

Chief Financial Officer's Report to
Priorities and Finance Committee
2019 November 05

ISC: UNRESTRICTED
PFC2019-1294

Attainable Homes Calgary Corporation – Progress Update Report

EXECUTIVE SUMMARY

This report provides an update on Attainable Homes Calgary Corporation's ("AHC") Reach Martindale housing project ("Martindale Project") and AHC's credit facilities.

ADMINISTRATION RECOMMENDATION:

That the Priorities and Finance Committee recommends that Council:

- 1) Direct Administration to provide a one-time waiver of AHC's breach of its annual Interest Coverage Ratio for the period ending 2018 December 31, subject to the same waiver being received from AHC' Lender;
- 2) Direct Administration to amend any existing agreements between The City and AHC as applicable and to reflect AHC's credit facility renewal with its financial institution in form and content acceptable to the City Treasurer; and
- 3) Receive the progress report for the corporate record.

RECOMMENDATION OF THE PRIORITIES AND FINANCE COMMITTEE, DATED 2019 NOVEMBER 5:

That Council adopt the Administration Recommendations contained in Report PFC2019-1294.

PREVIOUS COUNCIL DIRECTION / POLICY

On 2010 January 25 (M2009-11), Council passed Bylaw 64M2009, authorizing The City to lend to AHC up to \$10 million for financing AHC's operating expenditures.

On 2013 July 29 (NM2013-20), Council resolved that AHC work with Administration to determine appropriate credit facility options and make recommendations to support achieving its mandate and report back to Council through the Priorities and Finance Committee no later than 2013 December 10.

On 2013 December 10 (PFC2013-0754), Administration requested a deferral to report back to the Priorities and Finance Committee by 2014 May to allow sufficient time for AHC to prepare and present its business plan to its Board of Directors and enable Administration to complete its due diligence and provide recommendations.

Through its business plan review, in 2014, AHC concluded that a revolving debt facility would better support its lumpy cash flows and requested to convert its \$10 million loan facility with The City into the Revolving Debt Facility. An independent third-party financial consultant was utilized by The City to assist in evaluating the business plan and AHC's request.

On 2014 July 22 (PFC2014-0392), Council passed Bylaw 41M2014, authorizing The City to guarantee the repayment of the Revolving Debt Facility to a maximum sum of \$10 million in accordance with terms and conditions outlined in a credit agreement between The City and AHC.

On 2016 April 13, in response to an Urgent Business Notice of Motion, Council directed Administration to postpone and subordinate The City's security position in favour of any

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lender who provides financing to AHC, outside of the Revolving Debt Facility, from time to time, provided that such postponement and subordination shall only secure the value of the assets being financed by the lender.

On 2019 May 27 (C2019-0708), Council directed Administration to postpone and subordinate security that The City held with respect to AHC's Reach Martindale housing development and provide a consent to assign proceeds from the sale of housing units within the Martindale Project. Administration was also directed to work with AHC to review its long-term business plan when available and bring a progress update report back to Council through the Priorities and Finance Committee no later than 2019 November 5.

BACKGROUND

AHC is the active project manager on the Martindale Project where it recently completed the first three of twelve proposed buildings. As developer/manager of the Martindale Project, AHC is responsible for all costs associated with the project and any related sales and marketing activities. AHC is required to front all construction costs while sales proceeds from the project are typically deferred until after completion of housing units. In 2019 April, AHC realized the construction costs associated with the Martindale Project, in addition to managing its existing property inventory placed significant pressure on liquidity due to an extended construction/sales cycle. To address the timing difference between outflows and inflows, AHC successfully negotiated the provision of short-term liquidity through AHC's Lender to meet financial commitments to guarantee completion and transfer of units to homebuyers in 2019 Q3.

AHC requested from The City, in its capacity as guarantor, that additional security be provided to AHC's Lender to enable the New Debt Facility. To accommodate the New Debt Facility, The City was asked to subordinate and postpone any security interests in the Martindale Project up to a maximum property value of \$4.5 million and provide an irrevocable assignment of sales proceeds up to a maximum of \$2 million with respect to Martindale Project housing units.

On 2019 June 11, as requested by AHC and directed by Council, The City provided subordination and postponement of its security in the Martindale Project and consented to the irrevocable assignment of sales proceeds at the Martindale Project.

On 2019 June 12, AHC's Lender approved a \$2 million temporary bridge loan facility ("New Debt Facility") by way of one advance made directly to AHC's builder partner with all amounts owing under the New Debt Facility becoming due and payable in-full on 2019 August 15. Proceeds from the New Debt Facility were immediately applied to trade payables owed to its builder partner for construction costs incurred at the Martindale Project to avoid any delays with turning over housing units to AHC customers.

AHC closed sales on a total of 24 units at the Martindale Project during 2019 Q3. Net proceeds inflows from sales in June and July were approximately \$2.6 million and were applied to reduce AHC's \$10 million City-guaranteed Revolving Debt Facility extended by AHC's Lender

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("Revolving Debt Facility") from \$9.8 million as at 2019 May 31 to \$7.2 million as at 2019 July 31. Additional net proceeds of \$2.9 million were received in August, from which \$2 million was used to permanently repay the New Debt Facility on 2019 August 7 in advance of the maturity date and the excess was applied to further reduce the \$10 million Revolving Debt Facility to \$6.3 million at 2019 September 30. AHC's Lender subsequently confirmed that it provided a full discharge of the above security to AHC's legal counsel to be removed from title on all remaining units. AHC's Lender also, as part of its credit facility review, acknowledged a breach of AHC's interest coverage ratio covenant of not less than 1.5:1 at all times, tested annually, at 2018 December 31 ("Interest Coverage Ratio") and confirmed its intention to provide a waiver of this breach as part of its annual review. The City, as guarantor to AHC's credit facilities, requires that AHC similarly maintain an Interest Coverage Ratio not less than 1.25:1 at all times under a separate agreement ("City Credit Agreement"). Interest Coverage Ratio was -6.22:1 per AHC's audited financial statements as at 2018 December 31 with the formal breach acknowledged in AHC's compliance certificate provided to AHC's Lender on 2019 May 27, subsequent to the previous report to Council.

The above actions and provision of the New Debt Facility enabled AHC to manage immediate liquidity challenges and improve its overall financial position; however, there continue to be risks associated with the current model requiring the full attention of management and shareholders to properly mitigate. The City continues to collaborate with the AHC's management team, as they are in the process of developing a comprehensive long-term business plan to present for review/discussion and anticipated by 2019 Q2.

INVESTIGATION: ALTERNATIVES AND ANALYSIS

Credit Facilities

Outstanding indebtedness on AHC's Revolving Debt Facility decreased from \$9.8 million at 2019 May 31 to \$6.3 million at 2019 September 30, including a \$0.3 million letter of credit in favour of The City.

In relation to the guarantee provided by The City to AHC's Lender ("City Guarantee"), The City and AHC entered into the City Credit Agreement which, generally and among other things, provided a commitment by AHC to reimburse and pay to The City any amounts paid by The City to AHC's Lender under the City Guarantee, and as security for performance of such obligations, AHC granted, generally, a first-ranking security interest in all its property in favour of The City.

AHC established the Evergreen Loan Facility in 2016 to acquire completed units from various housing projects and developments in The City. Repayment of the Evergreen Loan Facility is not guaranteed by The City. Current outstanding indebtedness on the Evergreen Loan Facility was repaid from \$1.03 million to \$0 in 2019 June with proceeds from the sale of units previously acquired by AHC; availability under this Facility is currently capped at \$0 by AHC's Lender.

Stakeholder Engagement, Research and Communication

Treasury staff within the Finance Business Unit continue to work with AHC regarding financial performance, forecasts, operating challenges, and planning in the near to long-term.

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Strategic Alignment

AHC is a non-profit, social enterprise, created and wholly-owned by The City, working to help moderate-income Calgarians achieve their dreams of quality home ownership.

Social, Environmental, Economic (External)

AHC was created in 2009 with a mandate to build 1,000 well-made, entry-level homes for moderate-income Calgarians.

Financial Capacity

Current and Future Operating Budget:

The City, as guarantor, would be obligated to pay the debts and liabilities of AHC under the Revolving Debt Facility up to a maximum sum of \$10 million should AHC's Lender ever decide to call on the City Guarantee.

Current and Future Capital Budget:

There are no current and future capital budget impacts as a result of the recommendations in this report.

Risk Assessment

Current Default

As at 2018 December 31, AHC was in breach of certain terms and conditions outlined in the credit agreement with AHC's Lender and therefore, was also in breach of its City Credit Agreement. AHC's Lender was in the process of conducting an annual review of existing credit facilities in May and is currently working to finalize its renewal of AHC's credit facilities. AHC updated The City as to the process and indicated its Lender intends to waive the breach at year-end and will be amending certain covenants to better match AHC's operating cycle going forward. The City Credit Agreement is on terms and conditions similar to AHC's Lender and will require the same waiver to avoid a cross default between the two agreements.

AHC's Lender Approval

The Lender indicated they were comfortable with the above waiver and reconsideration of certain covenants attached to AHC's credit facilities due to the reliance on these facilities to fund construction costs in advance of proceeds from the sale of housing units.

Credit facilities will be reviewed again once AHC completes its updated business plan and long-term outlook with respect to buildings 7-12 (Phase 2) at the Martindale Project and its other projects. The City will continue to work with AHC through the process to understand what's required to deliver on its plans and what/if any impacts there might be on the existing structure.

Erosion of The City's Security

The City and AHC's Lender each have a charge registered against AHC's property, including its interests in purchase and sale agreements for units in the Martindale. The City's charge currently has a priority position over AHC's Lender's charge. Any postponement and subordination of The

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City's charge in favour of AHC's Lender, or assignment of assets by AHC to AHC's Lender, results in less coverage on indebtedness and increases the risk of a less than full recovery of obligations.

Subject to confirmation of financing options to support Phase 2 at the Martindale Project, it is likely that any additional support provided by its Lenders could require further postponement, subordination, and assignment related to the specific project. The City will work with AHC to better understand what implications this could have on existing Council approvals or risk to The City as shareholder and guarantor.

Obligations to Builder Partners

AHC has entered into \$16.2 million of builder contracts binding them to material purchases in 2019 without a confirmed source of funding; however, management has confirmed through various conversations with its partners they are able to defer any outright purchase of units in the absence of a buyer in exchange for carrying costs in the interim. AHC was able to negotiate a smaller commitment to its partners and further reduce its obligation to purchase units but must continue to manage liquidity to meet all current and future obligations.

Liquidity

Capacity under the existing Revolving Debt Facility improved from \$Nil at 2019 May 31 to \$3.6 million at 2019 September 30 (net of \$0.3 million letter of credit) and provides AHC with some flexibility to meet ongoing obligations; however, remaining costs to complete buildings 1-6 (Phase 1) of the Martindale Project are approximately \$2 million that without additional confirmed sales/closings will consume most of the available liquidity.

The Evergreen Loan Facility is capped at zero and does represent additional liquidity available to AHC currently. The cash flow forecast depends heavily on high-level sales assumptions being converted to actual sales, availability/marketability of product, and market absorption.

Repayment

Repayment of any outstanding indebtedness remains subject to: 1) completion of the units at the Martindale Project; 2) removal of all conditions to closing under purchase and sale agreements, and 3) turnover of properties held in existing inventory.

The Martindale Project continues to experience strong traffic through its show homes with remaining buildings in Phase 1 still under construction and timing of completion/turnovers dependent on achieving internal presale targets. AHC currently has one firm and one conditional sale of a total six available units in building 4 with construction of this building on hold until 60% presales target has been achieved. Building 5 has three firm and one conditional sale with anticipated closings in 2020 Q2. Building 6 has sold-out with anticipated closings during 2019 Q4.

Anticipated costs to complete remaining buildings in Phase 1 of the Martindale Project are estimated to be \$2 million and funded with the Revolving debt facility, as approved by AHC's Lender.

Phase 2 construction at the Martindale Project construction has not commenced and will be

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released for sale on a building-by-building basis, and construction will not progress until pre-sales targets are achieved. As a part of its long-term business planning, AHC plans to pursue project related financing through its AHC's Lender and will update The City accordingly.

Comprehensive Long-Term Business Plan

AHC is in the process of preparing a comprehensive long-term business plan, including financial projections to support sustainability. Administration will review AHC's comprehensive long-term business plan when it is available and will highlight any supporting recommendations at that time. Subject to completion of this plan and if necessary Administration may, at AHC's sole expense, engage an independent third-party to identify key risks and mitigation strategies, conduct scenario analyses, and assess the long-term viability of AHC's business plan. The long-term business plan will take AHC some time to prepare and timeline for completion is currently uncertain; however, a more detailed update is expected in 2020 Q2.

Upcoming Meeting Schedule

AHC has provided the following meeting schedule to Administration to outline next-steps in its business plan development:

- AHC's 2020 business plan will be reviewed by its Development Committee, Audit and Accountability Committee, and Corporate Performance and Governance Committee by the end of 2019 November.
- AHC's Board of Directors will review its 2020 business plan for approval in 2019 December;
- AHC's management will also provide its committees and Board of Directors with an updated budget for the Martindale Project, including pricing, sales pace, and costs;
- AHC's Board of Directors will meet in 2020 Q1 to review and approve the 2019 audited financial statements.
- AHC's management will present its annual report, 2019 audited financial statements and 2020 business plan to its Shareholder in spring 2020.

REASON(S) FOR RECOMMENDATION(S):

Administration acknowledges that AHC has undertaken significant steps to address near-term liquidity issues; however, there continue to be significant risks associated with AHC's operations that require addressing through a more comprehensive business plan and financial strategy. A one-time waiver of AHC's 2018 Interest Coverage Ratio breach is consistent with AHC's Lender approval of the annual credit facility renewal and removes the risk of conflict or cross-default between the City Credit Agreement and its credit agreement with AHC's Lender. AHC's financial covenant package is under review as part of its comprehensive long-term plans and may require further amendment to ensure the adequate protection against risks to ongoing operations.

ATTACHMENT(S)

None