MEMORANDUM

To: The Chairperson and Members
From: Eric Enderlin  
President
Date: January 21, 2020
Subject: Approval of Corporate Reserves to Fund HPD Cluster Sites Loans

I am pleased to recommend that the Members approve the Corporation’s use of unrestricted corporate reserves in an amount not expected to exceed $27,140,000 for the purpose of participating in a funding swap with the New York City Department of Housing Preservation and Development (“HPD”) to facilitate the next three phases of the acquisition of property for supportive housing by the City. The Members previously authorized a similar swap for the first phase of Cluster Sites (defined below) in an amount not to exceed $6,600,000 on March 28, 2019. As was the case for the first financing, in exchange for the use of HDC’s corporate reserves to fund loans for the Cluster Sites (each a “Cluster Loan” and collectively, the “Cluster Loans”), the Corporation will receive an equal amount of City funds through HPD to be used by HDC as a substitute for the Corporation’s funds for one or more HDC project loans to be subsequently approved by the Members.

Background

For the last 20 years, due to limited space in homeless shelters, the City of New York has housed some of the homeless population in need of shelter within privately owned apartments rented by the City and known as “Cluster Sites.” Because of ongoing issues with the condition of these apartments, the Mayor announced in 2016 and in the report “Turning the Tide on Homelessness” that the City would end the use of Cluster Sites for temporary housing and convert these buildings into permanent affordable housing by 2021. The first phase of this effort was enabled by the Members’ approval on March 28, 2019 of the use of corporate reserves to help fund the acquisition of 729 units within 21 buildings. This memo represents a continuation of this effort, which is expected to be completed in three phases, Phase 2, 3, and 4, which together will acquire
roughly 35 buildings containing 1,400 housing units in Manhattan and the Bronx over the course of 2020 and 2021 and convert these units to permanent supportive housing. The HPD financings are expected to follow the model set by the first phase of Clusters financing which entailed the City, acting through HPD, financing a not-for-profit corporation’s acquisition of selected properties in order to subsequently fund the rehabilitation and restructuring of such buildings to become supportive housing projects to house formerly homeless families.

In order to facilitate the acquisition of Cluster Sites and ensure ongoing operational stability, HPD intends to set up operational reserves for the Cluster Sites that are not considered an eligible capital expense for City capital funds. The City is therefore requesting that the Corporation help finance, in part, the acquisition of the Cluster Sites pursuant to the funding swap described herein. HDC will lend the funds necessary to establish the reserves and other related expenses simultaneously with the acquisition closing.

**Use of Corporate Reserves vs. City Capital Funds**

The Corporation’s reserves relate to the unrestricted funds of the Corporation that can be used, pursuant to Members’ approval, to fund any statutorily permitted activities of the Corporation. These monies are generally derived from the Corporation’s business activities which may include income from investments, spread from its mortgage lending and fees that HDC charges its borrowers for its servicing, loan origination and asset management oversight. The term “City capital funds” generally refers to capital raised by the City from its borrowing and can be expended pursuant to certain requirements established in the City’s charter and the New York State Local Finance Law. These requirements detail what are capital eligible expenses and the related minimum useful life term for City capital funds. As related to this memo the expenses that are necessary for the Cluster Sites program would not be capital eligible and as such the City and HPD are requesting the use of HDC corporate reserves to fund such expenses and the City will subsequently swap City capital funds for HDC Project Loans that are eligible uses.

**Proposed Uses**

The Corporation will help finance a portion of the acquisition pursuant to an interagency Memorandum of Understanding (“MOU”) with HPD. The MOU will provide that the Corporation make the Cluster Loans in an amount not expected to exceed $27,140,000 in the aggregate from unrestricted corporate reserves to be used to fund reserve accounts for each of the Cluster Sites (the “Cluster Reserve Accounts”). The Corporation will hold the Cluster Reserve Accounts and service them at the direction of HPD on behalf of the not for profit borrowers.

The acquisition financing for the Cluster Sites and the future rehabilitation financing for each site will be subject to HPD program terms and HPD will underwrite, perform due diligence and close each transaction. For each site HPD will enter into a regulatory agreement that places income restrictions on a portion of the units to be determined by HPD.

The Cluster Loans will be made in the Corporation’s name and will be assigned to HPD immediately at the acquisition closing. All interest and debt service payments, if any, on the Cluster Loans will be paid to HPD.
In exchange for the Corporation financing the Cluster Loans, HPD will provide City capital funds as subsidy loans or grants to HDC for one or more new construction or preservation projects financed by the Corporation (each an “HDC Project Loan”) that will be presented to the Members at a future date, in an amount equal to the cumulative amount of the Cluster Loans. HPD’s financing of the HDC Project Loan will be in lieu of the Corporation using its own unrestricted reserves for such loans pursuant to HDC’s programs and term sheets. The HDC Project Loan will be made in the Corporation’s name and either funded by HPD pursuant to construction loan participation agreements that will terminate no later than conversion of each loan to a permanent loan or a grant of funds to HDC pursuant to Section 661 of the Private Housing Finance Law.

Risks and Risk Mitigation

The repayment risk associated with the Cluster Loans will be at HPD’s risk. Also, any cost or expenses incurred by the Corporation for bank fees and investment breakage fees in connection with the performance of its duties shall be paid by HPD or the related borrower, which fees are expected to be paid from the Cluster Reserve Accounts. If funds in the Cluster Reserve Accounts are insufficient to fund a transfer request and related bank or investment breakage fees, the Corporation will not transfer the funds and will inform HPD. Risk to the Corporation relates to the timing of receipt of City capital funds from HPD to fund each HDC Project Loan. Corporation staff work closely with HPD to track timing of HPD funds.

Fees

The Corporation expects to retain any investment interest earnings on the amounts in the Cluster Reserve Accounts as a servicing fee in compensation for the servicing of these accounts. The Corporation will also collect its typical interest payments and principal repayment on the HDC project loans that are financed through the funding swap with City capital funds.

Action by Members

The Members are requested to authorize the use of up to $27,140,000 of the Corporation’s unrestricted reserves to fund the making of the Cluster Loans and the execution by an Authorized Officer of the Corporation of mortgage-related documents and any other documents necessary to accomplish the making of the Cluster Loans.