

DATE ISSUED: September 4, 2002

REPORT NO. 02-198

ATTENTION: Honorable Mayor and City Council  
Docket of September 10, 2002

SUBJECT: Encumbrance of City Properties as Collateral for HUD Section 108 Loans

### SUMMARY

#### Issues:

1. Should the City Manager be authorized to place encumbrances on City properties and other assets such as leaseholds to satisfy collateral requirements related to approved HUD Section 108 loans as specified below?
  - (a) The Central Police Station, 2501 Imperial Avenue, for the Section 108 loan related to its construction;
  - (b) The Ocean Beach Library, 4801 Santa Monica Avenue, the adjacent property at 4817-23 Santa Monica which is to be purchased with Section 108 loan funds, and the improvements that are to be placed thereon for the Section 108 loan related to the proposed Ocean Beach Library expansion;
  - (c) The proposed new College Heights-Rolando Library to be built on the vacant lot that connects Montezuma Road and Reservoir Drive with Mohawk Street, for the Section 108 loan related to its construction;
  - (d) The Cortez Hill Transitional Shelter, 1449 Ninth Avenue, and the City Operations Building, 1222 First Avenue, for the Section 108 loan related to the purchase and renovation of the Cortez Hill property;
  - (e) The Viet Nam Veterans Homeless Facility, 4141 Pacific Highway, for the Section 108 loan related to the City's purchase of that property;
  - (f) The value of the lease related to the proposed new Logan Heights Branch Library, to be built on the Logan Elementary School site, and the City Operations Building, 1222 First Avenue, for the Section 108 loan related to the construction of the new library.

Manager's Recommendations:

1. Authorize the City Manager to encumber City properties and assets to satisfy collateral requirements related to HUD Section 108 loans as specified below:
  - (a) The Central Police Station, 2501 Imperial Avenue, for the Section 108 loan related to its construction;
  - (b) The Ocean Beach Library, 4801 Santa Monica Avenue, the adjacent property at 4817-23 Santa Monica which is to be purchased with Section 108 loan funds, and the improvements to be placed thereon, for the Section 108 loan related to for the proposed Ocean Beach Library expansion;
  - (c) The proposed new College Heights-Rolando Library to be built on the vacant lot that connects Montezuma Road and Reservoir Drive with Mohawk Street for the Section 108 loan related to its construction;
  - (d) The Cortez Hill Transitional Shelter, 1449 Ninth Avenue, and the City Operations Building, 1222 First Avenue, for the Section 108 loan related to the purchase and renovation of the Cortez Hill property;
  - (e) The Viet Nam Veterans Homeless Facility, 4141 Pacific Highway, for the Section 108 loan related to the City's purchase of that property;
  - (f) The value of the lease related to the proposed new Logan Heights Branch Library to be built on the Logan Elementary School site and the City Operations Building, 1222 First Avenue, for the Section 108 loan related to the construction of the new library.

Other Recommendations: None

Fiscal Impact: Other than recording fees, estimated at \$200 or less, there is no significant direct cost. However, it should be noted that encumbrances on these properties will total \$19,100,000 and, to the extent to which each is encumbered, these assets of the City will not be readily available to collateralize future loans or long term debt issuances. On the other hand, as noted below, HUD is flexible about accepting substitute collateral at a later date and taking a junior position as long as their collateral requirements are met. The value of the encumbrances will decrease as each annual principal payment is made.

BACKGROUND

The HUD Section 108 Loan Guarantee program, which is part of the Community Development Block Grant (CDBG) program, is one of the major public investment tools offered to local governments. It allows cities to leverage relatively small portions of their CDBG

funds into

federally guaranteed loans large enough to stimulate and/or pay for major community and economic development projects. This mechanism allows the City to borrow significant amounts of money at a favorable interest rate and requires the pledge of current and future CDBG allocations as security for repayment. CDBG funds may also be used as the source of repayment. As an additional layer of security, HUD requires pledged collateral. The amount of collateral has changed from time to time but is now 125% of the loan amount. The collateral is generally the real estate (land and/or improvements) for which the Section 108 funds are used; however, HUD will consider other options. Section 108 projects must meet the same eligibility requirements as other CDBG projects.

The City of San Diego has used this mechanism to facilitate revitalization and redevelopment efforts in a number of neighborhoods. Public facilities such as police and fire stations, homeless facilities, public improvement projects and economic development projects have been assisted with 108 financing. Most of the City's loans are being repaid with our annual CDBG entitlement funds; however, repayment can be made from other sources such as developer commitments (as with the Regional Transportation Center project) or Redevelopment Agency tax increment revenue. Attachment I summarizes City projects which either have an active Section 108 loan or have received HUD approval but require additional processing.

## DISCUSSION

Federal requirements regarding collateral for Section 108 loans have changed over time. While some of the earlier projects had no collateral requirements, HUD now requires collateralization at 125% of the loan value. Neither the City Manager nor HUD believes an occasion will arise when the collateral will be needed to ensure repayment of the loans; however, it is required by Federal law. The matter of collateral is always included in the City's application to HUD for the financial assistance but has not always been formally presented to the City Council. A recent review of our Section 108 loan portfolio (which includes funded loans and approved loan applications) revealed a number of loans for which the collateral process either has not been formalized or may be unclear. To be fully compliant with HUD regulations, collateral must be established for all loans, including several that are already funded.

Approval of the Manager's recommendations contained in this report will confirm and clarify that the primary source of collateral for Section 108 assisted projects is the real estate associated with the project and will authorize the encumbrance of those specific properties. However, there is also need for policy direction and action when project related real estate does not have sufficient value to meet the 125% requirement or can not be used as collateral, e.g., the project is on parkland, the asset is already encumbered, or the asset is needed to collateralize another City project.

Therefore, it is recommended that the City Operations Building (COB) be used to fulfill the collateral requirements for the Cortez Hill Transitional Shelter and the Logan Heights Branch Library as these properties on their own cannot fulfill the requirements. The Cortez Hill property is short \$825,000 of meeting the 125% requirement. The City cannot offer the new Logan Heights Library as collateral for two reasons: (1) we do not own the land and (2) the improvements are subject to restrictions related to the School District lease as well as to the anticipated Proposition 14 library bond funding. To the extent that the leasehold value (estimated at \$300,000) is accepted by HUD as collateral, the Manager would use that first and supplement it with value from COB, but it is possible that the entire collateral requirement for the library (\$3,787,500) may have to be met by COB. COB is free of other encumbrances and we are not aware of plans for the property which would preclude it from being encumbered for these loans. A maximum of \$4.6 million of COB's estimated \$18-20 million value would have to be pledged as collateral for these two projects. It should be noted, however, that when Phase II improvements at Cortez Hill are completed, the Manager intends to substitute the value of those improvements as collateral, thereby removing as much of the \$825,000 encumbrance as possible from COB.

In addition to its use for these two projects, COB has sufficient value to allow it to be used for other projects, such as the new loan being proposed by the Southeastern Economic Development Corporation (SEDC). (See companion item on today's docket which recommends using COB to collateralize a \$3.535 million loan for SEDC. The proposed senior center cannot be used as collateral because it will be on dedicated parkland, and the proposed public improvements cannot be used as collateral.)

Designating one property with substantial value as a source of supplemental collateral, rather than individual properties on a case by case basis, affords the Manager greater efficiency in implementing the Section 108 loan program and enhances our ability to track encumbrances. HUD has indicated that they would be willing to accept designation of a single property as collateral for more than one loan, provided we can show sufficient unencumbered value in the property to meet the 125% requirement. It should be noted that HUD is also flexible about taking a junior position or substituting one asset for another as long as their 125% requirement is still met. As a result of this flexibility and the fact that the value of the encumbrances will decrease with each annual loan principal payment, none of the properties encumbered as collateral, including COB, are precluded from being used as collateral for other projects in the future.

Attachment II lists the 6 projects that are affected by the proposed actions and summarizes both the collateral requirements and the correlating Manager's recommendations. The impact of using COB to collateralize the proposed SEDC loan is also shown on Attachment II. Starting with the proposed SEDC loan, the Manager will confirm collateral requirements with the Council at the time the authorization to apply for a loan is requested. The Manager will continue to use the loan related property as the primary source of collateral and will use the City Operations Building when necessary.

## ALTERNATIVES

1. Do not authorize the encumbrance of City property for future Section 108 loans and terminate the use of this financing mechanism.
2. Designate a property or properties other than the City Operations Building to serve as a source of supplemental collateral for the Cortez Hill and the Logan Heights Library projects and for future loans if necessary.

Respectfully submitted,

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Hank Cunningham, Director..... Approved: Bruce Herring  
Community and Economic Development..... Deputy City Manager

CUNNINGHAM/FISCHLE-FAULK/BC

Attachments:

1. HUD Section 108 Loan Summary
2. Collateral Requirements Summary

## ATTACHMENT I HUD SECTION 108 LOAN SUMMARY

### CATEGORY I. ACTIVE (FUNDED) LOANS. ....

PROJECT .....	PRINCIPAL BALANCE	PAYOFF DATE
	(as of 8/1/02)	
Mid City Police Station #1.....	\$ 490,000.....	2003
Mid City Police Station #2.....	\$ 220,000.....	2003
Golden Hill Fire Station .....	\$ 110,000.....	2003
Barrio Logan Mercado .....	\$5,865,000 .....	2015
Urban Village Library/Park.....	\$4,340,000.....	2007
SEDC (3 projects) .....	\$5,890,000.....	2017
Central Police Station .....	\$3,210,000.....	2018
Vietnam Veterans Homeless Facility.....	\$ 850,000.....	2019
Regional Transportation Center. ....	\$2,250,000.....	2020

**CURRENT 108 DEBTS\$23,225,000**

### CATEGORY II. APPROVED LOANS REQUIRING ADDITIONAL PROCESSING

PROJECT .....	LOAN AMOUNT
Logan Heights Family Health Center.....	\$1,000,000
College Heights-Rolando Library.....	\$3,150,000
Ocean Beach Library .....	\$2,000,000

Cortez Hill Transitional Housing.....\$2,700,000

Logan Heights Library .....\$3,030,000

**TOTAL APPROVED.....\$11,880,000**

**ATTACHMENT II.  
COLLATERAL REQUIREMENTS SUMMARY**

PROJECT .....LOAN AMOUNTCOLLATERAL RECOMMENDED SOURCE (S) OF  
REQUIRED .....COLLATERAL.....

..... **LOAN RELATED PROPERTY..COB**

1. CENTRAL POLICE STATION...\$ 3,600,000.....\$ 4,500,000.....\$ 4,500,000..... \$0

2. OCEAN BEACH LIBRARY\$ 2,000,000.....\$ 2,500,000.....\$ 2,500,000..... \$0

3. COLLEGE HEIGHTS-ROLANDOS\$ 3,150,000.....\$ 3,937,500.....\$ 3,937,500..... \$0  
LIBRARY

4. CORTEZ HILL .....\$ 2,700,000.....\$ 3,375,000.....\$ 2,550,000.....\$ 825,000  
TRANSITIONAL SHELTER.....

5. VIET NAM VETERANS .....\$ 1,000,000.....\$ 1,000,000\* .....\$ 1,000,000..... \$0  
HOMELESS FACILITY

6. LOGAN HEIGHTS LIBRARY...\$ 3,030,000.....\$ 3,787,500.....\$ 300,000 (tentative)\*\*....\$ 3,487,500 (tentative)

**SUB TOTAL** ..... **\$15,480,000.....\$19,100,000.....\$14,787,500.....\$4,312,500**

*PROPOSED SEDC LOAN.....\$ 3,535,000.....\$ 4,418,750..... \$0.....\$4,418,750*

**TOTAL**

.....\$19,015,000.....\$23,518,750.....\$14,787,500.....\$8,731,250.....

\*100% collateral requirement, rather than 125%, per loan contract

\*\* Acceptance of leasehold value as collateral by HUD is subject to negotiation; it is possible that the entire \$3,787,500 will have to be collateralized by COB