

UMB SEISMIC SAFETY LOAN PROGRAM
LOAN APPLICATION PRESENTATION AND ANALYSIS
Walden House Adult Residential Facility
815 Buena Vista West
PREDEVELOPMENT LOAN

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Loan Committee Date: April 14, 2005

Applicant/Sponsor Name:	Walden House, Inc.
Project Name:	Adult Residential Substance Abuse Treatment Center
Project Address (w. cross street):	815 Buena Vista Street
Number of Units/Beds (specify):	46 resident rooms; 108-bed capacity
Amount of Funds Requested:	\$285,000 for predevelopment costs (Loan request of approximately \$1,610,000 anticipated for construction)
Staff Recommendation:	Fund \$285,000

Loan Request Summary

The Borrower is seeking a \$285,000 UMB loan to finance pre-development soft costs in advance of a planned seismic retrofit of the subject property. This loan will enable the borrower to contract with an architect to complete renovation plans, bid out the construction project and obtain a building permit. The proposed uses of the requested loan funds are shown on the attached Exhibit A. Once a final line item budget and plans are obtained, the borrower will apply for a UMB loan program construction loan. The budget and plans will also be reviewed by an independent construction monitoring consultant for the UMB loan program prior to closing of the construction loan.

The subject UMB loan will be secured by a blanket third deed of trust on the subject property and second deeds of trust on two other properties owned by the Borrower.

Property and Improvements

The following information is based on materials submitted by the Applicant, including a signed UMB Loan Application. The subject property is improved with a partial four-story and one-story

group housing facility. The building is a concrete masonry structure constructed in 1916. The gross building area is approximately 30,036 square feet, and the land area is approximately 9,753 square feet. The upper two floors are utilized for individual bedrooms (108 beds) with community bathrooms. The lower floors contain administrative offices and counselling rooms, a multi-purpose hall, a commercial kitchen and dining room.

Borrower

The Borrower will be Walden House, Inc., a California non-profit corporation. Walden House is well-known provider of psychological and social services to the general public, primarily related to drug and substance abuse rehabilitation and HIV prevention. Walden House operates a network of treatment facilities, halfway houses at a variety of locations, primarily in the San Francisco Bay Area.

In the 35 years since it first opened its doors as a local drug and alcohol treatment center, Walden House has evolved into a national leader in developing strategies to help addicts recover and maintain their lives. Walden House treats more than 3,400 men, women and children daily. Walden House provides a full-continuum health care system specializing in all aspects of addiction services including detoxification, comprehensive medical care and mental health services. Clients receive legal, educational and vocational services as fundamental parts of their treatment. Walden House endeavors to promote a “culturally sensitive treatment environment that is designed to foster the open communication, self-help and empowerment of each person within the context of the greater community.” Walden House has over 400 employees in over 150 job titles.

A few of Walden House’s specific services include:

- * Adult residential programs providing substance abuse and mental health treatment services in its facilities at the subject property and at 890 Hayes Street. Similar services are provided for State prison system parolees at its Hill street facility in Los Angeles and at the Female Offender Treatment and Education Program facilities on Treasure Island and in El Monte, CA.

- *Adult outpatient and day treatment programs at the Multi-Services Center at 1885 Mission Street. These services are provided for people on the waiting list for residential services and for those not requiring residential care.

- *Criminal justice treatment programs including the Sisters in Sober Treatment Empowered in Recovery Project which provides in-custody substance abuse treatment to women in the San Francisco County jail, with continuing services at the Multi-Services Center. Walden House has approximately 10 contracts with the California Department of Corrections to provide service to parolees and inmates.

*Residential program for adolescents at 214 Haight Street and at the St. Michael's facility on Farallones Street. The Walden Academy provides on-site educational services to adolescents assessed as having special needs by the San Francisco Unified School District, and operates a community day program serving those not needing special educational services.

*Adult HIV/Mental Health programs and vocational services.

Walden House receives funding through a host of governmental grants, contracts and charitable donations. For FYE 6/30/04, total revenues were \$41.876 million. Approximately 86% of this income was derived from governmental grants and contracts, 6% from AFDC-Foster Care payments, 2% from welfare departments, and 6% from in-kind and cash donations. Expenditures on program services totaled \$37.7 million and management and general expenses totaled \$4.41 million for a total of \$42.115 million. Thus the organization showed a \$243,000 operating loss. However, if depreciation and amortization expenses \$640,047 are added back, there was a positive cash flow. It is also noted that for the six months ended 12/31/04, Walden House had total income of \$21.7 million and positive net income of \$3,000. Available cash flow would be more than sufficient to repay the requested predevelopment loan.

For the FYE's 6/30/03, 6/30/02 and 6/30/01, total revenues were \$44.7 million, \$49.7 million and \$42.8 million, respectively, and net operating income was \$111,000, \$321,000, and (\$724,000). The following commentary has been obtained from the bond prospectus issued last year. Walden House had significant revenue growth in the late 1990's (i.e. from below \$20 million to over \$40 million) due to the State's public policy decision to provide alcohol and other drug treatment services within its prison system. With this expansion came "increased fiscal pressures on an antiquated financial infrastructure. The Corporation has made considerable progress in rectifying past financial weaknesses by evaluating internal controls and improving monitoring and reporting systems. Over the past year, the Corporation has made significant progress in decreasing expenditures through improved efficiencies, as federal and state funding have declined due to budgetary and policy constraints. Improvements have also been realized in the billing and collection of the Corporation's receivables, thus improving cash flow... The Corporation plans to concentrate on strengthening its internal management and administration for the next three to five years. The only program expansion targeted over this period is the development of a program for youth mentoring and prevention services. All other efforts will concentrate on seeking funding to enhance existing services, programs and facilities."

The prospectus also notes that in January, 2004, the Charitable Assets Division of the State Attorney General's office conducted an investigation of possible violations by previous management. The investigation found that expenditures of approximately \$470,000 in 1994 and between 1998 and 2003 were either not appropriately approved the Corporation's Board or insufficiently documented. The investigation prompted the resignation and/or termination of "certain personnel" cited by the State. "Current management of the Corporation believes it has

taken the corrective actions necessary to address the conduct of former management and to cause the Corporation to be in compliance with the laws that regulate its operations. However, because of the actions by the former and deceased CEO and certain former senior management personnel, the Corporation may face possible fines and penalties from regulatory agencies, including the IRS, and/or the revocation of its exempt status.” According to Rod Libbey of Walden House, however, The Attorney General’s investigation of Walden House was concluded a number of months ago, and Walden House “has not faced any fines or been notified of any concerns whatsoever by the IRS, including concerns with Walden House’s exempt status.”

Lastly, the prospectus notes that the current management’s June, 2004 “corrective action plan” was approved by the State, and the State has since notified management that the “Corporation has satisfied the Attorney General’s requirements” except for the employment of a new CFO and implementing an education program for members of the Board of Directors. A new CFO, Keith Spindle, former CFO of the Golden Gate Conservancy, was hired on March 15. The Board of Directors received the recommended training on “Duties of a Director under California Nonprofit Law” by Cynthia Rowland of Coblenz, Patch, Duffy and Bass, LLP on 12/8/04. The successful \$7,475,000 bond refinance in December, 2004 was another positive development for Walden House’s new management, both in terms of its successful placement and the estimated \$117,000 in projected future annual savings.

Walden House’s President/CEO is now Chuck Deutschman, appointed President/CEO in July, 2003. Mr. Deutschman was previously the Substance Abuse Program Director for the Contra Costa County Health Services Department, a position he held since 1986. In addition to the recent hiring of CFO Keith Spindle, Purchasing and Operations Director Charlie Greene, formerly of Robertson Stephens, was hired in 2004. Another new key hire was Rod Libbey as Director of Human Resources in 2004. Mr. Libbey retired from Bank of America after a 17-year career in human resources.

Walden House has retained Swinerton Management and Consulting as the project manager. Swinerton will represent the Borrower in pre-construction planning, including working with the architect and engineering, developing a package for bidding contractors and reviewing the bids. Swinerton will oversee construction on behalf of the Borrower. (It is noted that Swinerton will not represent the City as the UMB loan inspector for this project). Walden House has also selected Cee Architects and Structural Design Engineers. Arturo Carrillo, Vice President and Director of Operations with Walden House, will be overseeing this project as well.

Project Economics

The currently proposed loan (and for the subsequent UMB construction loan) shall be secured by a blanket second deed of trust on three Walden House-owned properties:

1. 815 Buena Vista Avenue (subject property to be renovated): \$6,800,000 appraised value as of 9/17/01 (update to be requested prior to construction loan closing);
2. 890 Hayes Street (four-story, 32,248 square foot, 100-bed residential group home facility): \$7,000,000 as of 1/12/05 with 100 beds; and
3. 214 Haight Street (three-story, 23,920 square foot group housing and counselling facility): \$4,600,000 appraised value as of 9/21/01.

Although valued at various times, the combined values for these three properties based on the most recent appraisals was \$18,400,000. Given the increase in multi-family property values since 2001, it is likely that the values for the subject property and 214 Haight Street have increased since that time.

The above properties are encumbered by a first deed of trust securing approximately \$7,475,000 in bond financing, with approximately \$620,000 in annual debt service, interest at 2% increasing to 4.5%, and maturing in 2022. The fully-amortizing bonds were issued in December, 2004 by the California Statewide Community Development Authority. There is also a loan from the Department of Housing/Community Development with a balance of approximately \$67,000. This loan is fully amortizing and matures in 2010, and it is secured by a second deed of trust on the subject 815 Buena Vista West property only. The total combined debt including the UMB loan would be \$7,827,000 or about 42.5% LTV.

While it would be speculative to estimate a budget for the retrofit project to follow, the current working estimate is in the \$3,000,000 range, including hard and soft costs. Walden House has obtained a \$1,000,000 Emergency Housing and Assistance Program (EHAP) Capital Development 10-year "forgivable" loan, and has received a \$393,426 grant from the federal Health Resources and Services Administration (HRSA) program. The EHAP loan will be subordinate to the UMB loan. The UMB loan would finance the balance of the project. Assuming a \$1,610,000 UMB construction loan, the combined loan to value with the existing senior financing would be approximately 49.7%. These ratios are within UMB loan program guidelines.

Conclusions

Based on the preliminary budget, economic analysis and other information provided by the Applicant, the requested loan appears to conform with the loan to value criteria of the UMB loan program. The City staff and UMB Seismic Safety Loan Committee are advised of some of the following specific risk factors in connection with this loan request:

- While the loan adequately meets the program's LTV requirements, the Borrower is heavily reliant on governmental funding sources to meet its operating obligations. However, Walden House is an established leader in its field and its track record demonstrates a history of competing well for such funding.
- Historical financial performance has been sub-par in several of the recent years, and previous serious managerial issues have been noted. However, according to the current management, "Walden House is not currently subject to any liability for the actions of previous management. The 2004 audit reported no material weaknesses or reportable conditions. Additionally, a global settlement was recently reached at no expense to Walden House, settling any future claims by numerous individuals formerly associated with Walden House. Finally, a second settlement is being mediated which will effectively end any claims against Walden House as a result of past management practices."
- The ultimate costs of the pending construction project are unknown at this time. However, the currently requested loan and the projected construction loan will be secured by ample collateral through a blanket deed of trust on three properties.

Reference is made to the general risk factors in extending loans under the UMB Seismic Safety loan program on file with UMB loan program office.

Conditions Precedent to Loan Closing

The loan shall be for a term of 20 years, and the interest rate shall be fixed at 2.5% for the term of the loan. The loan closing is subject to Borrower's compliance with all UMB Seismic Safety Loan Program requirements, and the timely submission of pre-closing items, including, but not limited to:

1. Borrower to covenant that UMB loan program guidelines will be followed for obtaining contractor bids.
2. Phase 1 Environmental report.
3. Receipt of certificate of property and liability insurance per the UMB Loan Program Insurance

Requirements.

4. Review of a current preliminary title report by Office of the City Attorney, with recommendations as to acceptable exceptions to ALTA title insurance policy. All applicable borrowing entity formation documents shall be subject to review by the Office of the City Attorney.
5. Execution by Borrower of all UMB Loan Documents, including, but not limited to: Construction Loan Agreement (if deemed applicable by City Attorney), Promissory Note, Deed of Trust, Assignment of Plans (if deemed applicable by City Attorney), Environmental Indemnity, Regulatory Agreement UMB Loan Program Contractor Requirements Acknowledgement Form and Escrow Instructions. The subject UMB loan shall be secured by a Deed of Trust with a second priority position behind the aforementioned bond financing.
6. The holder of the first deed of trust shall provide written consent to allowing the proposed loan and the prospective UMB construction loan to secure by a subordinate deed of trust.
7. Borrower's payment of all loan fees, title insurance, escrow and other closing costs. Loan modifications, assumptions, subordination reviews and reconveyance fees during term of loan subject to UMB loan program Schedule of Fees. UMB loan program fees do not include any other inspection fees, permits and other fees costs that may be charged to Applicant by other City departments or agencies.
8. All disbursements during the term of the loan will be subject to: (1) Borrower's submission of a fully completed Loan Disbursement Request Form signed by Borrower; (2) Borrower's submission of supporting invoices for soft costs; and (3) compliance with contractor requirements pursuant to Administrative Code Chapter 66A, if deemed applicable by the City Attorney.
9. The loan commitment shall be valid for a period of 120 days from the date of the UMB Loan Committee's initial approval, and it is the Borrower's responsibility to satisfactorily meet all closing conditions within this period. Any extensions to the loan closing commitment shall be subject to a re-application to the UMB Loan Committee, and approval by the UMB Loan Committee.