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SPECIAL FEATURE

NSO Building–Finally a Reality

Part Two of Two

By Rochelle Lento, Dykema Gossett PLLC

Last month, part one of this article described how the first phase of financing was secured for the rehabilitation of the NSO Bell Building, formerly known as the Michigan Yellow Pages Building. This month, part two examines challenges related to the various financing tools that were used, including the low-income housing tax credit (LIHTC) and state and federal historic tax credits (HTCs), as well as how a second phase of development was financed with new markets tax credits (NMTCs).

Challenges and Solutions

The NSO Bell Building's historical uses created a perfect storm of environmental concerns. The Michigan State Housing Development Authority (MSHDA) declined NSO's first LIHTC application in October 2008 because of environmental factors. Its second application in August 2009 received a "conditional go" from MSHDA on environmental issues. To address these issues and comply with funder and state requirements, the project completed a Phase I Environmental Site Assessment (ESA), Phase II ESA, Baseline Environmental Assessment (BEA), Due Care Plan, MSHDA's Additional Phase I Requirements, National Environmental Protection Act Review and Clearance, and a Response Activity Plan, the latter being a Michigan Department of Environmental Quality requirement. An extensive remediation plan was developed to address all environmental conditions and bring the building within acceptable standards for residential use. Overall, environmental remediation costs exceeded $2 million, creating budget challenges for the developer.

"Providing a clean place to live is important for the new residents to be able to focus on their futures," said Steven Innis, senior project engineer with NTH Consultants Ltd., the environmental consultant for the project. This is even more important for formerly homeless individuals, as their immune systems can be compromised by greater exposure to environmental toxins such as exhaust fumes, heavy metals and contaminated soil. Although the Bell Building, like most historic structures, had many potential environmental hazards, they were successfully identified and abated. The building now provides an indoor and outdoor environment equivalent to a newly constructed building. For new residents, the Bell Building will be a clean environment and will have a significant and immediate impact on people's lives."

The mixed use aspect of the building, coupled with restrictions of the funding sources, particularly Internal Revenue Code Section 42, which controls the LIHTC and the federal HOME Investment Partnership Act, and restricts those funds to residential uses, caused the developer to create a condominium form of ownership. NSO has a common thread of ownership for both the residential and commercial condo units. The residential property owner is NSO Bell Housing Limited Dividend Housing Association

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Limited Partnership, which is comprised of NSO Bell Housing Inc. as the .01 percent general partner (NSO is the sole shareholder of this corporation); the Michigan Historic Preservation Network (MHPN) as the state historic and brownfield equity investor and 1 percent limited partner; and LIHTC Affordable Housing Fund I LLC, an affiliate of the National Trust Community Investment Corporation (NTCIC), as a 98.99 percent limited partner.

Because of the federal HTCs, the ownership structure is further tiered with a master tenant structure. The master tenant, or NSO Bell Housing Master Tenant LLC, is comprised of the federal HTC investor, NTCIC Historic Preservation Fund 5 LLC as the 99.99 percent investment member and NSO Bell Housing Inc. as the .01 percent managing member. The primary motivation for the master tenant structure was due to the inclusion of the federal historic tax credits. It is expected at the end of the five-year historic tax credit compliance period that the investor member will exit the master tenant partnership, which will be dissolved as an entity. A chart prepared by Plante Moran, accountants for the development, illustrates the corporate structure and the financing sources for the residential project. "The NSO Bell Building project is so unique because of the number of different tax credits involved in the financing stack, including historic tax credits, new markets tax credits, low-income housing tax credits and brownfield credits. Our firm is extremely proud to be involved with a project that will have such a tremendous impact on the city of Detroit," said Matthew Kosciow of Plante Moran, the accountant for the transaction.

Another challenge that occurred during the closing process resulted from a political and legislative shift. Michigan's newly elected governor, Rick Snyder, eliminated the state brownfield and historic tax credits. This occurred in the late fall of 2010, just months before NSO's scheduled closings. Despite having secured purchase agreements from the potential investors that MHPN had identified to purchase these state credits, their commitment and the realistic availability of these state credits all became quite uncertain. Because the NSO Bell Building had an allocation of state HTCs preceding the change in the legislative authorization to discontinue the credits, NSO Bell development will be grandfathered into the use of those credits. Whether the purchasers will still be interested, and/or will have the necessary corporate income to offset with a tax credit remains to be seen, however it is not fatal if they do not. The state replaced these state credits with a grant exchange program providing approximately 85 cents on the dollar to each secured recipient of such credits, for which NSO Bell qualifies.

Another important dynamic was the involvement and commitment of the NSO not-for-profit board of directors. As the

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chart above indicates, NSO is affiliated with, and/or controls all of the entities involved in the project. In addition, the foundation grant funds and the public grant sources all flow through the not-for-profit sponsor. Also, for all key funding sources, NSO is providing various levels of guarantees to assure timely construction completion, timely delivery of tax credits, repayment of construction loans, and compliance with all local, state and federal regulations. The board of directors of NSO embraced the project, while demanding detailed accurate information to make decisions and resolutions, all the time understanding that NSO is committed for the long term to this development.

NSO Service and Administrative Headquarters: The Second Phase of the Development

The majority of the first floor and part of the second floor are being rehabilitated to house the NSO administrative offices and other social services the organization provides for the community at large. These include emergency telephone services, a crisis hotline, and older adult services for individuals who have mental health issues. The commercial area will comprise approximately 75,000 rentable square feet, and will be owned by the commercial condominium owner, NSO Bell Commercial LLC. Total development costs for the commercial space are estimated to be approximately $11 million. The final closing on the commercial financing had not occurred at the time of this publication, but is scheduled for the summer of 2012.

The project is in a census tract that enables receipt of NMTCs into a qualified equity investment (QEI) into a community development entity (CDE). If the CDE then makes an equity investment or a loan to a qualified low-income community business (QALICB) and all other criteria of the NMTC program are met, the NMTCs will be the primary source of financing for the commercial portion of the development. The CDE is projected to receive a QEI totaling $7 million during a seven-year period. Although somewhat atypical, and partly due to the constraints of reaching a placed-in-service date for the residential rental units to comply with the LIHTC compliance issues, the residential closing was bifurcated from the commercial closing. Although gearing towards closing on the commercial financing was set for the end of 2012, the original leverage lender advised the developer, NSO, that it had not been able to raise the necessary capital from its proposed funders. This resulted in a major gap in the financing. The solution has been derived by raising additional sources for the residential portion (i.e. additional city of Detroit HOME funds) and shifting flexible, unrestricted funds from residential to commercial.

Fortunately, key partners such as NMTC allocatee Corporation for Supportive Housing, bridge and leverage lender Local Initiatives Support Corporation (LISC), NMTC investor JPMorgan

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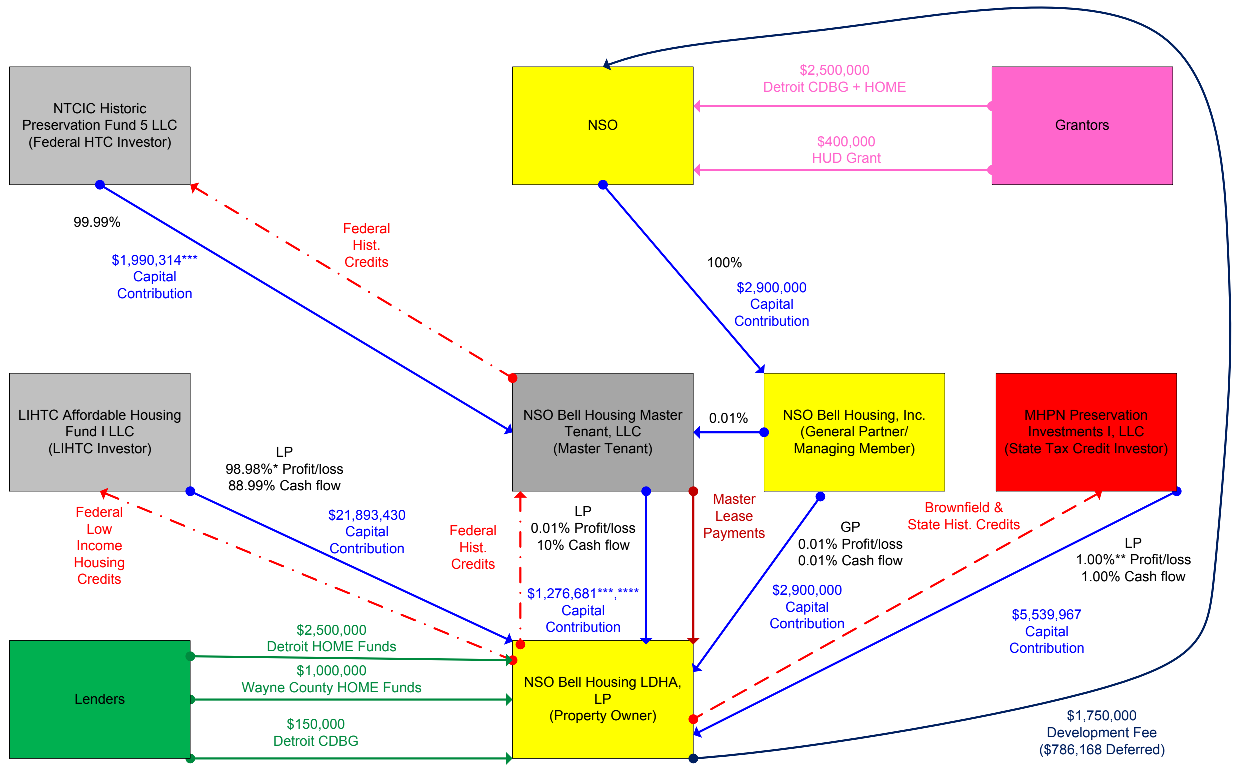
Bell Building – Residential
$2.5 Million Grants



Notes:
* Represents Profit/Loss ownership. Ownership share of depreciation is 99.97%
** Represents Profit/Loss ownership. Ownership share of depreciation is 0.01%
*** Excludes capital contribution to be made at the end of the HTC compliance period
**** Represents $1,598,192 capital contributions less $321,511 return of capital

Chase Bank, state HTC investor MHPN and federal HTC investor NTCIC have remained steadfast in their commitment to fund the commercial project.

NSO Bell Building – Commercial Sources

New Markets Tax Credits	$1,992,701	Corporation for Supportive Housing (Allocatee)
Historic Tax Credits – Federal	$1,324,312	National Trust Community Investment Corporation
Historic & Brownfield Tax Credits – State	$1,666,997	Michigan Historic Preservation Network
Leveraged Loan/Equity	$3,058,534	NSO from Art Van, Kresge + McGregor Foundations, NTCIC
Leveraged Loan	$2,000,000	LISC
TOTAL	**$10,630,581**	

Closing on the NMTC and related financing for the commercial portion of the building is expected to occur by September 2012. Construction on the project began in March 2011 and a certificate of occupancy for the residential rental units is expected in August 2012. There will be 155 one-bedroom apartments, which will all be affordable units regulated under LIHTC and HOME rules. Each unit will be approximately 500 square feet with anticipated monthly rents of $733, which will include a utility allowance. The project is 100 percent supported by project-based vouchers, so all tenant rent will be subsidized. With Detroit's large homeless population of nearly 20,000 people, NSO does not anticipate any challenges in filling the units, and already has a waiting list of qualified tenants. In addition to the apartment units and social services NSO will provide on-site, the building will have other amenities including a basketball court, gymnasium, sundries shop, a computer room, library, art room, chapel and music room on other floors in the building. "The NSO Bell Building will provide us with an opportunity to truly impact homelessness in our community and

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positively change the lives of 155 individuals who will occupy these apartments. In addition, we are proud to be able to restore and bring new life to a historic Detroit landmark," said Sheilah Clay, NSO's President and CEO.

Rochelle E. Lento's practice at Dykema Gossett PLLC focuses on affordable housing development and economic development representing developers in transactions involving low-income housing tax credits, historic tax credits, federal HOME and other HUD financing tools, new markets tax credits and general real estate. She can be reached at 313-568-5322.

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