AGENDA ITEM NO. 4 – PREDEVELOPMENT TECHNICAL ASSISTANCE

Attachments:

- 4.1 R3 Programs and Services
- 4.2 Needs and Opportunities Analysis Task Order
- 4.3 Feasibility Assessment Task Order
- 4.4 Planning Assistance Task Order
- 4.5 Design Assistance Task Order

Background

Last month, we discussed, and the Board approved, a list of four program areas and 10 services that R3 would provide. We also developed a notional distribution of funding for these programs. These programs, services, and fund distribution are enclosed (4.1) for reference.

I have structured this meeting's agenda to align with our four program areas: Predevelopment Technical Assistance; Direct Investment; Implementation Support; and Administration & Strategic Reserves.

As discussed during our last meeting, the R3 consortium was set up to operate under task orders, which are defined in the IGA as follows: "Task Order" means a contract between the Consortium and a Project Sponsor that provides the specific Project's scope, cost, and schedule.

The Board will need to issue Task Orders to define further the work you want the R3 contractors to perform and authorize the work.

You are not in a position to authorize the work until the grant agreement is approved and the Department of Administrative Services releases funds. However, we can define the work and prepare the task orders now to be ready when the funding is available.

Discussion

This agenda item addresses the Predevelopment Technical Assistance program area and includes four potential task orders, one for each service we will provide.

The Board allocated ten percent of our funding ($1,000,000) toward Predevelopment Technical Assistance activities. These services will be provided statewide to cities under 50,000 people, focusing on cities of 10,000 or less. It includes four specific tasks:

1. Needs and Opportunities Analysis
2. Feasibility Assessment
3. Planning Assistance
4. Design Assistance

Four draft task orders have been developed, one for each service, with a detailed scope of work and estimated cost.

Recommendation

Please review each task order and come prepared to discuss changes you would like to make for each one.

AGENDA ITEM NO. 5 – DIRECT INVESTMENT

Attachments:

- 5.1 For Sale Residential Development Model – The Ridge

Background

The bulk of our funding ($7.5 million or 75%) is reserved for direct investment in housing, infrastructure, and community development projects that support housing.

Each party identified an initial set of projects they would like funded. We'll review and discuss these projects and their individual financing needs, but the main purpose of this agenda item is to discuss our investment approach with the Board.

This topic presents key terms in commercial real estate investment and how to apply leverage to our state grant funds to achieve economies of scale and efficiency that will allow us to make a real impact for good in the markets we serve.

Discussion

Residential lenders typically allow 85% up to 95% cost-to-loan ratio, meaning that a borrower needs 5% - 10% equity in the land or cash to secure financing for a new home construction loan. This is called the Loan to Cost (LTC) ratio.

For example, a borrower who wants to build a $350,000 home and needs $17,500 (5%) in equity to secure the loan has an LTC of 95% and can borrow $332,500 (95%) in loan funding to pay for the home's construction. If they built a 1,800 sf home, then the exit price of the home would be $194/sf. They would pay interest to the bank on the construction loan based on their monthly draws (how much of the principal they need each month to build it) and a small fee for the bank to process the loan, called the origination fee. When the home has a certificate of occupancy at the end of the construction, the owner can convert their construction loan to a fixed or variable-rate permanent loan, often called a term loan, and the bank gets the interest off the money they lent plus their origination fee in addition to the return of their principal to use on another home loan.

Wholesale commercial lenders take this approach and scale it to the enterprise level. They offer commercial real estate (CRE) loans at a discount to brokers, who then coordinate to match those lenders' funds with projects or businesses that need them to make large-scale investments.

R3 will have $7.5 million in liquid funds available to invest in land development and new home construction. We could spend it all directly, providing 100% financing to our projects, in which case we would likely only be able to do a few projects.

Taking the previous illustration of a $350,000 home, if we provided the construction loan financing, we could fund the construction of 22 homes ($332,500 per home), assuming each prospective owner or developer brings the remaining 5% equity.

However, if we instead used our $7.5 million as equity on a CRE loan that allowed us to take a 95% LTC ratio, we could fund the construction of 428 homes ($17,500 per home). That's investing at scale!

Here's the key. We only need to tie up our money until the home is built and there's a liquidation event (i.e., the home sells or rents to its future occupant). Assuming a 10-month construction cycle and two months to sell, we could build 428 homes yearly using the leverage a CRE loan provides. As soon as a unit sells, our funding comes back to us, and we have effectively created a revolving loan fund to facilitate housing development that can be used on the next units in the queue.

But if it were that simple, everyone would be doing it. Most CRE lenders want a lower LTC ratio (meaning more equity in the deal) and will lend to a broker who also takes a percentage of the loan. We are also building housing in unserved markets where the home's final cost may exceed its construction cost. In other words, the home ends up with negative equity, and we have to buy that out for the home to sell.

Here's another example. Let's say our $350,000 target ends up costing $375,000 to build due to unforeseen expenses or a jump in the cost of materials, but when it appraises, the home's value is $360,000. The bank won't lend to a future buyer at our cost to build it. They'll lend based on its appraised value. Someone has to clear the $15,000 in negative equity.

Enter R3. We write down the difference as a grant, take the loss to ensure the home can sell at or below its appraised value, and we still get to move on to the next home, just with a little less principal in our revolving loan fund. Where R3 substantially differs from private CRE investments is that they need to hit an internal rate of return (IRR) that is positive (typically 15-25 percent), whereas we can break even or even take a minor loss on our IRR because our goal isn't to make a profit, it's to provide housing. In other words, we measure our impact based on quality units built and owner-occupied homes in underserved markets, not based on how much money we get back on the deal.

The other factor for the Board to consider is that right now, we couldn't build 428 homes a year if we wanted to. We don't have the labor in the market, the buildable lots on the ground, or the contractors to help finish them. So, while we are assembling our design team, our planning and implementation team, and working with our local project sponsors to get site control on buildable lots and our construction teams in place, our state funding is earning interest on every dollar invested. In the early years, we'll likely make money through passive income on our investments that have yet to be moved into capital projects. In other words, our future write-downs (if needed) will be more than offset by early gains in our investment portfolio.

Recommendation

If the Board concurs with this approach, I would like to engage a CRE investment bank to help us plan our initial round of funding. We'll need to identify our LTC ratio, the amount of funding they'll lend (total capital), and other terms until we find the right investment partner. Once we've selected them, we can evaluate those financial terms in the context of our specific projects and significantly increase the number of projects we can achieve.

Here is one example of how we could put policy into practice using an identified R3 project in John Day, with an accompanying Proforma.

Example 1. John Day single-family housing (The Ridge).

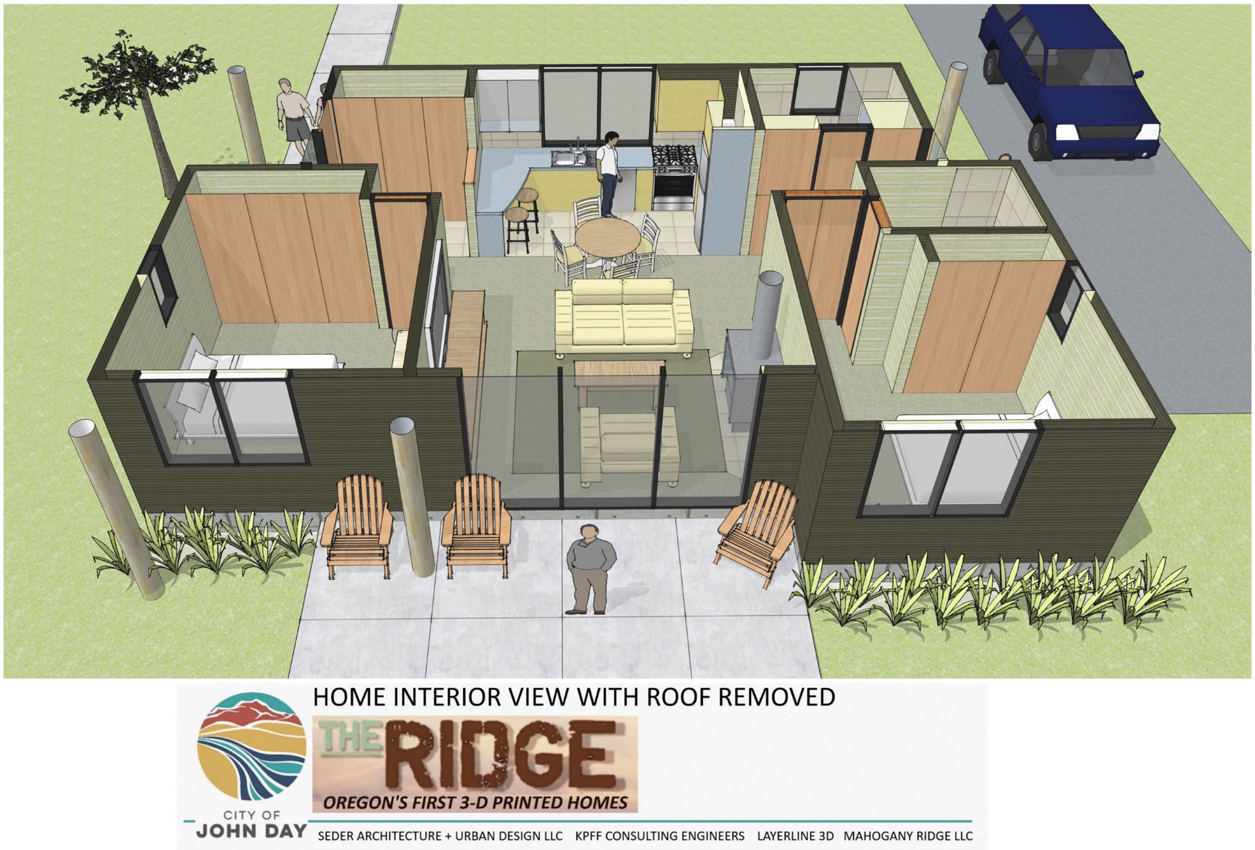
The Ridge is an 11-lot development on the east end of John Day. The development is in the City's urban renewal area and is eligible for SDC payment and 7 percent cash back on the change in assessed value. All utilities, streets, and site improvements are installed. The project location is shovel-ready and has one home currently in construction and two other lots sold and pending development (Figure 1).

Figure 1. The Ridge, Phase 1

As you enter the development, Lot 1 is the first lot on the right, directly above the Church of Jesus Christ of Latter-day Saints. Lot 1 is a 2.34-acre parcel that could host up to 10 cottage cluster units with accessory structures. An average square footage of 880 sf per unit would result in 8,800 sf of built environment (approx. 10% lot coverage area) with plenty of surrounding open parking spaces, landscaping, and accessory shops for RV/trailer parking and hobbies.

The total projected cost per unit is $201,509. Using the land as equity (est. $120,000 value) and assuming an LTC of 80%, the developer will need $285,000 in additional equity and $1.6 million in loans for construction financing.

The Ridge plans to use the 3D home printing plans developed by John Day, Burns, and Lakeview through their DLCD grant. These plans are rendered in the image below.



In this scenario, R3 could pledge $285,000 in cash and $1.6 million from its CRE loan over the 10-month build period. Assuming 3-4 months for lease-up, total financing costs would be approximately $16,121 in loan fees and $76,241 in capitalized interest. Upon sale, the development would generate $63,625 in profit. This profit would be used to pay the developer their URA rebate of $116,146 (7% of assessed value) and system development charges of $75,000, for a total public incentive of $191,146.

This results in a net subsidy of $127,521 needed for the project, or $12,752 per unit (the levered profit of $63,625 minus the development incentives of $191,146).

In other words, R3 can put an entire team together to build ten new dwelling units, finance the whole project with our CRE loan, and have the project rented or owner-occupied within 15 months of construction for a net capital outlay (grant) of $12,752 per unit (or 1.7% of our direct investment budget of $7.5 million).

At the same time, we put the developer in a position where they get $120,000 in revenue from the land sale, $116,146 in profit on the build, plus their time and materials to construct a project that keeps their team employed for a year.

The project sponsor (John Day) benefits from the $75,000 in SDCs paid to them, the increase in property tax receipts of $28,000 per year in their general fund, and ten new homes affordable at 124% of the area's median income.

See Proforma (5.1) enclosed for additional details.

This is an example of the power of R3’s public-private investment approach working to deliver multi-dimensional benefits to put new housing in an underserved market.

AGENDA ITEM NO. 6 – IMPLEMENTATION SUPPORT

Attachment(s)

- None

Background

Implementation support begins once the Board has selected projects for funding. It comprises three main activities or services: Joint Development Agreements; Project and Construction Management; and Asset Management.

Joint Development Agreements

We will develop the funding agreement for each project as a joint development agreement specifying the roles and responsibilities, schedule, funding, and other milestones and deal terms. This agreement is essentially a contract between multiple parties – R3, the project sponsor, and the project beneficiary. In some cases, the sponsor and beneficiary will be the same. For example, infrastructure development on public lands or in public rights of way leading up to a development will ultimately be owned and operated by a municipal jurisdiction. Sometimes, the funding agreement may be directly with a land developer, referred to as privately engineered public improvement (PEPI) projects.

We will work with R3's attorney to develop the tempalte agreement and use that template for all projects.

Project Management & Construction Management

As an activist investor, we aren't just funding a project. We need to be actively involved in each step of its development, from concept to permits through construction and lease-up. Our team needs to be engaged so we can identify lessons learned, identify opportunities to increase efficiency, and identify problems before they become serious. We also need to monitor the projects to ensure milestones are being reached and inform the Board of their progress.

Asset Management

At times, our ideal exit strategy from a project won't work. We can anticipate the market outcomes and aim for the one we want, but we can't guarantee a project will sell at our expected price or on our expected timeline. Some assets will need to be actively managed until they can be liquidated. These assets will be reflected on our balance sheet and in most cases can generate revenue as leased units or short-term rentals until we have a buyer to transition them to.

Summary

Implementation will be critical, but for now, the scope of potential activities is vital to recognize. What we do may be different, but it will likely fit into one of these categories as our projects mature.

AGENDA ITEM NO. 7 – ADMINISTRATION & STRATEGIC RESERVES

Attachment(s)

- None

Background

Our reserve fund of approximately $1 million is strategic in nature. It can be used for internal overhead and administrative costs. It can also be used for gap financine through short-term loans (less than five years) or grants to round out projects in need.

By nature, we're reserving these funds for unexpected contingencies. They will also generate revenue because we will invest them in interest-bearing accounts, and the interest can further augment our programs and services.

AGENDA ITEM NO. 8 – GENERAL DISCUSSION OF PRIOR TOPICS

Attachment(s)

- None

BACKGROUND

Topics:

- Baker City Board Status – new member (Loran Joseph)
- DAS Grant Agreement update
- At-large board member applications
- Biannual Request for Qualifications – RFQ-2023-01
- Auditing Services Proposals – RFP-2023-02
- Accounting Services Proposal – RFP-2023-03
- .GOV Domain and R3 website (pending funding from DAS)

AGENDA ITEM NO. 9 – BOARD COMMENTS & UPCOMING MEETINGS

Attachment(s)

- None

BACKGROUND

Board members may discuss topics of their choosing or suggest future agenda items.

UPCOMING MEETINGS

The Board agreed to use the third Wednesday evening of each month for their board meetings.

December 18 – Board Meeting
January 15 – Board Meeting