

## Approval Loan Recommendation Summary – Babcock Village Apartments

**Preliminary:**

**Firm: X**

**Date: May 6, 2020**

### 1. OVERVIEW

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Babcock Village Apartments is an existing 151-unit family affordable housing development located in Westerly, RI (“Babcock Village” or “Development”) that is currently financed by RIHousing. The Development is owned by New Babson Associates LP (the “Mortgagor” or “Borrower”). Affordable Housing Strategies, Inc., is the sole general partner. GK Acquisitions, LLC is the limited partner. Cathedral Development Corporation is the developer (“CDG” or the “Developer”). CDG is the sole shareholder of the limited partner. No change in either the general partner or a limited partner with greater than 25% ownership interest is anticipated.

Babcock Village is subsidized by a Section 8 Housing Assistance Payment (“HAP”) Contract that is effective through April 2031. The Developer is seeking to refinance the Development with a taxable first mortgage in the principal amount of \$17,779,000. The Developer will use the proceeds of the new financing to pay off the existing mortgage, undertake elevator, accessibility, energy efficiency and life safety upgrades to the Development, and make an equity distribution to the partners. The construction budget includes only critical items for life safety and accessibility. The initial deposit to the replacement reserve of \$8,651 per unit was sized according to the capital needs assessment commissioned by RIHousing plus an additional contribution as determined by a staff assessment of the property to ensure that there are adequate resources to cover repairs into the future. The proposed refinancing is consistent with RIHousing’s taxable loan program that was introduced to replace the Treasury-HUD Federal Financing Bank (“FFB”) HFA Multifamily Risk Sharing Loan Financing Initiative which was suspended by HUD in 2018.

As part of the approval process, staff has determined that the Development and owner meet RIHousing’s requirements for participating in the taxable loan program. Broadly, this review includes:

- Compliance with HUD’s requirements
- Demonstrated responsible long-term ownership and management of the property
- A 20-year HAP contract
- Well-funded reserves
- Low vacancy rates
- Consistency with RIHousing’s standard underwriting requirements
- Financially beneficial to RIHousing

- Execution of a new 40-year affordability agreement.

**Specifically, under the taxable loan platform, RIHousing will agree to a refinancing if, at a minimum, all of the following additional conditions are met:**

- The borrower has demonstrated responsible long-term ownership and management of the property;
- The property is in good physical condition and RIHousing is satisfied based on review of a current capital needs assessment that all capital needs are adequately funded during the life of our loan;
- The transaction conforms to RIHousing’s Risk Share Underwriting Guidelines and the Taxable Loan Program Term Sheet.

## 2. EXECUTIVE SUMMARY

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**Property Address: 122 Cross Street, Westerly, RI 02891**

**Developer: Property Advisory Group, Inc.**

**Amount(s) Requested: \$17,779,000**

**Loan to Value (LTV) Test:**

	<b>Appraisal</b>	<b>Per Unit</b>	<b>Variance</b>	<b>Current UW</b>	<b>Per Unit</b>
Net Operating Income	<b>\$1,234,662</b>	<b>\$8,177</b>	<b>(\$70,875)</b>	<b>\$1,163,787</b>	<b>\$7,707</b>
Appraisal Cap Rate	6.25%			6.25%	
Valuation	<b>\$19,755,000</b>	<b>\$130,828</b>	<b>(\$1,134,403)</b>	<b>\$18,620,597</b>	<b>\$123,315</b>
Loan Principal	\$17,779,000	\$117,742		\$17,779,000	\$117,742
LTV	<b>90.00%</b>		<b>5.5%</b>	<b>95.48%</b>	

**Loan terms (rate/term):**

- Rate: 4.375%
- Term: 40-years with a balloon payment in Year 30. The projected debt coverage in Year 30 with negative trending is 1.50.

## Proposed Sources & Uses:

Sources	Firm	
	Amount	Per Unit
RIH First Mortgage	\$17,779,000	\$117,742
Operating Reserve	\$557,692	\$3,693
Replacement Reserve	\$500,479	\$3,314
<b>Total Sources</b>	<b>\$18,837,171</b>	<b>\$124,749</b>

Uses	Amount	Per Unit
	\$95,750	\$634
Contingency	\$110,000	\$728
Acquisition	\$9,526,111	\$63,087
Soft Costs	\$270,823	\$1,794
Financing	\$516,699	\$3,422
Operating Reserve	\$210,793	\$1,396
Replacement Reserve	\$1,306,250	\$8,651
Other Reserves	\$96,069	\$636
Equity Takeout	\$6,704,676	\$44,402
<b>Total Uses</b>	<b>\$18,837,171</b>	<b>\$124,749</b>

### Deviations from standard underwriting – YES.

- A 4% vacancy rate was applied to underwriting as the historical vacancy ranged from 1.2% to 1.7% since 2017.
- 3 months (versus 6) of operating reserves were included in the budget. The borrower and property have an excellent repayment history and the higher HAP rents provide additional debt coverage.

**Recommendation:** Firm approval of a first mortgage in an amount up to \$17,779,000

### 3. OPPORTUNITY (BENEFITS) / CHALLENGES

**3.A Benefits:** The proposed refinancing preserves 151-units of family housing and will extend the affordability period for the Development for 40 years, while allowing the Developer to enhance accessibility, improve energy efficiency, upgrade mechanical equipment, update life-safety features and adequately capitalize the renovation reserve to provide for future upgrades to the Development over the next 15 years.

**3.B Risks/Challenges:** The refinancing transaction assumes continuation of Section 8 assistance to support the new first mortgage debt, however, credit enhancement in the form of FHA Risk Share Insurance will be required

**3.C Affordability:** 40-year affordability restriction will be recorded at closing.

**3.D Pertinent risk factors for this development are:**

***Market - Low Risk*** – The Development has historically low vacancy rates, and except for standard turnover, the Development is essentially 100% occupied with a waiting list. All the units are subsidized with a HAP Contract. The loan is underwritten to the market rents which are lower than the HAP rents.

***Construction – Low Risk*** – The scope of work is small and the Developer has demonstrated capacity to both self-perform and subcontract work. Completed architectural plans will be required before closing for ADA upgrades, life safety and other work as required by RIHousing and building code. A Capital Needs Assessment will be commissioned every five years to reassess needs per Risk Share requirements.

***Developer – Low Risk*** – PAG has had an ownership interest in the property and managed the Development since 1998.

***Community Opposition – Low Risk*** – Not Applicable. The site is existing and has been operating since 1980.

***Financing - Low Risk*** – This transaction assumes payoff of the existing RIHousing debt. The primary source of permanent financing will be a 40-year mortgage supported by the lower of HAP or market rents which will be insured through the FHA Risk Sharing Program.

***Underwriting Assumptions – Low Risk*** – The transaction is underwritten to RIHousing standard guidelines with negative trending and a 4% vacancy rate. The Development's debt coverage ratio is 1.15 in year 1 and increases annually thereafter. Capitalized reserves will equal RIHousing's required amounts.

***Other*** – Not applicable.

#### 4. UNDERWRITING

**4.A Rent Comparison –**

Bedrooms	Number of Units	LIHTC Max Rent	Gross Market Rent	Gross HAP Rent	Gross UW Rent
1	135	\$933	\$1,310	\$1,278	\$1,278
2	15	\$1,120	\$1,525	\$1,484	\$1,484
2	1	\$1,120	\$1,525	\$0	\$0
Total	151	\$143,875	\$201,250	\$194,790	\$194,790

**Note** – Underwriting rents are lower than the Market rents. The HAP contract rents were recently increased effective this May 2020.

**4.B Trending** – 2% income; 3% operating expenses

**4.C Vacancy Loss and Bad Debt**— 4%

**4.D Other Income** – 0%

**4.E Operating Expenses** – Forecasted at \$7,345 including the annual deposit to the replacement reserve

**4.F RE Taxes** – 8% of gross revenue trending at 2% per year to be consistent with income trending.

- **4.G Proposed Replacement Reserve Deposit** – \$1,306,250 initial deposit (\$8,651 per unit) plus annual deposits of \$300/unit/year. It is important to note that the borrower is capitalizing the Replacement Reserve with \$8651/unit compared to standard 2000/unit. Out of an abundance of caution, the borrower intends to undertake work in the 12-18 months after closing due to COVID-19. The borrower will undertake the full scope of work when there is adequate time to get into the units and prepare plans and specs. Only the critical needs identified in the CNA are being done immediately.

**4.H Proposed Operating Reserve Deposit** – \$210,793 equals the three (3) months of operating expenses and debt service, less the amount of the initial deposit into the replacement reserve.

**4.I. Other Proposed Reserves** – Not Applicable.

**4.J Resulting NOI for Debt Service**

- \$1,163,787 in the first year
- Model performs above 1.24 for 30 years with negative trending

## 5. PROPERTY DESCRIPTION

Babcock Village, built in 1980, consists of one parcel of land totaling 14.04 acres and is improved with one, three-story elevator apartment building containing 151 one and two-bedroom apartment units. Of the total 151 units, 150 have the benefit of project-based rent assistance through a HAP Contract and a single two-bedroom unit is utilized as the on-site management office. While designated as a family development, the property manager reported that most of the property's population is over 75 years old or disabled.

The entryway to the property is located on the first floor. There is an outdoor walkway around the perimeter of the building, a gazebo, several outdoor benches, and an outdoor grill for tenant use. The remaining space is comprised of common hallways, stairwells, and residential units. The property is equipped with an emergency pullcord system and security cameras in the entrances and common areas. The property offers accessible features including mounted handrails in the hallways and emergency pull cords in the units.

## 6. DEVELOPMENT ENTITY AND CAPACITY

**6.A Prior Developments and Current Operational Capacity** - CDG is a Rhode Island based real estate ownership. They control the general partner interest in approximately 10 Section 8 developments financed by RIHousing and they have proactively preserved most of their portfolio with RIHousing through its various preservation programs. Their identity of interest management company, Property Advisory Group ("PAG"), is an experienced management agent providing services to its developments. CDG and PAG own and operate other developments in Rhode Island, New York, Delaware, Wisconsin and Arizona.

**6.B Financial Strength** - RIHousing has reviewed the Borrower's audited financials for the preceding three years and has determined that they are financially stable and represent a reasonable credit risk.

**6.C Guarantees** – A construction completion guaranty will be required and 20% of the equity will be withheld until completion.

## 7. BRIEF DESCRIPTION OF THE NEIGHBORHOOD

Babcock Village is located along Cross Street in the western area of Westerly, RI. The immediate area is a mix of one- and two-story residential uses as well as commercial uses opposite the quarry pond immediately west of the subject. The town of Westerly has good access to employment opportunities, retail/commercial services, transportation routes, and

cultural events. Babcock Village is located in the western section of the town between Routes 1 and 78. The Development's more immediate neighborhood has access to several restaurants, retail, and other commercial and industrial uses along Franklin Street (Route 1). The Granite Street Shopping Center is two tenths of a mile west of the subject and features a number of dining options, banks, entertainment venues (Bowling Center, Virtual Golf), religious institutions, and medical & pharmacy centers.

## **8. CONCLUSION**

Staff recommends firm approval Firm approval of a first mortgage in an amount up to \$17,779,000

## **9. ATTACHMENTS**

A: Pro forma