECOMMENDATION: That City Council:

- (1) Approve the City's provision of a completion guarantee to support AHDC's performance guarantee and strengthen AHDC's negotiating position with potential tax credit equity investors for The Station at Potomac Yard; and
- (2) Authorize the City Manager to execute agreements, as may be required, to provide this guarantee.

BACKGROUND: AHDC is a non profit housing development entity that was established by the City of Alexandria in 2004 to identify, secure, develop and/or preserve local affordable and workforce housing opportunities. AHDC is governed by a Board of Directors with professional expertise in all aspects of development, community development, and affordable housing finance and law, among other things. Pending the organization's eventual organizational self-sufficiency, the City provides operating support to AHDC and Housing staff attend AHDC meetings and provide technical assistance, as required.

Among other projects, AHDC is currently actively participating with the City in the development of The Station at Potomac Yard project ("The Station"), a mixed-use building that combines a new fire station with 64 units of affordable and workforce rental housing and a small retail component. Because ownership cannot legally be divided between the City (for the fire station) and AHDC (for the residential and retail components) until construction is completed, the property is currently owned by a sole purpose limited liability corporation (LLC) consisting of the City and AHDC, with the City as managing member. Upon project completion, AHDC will own, operate and manage the residential portion of the building as affordable and workforce housing, in perpetuity. AHDC will also own and manage the retail space. Construction of the

project began in early January, 2008 and the project is anticipated to be completed by the end of the calendar year 2009.

The total development cost for The Station is approximately \$30 million,¹ with the cost of the residential and retail spaces, including related common areas and underground parking estimated at \$23.5 million. In May 2007, pursuant to a very competitive selection process administered by the Virginia Housing Development Authority (VHDA), AHDC's proposal for the residential portion of The Station at Potomac Yard was awarded \$10 million in tax credits. With this award (AHDC is expected to realize around \$9.5 million in equity funding generated through the sale of tax credits to an investor), AHDC is close to completing its financing package for its portions of the project. Sources include \$6 million through the City, pursuant to Potomac Yard Development's voluntary affordable housing contribution for the project; VHDA construction and permanent loans of up to \$8.5 million; and approximately \$9.5 million in tax credit equity.

AHDC is currently in the process of marketing and selling the tax credits received to potential investors. Typical underwriting and due diligence standards include consideration of a developer's track record and balance sheet. Since an investor makes equity contributions at various points prior to actual project completion, it seeks assurances that, in the case of unanticipated delays or cost overruns, the project developer has the financial capacity to complete the development and place the tax credit units in service based on the schedule negotiated with the investor, no matter what issues arise. While AHDC's close association with the City on all aspects of The Station development is a favorable consideration for potential investors, and since the project is AHDC's first project and the organization lacks significant assets or capital of its own at this time, AHDC is requesting that the City provide a back up completion guarantee to accompany AHDC's own performance guarantee to best position itself to market its credits and obtain maximum leverage. The City guarantee AHDC seeks does not require the City to provide actual funds to AHDC now, nor is it a repayment guarantee for any loan obligations that AHDC otherwise incurs with regard to the project, but would only require a potential City investment, likely in the form of a loan to AHDC, in the future in the highly unlikely event, given the number of conservative safeguards that AHDC and the City have put in place to limit project costs and risks, that AHDC cannot marshal sufficient resources elsewhere to complete the project.

While a development or performance guarantee is an investor requirement that frequently occurs in tax credit transactions, given the recent downward shifts and uncertainty impacting national real estate and credit markets, and extreme risk avoidance of lending institutions at this point in time, it is unlikely that any deal, regardless of the developer involved, could be underwritten without such a completion guarantee being provided. The City with its financial resources, AAA

¹ In addition to the parcel of land on which the project is located, the City of Alexandria is receiving a donation from Potomac Yard Development, LLC (PYD), of \$6.6 million toward the cost of constructing the Fire Station; with the City providing additional funds for a fourth bay and LEED design related features. PYD is also providing a voluntary affordable housing contribution of \$6 million which the City is applying to this project.

bond ratings, and long history of sound financial management can provide the level of comfort necessary for the lending institutions to provide the necessary tax credit financing.

The LLC and AHDC have taken substantial steps to limit potential time and cost risks associated with the development and construction of The Station at Potomac Yard. For AHDC, given the inherent limitations of its start up capacity and net worth, this has been particularly important in order to attract investment partners and lenders to the project. Chief among these safeguards are a guaranteed maximum price construction contract with Whiting Turner (including a negotiated “transparent” bidding and pricing process with opportunities for “shared savings”, a robust contingency budget, a detailed change order review and approval procedure, a built-in schedule which commits the general contractor to meet a September, 2009 project delivery date, as well as a requirement that Whiting-Turner provide a bond, assuring construction completion). With the City LLC, AHDC has hired an Owner’s representative, to proactively monitor and supervise construction progress to maintain momentum, and it has entered service contracts with engineering and design professionals and consultants that include well defined scopes and budgets. Beside the general contractor, the team assembled for the project by AHDC and the City includes leading architects, lenders, property management professionals and attorneys, among others, who have worked collaboratively to ensure that the project continues, on time and within budget, through completion, delivery, lease up and initial operations. There is also a sizable project contingent of \$1.8 million budgeted.

Given these safeguards, the designated critical milestones agreed upon by the parties, and the schedule for development, the requirement to actually draw upon the City’s guarantee is considered highly unlikely, as there should be ample time prior to project completion in late 2009 to anticipate, address and resolve/meet cost overruns caused by delays and “unforeseen” conditions, if encountered, long before the City’s guarantee might be called upon by AHDC. In construction, the riskiest portion of the work typically occurs as the project “gets out of the ground,” and site work, excavation and structured parking are completed. At this time, approximately 50% of the excavation is complete, and no significant problems have been experienced although The Station’s project budget included allowances for a variety of issues. Above ground, the portion of The Station project that comprises the residential facility (and necessitates the City-backed guarantee), is a four story stick-built structure, of relatively limited cost to complete. Taking a worst case scenario approach, among the possible alternate sources to pay for unexpected contingencies should they arise in the residential project, would be revenues from other Affordable Housing program funds and/or voluntary developer contributions such as the future forthcoming PYD contributions.

FISCAL IMPACT: According to the City Attorney’s Office, the City has the legal authority to provide the guarantee requested by AHDC (akin to an extension of conditional credit) pursuant to the limitations of its statutory authority to make loans to AHDC or to any non profit organization for the purpose of promoting affordable housing. While the City’s guarantee of AHDC’s guarantee would not need to be funded up front and City funds reserved, and does not have a probable fiscal impact, as per accounting standards it would need to be disclosed as a

footnote in the City's financial statements when the City's Comprehensive Annual Financial Report (CAFR) is issued until the requirement for the guarantee expired, i.e., when the building is "placed in service" and stabilized, both milestones anticipated to be reached by Spring, 2010. As long as it appears that the City guarantee will not need to be used or drawn upon, no funds would need to be set aside or reserved. Since this construction project was carefully structured in regard to risks to AHDC, the City's provision of a completion guarantee to AHDC carries minimal fiscal risk to the City. However because the national credit markets are in a state of extreme risk accordance, the City's backstopping of AHDC provides a higher level of comfort necessary to achieve the necessary \$10 million in tax credit financing.

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