

DATE: May 10, 2011

ITEM: 7.E.

RE: LOAN EXTENSION POLICY CONSIDERATION AND APPROVAL

PROJECT AREA: ALL PROJECT AREAS

PREPARED BY: Matt Dahl

EXECUTIVE SUMMARY: The Redevelopment Agency of Salt Lake City (RDA) currently offers new construction, renovation, property acquisition, and environmental remediation loan programs. The RDA's loan programs have been successful at catalyzing development in every RDA project area. While exceptions have been made, the majority of the loans originated by the RDA have a twenty-year amortization and either five- or ten-year terms. This year, and every subsequent year, the terms of several loans will expire triggering a payment of all outstanding principal and interest (the "Balloon Payment"). We anticipate that some borrowers will request loan extensions in an effort to postpone making the Balloon Payment. Staff initially proposed extension terms for consideration by the RDA Board at its April meeting. At the meeting, the RDA Board requested further analysis of the issue. Staff has conducted the additional analysis and has amended the proposal for extension terms. Staff is seeking a policy recommendation for addressing RDA loan extensions.

ALTERNATIVES:

1. Pass a motion approving the proposed loan extension policy.
2. Pass a motion approving the proposed loan extension policy with modifications.
3. Do not pass a motion approving the proposed loan extension policy.

ANALYSIS AND ISSUES: The RDA currently offers six different loan programs in its project areas: New Construction, High Performance Construction, Building Renovation, High Performance Building Renovation, Environmental Assessment and Remediation, and Housing Property Acquisition. Each of the programs provides low interest rate loans to achieve specific objectives that encourage redevelopment. Each loan program also has a specific set of programmatic terms set by the RDA Board, including the length of the loan term, which typically is three, five, or ten years as shown in Table 1. The relatively short term of the RDA loans is intended to provide a steady stream of available loan funds to catalyze new development throughout the RDA project areas.

Table 1

Loan Program	Objective	Loan Term
New Construction	Developers can use the funds to finance the construction of new residential, mixed-use, or commercial buildings.	5-year term with potential for second 5-year term.
High Performance Construction	Loans are provided to developers who construct new residential, mixed-use or commercial buildings to a LEED-certified level.	5-year term with potential for second 5-year term.
Building Renovation	Building owners and developers can receive funding for up to 50% of building renovation costs including restoring the façade of the building to its original appearance.	10-Year Term
High Performance Building Renovation	Property owners or developers can receive financing for 50% of building renovation costs at 0% interest for buildings that achieve a LEED certification level or an ENERGY STAR rating.	10-Year Term
Environmental Assessment and Remediation	Loans are provided for 50% of the costs associated with assessment and remediation work for environmentally contaminated properties.	10-Year Term
Housing Property Acquisition	Short-term loans are available to non-profit and for-profit developers who acquire property for mixed-income housing projects.	3-Year Term

In addition to low interest rates, the RDA typically calculates loan payments using a twenty-year amortization. The longer amortization results in lower monthly payments, which eases the debt service burden for the borrower during the term of the loan. The result of this policy is a requirement that a Balloon Payment be paid at the end of the loan term. If a typical borrower makes only the required monthly payments, they will still owe approximately 57% of the loan principal at the end of a ten-year term. Historically, RDA loans have been paid off by borrowers making payments in excess of their required monthly loan payments or by refinancing the loan prior to the expiration of its term.

Table 2 shows the number of balloon payments that will come due in the next four years.

Table 2

Year	Number of Balloon Payments	Total Balloon Payments
2011	2	\$476,000
2012	4	\$1,834,000
2013	1	\$115,000
2014	2	\$592,000

The RDA has begun to receive requests and inquiries from borrowers that are interested in extending the term of their loans, because they are unable, or anticipate that they will be unable, to make their Balloon Payment. Their inability to pay may be the result a number of variables, including the economy, poor management, or the inability to secure financing due to new stringent lending requirements. The RDA’s current policy would require every request for extension to be heard by the RDA’s Loan Committee and the RDA Board, though existing policy does not provide guidance upon which to base a loan extension decision. The New Construction and High Performance Construction Loans indicate that the RDA could provide a five-year extension to their initial five-year term, but do not provide guidance on what the basis for an extension should be. Staff is seeking the RDA Board’s approval of a policy for granting extensions on RDA Loans. The following are policy options for consideration:

Should the RDA allow current and future loans to be extended?

Table 3

Pros	1) Allowing extensions prevents borrowers from defaulting on their RDA loan if they are unable to make the balloon payments. If the RDA is in a subordinate position, foreclosing on a property due to uncured default may not result in the RDA being fully repaid.
Cons	1) Extensions postpone the RDA’s reuse of the loan funds for new projects. 2) Borrowers may expect extensions or be less proactive in seeking refinancing if RDA policy allows for extensions.

Should there be criteria for extending a loan? If the RDA determines that extensions may be allowed, it will be necessary to determine in what instances extensions will be granted. Examples include allowing everyone to have an extension, requiring the extension to be a last resort, requiring partial payment of the balloon, requiring proof that the balloon payment creates an economic hardship, and/or requiring that the borrower be in compliance with all terms of their existing loan. The following is a summary of the potential options.

Table 4

No Extension Requirement	
Description:	The RDA could approve all requests for extensions.
Pros:	Provides a clear policy for all borrowers.
Cons:	1) Encourages more borrowers to seek extensions. 2) Would result in most loans essentially becoming 20-year loans. 3) Reduces ability of RDA to continually recycle loan funds.
Extension As Last Resort	
Description:	The RDA could require borrowers to provide evidence that they have unsuccessfully made reasonable efforts to seek refinancing and lack the capacity to repay. This could be fulfilled by a certain number of denial letters from legitimate lenders.
Pros:	1) Requires borrower to be proactive in preparing to make their balloon payment. 2) Makes it more likely that borrowers will find a lender to refinance the RDA's loan.
Cons:	1) This requirement would prevent quick extensions and may result in borrowers going into default if they do not start searching for refinancing well in advance of the balloon payment.
Extension Due to Hardship	
Description	The RDA could require borrowers to provide evidence they do not have the financial resources to make the balloon payment or that to do so would constitute an undue economic hardship.
Pros:	Prevents extensions when not needed.
Cons:	Determining economic hardship is difficult.
Compliance Requirement	
Description	The RDA could require that the borrower be in compliance with all loan terms and require the necessary documentation to verify that the project still meets the RDA's Loan-to-Value Ratio and Debt Service Coverage requirements.
Pros:	Supports borrowers that have met all of their loan obligations.
Cons:	May prevent struggling borrowers from taking steps to save their business or development.

If a loan is extended, what should the loan terms be? All borrowers are made aware that they will have a balloon payment at the end of their loan term. Extensions provide borrowers with significant benefits as a result of the RDA's low interest rates. Without adjusting the loan terms, the extension provides few benefits for the RDA. Changing the terms may make the extension more beneficial to both parties. The following terms should be considered in establishing a loan extension policy:

Table 5

Maximum Term of Extension	
Description:	The RDA could set a maximum term length for all extensions.
Pros:	<ol style="list-style-type: none">1) Setting a policy in advance of receiving extension requests will provide clear expectations for borrowers and help them determine if it is worthwhile to seek the extension.2) By putting a cap on the length of the extension, the RDA could increase the likelihood of the loan being paid off before the end of the amortization period, especially if each extension requires a partial payment of the outstanding balance and/or an extension fee.
Cons:	<ol style="list-style-type: none">1) Setting an extension cap policy may not provide the flexibility that all borrowers need to successfully pay off their loan.2) Borrowers will seek the maximum extension even if they can pay off the loan sooner.
Interest Rate	
Description:	The RDA could require a higher interest rate during any extension period.
Pros:	<ol style="list-style-type: none">1) Higher interest rates will deter borrowers from seeking loan extensions.2) Higher interest rates will encourage those borrowers that receive extensions to payoff their loan sooner.3) Higher interest rates compensate the RDA for being unable to reinvest loan funds to catalyze new projects.
Cons:	<ol style="list-style-type: none">1) Not all borrowers may be able to pay higher monthly payments.2) Borrowers may be more likely to default if the higher interest rate significantly reduces the borrower's ability to make debt service.3) In cases where the RDA is the junior lien holder on the collateral, the senior lien holder may prohibit changes to the RDA's interest rate.
Partial Payment	
Description	The RDA could require a partial balloon payment at the end of the loan's initial term. The partial payment would likely be a percentage of the outstanding loan balance.
Pros:	<ol style="list-style-type: none">1) Requiring a significant partial payment will deter borrowers from seeking extensions for their RDA Loan.2) The RDA would be able to use the partial payment to invest in other development projects.
Cons:	<ol style="list-style-type: none">1) Not all borrowers may be able to pay the required partial payment.2) Borrowers who make the partial payment may be more likely to default during the extension if the partial payment leaves the borrower with limited cash reserves.
Extension Fee	
Description	The RDA could charge a percentage of the outstanding loan balance or a set dollar amount as an extension fee.
Pros:	<ol style="list-style-type: none">1) Requiring an extension fee will deter borrowers from seeking extensions for their RDA Loan.

	2) Given that extensions do not directly promote new development or address the RDA's mission, it would be appropriate to cover staff time required to administer the extension through an extension fee.
Cons:	1) Not all borrowers may be able to pay the extension fee.

Given the possible terms discussed above, staff would propose the following terms as the foundation for a new loan extension policy:

Table 6

Extensions:	The RDA should allow extensions, but only when the borrower meets certain criteria and the loan terms are modified as described below.
Extension Criteria (Criteria shall also be used for all loan programs that currently indicate extensions are possible.):	<ol style="list-style-type: none"> 1) The borrower should be in compliance with all terms of their RDA loan. 2) The borrower shall provide evidence that they have unsuccessfully sought refinancing from at least two legitimate lending institutions. 3) The borrower shall provide financial documentation, including tax returns, account balances, and other financial statements, showing that they are unable to reasonably pay the balloon payment. 4) The borrower shall provide all necessary documentation to verify their project's loan-to-value ratio and debt service coverage requirements. 5) Borrower shall provide sufficient information to confirm that all loan guarantors will continue to guaranty the loan and have the financial resources to do so.
Extension Terms (Proposed terms shall be subordinate to existing extension policies.)	<ol style="list-style-type: none"> 1) The maximum extension term shall be five years. 2) The interest rate during the extension period shall be 2% higher than the interest rate during the initial term, but not less than 3%. The interest rate during the extension period shall be the Prime Rate (currently 3.25%) plus 8.00%, with a floor of 10.00%. 3) Borrowers shall make a partial balloon payment at the end of the initial term. The partial payment shall be 24% of the amount of the balloon payment. 4)3) The loan payment will be recalculated utilizing the outstanding principal balance, the new interest rate, and a 10-year amortization. 5)4) Borrower shall pay an extension fee of 1% of the loan's outstanding balance. The extension fee will not be applied to the loan principal or interest. 6)5) Borrower shall pay all legal fees resulting from the extension.

Table 7 shows that the proposed terms for a five-year extension, when compared to our standard terms, would result in a 43% increase in the monthly payments and a 66% increase in the total interest paid to the RDA overall. Table 7 also indicates that the 10-year balloon payment on a \$100,000 loan would be \$57,435, thus requiring that the borrower pay an extension fee of \$574.

Table 7

Loan Payments	Unmodified Extension Terms (3% Interest/20 Year Amortization)*	Modified Extension Terms (11.25% Interest/10 Year Amortization on Principal Balance)*
Original Loan Amount	\$100,000	\$100,000
Original Monthly Payments	\$555	\$555
Initial Balloon Payment	\$57,435	\$57,435
Extension Fee	\$0	\$574
Monthly Payments During 5-Year Extension	\$555	\$799 (43% Increase)
Balloon Payment at End of 5-Year Extension	\$30,865	\$36,533 (18% Increase)
Cumulative Interest at End of 5-Year Extension	\$30,692	\$51,065 (66% Increase)

*Assumes that no extra payments have been made by Borrower.

If the RDA Board approves a loan extension policy, staff will make the text of the policy available for all current and future borrowers. Additionally, staff will use the policy to address all future requests for extensions. If the Board does not approve the extension policy all requests for loan extensions will be submitted to the Loan Committee and RDA Board for individual consideration.