NYC HDC

NEW YORK CITY
HOUSING DEVELOPMENT
CORPORATION

MEMORANDUM

To: The Chairperson and Members

From: Marc Jahr
President

Date: April 9, 2012

Subject: Limited Guaranty to CPC Funding SPE 1, LLC

I am pleased to recommend that the Members approve the Corporation providing a limited guaranty for affordable housing construction loans ("Loans") to be originated by CPC Funding SPE 1, LLC ("CPC SPE") pursuant to programmatic guidelines described below. CPC SPE is a bankruptcy remote, special purpose entity to be formed by the Community Preservation Corp. ("CPC"). Loans made by CPC SPE will be funded through a construction loan facility ("Citi Facility") to be established by Citibank N.A. ("Citibank") in an amount not to exceed $100 million.

The Citi Facility will be used by CPC SPE to fund mortgage loans for the construction, rehabilitation, and refinancing of affordable rental housing properties in New York City which are underwritten and financed in conjunction with the New York City Department of Housing Preservation and Development ("HPD"). Subject to the Members' approval, the Corporation will provide a guaranty equal to a 10% top loss of each Loan up to a maximum exposure of $10 million ("HDC Guaranty"). The CPC SPE Loans will be participation loans financed through HPD programs such as the Preservation Participation Loan Program ("PLP"), the Third Party Transfer Program, and the Article 8A Loan Program or construction loans on projects receiving an allocation of 9% low income housing tax credits ("LIHTC") from HPD.

The Corporation's staff is recommending that the Members approve the HDC Guaranty to CPC SPE. Staff believes that the HDC Guaranty furthers HDC's goals for the preservation and creation of affordable housing in New York City and provides important access to capital for developers seeking construction financing or refinancing on affordable housing developments. The HDC Guaranty will also further the production capacity for HPD under the Mayor's New Marketplace Housing Plan and is consistent with HDC's mission to provide access to capital for affordable housing. This memorandum will provide a description of the HDC Guaranty economics, mechanics, and a discussion of the risks and mitigants.

Authority, Guaranty Economics and Mechanics

Pursuant to the authority granted to the Corporation in subdivision 23-h of Section 654 of the Private Housing Finance Law, the Corporation may guarantee loans to preserve, construct or acquire dwelling accommodations for people of low and moderate means. All of the Loans will be made in conjunction with HPD's affordable housing programs that satisfy the statutory provisions in the Private Housing Finance Law.

The HDC Guaranty will be provided on a loan-by-loan basis (and not on the pool as a whole) which greatly reduces the Corporation's risk from one or two large scale defaults causing a disproportionate claim on the HDC Guaranty. As part of the Mayor's New Housing Marketplace Plan, HPD makes a 1% subsidy loan using city or federal funds which are combined with bank financing from a participating lender such as CPC SPE or allocates LIHTC. HPD's subsidy loans are generally structured as a pari-passu loan in co-first position with the CPC SPE Loan during construction or as a subordinate construction loan depending on the development underwriting and at the request of CPC SPE. HPD's subsidy loan stays in the project at permanent while the takeout for the CPC SPE Loan is a permanent loan funded through the New York City Employee Retirement System ("NYCERS") with mortgage insurance from the State of New York Mortgage Agency ("SONYMA").

The Corporation will receive an origination fee for the HDC Guaranty equal to 10 basis points on each Loan and an annual fee equal to 10 basis points of the outstanding amount of each Loan; the HDC annual fee will be added to the CPC SPE mortgage loan rate stack. The HDC Guaranty will be structured as an obligation of the Corporation to purchase a 10% subordinate participation in the CPC SPE portion of the applicable mortgage loan. The HDC participation will be subordinate to the repayment of the remaining 90% CPC SPE portion of the loan. HDC would be required to purchase the participation within 180 days of the issuance of a notice of an Event of Default to the borrower of the mortgage loan unless within the 180 day period the Event of Default is cured and the cure is accepted. The HDC Guaranty will terminate as to each Loan upon the conversion of that Loan to permanent status; the obligation to provide the HDC Guaranty will terminate at the end of the term of the Citi Facility. The expected term of the Citi Facility is five years consisting of an origination period of two years following the issue date of the facility, and a three year maturity date from the date of the last mortgage loan originated by the facility.

The Community Preservation Corporation ("CPC")

History of CPC and Relationship with HPD

Incorporated in 1974, CPC is a non-profit, lending institution that finances affordable multi-family housing. A total of 69 lenders participate in a revolving loan fund (the "CPC Revolver") that is used to fund CPC's lending activity. Initially, CPC's focus was on restoring and rebuilding New York City's aging neighborhoods. During the early 1980s, CPC expanded to cover all the non-luxury areas of New York City, and in the late 1980s expanded into the Hudson Valley. In 1995, CPC merged with an upstate non-profit mortgage lender, The Community Lending Corporation ("CLC"), thereby becoming a New York State-wide organization. During the 2000s, CPC further expanded its geographic reach into New Jersey and Connecticut. In its 38 year history, CPC has financed more than 140,000 new or rehabilitated units, and worked to secure approximately $8 billion in public and private investments.

CPC has partnered with HPD to fulfill the joint mission of fostering affordable housing preservation and development throughout CPC's history. CPC has worked with HPD to coordinate public and private resources to create a "one-stop shop" where local property owners can obtain construction and permanent financing, public subsidy, and assistance in moderate rehabilitation. As part of this effort, CPC has participated in and/or taken a leading role in various HPD programs, including PLP, the Third Party Transfer Program, the Article 8A Program, the New Homes Program, the Rehab and Sales Program, and the Vacant Buildings Program. Since 1977, CPC has stated that it has financed the preservation or creation of approximately 27,350 units in coordination with HPD and together CPC and HPD have lent approximately $908 million.

CPC's involvement in a range of HPD programs has been critical to the success of those programs. In the PLP alone since 1998, accumulated PLP loans total $221 million – of this, CPC loans total $84 million (or 38%), with HPD Capital Fund loans at $107 million, and HPD-administered HOME loans at $30 million. According to HPD, these loans funded the rehabilitation and preservation of 113 buildings with a total 2,948 units (2,200 occupied/748 vacant).

Challenges Facing CPC

As CPC expanded beyond its original New York City market, it also diversified into more risky areas of lending, most notably condominium development lending. While CPC's initiatives served to bolster the troubled economies of upstate New York and surrounding areas, it moved away from its traditional core business and competency – affordable multi-family rental housing in New York City. Moreover, CPC chose to create a separate for-profit affiliate, CPC Resources, Inc. to undertake development activity for its own account. As a result, during this most recent economic recession, CPC saw its asset quality dramatically deteriorate. As CPC's asset quality suffered, its ability to secure funding for its core business was badly compromised. Ultimately, the lenders in the CPC Revolver elected to halt any further advances under the CPC Revolver, crippling CPC's business.

CPC Management Initiatives

Since mid-2011, in response to its severe financial problems, CPC has been restructuring its organization. Major organizational changes and initiatives include:

- In May 2011, CPC replaced its Chief Credit Officer.
- In June 2011, CPC implemented its Risk Asset Acceptance Criteria ("RAAC") to address and manage risk in its lending model. RAAC establishes key criteria in rental construction lending in the following areas: project, borrower profile, loan structure, market, construction, architect, and management.
- In August 2011, CPC established a formalized risk management function and added a Chief Risk Officer. Additionally, the loan work-out function has been refocused and

centralized to a Special Assets Group staffed by nine seasoned professionals headed by a Senior Vice President/Director of Portfolio Management.

- Finally, in January 2012, CPC appointed Mr. Rafael Cestero, former Commissioner of HPD, as President and CEO, succeeding CPC's long time CEO, who retired.

Credit Facility

On March 8, 2012, CPC announced that it had secured an extension of the CPC Revolver from its member institutions allowing for up to $70 million in lending over the next two years. The extension of the CPC Revolver will enable CPC to leverage approximately $225 million in construction loans and $300 million in permanent loans.

Risks and Risk Mitigation

The risks associated with the limited guaranty are construction risk, loan conversion risk, and the risk that CPC will file for bankrupcy. These risks and their mitigants are discussed below. To mitigate the risk of the Corporation making a payment under the HDC Guaranty, the guaranty will be called upon only after a 180 day period during which time an Event of Default on a Loan may be cured.

1. *Construction Risk*

The primary risk to HDC is the loan performance of the CPC SPE's Loans during the construction period. This risk is mitigated by the fact that the HDC Guaranty will only be available on participation loans with HPD or construction loans on deals receiving an allocation of 9% low income housing tax credits from HPD. These programs constitute part of CPC's "core" lending activity. CPC's "core" lending product is defined as construction loans on rental properties with rate-locked permanent loan takeouts.

The portfolio of core lending has traditionally performed well regardless of the prevailing economic conditions. As of December 31, 2011, the 60+ day delinquency rate among CPC's core portfolio was a manageable 5.3%, versus 61.7% on CPC's non-core portfolio. Between 2004 and 2008 (prior to the most recent financial crisis), CPC's 60+ day delinquency rate on its core portfolio averaged 4.8%. On CPC/HPD rental construction loans, the current delinquency rate is 1.9% 30 days plus past due, which is low by industry standards. This is on a total committed rental construction portfolio of $184 million ($64 million CPC share and the balance HPD PLP).

Underwriting standards for Loans to be included in the CPC SPE have been established and are within the Corporation's programmatic underwriting standards. It is anticipated that the Corporation will have a representative on the loan committee that will approve each Loan as meeting the lending criteria of the Citi Facility. In the event a payment is made on the HDC Guaranty, (i) if the CPC SPE or Citibank retains an interest in the first mortgage or the project, HDC will receive a 10% junior participation in that interest, and (ii) where the CPC SPE or Citibank is later made whole on the Loan in question, HDC will be repaid the amount advanced on its guaranty of that Loan.

2. Conversion Risk

Over the past two years, CPC's delivery of loans to the New York City Pension Fund was on average two years late. The majority of these deals were conversions of CPC-originated construction loans that were delayed due to construction and administrative issues. CPC has recently increased its focus on portfolio management and has implemented several policies and procedures which are designed to improve the timing of deliveries, including pre-closing construction loan review, construction loan monitoring, new maturity extension procedures, and a streamlined conversion process.

HPD recognized the need to improve and accelerate the permanent loan conversion process and, as a consequence, over the last two years it has put renewed focus and attention on converting HPD/CPC loans as quickly and efficiently as possible to pay down CPC's Revolver with the banks and to help it deliver on future projects. In establishing regular conference calls with staff at CPC, HPD was able to designate and delineate responsibilities between HPD and CPC staff, enabling the teams to avoid overlapping efforts and provide more efficiency to the process. At the same time, HPD has significantly improved staffing for the loan conversion unit.

HPD has focused on managing the rent restructuring process and Section 8, HOME compliance, and tax exemption status, including J-51 tax exemptions. CPC has focused on identifying and resolving construction issues (a process CPC has supervised), and other items such as insurance, and re-underwriting. Over the same period, HPD has worked with CPC to be more proactive in sending default letters, including notices of default interest charges, and to motivate borrowers to complete the process of converting to permanent financing.

3. Bankruptcy Risk

With respect to bankruptcy risk, CPC SPE is a bankruptcy remote entity; although its bankruptcy is extremely unlikely. However, if CPC SPE does file for bankruptcy, Citibank will possess collateral assignments of all of the Loans and will step into the shoes of CPC SPE as lender. With respect to CPC, which will act as servicer for the Loans, the servicing agreement will provide for the assignment of the servicing agreement to Citibank in the event of a CPC bankruptcy, at which point CPC's servicing rights will terminate and Citibank will service the Loans.

Fees

The Corporation will receive an origination fee equal to 10 basis points on each Loan and an annual fee equal to 10 basis points of the outstanding amount of each Loan for providing the HDC Guaranty; the HDC origination fee will be paid at the closing of the construction loan and its annual fee will be added to the CPC SPE mortgage loan rate.

Action by Members

The Members are requested to approve the HDC Guaranty to CPC SPE for an exposure not to exceed $10 million.