NEW YORK CITY
HOUSING DEVELOPMENT
CORPORATION

MEMORANDUM

To: The Chairperson and Members

From: Eric Enderlin
President

Date: May 28, 2024

Re: HPD Funding Swap Initiatives

I am pleased to recommend that the Members approve the Corporation's use of corporate reserves in an amount not expected to exceed $17,000,000 for the purpose of participating in a funding swap with the New York City Department of Housing Preservation and Development ("HPD"). HPD has requested that HDC provide funding for two initiatives (the "June 2024 Funding Swap Initiatives" or the "Initiatives"): (1) an initiative to enable the conversion to permanent financing of certain City-funded projects (the "HPD Workout Loans"); and (2) an initiative to enable the provision of new HPD capital financing for Mitchell-Lama developments within HDC's portfolio (the "ML Rehab Loans" and, collectively with the HPD Workout Loans, the "City Project Loans").

Background of Proposal

The HPD Workout Loans will be new subordinate mortgage loans provided by HPD (other than the portion that HDC will provide as described below) to projects with existing HPD and/or private construction financing that have experienced cost overruns prior to permanent conversion. The HPD Workout Loans will finance the completion of scopes of work, the establishment of upfront project reserves and any soft costs necessary for conversion to permanent financing (including construction interest and servicing fees, mortgage insurance premiums and/or borrower/bank legal costs). Because the projects cannot leverage additional senior financing, and HPD's financing is limited by capital eligibility guidelines, HPD has requested that HDC fund a portion of the HPD Workout Loans equivalent to the sum total of capitally ineligible costs required to complete the projects.

The ML Rehab Loans will be new subordinate loans made by HDC, using grant funds from HPD (other than the portion that HDC will provide as described below), to Mitchell-Lama cooperative projects that have existing HDC senior permanent financing. The projects have significant capital needs but have been unable to support a refinancing of their existing HDC senior loans due to recent operating expense inflation (particularly Fire & Liability Insurance) and current interest rates. HPD plans to provide new subordinate financing to these projects to fund the scopes of work through their capital programs with deferred interest payments that do not increase the projects' paid debt service. The project budgets include certain capitally ineligible costs (such as borrower's legal, the replenishment of project reserves, the payoff of certain vendor payables and, in one case, the repayment of HDC debt service arrears), HPD has requested that HDC fund a portion of the ML Rehab Loans equivalent to the sum of the capitally ineligible costs related to the rehab financing.

Proposed Structure and Terms

The City Project Loans originated pursuant to the Initiatives will be subject to an interagency Memorandum of Understanding ("MOU") between HDC and HPD. The MOU will provide that HDC establish a dedicated account ("Dedicated Account") totaling $17,000,000 from corporate reserves to be used to fund the Initiatives.

In exchange for HDC's allocation of corporate reserves to the City Project Loans, HPD will grant City Capital funds to HDC pursuant to Section 661 of the Private Housing Finance Law to partially fund the HDC subsidy loans on one or more new construction projects financed by HDC (the "HDC Project Loans") in an amount equal to HDC's allocation to the Dedicated Account. HPD's financing of the HDC Project Loans will be in lieu of HDC using its own corporate reserves for such loans pursuant to HDC's programs and term sheets.

The City Project Loans originated pursuant to the MOU will be subject to HPD's program terms. For the HPD Workout Loans, HPD program staff will underwrite and close each of the loans and will provide diligence to HDC as required by the MOU ahead of the loan closing. The HPD Workout Loans will be made in HDC's name and will be assigned to HPD at construction completion. HDC will not be responsible for compliance or construction monitoring of the HPD Workout Loans.

For the ML Rehab Loans, HPD program staff will underwrite the transactions with the assistance of HDC Development, and HDC Engineering is expected to provide construction monitoring of the scope of work. The ML Rehab Loans are expected to be originated by HDC and funded by a combination of City Capital and corporate reserves.

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" 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 capitally 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 Initiatives would not be capitally 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.

Fees and Earnings

For HPD Workout Loans serviced by HDC, HDC will charge a servicing fee equal to 0.25% per annum. In the event debt service is not paid on the HPD Workout Loans, HDC will deduct an annual servicing fee from the Dedicated Account equal to 0.25% per annum. In cases where there is a participating lender who will be doing construction servicing, HDC will advance the entire loan to the servicer at closing, that lender will perform all servicing functions and HDC will not charge a construction servicing fee. For the ML Repair Loans, HDC is anticipated to be the servicer and the servicing fees are expected to be waived.

All investment earnings and debt service payments on the HPD Workout Loans received during the construction period, minus the servicing fees, will go back to the Dedicated Account prior to construction completion, and will be paid to HPD once the loan has converted to permanent status. For each project that receives an HPD Workout Loan, HPD will enter into a regulatory agreement that places income restrictions on a portion of the units to be determined by HPD; for each project that receives an ML Rehab Loan, HDC will enter into a regulatory agreement that will establish income restrictions for the project, either jointly with or separately from HPD.

Risks and Risk Mitigation

The MOU will require the one-for-one swap of City Capital for corporate reserves, and vice versa, within the affected loans. All repayment risk associated with City Project Loans made through the Dedicated Account will be HPD's risk. Also, any costs or expenses incurred by HDC for bank fees and investment breakage fees in connection with the performance of its duties shall be paid by HPD from the Dedicated Account.

While the funding swap will not increase HDC's risk and the project-level underwriting for the HDC Project Loans will not be impacted by the use of City Capital as a partial funding source, the Initiatives will limit: (i) the flexibility of the use of proceeds that would have been possible if HDC was funding the loan with its corporate reserves, and (ii) the ability to pledge the HDC Project Loans to a bond indenture and issue bonds which allows HDC to securitize the HDC Project Loans' cash flows and raise proceeds for future lending. HDC regularly securitizes the cash flows from subsidy loans made by HDC on new construction projects to augment HDC's future lending capacity, but the form of grant agreement required by OMB to grant funds precludes HDC subsidy loans funded by City Capital through a funding swap to be pledged to a bond indenture and securitized to raise proceeds. Due to this restriction, the swap will result in a decrease of HDC's ability to issue $17,000,000 of bonds that could otherwise generate proceeds to be used for future lending capacity. This is a limitation of this program that merits further discussion and investigation as the number of funding swaps increases.

Action by the Members

The Members are requested to approve (i) the use of up to $17,000,000 of the Corporation's reserves to fund the June 2024 Funding Swap Initiatives Dedicated Account for the making of City Project Loans and (ii) the execution by an Authorized Officer of the Corporation of mortgage-related documents and any other documents necessary to accomplish the making of the City Project Loans.