Overcoming Risks and Issues in Using HUD 108 to fill a gap in a Private Development Project – Montgomery Park

Background – Northeast-Midwest Institute highlights brownfields projects that can serve as models for replication. In this case Montgomery Park serves as a model using a HUD 108 loan to fill a gap in a private development project. When HUD 108 is used to finance a speculative real estate project, there is a risk that, if the project defaults, the City's CDBG funds are jeopardized. Baltimore went to extraordinary lengths to assure that that scenario was not a possibility. The project also serves as a model for green/sustainable redevelopment of a brownfields site.

Baltimore Development Corporation (BDC), Baltimore's quasi-public economic development agency, envisioned Montgomery Park as having the potential to attract office tenants which the City was mostly losing to the suburbs. Thus, BDC became active in facilitating the project and in securing incentives.

Montgomery Park, typical of many urban redevelopment/brownfields projects, faced a financing gap:

- Steep upfront costs – for cleanup, building systems, roof – had to be undertaken to bring the project to the point of marketability. Developer did not have deep pockets.
- Lenders needed committed tenants and/or other financing sources in a subordinate position.
- Gap estimated @ $8 million **-** local and state funding sources were not of the magnitude to cover the gap.
- Higher cost "mezzanine financing" sources would have added costs that the project could not absorb.

HUD 108 fills the bill because:

- Sufficient size;
- Terms – interest rate is favorable, esp. compared to high rate mezzanine sources; interest-only for five years allows slow lease-up;
- Subordinate position is important factor in gaining commitment of primary lender.

Risks and Issues Overcome:

1. ***Threat to CDBG funds*** – HUD 108 uses the City's CDBG funds as the ultimate security for loans. This caused considerable concern at the City Housing Department. Six months of negotiations between the developer, Baltimore Development Corp., the Housing Department, and HUD produced an agreement that the following funds would be ahead of CDBG funds, in the event of default:
   a. $1 million BEDI grant already awarded to the project retained in an interest reserve account;
   b. A second lien on the property – the property appraised for several times the purchase price;
   c. Developer's $2 million personal guaranty;
   d. A $6 million debt service reserve account to be funded from net income, after distribution to first mortgage, HUD 108 debt service, and 3% return to tax credit investors. Distributions to the developer for return on investment (up to 25% of true equity) occur only *after* the debt service reserve account reaches $6 million.
   e. City Economic Development Loan funds are pledged as the last backstop.
2. ***Collateral*** **–** the above commitments (all ahead of CDBG funds in a default scenario) were more than sufficient for HUD's collateral needs and collateral issues were never raised.
3. ***Davis-Bacon wages*** – HUD funds, if used for construction, mandate Davis-Bacon wages. A new ownership partnership bought out the original partnership, and the HUD 108 funds were used to finance the purchase, rather than using the funds for construction.
4. ***Low-mod benefit.*** HUD funds must be justified under one of two national objectives: 'low-mod benefit;' or 'slums and blight' removal. HUD staff advised that the building could qualify under slums and blight, thus easing the developer's concern that the low-mod benefit reporting requirements would handicap the marketing of the building.[1]

[1] A HUD administrative reform establishes that the criteria to qualify a project as "Slums or blight" include "Known or suspected contamination." Federal Register, May 24, 2006.

Montgomery Park Business Center
Fact Sheet

Location/size:

- 1800 Washington Blvd (in Westside Empowerment Zone)
- land - 26 acres;
- Building - 1.3 million sq. ft.

Developer:

- Washington-Monroe, LLC (Himmelrich Assoc.)

Building History:

- Built in 1925 as the distribution center of the Montgomery Wards Catalogue operation;
- Closed in 1985.

Reuse and Economic Impact

- Office and technology reuse
- 3,500 – 5,000 jobs at build out, in Empowerment Zone
- $100 million investment at build out

Financing

Public Sources and incentives:

- $8 million HUD 108 loan; $1 million HUD BEDI grant
- Historic Tax Credits converted to $16 million in equity
- $2 million loan from Maryland Department of Business and Economic Development under the Brownfields Revitalization Incentive Program
- $4.5 million loan from Empowerment Zone

Leveraged Private Investment:

- $27 million in private/lender financing for Phase 1
- Additional $30 million projected for additional phases

Brownfields Issues

- $3 million cleanup - lead paint, asbestos, petroleum, and PCB's
- Maryland Voluntary Cleanup Program – received "No Further Requirements Letter"

"Green" Building

- "Green Roof"
- Innovative use of "gray water" in toilet water
- Bio-retention for storm water
- Use of Re-cycled materials
- Low energy heating, cooling, and lighting systems
- Bike lockers and showers

Leasing and employment

Tenant	**Sq ft**	**Employment**
MD Dept of Envir't	262,000	850
MD Lottery	80,000	200
NCO	80,000	800
First Health	10,000	50
M & T Bank	100,000	400
TOTAL	**532,000**	**2,300**

For more information

- website: http://www.montgomerypark.com/index.htm
- Developer: Sam Himmelrich, 410-779-1234
- Public agency: Baltimore Development Corp.410-837-9305

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