

# Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Leslye Corsiglia  
Jennifer A. Maguire

**SUBJECT:** SEE BELOW

**DATE:** March 29, 2013

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3/29/13

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**COUNCIL DISTRICT: 6**

**SUBJECT: APPROVE THE FINAL STRUCTURE FOR CITY FINANCIAL ASSISTANCE FOR THE SAN CARLOS SENIOR APARTMENTS PROJECT AND RELATED APPROPRIATION ORDINANCE AND FUNDING SOURCES RESOLUTION AMENDMENTS**

**RECOMMENDATION**

**A. Adopt a resolution:**

1. Approving the final structure of City financial assistance, with no additional City funding, for the 95-unit San Carlos Senior Apartments Project (Senior Project or Project) located at 1535 West San Carlos Street, as follows:
  - (a) A construction/permanent loan in the aggregate amount of \$6,208,420, reflecting the amount equal to the Senior Project's original conditional grant of \$4,775,000, refinance of the existing loan of \$536,238 for construction of infrastructure for the Project, and a capitalized payment in lieu of interest in the amount of \$897,182; and
  - (b) Approving the extension of the term of an existing loan with a principal balance of \$2,973,834 for the San Carlos Townhomes project ("Townhomes Loan") to match the Senior Project Loan, adding borrower, recording a deed of trust against the Senior Project to secure the Townhomes Loan and the repayment of the Townhomes Loan from residual receipts from the Seniors Project; and
  - (c) Authorizing the Director of Housing to negotiate and execute all legal documents to effectuate the transaction, including loans and an option to purchase.

- B. Adopt the following Appropriation Ordinance and Funding Sources Resolution amendments in the Low and Moderate Income Housing Asset Fund:
1. Increase the revenue estimate for Earned Revenue by \$5,700,000;
  2. Increase the Housing Loans and Grants appropriation by \$4,775,000; and
  3. Increase the Ending Fund Balance by \$925,000.

### **OUTCOME**

Approval of the recommended action will allow the developer to start construction and build 94 new affordable rental apartments for very low- and extremely low-income seniors with incomes from \$22,300 to \$42,450 and one unrestricted manager's unit. It will also enable repayment to the City of an outstanding construction loan balance from the adjacent San Carlos Townhomes project (Townhomes Project).

### **EXECUTIVE SUMMARY**

This memorandum clarifies how existing City Council approvals between 2002 and 2011 fit together to form a cohesive financing structure for the San Carlos Senior Apartments Project. This memorandum also makes necessary appropriation adjustments to fund a loan in an amount equal to a previously-approved grant, and clarifies that a ground lease will be effectuated after construction closing but before conversion to the permanent period of financing.

### **BACKGROUND**

On June 25, 2002, the City Council approved financing for two adjacent projects to be developed by Core Development, Inc. and ROEM Development Corporation, or their designated affiliate (Developers), on a 3.25-acre site located at 1523-1533 West San Carlos Street. The first project was a 100-unit affordable rental housing project for seniors, San Carlos Senior Apartments (Senior Project). City financing for the Senior Project was composed of a conditional grant of up to \$4,775,000 for site acquisition and predevelopment and a future construction/ permanent loan of \$4,830,000. The second project was 30-unit for-sale townhomes, the San Carlos Townhomes Project (Townhomes Project), for which the City committed \$4,113,600 for acquisition and construction funding and 15 homebuyer second-position mortgages.

The Developers received Planned Development Zoning in December 2002 for both projects plus commercial space (file number PDC02-102). During the planning process, the final unit count for the Senior Project was established at 95 units and the final count for the Townhomes Project was established at 32.

The source of the conditional grant for the Senior Project was tax-exempt bond proceeds secured by 80% redevelopment tax increment that was allocated to affordable housing by the San José Redevelopment Agency. In 2001, the City Council approved the use of \$25 million in such

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funds under a policy for the Housing Department to grant these funds to support the development of extremely low-income (ELI) housing units (ELI Supplemental Policy). Accordingly, the income targeting approved as part of the conditional grant to the Senior Project was for the creation of all ELI apartments.

In 2007, the City of San José approved a loan to the Townhomes Project in the amount of \$4,851,000. This loan was used to retire the existing \$4,113,600 loan and included capitalized interest from the initial loan. In addition, the City also amended the conditional grant agreement to require the Senior Project to remit all rents received from the existing commercial tenant on the property to pay down the principal balance of this newly-created Townhomes loan. The final unpaid balance of the Townhomes loan is \$2,973,833.58, as home sales prices during the extreme housing market weakness in 2008-09 did not generate enough sales revenue to repay the City loan in full.

While development of the Townhomes Project proceeded in late 2007, development of the Senior Project was impeded by several factors. An existing commercial tenant remained on site, which delayed the Senior Project until 2010. The Senior Project's financial feasibility was also problematic given the requirement for all ELI units and the City's inability to fund the additional construction/permanent loan of \$4,830,000 as originally anticipated in 2002. Furthermore, during this time period, the suppressed pricing for Low Income Housing Tax Credits (LIHTCs) limited the availability of additional financing for the project.

On March 3, 2009, the City Council approved a construction loan for the Senior Project in the amount of \$536,238 to reimburse the Townhomes Project for its share of off-site infrastructure costs built to benefit the Senior Project.

On June 14, 2011, the City Council approved a request for an assignment and assumption of the outstanding loan balance on the Townhomes Project to San Carlos Willard Associates, L.P., the development entity of the Senior Project. Included in that approval was a change in the Senior Project's income targeting to enhance financial feasibility. As consideration for changes approved by the City Council, the Developer agreed to: forgo an \$800,000 developer fee; increase the City's share of residual receipts on the Senior Project to 65%; and, convey the Senior Project site to the City and take back a long-term ground lease.

In December 2012, the Developer was successful in obtaining a highly-competitive 9% LIHTC award for the Senior Project. Prices paid by investors for the purchase of LIHTCs are substantially higher than five years ago, enhancing the Project's feasibility.

The Director of Housing, under the authority granted to her by the City Council per Section 5.06 of the San Jose Municipal Code, is allowed to negotiate final business terms and to execute loan documents. The final negotiation of terms and production of loan documents typically occurs close to construction closing in coordination with other lenders and investors, as the business terms affect one another. For the Senior Project, closing is anticipated to occur in April 2013.

**ANALYSIS**

This request does not involve the commitment of additional funds to the Senior Project; rather, this request is to approve the final structure of funds that were already committed to the Project. Moreover, the Project's previously-approved loans and grants are almost entirely disbursed—the undisbursed balance of the conditional grant is \$48,727, and the infrastructure loan of \$536,238 was fully disbursed in 2009. As the Senior Project received a LIHTC award and is now able to assemble the rest of its financing—including an unpaid City loan balance—the City needs to finalize its approvals at this time so the Project can move forward.

The following provides additional information about the components of the City's financing, comprised of 1) a primary construction/permanent loan of \$6,208,420, and 2) a secondary construction/permanent loan of \$2,973,834.

**Primary construction/permanent loan of \$6,208,420**

The primary construction/permanent loan of \$6,208,420 consists of a loan of \$4,775,000, an infrastructure loan of \$536,238, and a payment in lieu of interest in the amount of \$897,182.

***\$4,775,000 Grant vs. Loan***—When the City approved a conditional grant of \$4,775,000 in 80% tax-exempt bond proceeds in 2002, it was anticipated to help create all ELI units and to be used in conjunction with a 9% LIHTC structure. Such tax-exempt bonds must be granted to projects rather than loaned. Although this was a feasible structure at that time, recently, staff has been advised by tax counsel that the use of tax-exempt bond proceeds under these circumstances limits the tax credits available to the Project and is inadvisable.

To help support the Project's feasibility, the City Council's approval in 2011 amended the affordability for all units at or below 30% AMI to a mix of 29 units affordable to residents at or below 30% AMI, 31 units affordable to residents with annual incomes at or below 40% AMI, and 34 units serving residents at or below 50% AMI. Given these changes, funding this Project's current tiered income levels with a grant is inconsistent with the City's ELI Supplemental Policy.

Accordingly, the Developer will return the \$4,775,000 in conditional grant funds to the City prior to closing the construction loan. The City will receive those funds in the Multi-Source Housing Fund and, in turn, obligate those bond proceeds to other future uses eligible under legal requirements for tax-exempt bonds. While the Project is no longer eligible for a grant under the ELI Supplemental Grant policy, it is eligible for a City loan that is repayable from residual receipts. Therefore, upon approval of this request, the funding source for the newly-documented \$4,775,000 construction/permanent loan will be the Low and Moderate Income Housing Asset Fund, as indicated in the Budget Reference below. The Housing Director's approval of final loan terms will contain the interest rate, maturity, repayment provisions and other business terms for the loan.

***Infrastructure Loan of \$536,238***—This early disbursement of a construction loan from 2009 was originally intended to be repaid by a future additional City construction loan commitment.

However, as part of the financial restructure of this project over the past three years, the Developer agreed to proceed without additional City funds. Therefore, this amount—funded by 20% Low and Moderate Income Housing Funds (former '20% redevelopment funds')—will remain in place and will become part of the primary construction/permanent loan.

***Payment in Lieu of Interest in amount of \$897,182***—This payment reflects a capitalization of a payment in lieu of interest as partial consideration of for the restructuring of the Senior Project financing.

### **Secondary construction/permanent loan of \$2,973,834**

This secondary construction/permanent loan reflects the amount of the outstanding loan balance of the unsecured Townhomes Project Loan. This Loan will not actually be assigned to and assumed by San Carlos Willard Associates, L.P., the development entity of the Senior Project, as described in the earlier approvals. Instead, San Carlos Willard Associates, L.P., has agreed to be added as a borrower, to allow the Loan to be repaid from a portion of the residual receipts of the Senior Project, and to be secured by junior deed of trust against the Senior Project. This loan—originally funded by 20% Redevelopment funds—will remain documented separately from the primary construction/ permanent loan as it was not part of the Senior Project's application for LIHTCs, and needs to be separated for purposes of the Project's other financiers.

Due to the deep affordability of the Project, and because the Project is assuming the obligation to repay the additional outstanding loan balance of \$2.9 million, an appraisal that will be prepared for the senior lender shortly before construction closing is expected to result in a combined senior plus City loan-to-value ratio ("LTV") that will be higher than the City's LTV maximum guideline of 100%. However, this result is considered acceptable since project operations are expected to be feasible with permanent mortgage debt service payments at least 1.15 times. This is not an uncommon occurrence for deeply-affordable housing developments.

### **City Option and Ground Lease**

The City Council approved a memorandum on June 14, 2011 as mentioned earlier, which included the business term that the City would own the land (located at 1523-1533 West San Carlos Street) and lease it to the Project for a term of 55 years up to 99 years. However, due to time constraints and the need for the Project to start construction ahead of its tax credit deadline (completion of construction by the end of 2014), it was not possible for staff to effectuate the ground lease and comply with the requirements of Health and Safety Code 33433 in time for construction loan closing. Therefore, at or prior to construction loan closing, the Developer will grant an option to the City to acquire the property at no cost to the City, and the City will, upon compliance with the requirements of Health and Safety Code 33433 and prior to conversion of the City's construction loan to a permanent loan, exercise the option to acquire the property and concurrently enter into a ground lease with Developer. Prior to exercising the option, staff will return to the City Council for approval of the ground lease as required pursuant to Health and Safety Code Section 33433.

### **El Rancho Verde Loan Repayment**

Recommendations to recognize and appropriate a \$5.7 million loan repayment from the El Rancho Verde project is included as part of this memorandum. The original loan for this project was made in 2000. The City received this loan repayment in the Low and Moderate Income Housing Asset Fund, and the loan repayment is unrelated to the Senior Project. The use of the loan repayment will provide for the \$4,775,000 portion of the primary loan to the Senior Project also recommended in this memorandum. The remaining \$925,000 will fall to the Ending Fund Balance of the Low and Moderate Income Housing Asset Fund for future use.

### **EVALUATION AND FOLLOW-UP**

The Housing Department regularly reports on actions taken by Director under her Delegation of Authority in the form of an Information Memorandum. Once finalized, the Project's loan terms accordingly will be summarized and reported to the City Council. The Housing Department also posts quarterly reports on the status of its subsidized construction projects to its website, [www.sjhousing.org](http://www.sjhousing.org). If approved, the San Carlos Senior Apartments project would be included in these reports. In addition, staff will return to Council for approval of the ground lease in the next 18 months.

### **POLICY ALTERNATIVES**

To arrive at this recommendation, staff considered the following options:

**Alternative #1:** *Deny approval for the San Carlos Senior Apartment Project's final City financial structure.*

**Pros:** Maintaining the current grant financing structure despite possible project feasibility difficulties could reduce the demand on staff resources.

**Cons:** The Senior Project's willingness to repay the unpaid City loan balance of over \$2.9 million on the Townhomes Project over time is truly a win-win for the City and the Developers. By allowing the unpaid Townhomes loan balance to be repaid by this Project, the City will be repaid over time instead of writing off the full unpaid amount. With a structure including the assumed loan balance, the Developers have obtained a highly-competitive 9% LIHTC award, have identified private lenders and investors who want to fund the project, and are proceeding towards a construction closing in April 2013. To deny approval of the total structure would stop these units from being constructed, but does not free up funds, as almost all of the funds have already been spent on land, predevelopment and preliminary construction costs. This action does not provide additional City funding to this Project, so there is no alternative use of such funds for a different project. Further, as improvements were already funded with 20% Redevelopment Funds, the site

needs to support affordable housing per State Redevelopment Law.

**Reason for not recommending:** The City has been trying since 2002 to help this Project to proceed. Under its current structure, it will help to repay a \$2.9 million unpaid loan balance to the City. Approval of this action will enable 94 affordable apartments to be built to help very low- and extremely low-income residents of San José, which is consistent with both the City's goals and with State Law.

### **PUBLIC OUTREACH/INTEREST**

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

This item meets Criterion 1 set forth above. Accordingly, this City Council report will be posted to the City's website for the April 9, 2013, City Council Agenda.

### **COORDINATION**

This memorandum has been coordinated with the Office of the City Attorney.

### **FISCAL/POLICY ALIGNMENT**

This action is consistent with the Housing Department's *Five-Year Investment Plan for Fiscal Years 2007/08-2011/12* in increasing the supply of affordable housing, and with the City's *Consolidated Plan for 2010-15* in providing reasonably-priced apartments for very low- and extremely low-income households.

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**COST SUMMARY/IMPLICATIONS**

**1. ESTIMATED COSTS OF COMMITMENT (\$4,775,000 part of primary loan)**

<b><u>USES</u></b>	<b><u>AMOUNT</u></b>
Land	\$3,234,400
Hard Costs	\$153,840
Soft Costs	\$1,386,760
<b>TOTAL</b>	<b>\$4,775,000</b>

**2. SOURCE OF FUNDING:** Fund 346 – Low and Moderate Income Housing Asset Fund (El Rancho Verde Loan Repayment).

**3. FISCAL IMPACT:** There is no ongoing fiscal impact, and no net new funds are being requested for the San Carlos Senior Apartments project.

**BUDGET REFERENCE**

The Housing Department has received a \$5,700,000 loan repayment from the El Rancho Verde project in the Low and Moderate Income Housing Asset Fund. The actions recommended in this memorandum will recognize and appropriate this loan repayment, which will offset the \$4,775,000 loan as recommended in this memorandum.

Fund #	Appn. #	Appn. Name	Total Appn.	Amt. For Contract	2012-2013 Adopted Operating Budget Page	Last Budget Action (Date, Ord. No.)
346	0070	Housing Loans and Grants	\$6,444,957	\$4,775,000	XI-1	1/29/2013 Ord/Res #29204



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**CEQA**

CEQA: Exempt, PD04-103.

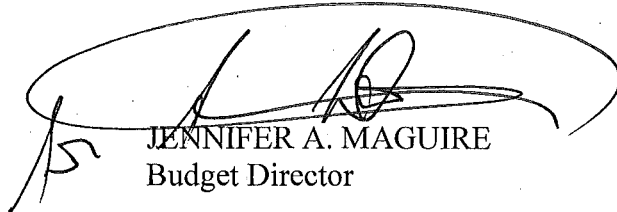
/s/

LESLYE CORSIGLIA  
Director of Housing



JENNIFER A. MAGUIRE  
Budget Director

I hereby certify that there will be available for appropriation in the Low and Moderate Income Housing Asset Fund in the Fiscal Year 2012-2013 moneys in excess of those heretofore appropriated therefrom, said excess being at least \$5,700,000.



JENNIFER A. MAGUIRE  
Budget Director

For questions, please contact Leslye Corsiglia, Director of Housing at 408-535-3851.