



Department of City Development  
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## MEMORANDUM

FOR MEETING DATE: May 21, 2015  
TO: Community Development Committee  
FROM: Jeff Vitton, CD Program Specialist  
SUBJECT: 1520 & 1536 Clark Street HOME Application

Lutheran Social Services of Wisconsin and the Upper Peninsula\* (LSS) and Herman and Kittle Properties (HKP, and herein collectively referred to as “Developers”) have submitted a HOME Investment Partnership Program proposal in accordance with the Request for Proposals and Application process presented to the CDC last August. As you may recall, per the 2013 HOME Program rule changes the application process was revised to be much more in depth, including a thorough level of financial review. The Developers are the second entity to apply under the new process.

LSS is a non-profit and was formed in 1882. LSS has over 1,100 employees and offers over 262 distinct social service programs at over 195 sites throughout Wisconsin and the Upper Peninsula of Michigan. HKP is the successor to companies that began in 1948, and has developed and managed multi-family properties for over 60 years. They currently manage over 115 properties including over 11,700 individual apartments. The Developers will form a for-profit company to develop and own the Property, and they will pay property taxes. Detailed information regarding the Developers is available in Section 9 of the application.

The Developers are requesting \$439,000 of financial assistance through the HOME Program to adaptively reuse an underutilized and deteriorating former manufacturing facility located at 1520 and 1536 Clark Street (herein referred to as “Property”) as 74 rental units targeted to veteran households with significant community amenities. The Property is actually an amalgamation of 19 individual buildings representing 128,936 square feet, while built over a period of time starting in the 1880’s most of the buildings are built of brick and have varying stories.

As one would expect after 135 years of industrial use the property does have recognized environmental conditions per a Phase One and Two Environmental Site Assessment. The costs associated with remediating and responding to brownfield (environmental) conditions at the Property still needs to be delineated further, and this further investigation will be completed in the next one to two months. That being said, costs associated with being a brownfield are **not** included in this application. The City is working in partnership with the Racine County Economic Development Corporation to help identify appropriate State and Federal programs to help finance the brownfield costs, such as the US Environmental Protection Agency’s Revolving Loan Fund program.

\*Note: LSS has no relation to Lincoln Lutheran of Racine.

The Developers' plans call for demolishing 43,273 square feet of the buildings to create interior courtyards, green space, and walking trails. It will also utilize one of the buildings for 35 covered in-door parking spaces, in addition to 72 parking spaces on surface lots. The development will be certified through the Wisconsin Green Build Homes program, be of high-quality design and construction, and feature a range of community amenities. These amenities include a fitness center, business center, media center, chapel, storage, a community room, a wellness center, and on-site management.

The total project cost is projected to be \$14,754,398.00, which is accounted for - in detail - in the application materials.

Major budget costs using rounded numbers are as follows:

- Acquisition: \$ 236,000
- Demolition: \$ 650,000
- Rehab/Construction: \$10,617,000
- Soft and Other: \$ 2,715,000
- Other Dev. Costs: \$ 1,067,000

Sources of funding for this project using rounded numbers are as follows:

- LIHTC\* Equity: \$7,714,000 (Secured)
- Historic Tax Credit Equity: \$4,087,000 (In process, highly likely)
- Fed. Home Loan Bank Grant: \$ 850,000 (to be applied for, likely)
- Deferred Dev. Fee \$ 304,000 (To be repaid by project, if feasible)
- Commercial Loan: \$1,370,000 (6% interest, amortized over 35 years)
- HOME assistance: \$ 439,000 (Issue at hand)

\*Note: LIHTC = Low Income Housing Tax Credit Program

Per a requirement from the LIHTC program 65 of the 74 assisted units must be rented by households earning less than 60% of area median income (AMI) and have their rents restricted to affordable levels based on 30% of the household's income (the nine remaining units may be rented regardless of income levels and charge market rate rents). Once completed, their primary target population for this project is veteran households and a referral agreement is in place with the Racine County Veterans Service Office. Nineteen of the units will be specifically reserved for very low income veteran households earning less than 30% AMI, and LSS will provide wrap-around social services for them. Based on 2014 Income and Rent levels, these "30% of AMI" units will rent for no more than \$386 for a one bedroom and \$463 for a two bedroom including utilities. Rents increase as income levels go up, but for reference purposes the average projected rent charged per unit is \$610 per month including utilities.

The LIHTC program, like most other affordable housing programs, restricts rent inflation to 2% while, historically, inflation is at 3%. This creates a troublesome scenario for affordable housing developers in that rents do not keep pace with inflation of operating costs, resulting in a dwindling cash flow over time. The Developers' Pro Forma (Form 8C of the Application) reflects this very issue, wherein debt to service ratios (operating income flow divided by debt payments) drops from 1.55 in year one to 1.26 in year 15. To further illustrate this point, in year one rental income is projected to be \$526,298 and operating costs are estimated at \$381,809 resulting in operating income of \$144,500. After making their mortgage payments (\$93,000

annually) their cash flow is \$52,000. In year 15, due to the inflationary pressures described above, their cash flow is reduced to \$24,000.

From reviewing the application materials, staff advises that the application is consistent with the HOME program requirements and is an eligible project for HOME funding. However, staff recommends that the terms of the financial assistance be flexible to account for unanticipated changes in the project's overall financial structure with the intent of making the project feasible while maximizing HOME program income.

Based on the projects current financial status as proposed and projected, staff would recommend terms as follows:

Total HOME Assistance of \$439,000, of which:

- One-Third, or \$146,333, be in the form of loan with 3% interest over a 15 year period. (Note: the Program would earn approx \$37,000 in interest payments)
- One-Third, or \$146,333, be in the form of a zero interest loan with a balloon payment due in 16 years, with an option to convert it to a 15 year loan at 6% interest at that time with no prepayment penalty.
- One-Third, or \$146,333, be in the form of a forgivable loan over 10 years (Grant)

All secured by a promissory note and a mortgage in second position to the commercial lender.

Based on staff's underwriting analysis of the project as presented, the Developers can absorb the additional debt noted above while staying within appropriate industry standards for debt to service ratios.

That being said, the project's financials could change based on the following factors including, but not limited to, a change in the LIHTC equity market, the Federal Home Loan Home Bank request not being fully funded, a decrease in allowable rent levels, and unanticipated brownfield related costs.

Therefore, staff recommends that the Community Development Committee move to recommend that the Mayor, City Clerk, and Director of City Development be authorized to execute a written agreement with the Developers consistent with its application and federal regulations for \$439,000 of HOME Funds for the purposes of assisting 11 rental units at 1520 and 1536 Clark Street, and if any presumed funding is not available staff and the appropriate officials are authorized to increase the level of assistance in the form of a forgivable loan or by decreasing interest rates. Conversely, if the project receives additional assistance from unanticipated sources, staff and the appropriate officials are authorized to increase interest rates and decrease the amount of forgivable loans.

**Fiscal Note:** The application was submitted in response to the request for proposals issued by the Department of City Development. There are sufficient HOME funds available for the grant.