



Date: September 30, 2019

To: Thomas J. Bonfield, City Manager
Through: Keith Chadwell, Deputy City Manager
From: Reginald J. Johnson, Director
Department of Community Development
Subject: Approval of an Interlocal Agreement with Durham County to establish the expectations for City funds to be used for the Veranda at Whitted School affordable housing project

Executive Summary

The Whitted School project was the renovation of the historic Whitted School building previously owned by the County, together with the construction of a new building on the same site. The project includes a residential component consisting of 79 units of affordable senior housing, as well as a public preschool. Whitted School was developed by Integral Development, LLC, as a public private partnership using historic tax credits, low income housing tax credits (LIHTC), a HUD mortgage, and funds provided by the City and the County. The City has invested \$600,000 in federal HOME funds to date specifically to support the affordable housing component of the project, the Veranda at Whitted School.

The project experienced significant cost overruns during the construction and renovation process, which resulted in construction liens being placed on the residential component of the property. Although construction was completed at the end of 2017 and the project is currently occupied, Integral has not been able to convert from construction to permanent financing because of the existing funding gap on the residential component, the Veranda at Whitted School. The project is now at risk of foreclosure, which could in the loss of all 79 affordable units.

The City, the County, and Integral have agreed to contribute additional funds to pay the costs of construction and renovation necessary for the contractor to release its liens on the Project and allow the project to convert to permanent financing. Under the terms of the proposed Interlocal Agreement (ILA), the City would provide \$681,000 to the County, which would use these funds and additional \$1,301,000 in County funding to address the immediate financial gaps on the Veranda at Whitted School affordable housing project.

Recommendation

The Community Development Department recommends that City Council:

1. Approve the execution of an Interlocal Agreement with Durham County to establish the expectations for City funds to be used to address the remaining funding gap on the Veranda at Whitted School affordable housing project; and
2. Approve the commitment of \$681,000 in Dedicated Housing Funds as an equity contribution for the Veranda at Whitted School.

Background

The Whitted School project was the renovation of the historic Whitted School building previously owned by the County, together with the construction of a new building on the same site. The project consists of two components: a 79-unit affordable senior housing development and a public preschool. In 2015, the City provided \$600,000 in federal HOME funds specifically to support the affordable housing component of the project, the Veranda at Whitted School.

The residential component experienced significant cost overruns during the construction and renovation process due to a variety of factors, including delays in closing project financing, additional costs associated with addressing unexpected structural and environmental conditions on the site, and the need to accelerate the construction process to meet the LIHTC placed in service deadline. In all, the project experienced cost overruns in excess of \$2 million dollars, which have been compounded by interest on the construction loan for the past two years and legal costs associated with the dispute between the general contractor and the developer over cost overruns. The general contractor, C.T. Wilson, placed construction liens in the amount of \$2,355,069 on the property in January 2018.

Because of the existing funding gap and the construction liens, Integral has not been able to finalize the LIHTC transaction or convert its construction loan to a permanent mortgage for the Veranda at Whitted School. At this point, the project is in default and is at risk of foreclosure, which could result in the loss of the affordable units.

Issues/Analysis

The City, the County, and Integral have been negotiating for several months to reach an agreement to stabilize the Veranda at Whitted School. Under the terms of the current agreement, the County will contribute \$1,301,000 and the City will contribute \$681,000, for a total of \$1,982,000 to close the immediate funding gap, reimburse the general contractor, and remove the construction liens to allow the project to convert to permanent financing. This will eliminate the immediate threat of foreclosure.

In addition, the County and Integral have developed a memorandum of understanding that establishes the framework for a second phase of negotiation to address concerns around the ongoing operation of the project. These include the strategies to improve the project's annual financial performance as it currently struggles to achieve breakeven and the continued role of Integral as the general partner/project manager. These issues were too complex and time consuming to resolve with the threat of foreclosure looming, so the parties agreed to defer the discussion until after the conversion to permanent financing was completed.

There is a possibility that this second phase of negotiation could result in a request for additional City funding, but the magnitude of such a request (if any) is not known at this time.

Alternatives

City Council could choose not to approve the Interlocal Agreement or make the funding available. In this event, it is likely that the project would be foreclosed upon and the affordable housing units lost.

Financial Impact

Under the terms of this ILA, the City will make \$681,000 in funding available to the County to close the gap on the Veranda at Whitted School affordable housing project. Sufficient funds are available in the Dedicated Housing Fund for this purpose. These funds, along with the

County's \$1.3M contribution, will be structured as an equity contribution to the project. This contribution is not a loan. However, there is the possibility of repayment structured into the operating documents for the project. If the County receives an equity distribution pursuant the Operating Agreement, the City is entitled to 8.75% of the distribution that the County receives. This percentage is a proportionate share of the City's contribution to the project.

Equal Business Opportunity Summary

Not applicable.