COUNCIL AGENDA: 6/17/14
ITEM: 2.26

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Leslye Corsiglia

SUBJECT: SEE BELOW

DATE: May 30, 2014

Approved [signature] Date 6/6/14

COUNCIL DISTRICT: 7

SUBJECT: APPROVAL OF A CONSTRUCTION/ PERMANENT LOAN COMMITMENT AND AN INCREASE TO THE PREDEVELOPMENT LOAN FOR THE METROPOLITAN APARTMENTS NORTH PHASE BEING DEVELOPED BY CHARITIES HOUSING DEVELOPMENT CORPORATION

RECOMMENDATION

It is recommended that the City Council adopt a resolution:

1. Approving a construction/permanent loan commitment of up to $12,981,000 of Multi-Source Housing Fund money to 2112 Monterey Road Apartments, L.P., a legal entity related to Charities Housing Development Corporation ("Borrower"), for development of the North Phase of The Metropolitan Apartments ("Project") located at 2112 Monterey Road ("the Site");

2. Approving an increase of $250,000 to the Borrower's existing acquisition/ predevelopment loan that is currently secured on the Site;

3. Authorizing the Director of Housing to negotiate and execute the necessary loan- and subdivision-related documents for the Project, including amendments, reconveyances, and consents; and

4. Authorizing a Loan to Value amount in excess of 100%.

OUTCOME

The recommended action will enable Charities Housing Development Corporation ("Developer" or "Charities") to assemble financing to build a 71-unit affordable family apartment building—the first phase of a planned two-phase affordable housing complex ("The Met") which will create a total of 102 apartments—to be constructed at 2112 Monterey Road ("Project") that it has been working on since 2008. Once constructed, the apartments will be affordable to Extremely Low-Income ("ELI") and Very Low-Income ("VLI") individuals and families with incomes between approximately $22,300 and $47,475 per year.

Approval also will allow Charities to incur near-term costs in order to apply for federal 9% low income housing tax credits ("tax credits") in the July 2014 application round to the California Treasurer's Tax Credit Allocation Committee (TCAC). Consideration of this action at the June 17, 2014 City Council meeting is necessary to meet the TCAC deadline.

BACKGROUND

Charities, a nonprofit affordable housing developer based in San José, has worked to advance development of The Metropolitan Apartments ("The Met") at 2112 Monterey Road since early 2008. As part of a structured financial workout with Emergency Housing Consortium ("EHC"), Charities agreed to purchase the Site in 2008 and has been planning the 102-unit affordable family rental project since that time.

The structure formerly located on the 2.86-acre Site was a mid-century motel that had been rehabilitated multiple times and converted to affordable apartments, which were then known as the Monterey Glen Apartments and the Markham Terrace Apartments. Further rehabilitation of the apartments was deemed economically unviable—therefore, demolition and the new construction project were planned for the Property.

On January 27, 2009, the City Council approved a several actions regarding EHC's financial workout. Among these actions was approval for a $500,000 predevelopment loan to Charities to support its project planning on the Site.

On August 4, 2009, the City Council approved a funding commitment of up to $6,280,000 to Charities for Site acquisition. The City closed its acquisition/predevelopment loan for up to $6,780,000 on December 24, 2009. This amount later was increased to $6,880,000 under the Director of Housing's delegation of authority on February 14, 2011, to cover additional carrying costs, primarily real estate taxes.

The old apartments' deteriorated physical condition constituted a safety hazard to the neighborhood, so in mid-2010, the City's predevelopment loan paid for demolition of the building under a demolition permit (PD10-001) approved by the Director of Planning, Building and Code Enforcement in April 2010.

Charities has completed considerable work on land use entitlements for the Project over the past several years, and both zoning and permits are in place to build 102 apartments. In February 2010, the City Council approved a Planned Development Zoning (PDC09-015) for both phases of The Met. In July 2011, the Director of Planning, Building and Code Enforcement approved a PD Permit (PD11-011) for both phases.

While progress has been made on the Site, the City's financial constraints have impacted Charities' ability to assemble development financing since 2008. Difficulties in the financial markets in 2008-09 froze funding disbursements and awards by the State of California, delaying many affordable projects already in process. This Project also waited for a City funding commitment during the State's take of redevelopment funds and the dissolution of redevelopment. Given these delays, on June 18, 2013, the City Council approved a performance-based loan of up to $80,000 per year for up to 3 years—a total of $240,000—to pay for the Property's ongoing operating costs including site security and taxes.

Finally, because more funding is available from a variety of sources, including program income from the City's affordable housing loan portfolio and inclusionary in-lieu fees, staff now is able to bring forward a request for a construction/permanent loan for The Met's 71-unit North Phase. Staff expects to return to the City Council in the near future with a funding request for The Met's South Phase containing the other 31 planned apartments. In total, 102 apartments—studios, one-, two- and three-bedrooms—will be built for families, of which 100 will be income-restricted and two will be unrestricted managers' units.

The two phases are expected to move forward separately and will assemble separate financing packages. While the apartments are already designed to be phased, Charities will file for a parcel map to officially allow physical phasing in the near future.

ANALYSIS

Project

The North Phase will consist of 71 apartments, comprised of 11 studios, 25 one-bedrooms, 13 two-bedrooms, 21 three-bedrooms, and one two-bedroom manager's unit. Eighteen (18) units will be restricted to Extremely Low Income households earning up to a maximum of 30% of Area Median Income (AMI), 52 units will be restricted to Very Low Income households earning up to a maximum of 45% AMI, and one manager's unit will be unrestricted. Affordability restrictions will be recorded at construction closing to effectuate these rent and income limits for at least 55 years.

The Project will be located on a 2.03-acre portion of the Property, will be an L-shaped building ranging in height from two to four stories, and will contain two offices for property management and resident services as well as a fitness center and laundry room. The North Phase will contain the parking and all amenities for both phases, which should allow the South Phase to proceed more easily once the North Phase has obtained its financing commitments.

Loans

The requested construction/permanent loan amount for the North Phase of $12,981,000 includes the $4,816,000 already disbursed for predevelopment and land acquisition for the North Phase. The City's existing $6,880,000 acquisition/predevelopment loan secured on the entire Site, plus accrued interest, is allocated 70% to the North Phase ($4,816,000) and 30% to the South Phase ($2,064,000) based on the ratio of affordable units in the North Phase to the South Phase. Therefore, a total of $8,165,000 in new funds for use during construction and the permanent period for the North Phase is being requested through this Memorandum.

The City's construction/permanent loan commitment is necessary at this time to enable Charities to proceed with its pursuit of other public and private funding sources for this Project. City funds are always committed first in deeply affordable developments, which can take years to put together. Development costs for the Project are expected to be approximately $36.2 million. In order to secure highly-competitive 9% tax credits, a significant local subsidy is required. Charities will pursue other financing sources including the Federal Home Loan Bank's Affordable Housing Program ("AHP"), State Infill Infrastructure Grant funding through Proposition 1C (if available), and a conventional mortgage loan.

Staff believes that this Project will compete successfully for 9% tax credits, as the City's new commitment combined with the Site's pre-existing City and County subsidies will permit the Project achieve a relatively high tiebreaker score that is needed to be competitive.

The Project's depth of affordability and underwriting parameters are in accordance with the City's priorities for funding commitments. Charities also has a strong track record of producing affordable rental housing in San José, as it owns and operates seven other affordable rental properties here containing 565 apartments. Many of Charities' apartments also house residents with special needs. Separate from this action, Charities has expressed willingness to work with the City to accommodate homeless residents who possess rental vouchers. This willingness is important given the City's heightened focus on housing San José's homeless.

In addition, Charities is requesting that another $250,000 in predevelopment funds be made available prior to closing construction. Significant predevelopment costs are part of preparing for application for 9% tax credits, as a project must have preliminary building plans completed so that it can close and start construction within 90-120 days after receiving an allocation. Resources are required during the predevelopment phase to pay for third-party reports, the development of plans and specifications, and other early costs. These early costs often exceed $1 million. Therefore, nonprofit developers usually request and receive predevelopment loans from the City.

The period of time that Charities would have been working on this project prior to construction closing, were it to obtain the City Council's approval and then compete successfully in the July 2014 round for 9% tax credits, would total seven years. The City's additional predevelopment loan of $250,000—which will be repaid by the City's construction/permanent loan, so is part of the Project's total commitment amount of $12,981,000—will help to defray further early costs for the engagement of reports, preparation of plans and specifications, and other costs prior to construction. The additional $250,000 would bring the City's total predevelopment funding for the North Phase to $578,000, which includes a 70% allocation of the $240,000 loan for operating costs that the City Council approved in mid-2013. The increase in predevelopment funds would bring the proportional total for the acquisition/predevelopment loan for this Phase to $5,066,000.

Loan-to-Value

Due to the deep affordability of the Project—which both increases needed public subsidy and decreases the Project's market value—and to the pre-existing loan commitments to the Site's previous affordable housing project, there is an unusually high amount of public debt on this Site. Therefore, an appraisal that will be prepared for the senior lender before construction closing is expected to result in a combined senior plus City loan-to-value ratio ("LTV") that significantly exceeds 100%, which is the City's LTV maximum guideline. 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 project operating income. High LTVs are not an uncommon occurrence for deeply-affordable housing developments.

The City's loan will be repaid from residual receipts out of net cash flow, as it is available; however, a percentage of net cash flow will need to be shared among the Project's subordinate loans, resulting in an expected low level of loan repayment in the near- to mid-term. Repayments will likely improve once older debt matures and additional revenue is freed up.

Approval of these actions will allow the Director of Housing to negotiate the loan terms and execute loan documents for the construction/permanent Project, as well as negotiate and execute amendments to existing loan acquisition/predevelopment loan documents. As the Site is expected to be subdivided, these approvals will include changes to the legal descriptions and other changes related to the subdivision for this Project.

Economic Development Benefits

Taking actions to further this Project will benefit San José economically in three ways. First, the developer expects to pay City fees of $2,092,166 in order to proceed with the development process. Second, total local impacts for communities in the area are defined as benefits of the direct construction activity itself as well as the impact of local residents who earn money from the construction activity and spend part of it within the area. According to a 2009 study by the National Association of Homebuilders (NAHB) on the economic benefits to local areas for multifamily low-income housing tax credit-funded construction, 71 units of family housing are estimated to generate over $5.7 million of local benefits in the first year and approximately $1.5 million each year thereafter. Third, according to the NAHB metrics, it is also anticipated that proceeding with and completing the development of the Project will create 127 local jobs in San José in the first year, directly and indirectly, and 27 local jobs each year thereafter. The Project's location across the street from the Plant, with more than 50 stores, restaurants, and services makes this an ideal location for housing affordable to retail workers.

EVALUATION AND FOLLOW-UP

The Housing Department posts periodic reports on the status of its subsidized construction projects to its website, www.sjhousing.org. If approved, The Metropolitan Apartments would be included in these reports.

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. Accordingly, a copy of this Memorandum will be posted to the City's website for the June 17, 2014 meeting.

Several public meetings were held to present the project concept and design to the community and provide opportunities for feedback during the course of award of land use entitlements. The project was well-received; there was support expressed by neighboring residents, and there were no concerns expressed that resulted in the need for design changes to this Project.

POLICY ALTERNATIVES

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

Alternative:	***Deny or delay the requested funding commitment.***
Pros:	The funds being requested could be used for other affordable housing projects and programs.
Cons:	The subject Project needs to be given the opportunity to win tax credits in the July 2014 tax credit round of applications. As the City has already expended Low and Moderate Income Housing Funds on the land and on predevelopment activities, affordable housing must go forward on this site.
Reason for not recommending:	The proposed Project will help to meet the demand for deeply affordable housing that is affordable to ELI and VLI households, helping the City to fulfill its affordable housing goals. Approval of this Project's financing will

assist this very important affordable housing project to move ahead after years of delays.

COORDINATION

This Memorandum was coordinated with the City Attorney's Office.

FISCAL/POLICY ALIGNMENT

This expenditure is consistent with: the City's *Envision 2040 General Plan* and *2007-14 Housing Element* in that it provides a range of housing opportunities across income groups; the City's current *Housing Investment Plan* in that it increases the supply of affordable housing; and, the City's *Consolidated Plan 2010-15* in that it provides units for very low- and extremely low-income households.

COST SUMMARY/IMPLICATIONS

1. **ESTIMATED COSTS OF COMMITMENT:**

USES		AMOUNT
Hard and Soft Project Costs		$8,165,000
Existing Acquisition/Predevelopment Loan		$4,816,000
	TOTAL	$12,981,000

2. **SOURCE OF FUNDING:** Fund # 448 - Multi-Source Housing Fund

3. **FISCAL IMPACT:** No ongoing fiscal impact.

BUDGET REFERENCE

The table below identifies the funds and appropriations proposed to fund the commitments recommended as part of this Memorandum.

Fund #	Appn #	Appn. Name	Total Appn	Amt. for Contract	2013-2014 Adopted Budget (Page)	Last Budget Action (Date, Ord. No.)
448	0070	Housing Loans and Grants	$20,910,000	$12,981,000	XI-74	6/18/2013 Ord. 29271

CEQA

Mitigated Negative Declaration File Nos. GP08-07-04 and PDC09-015.

/s/
LESLYE CORSIGLIA
Director of Housing

For questions, please contact LESLYE CORSIGLIA, Director of Housing, at 408-535-3851.

Attachments

ATTACHMENT 1

Anticipated Project Timeline
The Metropolitan Apartments -- North Phase

City Council Approval of Funding Commitment	June 2014
Low Income Housing Tax Credit Committee Application	July 2014
Low Income Housing Tax Credit Award	September 2014
Federal Home Loan Bank Application for Affordable Housing Program Award	March 2015
Start Construction	March 2015
Complete Construction	Mid 2016

ATTACHMENT 2

Site Map
Metropolitan Apartments -- North Phase