



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Leslye Krutko

**SUBJECT:** SEE BELOW

**DATE:** March 4, 2008

Approved

Date

3-5-08

**COUNCIL DISTRICT:** 3  
**SNI AREA:** Spartan Keyes

**SUBJECT: APPROVAL OF UP TO \$100,000 IN SECOND MORTGAGE COMMITMENTS TO FIRST-TIME HOMEBUYERS AT THE WORKS**

## **RECOMMENDATION**

It is recommended that the City Council adopt a Resolution approving a funding commitment of up to \$100,000 to provide second mortgages of up to \$50,000 each to low- or moderate-income households for the purchase of one of the remaining two affordable units at The Works development, located at the corner of Patterson and South Third Street in the Spartan Keyes Strong Neighborhood Initiative (SNI) Area.

## **OUTCOME**

Upon approval of this memo, the Department of Housing will immediately make available up to \$100,000 to assist income-eligible homebuyers at The Works, which will support homeownership opportunities for low- or moderate-income households in San José.

## **BACKGROUND**

The Works is a 74- unit condominium development located in the Spartan Keyes SNI Area. The development consists of studios, and one- to two- bedroom units. The developer is Barry Swenson Builders (BSB), and the project was completed in October 2006.

The Works is subject to the City's Inclusionary Housing Program Policy that was in effect in 2006, which required the developer to provide 20% of the units at an affordable cost to either low- or moderate-income households. As a result, 15 resale-restricted units were reserved for eligible homebuyers and each household was offered a deferred repayment second mortgage in exchange for purchasing a restricted unit.

In 2006, the City of San José was also awarded \$420,000 in Building Equity and Growth in Neighborhood (BEGIN) Program funds through State Proposition 46. BEGIN program regulations require that the funds be loaned to low- and moderate-income first-time homebuyers in The Works. The City and the developer combined the BEGIN loans with the existing project based loans available to low- and moderate-income buyers of the affordable units at this development.

The City's Inclusionary Housing Policy sets forth a mortgage based calculation that limits what the buyer can apply toward their total monthly housing costs. The hypothetical maximum sales price produced as a result of the mortgage based formula is referred to as the "maximum affordable sales price." The developer is required to fund the difference between the market value of the home (fair market value) and the amount the household can afford to pay for the home (maximum affordable sales price) in the form of a deferred repayment loan in favor of the City with equity share repayment terms. The City receives a recorded Affordability Restriction and Deed of Trust securing the value of the developer discount loan.

Since October of 2006, the owner has sold thirteen of the fifteen affordable units. Until recently, the affordable units had a fair market value of \$310,000 and the amount of the owner funded developer discount loan for the homebuyer was calculated at \$29,600.

### **ANALYSIS**

Over the last eighteen months, the market value of the units has fallen from \$310,000 to \$295,000. The reduction in market value combined with other lower costs such as reduced interest rates and property tax assessments has resulted in a situation in which the maximum affordable sales price is greater than the units' market values. It is highly unlikely that a low- or moderate-income first-time homebuyer would be willing to buy a restricted unit without having received any financial benefit for doing so.

The developer of the Works remains in compliance with the City's Inclusionary Housing Policy, and has already provided over \$730,000 in deferred repayment downpayment assistance loans to homebuyers from net sales proceeds for 13 of the 15 affordable units. However, the owner is not required to offer larger developer discount loans above what is necessary to make 20% of the units affordable to moderate-income homebuyers, based on the formula in the policy.

In order to continue to attract new low- and moderate-income homebuyers to this development, and in an effort to deepen the affordability and reach lower-income households, the Department of Housing is requesting approval to make available up to \$50,000 to each household purchasing an affordable unit. In consideration for City funding, each of the assisted units would become an affordable housing unit with deeper affordability than would be available without the additional City funds. In addition, each unit would be subject to a 45- year affordability restriction and a recorded deed of trust securing the \$50,000. Each of these loans would become due and payable upon the sale or transfer of the property. In addition, if the units are sold or transferred prior to the termination of the affordability period, the City would receive an additional equity-share

amount from the proceeds of the subsequent re-sale. These funds would be repaid to the Department of Housing and used to create new affordable units elsewhere in the City.

Through the commitment of new City funds to these units, the BEGIN funds already awarded to the City for homebuyers at this project would be more likely to be utilized prior to the current contract deadline of June 30, 2008.

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

Upon approval of this funding request, Housing Department staff and the project owner will jointly advertise and market the availability of the funds in the project to prospective homebuyers.

### **POLICY ALTERNATIVES**

To arrive at this proposal, staff also considered the following option:

**Alternative #1:**     *Do not approve assistance for homebuyers in this project.*

**Pros:**                These funds could be used to finance other projects targeted to low- and moderate-income households.

**Cons:**                By authorizing a funding commitment to homebuyers at The Works, the City is encouraging future homebuyers to purchase a home in the Spartan Keyes SNI Area. In addition, it is unlikely that the owner would be able to sell a resale-restricted unit in this depressed for-sale housing market without offering significant financial incentives to attract first-time homebuyers.

**Reason for Not  
Recommending:**    The Works provides an opportunity for low- and moderate-income homebuyers to purchase a new home near San José State University and Downtown San José.

### **PUBLIC OUTREACH/INTEREST**

Although this notice does not meet any of the criteria below, this memo will be posted to the City Council Agenda for March 25<sup>th</sup>, 2008 via the City's website. If approved, the Housing Department will work with Barry Swenson Builders and their sales team, Pacific Marketing and Associates Inc., to market the City funds to prospective homebuyers at The Works.

- 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)**

**COORDINATION**

This memorandum has been coordinated with the City Attorney’s Office.

**FISCAL/POLICY ALIGNMENT**

This expenditure is consistent with the most recent council-adopted “Five-Year Housing Investment Plan for FY 2007/2008 through FY 2011/2012,” which sets forth a goal of providing at least 553 new low- and moderate-income homebuyers with downpayment assistance over the next five years. Further, the usage of funds for downpayment assistance in new construction projects is consistent with the City’s For-Sale Housing policy, adopted in 1988, which authorizes a forward commitment of second mortgages to future residents in for-sale developments.

**COST SUMMARY/IMPLICATIONS**

1. **COST OF PROJECT:** N/A--Not a Project
2. **COST ELEMENTS OF CITY LOAN(S):** Not to exceed \$100,000
 

<u>Uses</u>	<u>Amount</u>
Downpayment Assistance	<u>Two loans at \$50,000</u>
<b>TOTAL</b>	<b>\$100,000</b>
3. **SOURCE OF FUNDING:**Fund 443 - Low and Moderate Income Housing Fund.
4. **FISCAL IMPACT:** No ongoing fiscal impact.

**BUDGET REFERENCE**

Fund #	Appn #	Appn. Name	Total Appn	Amt. for Contract	Adopted Budget Page	Last Budget Action
443	0070	Housing Loans and Grants	\$29,000,000	\$100,000	XI-48	3/04/2008, 28261

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**CEQA**

N/A-Not a Project.



LESLEYE KRUTKO  
Director of Housing

For questions, please contact Jacky Morales-Ferrand at 408.535.3855.