Central Puget Sound
Regional Equitable Development Initiative (REDI) Fund

Business Plan Framework
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Introduction

TOD Equitable Development Fund
Transit oriented development (TOD) is a pattern of higher density mixed use development that includes housing, commercial space, services, and employment opportunities in close proximity to public transportation, especially high-capacity rapid transit stations. TOD is intended to reduce dependency on automobiles, to increase transit ridership, reduce household transportation costs, and to better link residences to jobs and services. Equitable TOD accommodates population and employment growth while enhancing the quality of life and access to opportunity for current and future residents regardless of income, race, culture, disability, or age.

The TOD equitable development fund is a new innovative tool now in use in several metropolitan regions to facilitate equitable TOD. Seeded by public capital, and substantially funded by private capital from banks, community development finance institutions, and mission investors, a TOD equitable development fund achieves leveraged value from the investment of limited public resources. Administered to provide loans to developers on a revolving basis, the fund can achieve ongoing public benefit for many years, thus magnifying the one-time public investment.

This document proposes a framework for a business plan for a TOD equitable development fund to be established in the central Puget Sound region. The framework described in this paper was developed by Enterprise Community Partners and Impact Capital, both of which are Community Development Finance Institutions (CDFIs) that are active in the central Puget Sound region. The proposed fund, which is called the Regional Equitable Development Initiative (REDI) Fund, is designed to provide loans to secure sites and multifamily projects near existing and future transit stations and corridors throughout the central Puget Sound region and repurpose these sites as affordable housing and supportive community facilities. The REDI fund will fill the gap in the spectrum of financial products currently available to developers interested in equitable TOD by allowing mixed income projects, providing longer term loans for land banking purposes, and providing larger loans for larger sites and completed properties.

The REDI Fund proposal emerges from the work of the Growing Transit Communities (GTC) Partnership, a consortium of public, private, and non-profit stakeholders led by the Puget Sound Regional Council (PSRC). GTC was made possible with a $5 million 3-year Sustainable Communities grant from the federal Department of Housing and Urban Development (HUD). The GTC Partnership brought together key stakeholders from throughout the region to
promote equitable growth in transit station areas through new and innovative tools, partnerships, and targeted investments. The REDI Fund, one of several housing and community development tools advanced as part of the GTC work program, builds on the experience of funds in place in other comparable regions.

**Overview of Business Plan Framework**
This document establishes a framework for design and operation of the REDI Fund that responds to demonstrated need for a fund in the region and is built on national and local experience in equitable development finance. The document makes recommendations in the areas of 1) loan products, 2) project and borrower eligibility, 3) fund structure, 4) terms and underwriting, 5) fund size, and 6) management and oversight. The business plan framework concludes with an update on potential funding partners, including an analysis of several models for public seed capital that may be pursued in the central Puget Sound region. The Next Steps section describes an implementation strategy for financing and initiating the REDI Fund in the next year.

**1-Background**
Equitable transit oriented development (TOD) can achieve a number of important public policy goals. Providing affordable housing choices and increasing access to employment, education, and services in transit communities ensures that all households, regardless of income, can benefit from regional investments in transit.

In addition, equitable TOD also improves overall affordability for low and even moderate income households. The cost of living in any location includes both the cost of the housing itself and the cost of transportation. Locating affordable housing in communities with easy access to transit, employment, education, and services magnifies the benefit to low- and moderate-income households. Conversely, housing located far from transit options may carry added transportation costs that undermine any advantage in lower rents and home prices.

Finally, equitable TOD can boost transit ridership and promote social justice goals for transit agencies. According to the American Public Transportation Association\(^1\) and the Center for Transit-Oriented Development\(^2\), among others, residents of low-cost housing tend to be the most frequent transit users. Due to income, age, and/or disability, many of these residents depend on transit as a primary mode of travel to work, education, and essential services.

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\(^2\) Center for Transit Oriented Development. TOD 201: Mixed Income housing Near Transit: Increasing affordability with Location Efficiency.
**Growing Transit Communities**

The Growing Transit Communities Partnership (GTC) is an initiative, led by the Puget Sound Regional Council (PSRC), which includes a region-wide group of public, private, and non-profit stakeholders who share a common goal: to ensure equitable and environmentally sustainable development around the region’s rapid transit investments. VISION 2040, the region’s long-range strategy for growth management, transportation, and economic development, establishes a policy framework for preserving farms, forests, and open space and reducing our impact on global climate change by accommodating housing and jobs within existing communities and with access to transit. Growing Transit Communities is one important bridge from plan to successful implementation of VISION 2040 around the region’s ongoing $25 billion investments in regional transit.

The work plan and recommendations of the Growing Transit Communities Partnership further three key goals:

1. Attract more of the region’s residential and employment growth to high-capacity transit communities;
2. Provide housing choices affordable to a full-range of incomes near high-capacity transit; and
3. Increase access to opportunity for current and future residents of transit communities.

As the culmination of a 3-year process, the Partnership produced two documents—the Growing Transit Communities Compact and the Growing Transit Communities Strategy—intended to further “thriving and equitable transit communities” throughout the region. The Strategy contains a recommended action plan for equitable TOD regionally and within transit communities that have varying needs within the region. The Strategy recommends adoption of a full range of tools to meet affordable housing needs and promote equitable development. These include not only the TOD equitable development fund, but also strategic public investments, incentives, and supportive regulations.

As a multi-sector approach, the Strategy defines roles for public agencies (state, regional, local, transit, public health), for non-profits (housing, community groups, advocacy organizations), and private sector actors (finance, development, foundations, business). The Compact is a vehicle for each regional partner to formally endorse the goals and statement of intent to take action locally and collaborate regionally to implement the recommendations of the Strategy.

In fall 2012, PSRC published a white paper titled “A Regional TOD Fund: Ensuring that Transit Communities Grow Equitably,” documenting the need for creation of a fund and describing a high-level framework for what such a fund would look like, what organizations might be able to capitalize it, and how it would work to fill gaps in existing funding tools for housing. The
development of the white paper and of this document was guided by the GTC Affordable Housing Steering Committee, and specifically a TOD Fund Subcommittee with representation from key stakeholders. See Appendix 1 for a list of members of the TOD Fund Subcommittee.

Starting in early 2013, a consultant team from Enterprise Community Partners and Impact Capital, both of them Community Development Finance Institutions with national expertise in this work, undertook for the Partnership several key tasks in support of establishing a fund. The scope of work included interviews with dozens of stakeholders, assessment of supporting data on affordable housing supply and financing environment, development of a business plan framework, and incorporating feedback from a regional TOD fund subcommittee. In a parallel effort, Enterprise and Impact have also been exploring potential capital sources for the REDI Fund, including foundations, banks, and public agencies.

2 – Needs Analysis: Why a TOD Equitable Development Fund?
An analysis of existing conditions for equitable TOD in the region underscores the need for a TOD fund and suggests priorities for its use in the region. Market demand for key locations in proximity to transit stations, such as along the Link light rail, has led to increased property values and the potential for even further appreciation as the transit system builds out. While affordable housing developers are increasingly seeking transit accessible locations, the currently available funding tools are insufficient to meet the need for property acquisition for equitable TOD.

**Market and Need for Equitable TOD**
The central Puget Sound region is anticipated to grow by approximately 1.2 million people (600,000 households) by the year 2040. A significant portion of the region’s growth is expected to occur within walking distance of high capacity transit options, including light rail, commuter rail, streetcar, and bus rapid transit. As projected, this represents an enormous opportunity to create complete communities that enhance the region’s sustainability, and complement and support the region’s transit systems through transit supportive land uses and public and private investments. The goal of the Growing Transit Communities Strategy is to exceed 25% of all new housing growth and 35% of employment growth within walking distance of these transit services. This presents an even larger challenge to ensure that development near transit meets the needs of all types of households, all income levels, and all racial and cultural communities in the region.

Affordable housing here refers to housing whose price or rental amount is below market rate, typically a level that is affordable to households earning 80% of Area Median Income (AMI) or less. Region-wide, 43% of households earn less than 80% of Area Median Income (AMI) and a quarter of all households earn less than 50% of AMI. Existing conditions research on the GTC
Study areas found that households currently residing in transit communities have lower incomes and higher housing cost burdens than the region as a whole. Many existing or proposed station areas around the regional transit system have a current stock of housing and commercial space that is quite affordable compared with the region. However, more than half of the transit communities studied show a current or potential threat of displacement of low income residents and small businesses.

Region wide, the picture for affordable housing is one of insufficient supply and growing demand. The shortfall of affordable units is most acute for very low income households (defined as earning less than 30% of AMI). In more expensive markets within the region, including Seattle and East King County, the supply of affordable housing is also insufficient for households at higher income levels, especially housing suitable for families that earn up to 80% of AMI.

The region’s strong economy has created additional upward pressure on rents coinciding with a renewed focus among young households with means to live in accessible, central locations. The market is responding to this need by building near transit and increasing rents on formerly affordable units. Despite being the most in need of the access to services and transportation savings that these transit accessible locations offer, low and moderate income households are being outbid in the market place and this trend can be expected to continue as the transit system expands and matures.

Challenges for Equitable Development in Transit Communities

Transit station areas are challenging locations for affordable housing development and preservation and other types of equitable development. Reconnecting America and the Center for Transit-Oriented Development have documented research that shows how property values typically appreciate near new transit stations throughout the country. As property values increase, it becomes more difficult for affordable housing developers to acquire sites for a price low enough to accommodate long-term affordable housing. In addition, transit stations serving older urban areas are often surrounded by small parcels of land. Land assembly may be required to achieve a scale and efficiency of development that can be produced with affordability. Zoning requirements, such as for vertical mixed-use buildings, can also complicate both the design and financing of affordable TOD projects.

Beyond simply being able to afford a given site, the process by which most affordable housing projects are financed adds difficulty to land acquisition. A typical affordable housing project is funded by layering multiple financing sources—sometimes up to five different sources or more—from the state, city and county housing agencies and other sources of capital. These

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funds are awarded competitively and individually, and demand for all funding at all levels of government greatly exceeds the availability of funds. Developers must frequently reapply for funds. Assembling the financing for a successful project can take years because there are only one or two funding rounds each year for each source.

The difficulty in financing equitable TOD projects can be compounded with attempts to mix affordable housing units with market rate units or community facilities. While more difficult, mixed use and mixed income projects are critical to achieving the equitable TOD vision articulated in the GTC plan. A patient financing source that can allow sufficient time to structure such projects will be essential to their viability.

Ideally, affordable housing developers would be able to obtain site control by signing a purchase and sale agreement (PSA) or purchase option that allows sufficient time for the developer to secure financing before it is needed to actually purchase a site. However, affordable housing developers typically have to compete for sites with market-rate developers that can act on property acquisition more quickly and don’t need to wait years to secure financing. In an active real estate market, the length of PSAs and options is typically shorter, and in some cases as short as 60-90 days.

Acquisition financing tools are needed to enable affordable housing developers to compete with market developers to secure sites prior to long-term public financing being secured. Since land speculation may precede transit station development by a number of years, having a new financing tool that provides longer terms and lower rates would provide greater opportunity to affordable developers.

**Existing Sources of Acquisition Financing**

Several sources of acquisition financing currently exist. However, these existing tools are inadequate to address the current and growing challenges of supporting equitable TOD in the central Puget Sound region. Acquisition loans to non-profit housing developers for affordable housing in the region are provided from a variety of sources, but each has its limitations, resulting in a gap in currently available financing tools to meet the needs in transit proximate locations. Each acquisition funding source is evaluated in turn below for its ability to provide nimble, low cost, long term acquisition financing for mixed use and mixed income projects across the region. These conclusions are based on assessments of the product terms, interviews with the lending bodies and interviews with developers in the community trying to acquire sites with the currently available funding options.

**Source: Impact Capital and Enterprise Community Loan Fund**

Impact Capital and Enterprise Community Loan Fund are nonprofit Community Development Finance Institutions (CDFIs) that are active in the region. Impact and Enterprise were the
lenders on many of the TODs sites that have been developed with affordable housing in the region over the past 8 years. Both CDFIs currently offer acquisition loans at a rate of between 5% and 6.5%. Maximum loan terms are 3 years, but can go to 5 years in some cases with operating properties with strong cash flow. Limitations of these products include:

- **Loan size.** Neither CDFI will typically make individual loans higher than $3-$5 million. TOD site acquisition, particularly in high demand corridors, will often require more capital. This prohibits the acquisition of large sites or existing multifamily projects.

- **Eligibility requirements.** CDFI loans are typically only made to projects that have one or more permanent financing sources already secured, or when public agencies have clearly prioritized a project. Because competing for permanent financing is time consuming, this requirement makes acquisition of most sites on the open market infeasible.

- **Interest rates.** The higher interest rates that CDFIs must offer, because they are raising capital outside a fund structure, make the costs of holding TOD sites prohibitive for many affordable housing developers. The difference between paying 6.5% and 4.5% can undermine the feasibility of a project. For example, a 3-year $3 million loan would result in an additional $180,000 in interest payments.

- **Loan-to-Value.** CDFIs typically can only offer lower Loan-to-Values (LTV), especially on vacant land. For example, if a developer wants to buy a vacant parcel but has no permanent funding commitments, a CDFI would typically only lend 60% - 70% of the value of the land. For an occupied building, maximum LTVs would generally be 80-85%. For large scale projects, this can constitute a seven figure equity requirement to buy a site or existing project, well beyond what an affordable housing developer may be able to afford.

- **Recourse and guarantees.** CDFIs typically require full recourse loans with full guarantees, which developers are generally hesitant to agree to.

**Source: Craft3**
Craft3 is another CDFI active in Washington and Oregon providing business, real estate, and community development loans. Craft3 may provide some real estate acquisition loans, but it is not the focus of their business.

**Source: Rainier Valley Community Development Fund (RVCDF)**
RVCDF provides acquisition loans at generally low rates and can be flexible on terms such as interest payments and the maturity date of loans. While they have some flexibility to offer attractive acquisition debt, RVCDF products are limited geographically to the Rainier Valley area of southeast Seattle. RVCDF also provides small business loans and thus it is unclear what
portion of their lending can be expected to go toward housing in any given year. RVCDF’s funding priorities may change as their programmatic priorities evolve.

**Source: City of Seattle**
The City of Seattle provides acquisition bridge loans for up to 3 years with an effective blended rate of about 3%. (The blended rate includes the CDFI and the City loan interest rates.) Limitations include:

- Loans are only available for projects located in the City of Seattle.
- The City has approximately $5 million available to lend for acquisition loans each year, but does not have any funds currently deployed. The City is able to make bridge loans, but is hesitant to set up too much of a pipeline of highly subsidized, 100% affordable projects.
- The funds can only be used for affordable housing up to 80% of Area Median Income, and a 50-year regulatory agreement is recorded against the property.

**Source: King County**
King County’s Interim Loan Program provides acquisition loans at 3% interest for up to 5 years, including extensions. Eligible projects must have all the housing units set aside at 50% of AMI, with projects serving the homeless receiving priority. Limitations include:

- Loans are limited to non-profit developers and affordable housing projects
- Loans are geographically limited to locations in King County only
- Loans are generally 1-3 years.
- Requirements for depth of affordability and focus on housing for homeless populations are more restrictive than the range of project needs in transit communities

**Source: Washington State Housing Finance Commission (WSHFC)**
The WSHFC Land Acquisition Program (LAP) provides loans at 0-3% interest for a minimum of 4 years and maximum of 8 years, and interest payments can be fully deferred. The loans are for nonprofit developers building housing restricted at 80% of AMI, and the funds can be paired with a loan from another lender. LAP funds can finance up to 75% of acquisition costs and can go to 100% loan-to-value (LTV) ratio. The fund is currently capitalized at $16.5 million, with $8.6 million currently available statewide. WSHFC is currently considering increasing the size of the LAP fund. Within King County, WSHFC generally focuses its LAP funds on TOD development.

Limitations of LAP include:

- The LAP fund is a statewide resource with only a portion of the funds available for projects in the central Puget Sound region.
• At current funding levels, this source will be limited in the number of projects it can fund regionally\(^4\).
• LAP funding is available only to nonprofit developers building projects that are predominantly affordable to households earning less than 80% of Area Median Income. Community facilities are allowed if they are a functional part of a housing development. As noted above, an effective TOD fund would be able to provide financing to for-profit entities and for projects that may have a market rate component.

**Source: Private Bank Loans**

Private banks will sometimes provide acquisition loans, typically at rates lower than CDFIs. However, this source is limited in the following ways:

• Bank acquisition loans are infrequent as this is not one of their typical activities
• Typical loan term (1-2 years) is shorter than needed for many TOD projects
• Bank loans are generally not available for land banking acquisitions
• Typically, acquisition loans from private banks are only available from the bank that is also providing the eventual debt or equity financing for project development
• Banks typically have low Loan-to-Values and require the greatest amount of equity from a borrower.

**Summary of Findings**

Considering the full range of existing property acquisition fund sources, the following general statements can be made about financing factors that do or do not meeting the needs of developers of equitable TOD:

• **TERM:** Most of the available site acquisition resources generally have short loan terms (up to 3 years). Longer loan terms would allow for affordable housing developers sufficient time to assemble the necessary financing. It can often take 2-3 years for an affordable housing developer to secure sufficient financing to develop an affordable housing project. Longer loan terms would also allow time for land use approvals and assembly of multiple smaller parcels. Some transit areas may require time for a developer to assemble smaller parcels into a site feasible for affordable housing development.
• **FLEXIBILITY:** The need to already have one or more sources of permanent subsidy identified and secured typically precludes a developer from being able to be nimble in acquiring competitive TOD sites.

\(^4\) Assuming $5 million of the available $8.6 million is available for the central Puget Sound region, and WSHFC funds 75% of each project, this would only equate to four $1,250,000 acquisition loans across the four-county region. This assumes an acquisition price of $30,000 per unit for a vacant site that could only hold an average of 55 units (for a total of 220 units), well below the actual need for affordable housing in transit communities.
• **INTEREST RATES**: The majority of acquisition loans are funded by CDFIs at rates that add significant cost to the project and increase the need for public subsidy.

• **ELIGIBLE ENTITIES & USES**: Existing sources of acquisition financing generally are restricted to non-profit developers building affordable-only projects restricted to low or very low income levels. For-profits and non-profits have started to work together to develop larger sites by phasing the development of market rate and low-income housing. A need exists for a financing mechanism to acquire TOD sites for such mixed-income developments and joint ventures between non-profits and for-profits. In addition, there may be an unmet need for acquisition financing for several types of affordable housing development that involves for-profit developers.

• **MAXIMUM LOAN SIZE**: Most of the available resources are also limited in loan size. For preservation projects and large vacant sites, obtaining an acquisition loan for more than $5 million with existing resources can be very difficult. Larger loans require multiple funders, which increases transaction costs and makes it difficult to close quickly on properties in competitive TOD markets. More than one developer has cited this issue in their inability to acquire attractive sites that have come on the market.

These findings help to guide design of the REDI Fund to best meet the needs of affordable housing developers. As supported by this analysis and confirmed by input from affordable housing stakeholders, the gaps and limitations in the existing acquisition financing environment show that there is a need for a new financing tool that can provide more long-term flexible capital at a lower cost that closes the gaps outlined above. Ideally, that tool would be able to:

• Attract new local and national capital that would allow for higher-risk land acquisitions that can be held for a longer time period (due to both longer terms and lower cost of funds)

• Attract less-expensive capital than typically available to CDFIs – A new fund structure or financing tool could attract funds at better interest rates than Enterprise and Impact Capital are typically able to raise from national funders

• Provide sufficient capital for larger site acquisitions ($5-$10M)

• Provide a resource for site assemblage where that is necessary

• Allow for mixed-use and mixed-income developments

• Allow for non-profit and for-profit joint ventures, and for-profit developers building affordable housing

• Allow for higher Loan-to-Value (LTV) ratios to strong developers

• Incentivize alignment of resources to make more efficient of use of already available funding by blending and leveraging it with new funding

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5 For-profit affordable housing developers utilize the 4% Low-Income Housing Tax Credit (LIHTC) to build low-income housing typically at the 60% of AMI workforce housing level.
The proposed REDI Fund would complement existing financing tools for site acquisition available in the region by adding capacity to fill these gaps without significant overlap with existing resources. A new financing tool would leverage private capital as well as existing local resources. The most important piece would be the public catalyst investment, which would create significant public benefit by leveraging private capital.

2.1 – Generic Fund Structure

Capital Stack
Structured acquisition funds for equitable development are in operation in several metropolitan areas in the United States. Most have the same basic financing structure regardless of location or whether the fund focuses on transit-oriented development. Most funds have some variation of the three-tiered structure illustrated in Figure 1.

Figure 1: Property Acquisition Fund Capital Stack

First Tier Capital typically comprises 20-25% percent of a fund and is in the highest risk position if a fund experiences any losses. This first tier capital is typically granted or loaned at a 0% interest rate by a public agency (or agencies) and is the most critical part of any fund. This catalytic public investment or “top loss” capital allows for lower interest rates for borrowers, more flexible terms, and helps demonstrate the support of public funders to other sources of
capital. Having no-interest money in the highest risk position is the cornerstone of a leveraged fund because it allows the other lower tier investors to be in a less risky position without the fund being burdened by a high cost of capital for those high risk dollars.

It is important to understand that the even in the highest risk position within the fund, the risk of principal loss of the public investment is mitigated by rigorous underwriting and strong collateral. Both of these are detailed in later sections but they are generally as follows:

1- **Risk underwriting for the project and borrower.** The fund manager will be charged with carefully vetting projects for their viability and borrowers for their ability to execute the project as proposed. Financial underwriting of the borrower will screen for firms that are able to pay interest costs in excess of those projected and be able to advance the project as necessary.

2- **Collateral.** The REDI Fund will be used to buy real property. While there is certainly volatility in the value of real estate and the ability for a seller to sell a property quickly, the property acquired with a REDI Fund loan is a marketable asset that could eventually be sold if a there is no other way to complete a project on the site. While it can’t be stated that public catalyst investment is completely without risk, the intent for this fund is to secure sites in advance of the property value escalation that has typically followed light rail investment. This narrow focus helps to ensure collateral that holds its value.

**Second/Third Tier Capital** typically comprises the next 20-25% of a fund and is typically in second or “subordinate” risk position if a fund experiences any losses. Second tier capital is typically loaned by a foundation, mission investor, or public agency at a 1-2% interest rate. Mission-driven entities typically invest in a fund in a subordinate risk position to senior capital. The resulting interest rate of 1-2% reflects both the lower risk profile and the community development goals of the lenders.

**Senior Capital** typically comprises 50-60% of a fund and is loaned from banks and CDFIs at rates of from 4-6%. These funds are loaned in at rates similar to other bank loans, but the fund structure, and their tertiary risk position, is required to attract financial institutions to make their funds available for the types of land acquisition loans proposed by the fund.

Appendix 5 provides additional detail on the possible investors for each funding tier, focusing primarily on the public investment.

There are significant advantages to the pooling of public and private capital in this fund model. Pooled within a single fund, the various sources of capital are combined to provide loans that are at a lower rate and are more flexible than existing acquisition financing resources. This
structure also is a significant leverage opportunity for the public investment, which can attract capital into the other tiers at a 3:1 or 4:1 ratio and at rates and terms that might otherwise not be available.

Figure 1, above, shows the basic structure and the necessary types of capital for any acquisition fund. For illustrative purposes, assuming a $25 million fund, these are the approximate funding sources that a potential REDI Fund will need and the associated interest rates:

<table>
<thead>
<tr>
<th>Funding Type</th>
<th>Amount</th>
<th>Interest Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>First Tier</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>’Top loss‘ (catalytic capital)</td>
<td>$5,000,000</td>
<td>0%</td>
</tr>
<tr>
<td><strong>Second/Third Tiers</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mission Investment</td>
<td>$7,500,000</td>
<td>1.5%</td>
</tr>
<tr>
<td><strong>Senior Debt</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Banks, CDFIs</td>
<td>$12,500,000</td>
<td>6% (estimated)*</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$25,000,000</td>
<td>3.45% (blended cost of funds)**</td>
</tr>
</tbody>
</table>

*Banks typically provide capital at variable rates.

**Actual interest rates for borrowers will need to account for administration and third party costs, at roughly 1%.

The actual structure of how the funds are combined into a single financing tool will depend on a number of factors discussed in Section 3.4. Some of the funds might need to be held by a fund manager and other funds would be available at the closing of individual transactions. The eventual funders at all three tiers will need to negotiate the final approved structure. The actual rate charged to borrowers will depend on the actual rates charged by each of the fund sources.

**Revolving Loan Structure**

The mechanism for actually lending the funds is illustrated by the flow chart in Figure 2 below. The REDI Fund would receive grants and loans from public and private sources and then lend those funds to affordable housing and community facility developers to acquire properties. Developers would then acquire one or more properties and then begin to assemble financing. Depending on the type of project and availability of financing, the loan would begin to be repaid sometime between years 3 to 5 once permanent financing is secured. Those funds would then revolve and be re-lent to a new developer. Depending on the timeframe of the overall fund (most existing equitable development funds are structured for a 10 year term) and how quickly the loans get repaid, the fund could revolve two to three times over approximately one decade.

Appendix 3 shows an example of how a series of loans might be made from the REDI Fund during a 10 year period. Assuming a $25 million fund, the revolving nature of the fund could...
result in $50-$75 million in loans actually made. A $5 million public investment in the first tier could leverage $40 million to $60 million in private capital over the life of the fund.

Figure 2: Revolving Loan Structure

2.2 – Lessons from TOD Funds in other Regions

Several other metropolitan regions in the country have adopted TOD equitable development funds or other acquisition funds that are often used for TOD projects. Experience with each of these funds provides lessons for the central Puget Sound region in how to design and implement a fund to most effectively mitigate risk, attract new capital, and provide a needed financing tool for developers. Two existing funds—in Denver and the San Francisco Bay Area—are particularly instructive for the design of a fund in this region and provide different models for the all-important public catalyst investment that makes a fund possible.

Denver Transit Oriented Development Fund

The $15 million Denver Transit Oriented Development Fund was created with seed capital assembled in phases from the City of Denver, Enterprise Community Loan Fund, the State of Colorado Housing Finance Agency (HFA), and a coalition of foundations, banks, and CDFIs. The fund is now in its third year and has resulted in a pipeline of over 600 homes and several community facilities, with the first project completed and several others progressing through the development process. The Denver region is important as a model for the Seattle region
because of its comparable size and results achieved in a resource-constrained environment. The Denver fund has fully disbursed and is beginning to revolve.

The Denver TOD Fund is not a stand-alone entity; it is structured around a Revolving Credit Agreement (RCA) between all the public, foundation, and bank funders as well as with the sole borrower, the Urban Land Conservancy (ULC). ULC currently purchases all the properties financed by the Denver TOD Fund, and then resells them to affordable housing developers over time. ULC will often act as a master developer by helping to advance sites through the beginning stages of development before reselling them. This structure works in part because of the financial capacity and organizational strength of ULC. The fund is currently being expanded from a $15 million fund limited to the City of Denver to a $30 million regional fund, with additional funding from foundations, government agencies (including state agencies), and banks.

Figure 3 below shows how the fund is structured: the First Tier capital is provided by the City of Denver (and will be provided by the State Housing Finance Agency for the projects outside the City when the fund expands to $30 million); the Second and Third Tiers are provided by Foundations, Enterprise, and other public agencies. The Senior Capital is provided by banks and CDFIs. These sources total $13.5 million, and the remaining $1.5 million is ULC’s portion, for a total of $15 million.

The Revolving Credit Agreement governs the process of how funds are actually lent. Enterprise acts as the fund manager and holds the funds for a number of the capital sources, with the remaining funds provided when individual transactions close. Enterprise underwrites, closes, and manages all of the loans, and an Oversight Committee monitors and directs the operation of the fund.
Figure 3: Denver TOD Fund

Bay Area Transit Oriented Affordable Housing Fund

The $50 million Bay Area Transit Oriented Affordable Housing (TOAH) Fund was created in 2011 with seed capital from the Metropolitan Transportation Commission (MTC), which is the regional Metropolitan Planning Organization (MPO), and a network of foundations, banks, and CDFIs. This effort enables affordable housing and community facility developers to acquire sites across the highly competitive San Francisco Bay Area. The Bay Area region is important as a comparable case study for a central Puget Sound region fund because of its proximity, the larger regional aspect of the Fund, and the innovative leadership of a regional agency in seeding the effort. The TOAH Fund has disbursed about $27 million to date for projects containing over 700 affordable units, 135 market-rate units, and a mix of community facility and retail spaces. The TOAH Fund currently has a pipeline of about $8.3 million in loans that will result in about 200 additional units.

The TOAH Fund is a stand-alone corporate entity with six Community Development Financial Institutions (CDFIs) acting jointly as fund manager, and one of them, the Low-Income Investment Fund, acting as administrative agent. There is an overall Credit Agreement (CA) between all the public, foundation, and bank funders that governs the operations of the TOAH Fund and its lending activities. Any non-profit or for-profit entity can apply for a loan from the
TOAH Fund, and any of the six CDFIs can underwrite a loan. An oversight loan committee must approve each transaction.

Figure 4 below shows how the fund is structured. The First Tier capital is provided by the MTC. The Second and Third Tiers are provided by local and national foundations and the six CDFIs (including Enterprise, The Low-Income Investment Fund, and LISC, the national affiliate of Impact Capital). The Senior Capital is provided by the banks Morgan Stanley and City Community Capital. The regional agency is in the process of increasing its public investment from $10 million to $20 million, which will allow the overall fund size to double with the leverage of additional private capital.

**Figure 4: Transit Oriented Affordable Housing Fund**

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**Other Funds**

Property acquisition funds for equitable development are also in operation in New York, Los Angeles, Washington DC, and Phoenix. While these funds are not specifically focused on TOD development, many of the funded projects are TOD projects. Each of these funds is structured slightly differently, but they all have the basic structure noted above, and they rely on seed capital provided by public agencies. Several other metropolitan areas, including Atlanta, Chicago, and Boston, are currently exploring or implementing TOD funds similar to the funds in place in Denver and the Bay Area.

While not specifically pursuing a leveraged TOD fund at this point, the MPOs of Atlanta and Sacramento are in the process of investigating how they might use their resources to support land acquisition and other community development efforts around transit.
3 – REDI Fund

Section 3 of this document addresses the parameters that will define the structure, operations, and activities of the REDI Fund. Recommended approaches related to each aspect of the fund are based on lessons learned from existing funds, interviews with regional stakeholders, and the expertise that Enterprise Community Loan Fund and Impact Capital bring to this project. The actual adopted parameters of the fund will have to be worked out in more detail by the public and private investors in the REDI Fund and implemented through formal agreement.

As a starting point, the investors and public agencies with oversight of the REDI Fund should adopt a clear statement of the overarching mission guiding this initiative. The following proposed mission statement is based on input from the TOD Fund Subcommittee:

The mission of the Regional Equitable Development Initiative Fund is to promote equitable transit communities throughout the central Puget Sound region through strategic property acquisition lending that supports the development and preservation of housing and community facilities that meet the needs of low-income households and are located within walking distance of high-capacity transit services and stations.

3.1 – REDI Fund: Uses and Products

The REDI Fund is designed to strategically deploy capital to achieve equitable development outcomes in transit communities. The two primary products the fund will offer are acquisition loans and mini-permanent (“mini-perm”) loans. Several specific types of activities may be financed. The eventual project types and target affordability levels will be determined by the funders, and the final business plan will need to define more completely the REDI Fund terms. Across the entire fund portfolio, the mix of project types for which loans are made will also have to achieve a sustainable balance of risk, loan term, and geographic balance across submarkets. As an illustration, Appendix 2 provides more detail on several hypothetical loan scenarios.

Activity: Preservation of Affordable Rental Housing Units

Property acquisition for the purposes of preservation will enable the purchase of (1) buildings where the existing market rate housing is affordable to low income households but is expected to increase, or (2) projects with expiring rental subsidies and affordability agreements that could be renewed (such as Section 8 contracts). In both cases, the objective of acquisition would be to ensure the long-term affordability of those units for households earning 80% of AMI or lower, depending on local needs which will vary across the region. Revenue generating projects may be held for a period of time while other financing is assembled. The REDI Fund will likely need a portion of its portfolio to be cash-flowing projects. This will allow for greater risk to be taken on the land banking of vacant parcels.
Activity: New Construction of Affordable Rental Housing
Property acquisition for the purposes of new housing development will enable affordable-only rental projects to locate within walking distance of transit. Developers will be better able to compete for sites in desirable markets or in locations where values have escalated in anticipation of new transit infrastructure. Properties will include existing vacant land along with redevelopable sites. Land may be developed in the near term or banked for future development. Units would be affordable to households earning 80% of AMI or lower, depending on local market conditions, affordable housing needs, and conditions associated with existing available subsidies. The TOD Fund Subcommittee recommended that a rental project provide a minimum of 50% of the units set-aside for households earning 60% of AMI or below.

Activity: New Construction of Affordable For-Sale Housing
Property acquisition for new housing development could also include for-sale units that are priced below market rate for households earning up to 100% of AMI. This affordability threshold was not discussed in-depth by the committee, and should be studied further to ensure alignment with below market needs.

Activity: New Construction of Mixed Income Housing
Property acquisition for new housing development could also include mixed-income housing. Lending criteria, when finalized, should indicate desired mix of unit types and affordability levels in such projects. The TOD Fund Subcommittee recommended that a mixed income rental project provide a minimum of 50% of the units set-aside for households earning 60% of AMI or below. In practice, the fund will need to balance flexibility on project mix with ensuring equitable development.

The research and assessment process for the REDI Fund identified several clear gaps in the acquisition financing spectrum for affordable housing, a mature industry relatively well organized around a series of consistent permanent financing sources. In addition, stakeholders in the development of the REDI Fund proposal have emphasized a range of additional needs in the non-housing activities of equitable TOD. The final form of the REDI fund could allow a portion of the loans from the fund to be made to selected non-housing uses. Those funding activities may include the following:

Potential Activity: Construction and Preservation of Community Facilities
The REDI Fund could be made available to provide financial assistance for development of selected community facilities that serve the needs of low-income residents of transit communities. These facilities could include health clinics, community centers, educational and job training centers, and day care. Depending on available capital, a fund could also provide 5-10 year term loans for operating community facilities, such as
health clinics or daycare. This could include both acquisition loans and mini-perm loans, and could include New Markets Tax Credit leveraged loans.

**Potential Activity: Construction and Preservation of Affordable Commercial Space for Existing and New Local Small Businesses**

The REDI Fund may also be used to provide financing for retail space, which may be a key component of mixed-use TOD, targeting communities where small local-serving and/or culturally specific businesses are threatened with displacement. Mini-perm loans can be an effective way to provide capital for retail space to meet these needs. There would likely be limitations on the ability of a TOD Fund to originate small business loans; any potential loans would likely need to be real-estate based and not direct business loans. The Fund would likely need to work with Craft 3, Rainier Valley CDF, and other small business lenders on any small business loans. A fund could potentially participate with a small business lender by providing lower cost capital than typically provided by small business lenders.

Different parts of the region will have different community needs and market conditions, so the stated fund priorities and products offered will need to be flexible. The mix of loans that are actually made over time will depend on a number of factors. One is the range of project types applying for loans. On a case by case basis, loans will need to be underwritten based on the strength of the project, public funder support, organization, and site. Private funders will likely want the fund to be diversified in terms of types of projects, location, and acquisition of vacant land versus operating properties. Finally, interest payments will likely need to be made on most loans, so cash-flowing preservation projects will be easier to finance than vacant land.

**3.2 – REDI Fund: Eligible Project Locations**

**Transit Communities**

Projects eligible for financing assistance from the REDI Fund will be located within “transit communities” as defined by the public and private investors. The Growing Transit Communities process has identified several key parameters of that definition.

First, qualifying transit types should include multiple modes of high-capacity transit, including light rail, commuter rail, streetcar, ferries, bus rapid transit, and other transit nodes with frequent all-day service. Whatever the mode, service levels should be sufficient to anchor TOD investments and to provide strong connectivity to regional centers of employment, education, and services.

Second, the boundaries of the transit community will generally be defined by the estimated 10-minute walk distance to the transit station or stop. In establishing final REDI Fund eligibility
requirements, consideration should be given to adjustments to the boundary based on transit mode, service level, topography, or adjacency to other facilities. A regional agency, such as the PSRC or transit agencies could assist in creating and updating maps of the eligible transit communities within the region.

Regional Coverage
The TOD Fund Subcommittee, along with the Growing Transit Communities Partnership as a whole, has set as a goal for the REDI Fund to provide coverage to transit communities throughout the four-county region (King, Kitsap, Pierce, and Snohomish). Actual geographic coverage will depend on the jurisdictional boundaries of the public agencies providing seed capital, along with the policy direction from those agencies in setting final guidelines for the REDI Fund business plan. Regional coverage is most easily achieved with a public investment from a regional agency, such as PSRC. Other models that may be able to achieve regional coverage would include state and/or multi-county investment in the fund. Even if full regional coverage is not possible, the public investment assembled to establish the fund will have as a guiding principle achieving as broad a geographic coverage within the region as is feasible.

As loans are made for projects located within the defined regional coverage area, balance among sub-areas of the region will be a guiding principle. However, individual loans will still need to be underwritten based on the strength of the project, public funder support, organization, and site. As well, lending will be targeted to locations where a demonstrated need and priority for affordable housing production and/or preservation has been identified.

3.3 – REDI Fund: Eligible Borrowers
All the investors will need to agree on what developers will be eligible to borrower from the REDI Fund, but each borrower must also be underwritten (based on analysis of audits, strength of staff, performance of existing properties, experience in developing projects, borrowing history, etc.). Several models are available for what kind of borrower would be eligible for loans awarded by the REDI Fund.

Sole Borrower or Select Group of Borrowers
An equitable development fund could limit its lending to one or a selected handful of organizations. The sole borrower or borrowers must have strong organizational and financial capacity. The Denver TOD Fund, where the Urban Land Conservancy is the sole recipient of fund loans, is one example of this approach. The benefits of this model include:

- Ability to work closely with a trusted partner or partners
- Streamlined underwriting and closing
- More flexibility with developers
• A strong entity is able to hold property during periods of funding uncertainty
• A strong borrower can more easily act as master developer, taking on land assembly, entitlement, and master planning prior to selling it to the project developer

There are potential downsides to this model, however, that include:

• Use of the fund may be limited by the borrower’s organizational and financial capacity and geography
• One or a few organizations can exercise effective monopoly on the activities of the fund
• Risk that the borrower or borrowers will alter their mission or otherwise be unstable over time

No Restriction on Eligibility
As an alternative model, an equitable development fund can also be made available to any non-profit, for-profit, or joint venture entity. Funds in the San Francisco Bay Area, Los Angeles, and New York have adopted this approach to lending. As with the restricted approach, there are pros and cons. Having multiple and more varied borrowers allows for a greater range of development types financed, a greater variety of partnerships supported, and potentially a larger fund available over a larger geography. However, where each transaction may be with a different entity, the fund must deal with greater complexity in underwriting each loan. In addition, monitoring becomes more important to ensure that the fund is used to achieve the desired equitable development outcomes.

Allowing for-profit borrowers would likely require more oversight to ensure equitable development, and might require a regulatory agreement, but could allow for larger mixed-income developments. Joint ventures between non-profits and for-profits could also allow for equitable development to be part of a larger development, with the necessary oversight being dependent on the non-profit’s level of control over the project.

Non-Profit Only
A variant of the unrestricted eligibility model is a fund that is available to any non-profit entity and where for-profit developers would be ineligible. This model has many of the benefits of the previous model, with some key differences. On the plus side, working solely with non-profit developers means there is more certainty of equitable development outcomes. However, because of the limits on the scale of development and types of project that would be feasible for many non-profit developers, this approach may limit the size and range of types of projects that are funded.
Recommended Approach: Open Eligibility for Strong Borrowers
Ideally, the REDI fund would be open to all borrowers that demonstrate robust staff capacity and development experience in projects similar to those proposed, and the financial health to balance the risk of long term land holding. There are a core group of organizations in the region that have been identified as potential willing holders of property, and that meet these criteria. Establishing a process for prequalification would streamline lending to this core group.

For other borrowers that need to joint venture to meet the capacity criteria, the REDI Fund manager would underwrite borrowers as they apply based on the factors listed above. The fund manager could also advise smaller organizations on structuring acceptable joint venture partnerships. This approach would allow a group of exceptionally qualified borrowers to play a large role in use of the fund, while still providing new opportunities for smaller groups.

3.4 – REDI Fund: Structure
The TOD fund structure is the organizational framework by which dollars flow between investors and projects, and the roles, responsibilities and legal structure of the fund are defined. In practice, no two fund structures are exactly alike. Several different fund structure options are available for the REDI Fund to draw from.

Stand-Alone Structured Style of Fund
In this model, a separate corporate LLC entity acts as the lending entity. All funds typically flow through the fund and a fund manager is hired to administer the operations. The San Francisco Bay Area, Los Angeles, and New York City have all adopted a stand-alone fund structure.

A stand-alone fund has the benefit of more readily attracting capital by meeting the needs of public and national funders. The dedicated loan fund entity adds to the perception of security and certainty for investors. In addition, a stand-alone fund may be more appropriate for a larger fund because of the complexity involved in coordinating multiple funding sources.

The main disadvantage of the stand-alone model is primarily the relatively high cost of start-up. Some funders find the structure too costly in terms of overhead. Because it involves creating and maintaining a distinct legal entity, it can also be more cumbersome for the fund administrator than the participation structure, discussed below. This model is also somewhat less conducive to scaling up in the event additional catalytic capital is identified.

Participation Structured Style of Fund
In a participation structure, funds flow through the fund manager, which holds the funds on its balance sheet and then lends the funds directly to developers. Funds can flow to the fund manager when the fund is established, or funds can be provided prior to individual loan
closings. Underwriting is performed by an entity designated by the fund investors. This structure allows many CDFIs to collaborate to finance projects, while still having one designated CDFI acting as the underwriter and fund manager. If a funding source wanted to provide funds directly to the borrower, and not have the funds flow through a fund manager, then the transactions would be more complicated but could be accommodated.

Costs of setting up and maintaining the participation structure are lower than with the stand-alone structure. Because it is simpler, the participation structure is also easier to start up and easier to scale up as more capital becomes available. The key challenge of the participation structure is that investors may require a stand-alone structure due to general preference, internal bylaws, or financial regulations (depending on the specific legal structure of the investors).

**Recommended Approach to Fund Structure**

The ultimate fund structure adopted for this region, including the roles for and relationship between the various parties, will be negotiated by the actual investors and thus cannot be fully detailed here. To date, feedback from foundations and banks suggest that a stand-alone structured fund would be a more successful model with which to attract outside capital. In practice, a stand-alone fund would likely entail foundations and banks providing funds as each individual transaction closes. First tier capital would likely be held by the fund manager or another third party. Any additional start-up costs that may result from the stand-alone approach could be offset by grant dollars.

**3.5 – REDI Fund: Size of Fund**

**Factors in Setting Fund Size**

The overall size of the REDI Fund will be determined by several key factors, including economies of scale and administrative costs, the size of the public catalyst investment, the amount of capital from mission investors, and the supply of take-out financing.

Mission investors, while abundant in support for innovative programs like this that provide strong leverage to their dollars, are a finite resource and will not want to commit more investment than they are certain can be effectively utilized. One factor that will guide those investment decisions is the size of the permanent financing that will subsidize the ultimate development of these projects. While the intent of the fund is to hold key sites for a longer period than is possible with many of the current interim acquisition resources, there is a limit to the number of sites that can be prudently added to the development pipeline given the permanent financing available at any one time.
Based on these factors, the following parameters are recommended to guide decisions about how large of a fund to initiate and work toward within the central Puget Sound region:

<table>
<thead>
<tr>
<th>Fund Size</th>
<th>Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum: $10-$15 million</td>
<td>This is the minimum fund size to offset the fixed costs of administering the fund</td>
</tr>
<tr>
<td>Proposed: $25 million</td>
<td>A fund of this size would be large enough to provide multiple loans that could be distributed across the region and range of project needs. The fund could be further expanded as additional catalytic capital becomes available.</td>
</tr>
<tr>
<td>Estimated Demand $60 million</td>
<td>This is the estimated fund size based on projected project demand in TOD locations. The fund size needed to meet potential demand would increase if the amount of permanent financing increases, the share of permanent financing shifts to prioritize transit oriented projects, or more TOD sites require acquisition financing.</td>
</tr>
</tbody>
</table>

With any fund, there is a lower limit to the size of the fund to achieve necessary efficiencies and reasonable costs. For this region, that minimum fund size is approximately $10 million to $15 million. A fund smaller than approximately $10 million would simply produce too few projects to be considered a viable pilot and make too few loans to cover the administration and overhead.

The proposed initial REDI Fund size of $25 million would achieve the necessary efficiencies while only needing a modest amount of catalytic capital (about $5 million) to seed the fund. As well, with the regional interest and demonstrated needs for an equitable development fund, $25 million at start up would be large enough to provide lending across a full range of locations and housing types. A fund of $20-25 million is a scale that could justify the cost of the funds, achieve proof of concept, and most critically have enough capital to address the size of loans needed in the market.

Once the fund is established and successfully deployed to fund projects, the model described in this paper would allow for gradual ramping up of both public and private investment to meet identified unmet market demand with capacity to utilize a larger fund. If demand for loans is high, and adequate permanent financing is available, the REDI Fund could attract other resources and scale-up in size. A PSRC analysis (see white paper - A Regional TOD Fund: Ensuring that Transit Communities Grow Equitably) has estimated a potential fund size of $60 million based on a percentage of the TOD projects funded by public funders over the past five years.

The availability of the permanent financing that will ultimately be the source of repayment of these loan is also a consideration. Permanent financing and principal repayment is discussed in section 3.8.
3.6 – REDI Fund: Management and Oversight

Management
Property acquisition funds are typically administered by an outside fund manager. The fund manager will work with developers and other industry partners to identify opportunities, underwrite the individual loans, and manage the overall fund. The fund manager is typically a private sector lending entity and not a public agency. The fund manager typically has experience managing other funds, aggregating capital into a single lending initiative, and managing a portfolio of existing loans. Depending on the final fund structure, the fund manager will often hold funds on its balance sheet. For this reason, private funders will want the fund manager to have sufficient financial strength. There are two options for the type of private entity that may serve as the fund manager:

1) CDFI Fund Manager: CDFIs already manage funds, underwrite loans, and manage portfolios, so acting as a fund manager is an extension of their existing activities. Enterprise, LISC, and the Low-Income Investment Fund currently act as fund managers for a range of funds, and would have the expertise and financial strength. In order to cover costs, a CDFI fund manager would likely charge a loan servicing and fund management fee.

2) Fund Management Firm: There are options for third party fund management by firms that specialize in coordinating more complicated fund structures such as exist in New York and Los Angeles. This type of fund manager may be better able to attract capital from investors that want multiple levels of oversight. A fund structure that incorporates these tiers of oversight can potentially increase the operating cost of the fund.

Oversight
The oversight or governance of the REDI Fund will likely take two forms: an Oversight Committee that oversees the fund activity, and a Credit Agreement between all the public and private funders directing the activity of the fund and fund manager.

The Oversight Committee should include stakeholders from advocacy, housing development, and public agencies and jurisdictions within the lending area, and will need to have representatives from the investor entities (investors may want to have a role on the oversight committee or on a credit committee). The responsibilities of the Oversight Committee would be to:

• Establish the REDI Fund priorities
• Meet annually to oversee fund activity
• Depending on the ultimate fund structure, the funders may want to have a smaller ‘Loan Committee’ that meets monthly or even more frequently to approve loan requests
• Evaluate REDI Fund activity and advise on changes to fund priorities and structure

The Credit Agreement will specifically lay out all of the terms of the overall REDI Fund as well as the terms for individual loans, and will be executed by all the investors as well as the fund manager. The Agreement will also detail:

• The roles and responsibilities of the fund manager and investors
• The amounts and terms that each investor will provide
• The process by which the funds will flow (e.g., will the fund manager hold those funds or will the investor provide them when individual transactions close)
• Eligible borrowers
• Geography of lending activity, including eligible TOD locations and principles of regional balance in lending

3.7 – REDI Fund: Terms and Underwriting
The REDI Fund will be a revolving loan fund, and each loan is fully expected to be paid back by the borrower. Each loan will be underwritten and then have an executed loan agreement, promissory note, and deed of trust that will specify the terms for that specific loan. The exact terms (interest rate, length of loan, etc.) for each loan may differ somewhat, but the overall loan term parameters for the REDI Fund will be established up front. While designed to meet the financing needs of equitable TOD developers, the parameters for the REDI Fund also will be determined by the risk tolerance of all the investors, as well as the cost and time limit on the capital that they can provide.

Interest Rate
The REDI Fund will offer loans at a rate of interest that is affordable to equitable TOD developers and lower than many of existing loan products from CDFIs and private lenders. While a target rate as close to 3.5% as possible is ideal, based on current capital markets and the cost of operating a fund, a rate closer to 4.5% is more likely assuming the three investor tiers described above. If more capital can be raised from public and philanthropic sources, or if capital market conditions were to shift, the overall rate would likely be lower than 4.5%. The actual rate of interest that the REDI Fund is able to offer, and whether is it fixed or floating, will reflect a blend of the rates of return of the major sources of capital that create the fund. The most important factor in setting fund interest rate is the degree of success in attracting capital sources with a 0%-2% rate of return.
Interest Payment

Even at a low rate, the holding costs of properties acquired using the REDI Fund could be significant. A $5 million loan at 4.5% interest would require $225,000 in annual interest payments. Several options exist for assisting the borrowers in managing the cost. The REDI Fund will incorporate one or more of the following options:

• Include an interest reserve. A number of funds require that interest reserves be built in. Since loan LTVs (Loan-to-Value: ratio of loan amount to value of the property) can often go above 100% in acquisition fund structures, a loan could be made at higher than 100% LTV in order to include the reserve.
• Focus some portion of loans on operating properties so that cash flow can pay all or part of the debt service. Acquisition of operating residential or commercial properties for shorter-term holds (2-4 years) allows for cash flow during the hold period prior to preservation as long-term affordable units.
• Require the borrower to make interest payments. This would require borrowers to demonstrate strong cash flow from other assets and consistent profitability in their business operations.

Term

Loans will be awarded for varying terms, depending on the type of project, development timeline, and take-out financing. A recommended maximum loan term for the REDI Fund is five years. Capping the initial loan term would enhance the urgency to move projects forward. Loans could still be extended, on an as needed basis, to meet the needs of projects with longer timelines and projects where market conditions favor site acquisition very early in the station area development process.

Collateral

Collateral on a REDI Fund loan would be secured by a first position Deed of Trust. This ensures that the fund could, as a last resort, look to the sale of the property to repay the loan. The value of the property at the time of sale will be verified by appraisal. It should be noted here that the stability of the value of the collateral will vary by the strength of the specific locations and station areas where acquisition loans are made. This trade off should be kept in mind as public funders consider any geographic or project type constraints that they might place on the loans made from the fund.

Underwriting by the fund manager will also require an appraisal that justifies the sale price, Phase I environmental report, and additional due diligence as needed. These are industry standard practices in both community development and market rate lending.
Recourse/Guarantees
The recourse and guarantee requirements mean that the borrower is still responsible for full loan repayment regardless of whether the project moves forward and/or the borrower has to sell the property for less than they paid. Most CDFI acquisition bridge loans for unfunded projects require full recourse or a full guarantee. Different TOD funds have different requirements. The Denver Fund has a 50% recourse requirement. In Los Angeles, loans to non-profits are 25% recourse but loans to for-profits are 100% recourse. Depending on the terms of the capital sources, the REDI Fund may be able to have lower guarantee and recourse requirements. Not surprisingly, the majority of potential borrowers surveyed expressed a strong preference for lower recourse requirements.

Loan-to-Value Ratio
Loan-to-Value (LTV) is the ratio of loan amount to the appraised value of the property. Typically lending restricts the LTV to below 80%, but acquisition funds will often allow LTVs 90% or higher. The recommended LTV of 100% would allow borrowers to acquire larger sites and existing projects without a massive equity burden. Not requiring equity for acquisition also frees up developer’s capital to finance predevelopment costs without needing a second debt source. The ultimate LTV of the fund will have to be negotiated among investors at all three tiers.

Underwriting
The underwriting of each potential loan made by the REDI Fund will need to address three main factors:

1. Strength of borrower, including but not limited to net assets, liquidity, strength of organizational cash flow, development experience, and asset management capacity
2. Quality of site, including but not limited to proximity to transit, adjacent uses, strength of market, parcel shape, and topography
3. Likelihood that the loan will be repaid by permanent funding sources, including but not limited to track record of borrower, similar projects in development, and stated priorities of permanent funders

Even though the loan may not be paid back for 5 years, the borrower will need to present multiple feasible financing scenarios. These scenarios may change, and the eventual structure may be different, but there needs to be some analysis at the acquisition stage.

Some funds have a single entity underwriting all loans, while others allow multiple CDFIs to originate, underwrite and approve loans. Some funds such as the funds in the San Francisco Bay Area, New York, and Los Angeles, require additional oversight committee review and approval.
The recommendation for the REDI Fund is to have the fund manager originate and underwrite the loans, subject to the approval of the oversight committee loan subcommittee.

3.8 – REDI Fund: Principal Repayment
During the term of an acquisition loan, borrowers will develop the program and project design, secure any necessary entitlements, and assemble construction and permanent financing. The eventual take-out financing that could pay back the REDI Fund loans would likely include a mix of local, state, and federal resources, as well as private financing for mixed-use and mixed-income developments. Given the current budget uncertainties at all levels of government, the available public take-out financing over the next five to ten years cannot be projected with certainty. (The current state of the public subsidy sources is summarized in Appendix 4.) To mitigate that uncertainty, potential for repayment will be assessed in making each loan as a core piece of the underwriting. Additionally, because the fund has been proposed as a $25M pilot, rather than the $60M concluded in the need assessment described in Section 3.6, availability of take-out financing should not be a barrier to utilizing the REDI Fund.

As projects start construction, loans will be repaid to the fund. These funds will revolve to new projects until a set point when no new loans will be made closer to the end of the likely 10-year life of the fund. At that point, assuming the seed loan isn’t extended or converted to a grant, the fund stops lending and re-accumulates original capital pool to repay the investors.

Over the 10-year life of the fund, permanent financing levels and policy priorities may change. Funding for affordable housing overall may decline. Funding at existing levels may be increasingly targeted as a matter of policy toward TOD sites. Development plans for properties financed by this fund will need to change accordingly. This may affect the total number of units built, the affordability levels of those units, and the share of market rate units, among other things. Given the long loan terms, it is critical that this fund retain the flexibility to allow projects to evolve with policy priorities.

If no take-out financing is available, the last option to repay the loan principal is to sell a property on the open market for market rate development. Given this possibility, it is critical that the fund requirements not be overly restrictive. Greater flexibility will allow the property holder to respond to market conditions and changes in available capital to finance projects.

4 – Implementation Strategy and Next Steps
The establishment of an acquisition fund can be a lengthy and iterative process. The process of identifying lenders, negotiating priorities, and reaching consensus is convoluted and non-linear. One of the aspects that makes it particularly unpredictable is that each new investor has
influence on the subsequent stages of the process. Even after all the funding sources have been identified, it can take up to 12 months to hire a fund manager, get investor approvals, and negotiate the program details and the Credit Agreement itself.

Based on the experience of TOD funds that have been created to date in other regions, the following is a general framework of how the final steps in REDI Fund creation may transpire.

STEP ONE: SECURE COMMITMENT OF PUBLIC CATALYST INVESTMENT

Because the public investment plays a catalytic role in seeding the fund, securing this capital must be the first step in creating the REDI Fund. As first tier capital with “top loss” status, the public investment enables the lower tiers and attracts substantial capital from foundations, mission investors, and banks. The size of the public catalyst investment is crucial in determining the size of the fund, and must be secured before any subsequent private capital can be pursued in earnest.

The public agencies that contribute to the REDI Fund will determine its broad priorities. Once consensus is reached on those elements, the conditional commitment of public funds can be made contingent on a desired leverage rate (typically 3:1 to 4:1) of outside investment, along with any geographic or project type set-asides. The latter should be limited to those absolutely necessary, since set-asides that are difficult to achieve (alone or in combination) may scare off subsequent investors.

STEP TWO: SELECT FUND MANAGER

Once the public investment has been secured, a fund manager can be selected to raise the private capital and formally structure the fund. Selection is typically a competitive process to identify the entity with the combination of fund management and lending experience, financial capacity and financing relationships to secure the outside investors and be a strong long-term steward of the REDI Fund.

A fund manager could be selected before the fund commitments are final to review the commitment language for any potential issues. For budgeting purposes, the cost to raise the other tiers of capital and close the fund have been estimated at between $100,000 and $500,000, depending on the fund size and structure and the number of financing sources. The largest expenses will likely be the legal costs associated with setting up and closing a fund. These costs can be covered through a combination of philanthropic capital, public contributions, and existing grants resources held by the selected fund manager.

STEP THREE: SECURE CAPITAL COMMITMENTS FROM OTHER FUNDERS
One of the initial functions of the fund manager will be to take on the lead role in identifying investors for the second tier and senior tranches. The fund manager will likely come with many relationships to raise capital and will work with others in the region to identify and secure sources of mission driven capital for the intermediate tranche.

Informal conversations to date suggest that there is adequate interest in the fund among various types of investors to raise second/third tier and senior capital.

STEP FOUR: ESTABLISH OVERSIGHT COMMITTEE

Once all of the financing partners have been assembled, the oversight committee structure and representation will be determined by the investors in the fund. This committee will likely be made up of members of the investing organizations and other stakeholders who have the expertise and vested interest to effectively oversee REDI Fund operations. The responsibilities of the committee will include:

- Deciding on fund priorities (both hard set-asides and more general guidance) and final loan terms
- Negotiating the final business plan
- Overseeing the activities of the Fund Manager
- Modifying fund priorities and terms as needed

STEP FIVE: FINAL BUSINESS PLAN AND FUND AGREEMENTS

The final stage of the fund creation process is finalizing the business plan. This stage can be lengthy, and becomes exponentially more difficult as the number of public and private investors increase. The shared agreement will outline all of the terms and details for the fund, including the structure, terms, set asides, and other parameters, and will be the basis for the fund documents that will formally create and “close” the REDI Fund. Once all agreements are final and signed, the fund is ready to lend.

THE URGENCY

This is a unique time in the central Puget Sound region. A robust economy is driving rents higher while at the same time a once-in-a-generation transit expansion provides an opportunity to provide a cost-effective transportation alternative to cash strapped households. The data on increasing rents is clear. Rents in the Seattle Metro Area rose 9.2% in 2013. That is affecting where families can afford to live and in turn driving up their transportation costs and making it harder to access employment opportunities and quality schools.

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While not a perfect proxy, land values are closely tied to rent. As rents continue to rise, so does the value of the scarce sites near transit. The time to invest public funds to ensure equitable access to this new transit infrastructure is while the system is in its infancy, while there are still plenty of developable sites and before market rents drive up demand for the limited supply of real estate near transit. Creating a fund now will allow careful, opportunistic acquisitions to ensure an adequate supply of reasonably priced land in transit served locations for the affordable housing and community facilities that will ensure the future vitality of our growing transit communities.
Appendix 1: TOD Fund Subcommittee Members

Seth Benziger, Impact Capital
Michelle Connor, Forterra
Ryan Curren, City of Seattle
Amber Knox, Bullitt Foundation
Dave Koenig, City of Everett
Dan Landes, Shelter Resources
Jan Laskey, Bank of America
MA Leonard, Enterprise Community Partners
Cheryl Markham, King County
Chris Moxon, Impact Capital
Ian Munce, City of Tacoma
Judith Olsen, Impact Capital
Laurie Olson, City of Seattle Office of Housing
Steve Walker, Washington State Housing Finance Commission
Gary Prince, King County
April Putney, Futurewise
Kelly Rider, King County Housing Development Consortium
Morgan Shook, Berk Consulting
Mark Smith, Housing Consortium of Everett & Snohomish County
Arthur Sullivan, A Regional Coalition for Housing
Skip Swenson, Forterra
Tory Laughlin Taylor, Bellwether Housing
Stephanie Van Dyke, Seattle Housing Authority
Dan Watson, King County Housing Authority
Jeffrey Watson, Imagine Housing
Walter Zisette, Tacoma Housing Authority
### Appendix 2: Sample Eligible TOD Fund Station Areas and Project Types

<table>
<thead>
<tr>
<th>Study Area</th>
<th>Housing Units</th>
<th>Subsidized Units</th>
<th>Existing Land Use</th>
<th>Transit</th>
<th>GTC Approach</th>
<th>Potential Emphasis for REDI Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mountlake Terrace</td>
<td>2,195</td>
<td>-</td>
<td>Suburban town center: SF residential, commercial, recreation</td>
<td>Bus; Light Rail (2023)</td>
<td>Build Urban Places</td>
<td>New affordable housing; Community Facilities</td>
</tr>
<tr>
<td>Tacoma Dome</td>
<td>1,033</td>
<td>-</td>
<td>Underutilized city center: commercial, light industrial, civic and entertainment</td>
<td>Streetcar; Commuter Rail; Bus</td>
<td>Stimulate Demand</td>
<td>Mixed income housing; community facilities</td>
</tr>
<tr>
<td>Othello</td>
<td>3,258</td>
<td>889</td>
<td>Center city neighborhood: SF residential, multifamily &amp; commercial corridors</td>
<td>Light Rail; Bus</td>
<td>Protect and Grow</td>
<td>New affordable housing; Mixed-income housing; Affordable Housing Preservation;</td>
</tr>
<tr>
<td>Roosevelt</td>
<td>5,018</td>
<td>223</td>
<td>Center city neighborhood: SF residential, multifamily &amp; commercial corridors</td>
<td>Bus; Light Rail (2021)</td>
<td>Improve Access</td>
<td>New affordable housing</td>
</tr>
<tr>
<td>130th Avenue</td>
<td>1,001</td>
<td>8</td>
<td>Suburban mixed commercial – industrial corridor</td>
<td>Bus; Light Rail (2023)</td>
<td>Transform and Diversify</td>
<td>New affordable housing</td>
</tr>
<tr>
<td>Bremerton</td>
<td>1,096</td>
<td>558</td>
<td>Mixed-use suburban center</td>
<td>Ferry; Bus</td>
<td>NA</td>
<td>Mixed income Housing; Community facilities</td>
</tr>
</tbody>
</table>

The table above shows a sample of the station areas in the region. These are intended to be representative, though not exhaustive, of the different types of loans that could be made from the fund based on market conditions and opportunities that arise.
The most common loan scenarios are detailed below:

**Scenario 1: New Affordable Housing**

In a scenario like this, a site comes on the market at one of the station areas that could accommodate roughly 65 units of new housing. The development team illustrates that they have a few viable financing options for an entirely affordable project. Borrower purchases the vacant site for $2,000,000 for a 5-year term at 4.5% interest. The project is developed in a single phase in year six:

- **Loan amount:** $1,800,000
- **LTV:** 90%
- **Borrower equity payment:** $200,000
- **Closing costs:** $40,000
- **Annual interest payments:** $81,000
- **Total interest payments:** $405,000

Borrower would need to pay $240,000 at closing as well as $81,000 in interest payments per year. If the LTV can be increased to 110% LTV in order to capitalize an interest reserve (LTV is above 100% in some funds in order to allow for an interest reserve), Borrower would need to start paying interest in year four.

**Scenario 2: Affordable Housing Preservation**

A 50-unit apartment building comes on the market that currently has affordable rents, despite not being subsidized. The development team illustrates that the project has a few viable options for being rehabbed and refinanced. The project is purchased for $5,000,000 for a 5-year term at 4.5% interest. The project is rehabbed and refinanced in a single phase in year six:

- **Loan amount:** $4,750,000
- **LTV:** 100%
- **Borrower equity payment:** $250,000
- **Closing costs:** $90,000
- **Annual interest payments:** $213,750
Total interest payments: $1,068,750

Borrower would need to pay $340,000 at closing as well as $213,750 in interest payments per year. Assuming all 50 units are 1-bedroom units restricted at 60% AMI for King County (with $100 utility allowance), expenses are $5,000 per unit, and vacancy is at 5%, the project would have net cash flow of $30,260 and a DCR of 1.14. The Borrower would not need to come out of pocket for interest payments.

**Example 3: Mixed Income Housing**

A large vacant site comes available that is a good candidate for catalytic mixed income development. The development team illustrates that there are a few viable options for dividing the site into a multiple phases with a mix of uses and levels of housing affordability. The site is purchased for $12,000,000 for a 5-year term at 4.5% interest; the project is developed in four phases from years two through six:

- **Loan amount:** $10,800,000
- **Closing costs:** $125,000
- **LTV:** 90%
- **Borrower equity payment:** $1,200,000
- **Annual interest payments:** $70,000
- **Total interest payments:** $1,458,000

Borrower would need to pay $1,325,000 at closing as well as annual interest payments that start at $486,000 per year and decline to $97,200 per year prior to the last phase being developed. *If the LTV can be increased to 100% LTV in order to capitalize an interest reserve, Borrower would need to start paying interest in year four.*

**Example 4: Neighborhood Health Clinic**

A non-profit Federally Qualified Health Center (FQHC) wants to build a new health clinic on a vacant site that it already owns, and has raised $5 million in grant funds, as well as securing an allocation of New Markets Tax Credits (NMTC). It needs a $3 million 7-year term loan to match the 7-year NMTC credit period, and a $1 million bridge loan for some of the grant awards that
are provided after construction starts. The 6% interest is higher than other loans because of the longer loan period:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan amount:</td>
<td>$4,000,000</td>
</tr>
<tr>
<td>Closing costs:</td>
<td>$125,000</td>
</tr>
<tr>
<td>LTV:</td>
<td>80%</td>
</tr>
<tr>
<td>Repayment:</td>
<td>$1,000,000 from grants during construction</td>
</tr>
<tr>
<td></td>
<td>Partially amortizing payments during 7-year period (funded from clinic operations)</td>
</tr>
<tr>
<td></td>
<td>Refinance at end of year 7 or remaining loan balance</td>
</tr>
</tbody>
</table>