



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Leslye Corsiglia

SUBJECT: SEE BELOW

DATE: May 30, 2014

Approved

Date

6/6/14

COUNCIL DISTRICT: 3

**SUBJECT: APPROVAL OF A CONSTRUCTION/PERMANENT LOAN
COMMITMENT AND A PREDEVELOPMENT LOAN TO FIRST
COMMUNITY HOUSING FOR THE DEVELOPMENT OF THE SECOND
STREET STUDIO APARTMENTS**

RECOMMENDATION

Adopt a resolution:

1. Approving a construction/permanent loan commitment of Low and Moderate Income Housing Asset Funds to Second Street Studios, L.P., a legal entity related to First Community Housing, of up to \$8,000,000 for the Second Street Studio Apartments ("Project") located at 1140 South Second Street;
2. Approving a \$500,000 predevelopment loan for the Project; and
3. Authorizing a Loan to Value amount in excess of 100%.

OUTCOME

Approval of the recommended actions will enable the developer, First Community Housing ("FCH"), to assemble financing to build a 135-unit affordable apartment building with ground floor commercial space that it has been working on since 2006. Approval in June will allow FCH to incur near-term costs in order to apply for federal 9% low income housing tax credits ("tax credits") and other funding sources.

BACKGROUND

FCH, a nonprofit affordable housing developer based in San José since 1986, has been working on advancing this project since 2006. In August 2008, the City Council approved PD Zoning (PDC07-086) for the apartments, followed by a Director's approval of its PD Permit (PD07-094) in November 2008.

In September 2008, FCH applied formally to the City's Housing Department for a funding award. However, difficulties in the financial markets at that time 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. Finally, given the recent availability of program income from the City's affordable housing loan portfolio, staff is able to bring forward a request for funding.

FCH acquired the site in December 2013, having borrowed from a special public/private loan fund specializing in funding land acquisition for future transit-oriented affordable housing development projects.

Once it is constructed, Second Street Studios ("Project") will include 135 small apartments that will be affordable to Extremely Low-Income (ELI) and Very Low-Income (VLI) individuals, including special needs populations. As of 2014, the income range of qualifying residents would be between \$22,300 and \$42,450 per year.

The building will occupy four floors of a single building above retail on a 1.16-acre site located at the southeast corner of South Second and Keyes Streets. Of the 135 units, 128 will be studio apartments, six will be one-bedroom apartments, and one will be a two-bedroom manager's apartment. All apartments will have a kitchen and accessible bathroom, while the one- and two-bedroom apartments will also offer exterior balconies. The building will include a community room and a gym. Structured retail and residential parking will be provided on the ground floor and below grade. FCH will pursue LEED designation for the building, which is expected to be rated at the Gold or Platinum level.

Both rent and residents' incomes will be defined by affordability restrictions to be recorded on the site, as follows: 32 studios and two one-bedroom apartments are expected to be restricted to Extremely Low Income ("ELI") households earning up to 30% of Area Median Income ("AMI"); 64 studios and two one-bedroom apartments are expected to be restricted to Very Low Income ("VLI") households earning up to 40% AMI, and 32 studio and two one-bedroom units are expected to be restricted to VLI households earning up to 50% AMI. The manager's apartment will remain unrestricted.

Forty-seven (47) of the apartments will be set aside for special needs occupancy, primarily developmentally disabled tenants capable of independent living. Services for those residents will be provided through the Housing Choices Coalition, a nonprofit organization established to assist San José's developmentally disabled residents that were supported by the now-closed Agnews Center. Other special needs residents are expected to include those living with chronic illnesses.

Services for special needs residents will also be provided by State-funded In-home Supportive Service providers. Residents will receive free Eco-Passes for local transit usage.

The ground floor retail space will be divided from the residential space by a condominium subdivision and sold to a separate entity. Revenues from the sale will serve as a source of development for the apartments. The commercial plan includes 9,000 square feet of retail space on the ground floor that will be divided into approximately four to eight separate spaces for businesses, such as shops and restaurants, which will serve the local community.

ANALYSIS

FCH has completed 17 other successful affordable housing properties, 12 of which are located in San José, with two more currently under construction. FCH has sufficient financial strength to pursue this development, and has worked successfully with Branagh Construction and Rob Wellington Quigley Architects on multiple projects. FCH focuses on green building techniques and has done other mixed-use and mid- and high-rise residential buildings—several of which have received national recognition—so is highly capable of successfully completing this Project.

Predevelopment and Construction/Permanent Loans

The City's construction/permanent loan commitment is necessary at this time to enable FCH to proceed with its pursuit of other public and private funding sources for this Project. City funds are always committed first in these developments, which can take years to put together. Development costs for the Project are expected to be approximately \$40.7 million. In order to secure highly-competitive 9% tax credits, a significant local subsidy is required. FCH 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.

Application for 9% tax credits requires that the project have preliminary building plans completed so that a project can close and start construction within 90-120 days after receiving an allocation. Significant resources therefore 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 City's predevelopment loan of \$500,000—which will be repaid by the City's construction/permanent loan, so is part of the Project's total commitment amount of \$8,000,000—will be help to defray early costs for engagement of reports, preparation of plans and specifications, and other costs prior to construction.

While the source for committing both loans at this time will be repayments from former 20% redevelopment-funded loans in the City's Low and Moderate Income Housing Asset Fund, the City expects to eventually substitute in federal HOME funds shortly before construction closing.

Loan-to-Value

Due to the affordability of the Project, an appraisal that will be prepared for the senior lender before construction closing is expected to result in a combined loan-to-value ratio ("LTV") of senior plus City debt 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 project operating income equal to at least 1.15 times the permanent mortgage debt service payments. This is not an uncommon occurrence for deeply-affordable housing developments.

By her authority under section 5.06.335 of the Municipal Code, the Director of Housing will negotiate additional loan terms and execute loan documents for both the predevelopment loan and the construction/permanent loan in accordance with the City Council's approval, if granted, 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 \$975,000 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, 135 units of primarily studio apartments are estimated to generate over \$10 million of local benefits in the first year and almost \$3 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 202 local jobs in San José in the first year, directly and indirectly, and 51 local jobs each year thereafter.

EVALUATION AND FOLLOW-UP

The Housing Department posts periodic reports on the status of its affordable housing apartments currently underway to its website, www.sjhousing.org. If approved, the Second Street Studio 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, which requires Council action on the use of public funds equal to \$1 million or greater. A copy of the City Council memo will be posted to the City's website for the June 10, 2014 meeting.

During the entitlements process, two public meetings were held to present the project concept and design to the community and provide opportunities for feedback. The project was generally well-received, and there were no design changes resulting from the neighborhood meetings. Comments made were regarding affordable housing, the type of retail establishments that community members wanted, what type of finished product that people would like, and other amenities that the neighborhood needs.

POLICY ALTERNATIVES

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

Alternative #1: *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 a City commitment in order to prepare the project to apply for tax credits and for other funding. Given this predevelopment loan commitment, FCH will have greater certainty of repayment when incurring costs and will have sufficient time to conduct a NEPA study, which can slow down predevelopment activities but is necessary to use federal HOME funds. Federal HOME funds can be awarded to FCH as a CHDO in this jurisdiction, requiring the project to proceed timely in order to remain eligible for HOME funds—a major source of funding for affordable housing projects.

Reason for not recommending: The proposed Project will help to meet the demand for deeply affordable single-room occupancy housing that is affordable to ELI and VLI households. The project will help the City to fulfill its affordable housing goals.

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 *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:

<u>USES</u>	<u>AMOUNT</u>
Hard and Soft Construction Costs (including those incurred during predevelopment)	\$8,000,000
TOTAL	\$8,000,000

2. 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 at this time.

Fund #	Appn #	Appn. Name	Total Appn	Amt. for Contract	2013-2014 Adopted Budget (Page)	Last Budget Action (Date, Ord. No.)
346	0070	Housing Loans and Grants	\$13,000,000	\$8,000,000	XI-58	10/8/2013 Ord. 29320

HONORABLE MAYOR AND CITY COUNCIL

May 30, 2014

Subject: Second Street Studio Apartments

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CEQA

Mitigated Negative Declaration, File No. PDC07-086, adopted 8/26/2008.

/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 Second Street Studio Apartments

City Council Approval of Funding Commitment	June 2014
Conduct NEPA study and development of plans and specs	Fall 2014-Spring 2015
Application for Low Income Housing Tax Credits	July 2015
Award for Low Income Housing Tax Credits	September 2015
Application for Federal Home Loan Bank Affordable Housing Program Award	March 2016
Start of Construction	March 2016
Completion of Construction and Full Occupancy	July 2017

