August 27, 2009

To: Commissioner Nick Fish

From: Margaret Van Vliet, Portland Housing Director

Re: North Macadam Block 49
Proposed Mixed Income/Veterans Housing Development

Cc: Mayor Sam Adams
PDC Executive Director Bruce Warner

You requested that I conduct a thorough review of the proposed financing and programmatic elements of the North Macadam Block 49 development. During your term as Housing Commissioner, you have maintained a strong interest in providing new permanent housing for formerly homeless veterans while addressing a shortage of workforce rental housing and creating some local economic stimulus. Portland Housing Bureau (PHB) staff have pursued this charge at your direction, with the full knowledge that if major obstacles emerged that we would stop and regroup.

I have now completed my review of the project and I am recommending that the project as currently structured should not move forward. This memo will summarize my findings and propose some next steps.

**Economic Feasibility**

My primary concern with the development project as structured centers on the proposed financing mechanisms and long-term risks to the City that have not been adequately mitigated. As you know, the City Lights program has been the centerpiece of our financing package largely because the conventional affordable housing tools were deemed insufficient in the current economic environment. City Lights is a financing program involving the issuance of revenue bonds to finance housing projects that will be owned by the City. In this case, this means that the City itself would act as the owner for the term of the 30-year financing. That – in turn - creates long-term operating risks that take on greater significance than if the public financing were being provided to an independent developer/owner against which we could underwrite alternative sources of repayment.

In this light, I identified a number of issues that would need to be solved for, including:

- in-house capacity and cost for PHB to effectively provide asset management, ownership and general project oversight.
- leasing and sustained occupancy of the higher income rental units in a rapidly changing housing market that includes conversion of new condominium units to market-rate rentals
- management of a somewhat untested mix of populations in an emerging residential market
management and funding of long-term social service agreements to ensure the successful residency of the formerly-homeless veterans
• sustainability of the operating budget through time, which I believe could be severely tested
• assumptions about achievable voucher rental rates that the Housing Authority of Portland found potentially problematic
• other underwriting variables including interest rates, contingencies, operating and capital replacement reserves, and the like

Our staff was tremendously responsive in working to address this wide array of risks. In most cases, the proper method for mitigating risks was to build a more financially conservative deal structure. Naturally, this process led us to identify a large funding gap of close to $3 million. Given the schedule necessary to break ground this fall, and the requisite Council approvals needed to allow groundbreaking, it is my judgment that the project should cease working towards such a rapid closing so that time can be made available to examine alternatives.

Back-stopping the Bonds
Connected to, but separate from, the deal structure risks as outlined above is an issue of identifying a secondary source of repayment to the bondholders in the event the project itself became unable to make a scheduled payment. This is an issue the Portland Office of Management and Finance’s (OMF) Debt Management division has been analyzing and discussing with the Portland Development Commission (PDC). I am aware that negotiations between PDC and OMF had surfaced some potentially serious concerns, including general fund risks, that very likely would make it difficult for OMF to make a positive recommendation to Council to move forward on issuance of the City Lights bonds for the project.

Providing Housing for Veterans
With the project now at least temporarily on hold, I will direct the development and finance staff at PHB/PDC to analyze alternative methods of creating new housing options for veterans. Possibilities could include project-basing the VASH vouchers in another project that is in our queue; developing an alternative site in North Macadam into a smaller, more focused project that removes some of the operating risks connected to the mix of populations; securing unoccupied housing units recently built or under construction in the district; or restructuring the financing package on Block 49 to bring in additional capital and solve for OMF’s “backstop” concerns.

To aid this effort, I am working with senior officials from our local VA office to understand directly their priorities and solicit their assistance in finding options to create the needed housing.

Economic Stimulus
One of the disappointments with halting the project is the loss of short-term construction jobs that Council hoped would serve as an economic stimulus. Our private development and construction partners are naturally very disappointed by this situation. Core to this team are Walsh Construction and Williams and Dame Development. I will communicate closely with officials from these organizations in the coming days to help explain our reasoning, and solicit their assistance in finding a creative solution to the development of housing that meets our policy goals without subjecting the City to undue long-term risk.

I will report back to you within thirty days on our progress to identify alternative scenarios for both veterans and affordable housing in the South waterfront district.