Technical Briefs

Federal Reserve Bank of Philadelphia
Community Affairs Department

Pre-development Funding: The Pre-development Partnership Loan Program

Affordable housing is a critical need for many low- to moderate-income people. To combat the problem, a number of organizations have entered the real estate development field to create quality housing at reasonable costs for both the rental and home-ownership market. Many of the developers are local nonprofit groups that have become skilled in housing construction and project management. The housing projects they undertake are diverse but often share similar characteristics regarding the blighted nature of the housing stock, environmental challenges at the properties, complexity of construction requirements, and limited resources of the developers.

Most of these experienced groups are able to obtain long-term financing once a project has been deemed feasible. However, during the early stages of development, a variety of costs must be funded to adequately evaluate the viability of the project. Typically, these costs cover site options; preliminary architectural and engineering costs; legal, environmental, and consultant services; and certain financing fees related to the low-income-housing tax credit.

Nonprofit housing developers seldom have sufficient cash resources to fund the early-stage costs and need to borrow the funds. Often these "pre-development loans" are viewed as too high a risk for lenders since the source of repayment may be undetermined at the outset of the project. In New Jersey, a special program has been developed to mitigate the risk issues.

In 1997 the New Jersey Department of Community Affairs (NJDCA), in conjunction with local banks and two nonprofit community development financial institution (CDFI) intermediaries, developed a solution for the lack of available funding by using a risk-sharing concept. The program is designed exclusively for nonprofit housing developers and is known as the Pre-development Partnership Loan Program.

NJDCA has deposited public dollars with the intermediary, and these dollars are, in turn, used to fund 50 percent of each pre-development loan. NJDCA and a participating bank underwrite the transaction based on a set of pre-determined underwriting guidelines. Once both parties are satisfied that a transaction is acceptable, the bank funds the remaining 50 percent of the transaction. The CDFI manages all administrative responsibilities, loan documentation, and collection procedures.

The two local intermediaries selected to manage the program on behalf of NJDCA are The Reinvestment Fund, based in Philadelphia, and The New Jersey Community Loan Fund, based in Trenton.

This creative public / private partnership expands the pool of funding available for NJ housing groups and, in turn, helps to increase the number of development projects within the state.

To learn more about how to develop a program like this in your region, please contact:

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See program specifications on next page.

Use of Proceeds	Assist nonprofit housing developers with early-stage project costs.
Loan Size	Generally $50,000. Larger loans considered on a case-by-case basis.
Product Type	Short-term loan at 0% interest. Participating bank determines if committed funds are provided to intermediary and held in escrow until transaction is approved or if funds are advanced to intermediary at time transaction is approved.
Primary Repayment Source	Developers of feasible projects receive construction financing and repay the pre-development loan.
Secondary Repayment Source	Liquidation of developer's assets, if applicable.
Risk Sharing	50% NJDCA funds, 50% bank funds. NJDCA funds are managed by local intermediaries: the NJ Community Loan Fund and The Reinvestment Fund.
Underwriting	NJDCA reviews an application and discusses with intermediary. Bank participant underwrites transaction and approves or declines participation. Proceeds are advanced to projects on approval by bank participant and intermediary lender.
Collateral	Security agreement and UCC filings against project proceeds.
Documentation	Standard loan documentation is prepared for each transaction. The bank participant signs a participation agreement, which details its 50% ownership in the transaction.
Applicant Requirements	Must be a nonprofit developer of low- to moderate-income housing. Applicant must meet NJDCA program eligibility and underwriting requirements; once applicant is approved by NJDCA, a participating bank is solicited to act as partner in the loan (50% DCA / 50% bank). Applicant must also meet bank's underwriting requirements.
CRA Test	Contact your regulatory institution to determine how the program affects individual CRA requirements.
Program Performance	From inception in 1997 through July 1999, the NJ program has made 49 loans totaling $2,984,000. One borrower has defaulted.
Lenders	Chase Manhattan Bank, Dime Savings Bank, First Union Bank, First Union Foundation, Fleet Bank, PNC Bank, Sovereign Bank, Summit Bank; The Reinvestment Fund, The New Jersey Community Loan Fund.
NJ Program Information	To learn more about becoming a participant in the NJ program, please contact the NJ Department of Community Affairs, 609-292-2213.

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