



COUNCIL AGENDA: 5/3/05

ITEM: 2.6

# Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Leslye Corsiglia

**SUBJECT:** SEE BELOW

**DATE:** April 13, 2005

Approved

Date

4.18.05

**COUNCIL DISTRICT:** Citywide  
**SNI AREA:** All

**SUBJECT: REVISIONS TO THE PROJECT SELECTION SYSTEM FOR THE CITY'S AFFORDABLE HOUSING DEVELOPMENT PROGRAM**

## RECOMMENDATION

It is recommended that the City Council adopt a resolution approving amendments to the project selection system for the City's affordable housing development program to: add senior, adaptive re-use, and acquisition/rehabilitation developments as eligible housing projects; add as an additional application threshold a requirement that a minimum percentage of the units in each project be affordable to extremely low-income households; and convert from a funding-round process to an over-the-counter application process.

## BACKGROUND

On February 24, 2004, the City Council approved a new project selection system for the affordable housing program. The approved selection system – which includes threshold criteria and a weighting system for scoring proposed developments in competitive funding rounds – determines those affordable housing projects for which the Housing Department will recommend that the City Council provide funding commitments.

Under the current project selection system, three categories of new-construction, rental housing development are eligible to apply for funding: family apartment projects; projects serving special needs populations; and SRO/studio apartment projects. In order to be recommended for funding, projects must score a minimum of 70 points in the 100-point scoring system. That scoring system is weighted as follows:

	<u>Points</u>
1. Per-Unit Subsidy	30
2. Affordability	20
3. Leverage with Outside Funding Sources	10

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- 4. Points by Population Type (separate scoring for: large families; special needs housing; and SRO/studio apartments) 10
- 5. Excellence in Project Management (i.e., developer experience) 10
- 6. Meets Smart Growth Objectives 10
- 7. Sustainable Development/Green Building 5
- 8. Project Involves Other Public Benefit 5

MAXIMUM POSSIBLE POINTS 100

Negative Points (i.e., point deductions) for sponsors with poor histories in affordable housing project management Up to 20

In calendar year 2004, the Housing Department issued three Notices of Funding Availability (NOFAs) using the standards set forth in the project selection system. From those three NOFA rounds, applications for six development proposals, totaling \$42.6 million in funding commitments, have been recommended to and approved by the City Council. The following table summarizes the income levels and unit types in those six projects, in which the average per-unit subsidy is \$61,422:

**Results of Three 2004 NOFA Rounds**

	<b>SRO/ Studio</b>	<b>1 Bdrm</b>	<b>2 Bdrm</b>	<b>3 Bdrm</b>	<b>TOTALS</b>
Extremely low-income (ELI)	45	9	32	17	<b>103</b> 15%
Very low-income (VLI)	97	151	251	62	<b>561</b> 81%
Low-income (LI)				29	<b>29</b> 4%
<b>TOTALS</b>	<b>142</b> 20%	<b>160</b> 23%	<b>283</b> 41%	<b>108</b> 16%	<b>693</b> 100%

When the City Council approved the project selection system in February 2004, Housing Department staff estimated a bonding capacity of approximately \$60 million. As noted above, \$42.6 million of this amount has been committed to development projects over the past year.

Through restructuring of the City's current debt, including refinancing of \$124.7 million in outstanding Tax Allocation Bonds that is scheduled for City Council consideration on May 10, 2005, as well as the implementation of a new Redevelopment Agency Housing set-aside program by the California Debt Limit Allocation Committee, the Finance and Housing Departments have achieved substantial financing savings that have resulted in an increase in the bonding capacity of the 20% Fund. It is now projected that \$70 million will be available for future projects (which includes the \$17.4 million carryover from the 2004 NOFA rounds). These estimates are based

on conservative tax increment growth projections and bonding capacity models developed by Ross Financial Services, the City's financial advisor, and Citigroup Global Markets, Inc.

## **ANALYSIS**

### **Senior Housing Projects**

As noted above, the current list of eligible projects does not include rental housing for seniors. Senior housing projects were excluded from the competitive funding process based on market conditions in early 2004, including the fact that a large number of senior units were completed at the same time and had rent-up difficulties, and the adoption of State rules in 2002 limiting the percentage of Low- and Moderate-Income Housing Funds that may be used for senior housing.

The Housing Department's February 2005 survey of occupancy in City-financed senior housing developments shows that the vacancy rate overall – and particularly in those projects that were slow to rent up in the past year – is well below the industry standard of 5%. In addition, current projections of the amount of 20% Housing Funds to be committed on senior projects during the State compliance period indicates that the City can commit up to \$6.5 million for additional projects reserved for seniors and still comply with the strict State requirement. Given the ongoing need for housing for seniors, particularly for very-low and extremely low-income seniors, the Department is recommending that senior projects be eligible for future funding up to the limits established by State law.\* To be recommended for funding, senior projects must meet all other threshold requirements, including a minimum score of 70 out of a possible 100 points.

### **Adaptive Re-Use Projects**

“Adaptive re-use” projects are those involving the creation of dwelling units in a building originally constructed for a non-residential use. Thus, unlike acquisition/rehabilitation projects, while the structure is pre-existing, the dwelling units created were not previously a part of the housing stock. The adaptive re-use form of development has been used only rarely in San Jose, but is expected to become more common in Downtown and older, non-residential areas such as parts of Japantown and Midtown. That being the case, these types of developments should be eligible for affordable housing funding. To be recommended for funding, adaptive re-use projects must meet all other threshold requirements, including a minimum score of 70 out of a possible 100 points.

### **Threshold Criterion for ELI Units in New Construction and Adaptive Re-Use Projects**

In recent years, the Housing Department has sought to provide 10-20% of units in affordable housing developments at rents that are affordable to extremely low-income households. Under

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\* On April 5, 2005, the City Council approved sponsoring SB 527 which, if enacted would effectively increase the amount of the 20% Fund that could be spent on senior housing developments from 8.3% to approximately 20%.

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the first three NOFA rounds, 15% of all units in the six funded projects will be affordable to ELI households. Of the six projects, three provided ELI units in excess of 30% of the total unit count. Relying on other State funding sources, such as the Multi-family Housing Program (MHP) and the Low-Income Housing Tax Credit (LIHTC) Program, project sponsors achieved these income-targeting levels while maintaining City subsidy requirements at less than \$65,000 per unit. Based on this experience, the Department believes that, through aggressive efforts to obtain other funding sources, developers can structure projects with deeper subsidy, that are feasible and that meet the City's other policy goals.

Accordingly, the Housing Department intends to incorporate a threshold criterion in the NOFA that each project include at least 25% ELI units. The Department will re-assess the level of this threshold requirement based on results achieved in the first several months after it is instituted.

### **Acquisition/Rehabilitation Projects**

As noted above, the current list of eligible projects does not include the acquisition and rehabilitation of existing, market-rate apartment buildings. This was based on the desire to funnel the City's limited funds into new construction projects that provide an economic development benefit.

Compared to new-construction projects, newly affordable units in acquisition/rehabilitation projects are much less expensive to subsidize on a per-unit basis and they come on-line as affordable units much more quickly. Because the City should still put a priority on spending its funds on new construction, the Department recommends that acquisition/rehabilitation projects be eligible for up to \$10 million. This is not a true set-aside, since some or all of this \$10 million could be committed to new construction projects on a first-come, first-served basis.

Like new construction and adaptive re-use projects, acquisition/rehabilitation projects will need to score at least 70 out of a possible 100 points to be recommended for funding. Also, because acquisition/rehabilitation projects typically seek a City subsidy level at approximately one-third of what is needed for new construction, a lower NOFA application threshold criterion of 10% ELI units would be appropriate for acquisition/rehab projects.

### **Over-The-Counter System to Replace Funding Rounds**

The project selection system approved by the City Council in February 2004 included a provision that applications for City subsidy be accepted only in competitive NOFA funding rounds, with the condition that a projects must score a minimum of 70 out of 100 possible points in order to be recommended for funding.

Although the Housing Department timed the issuance of the three 2004 NOFAs to be able to provide developers with a City funding commitment prior to deadlines for outside funding, the NOFA round process is nonetheless burdensome to affordable housing developers. At a

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Developer Roundtable meeting convened on March 24, 2005 to review the experience with the City's NOFA system since its inception, developers recommended that the City accept and evaluate applications for funding on an ongoing basis, i.e. an over-the-counter process.

Housing Department staff agree that an over-the counter application system would be more responsive to the needs of developers and it would provide developers with more certainty of when they could apply for City funding. Experience in the first three funding rounds indicates that the minimum score requirement adequately ensures that the City's policy goals, as reflected in the scoring criteria and weighting, are achieved and that City subsidy levels are minimized to the extent possible.

**Timing the Implementation of Recommended Changes**

The Housing Department is aware that some developers are close to being prepared to file funding applications. Those developers are necessarily using the current NOFA criteria and scoring system to design their projects.

Therefore, most of the amendments to the project selection system recommended in this report should take effect on July 1<sup>st</sup>. The one exception is that making senior housing an eligible project should take effect immediately.

Accordingly, the Housing Department will conduct one additional NOFA funding round for new construction and senior housing under the current rules, for which funding recommendations, if any, would be forwarded to the City Council before the end of June.

**OUTCOME**

Approval of the recommended changes to the project selection system will allow the City to achieve its housing production goals and better meet the affordable housing needs of VLI and ELI seniors and families.

**PUBLIC OUTREACH**

The proposed revision to the project selection criteria was reviewed with members of the affordable housing development community at a Developer Roundtable meeting on March 24, 2005 and will be reviewed with the Housing Advisory Commission on April 14, 2005.

**COORDINATION**

Preparation of this memorandum was coordinated with the Finance Department and the Office of the City Attorney.

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**COST IMPLICATIONS**

None.

**CEQA**

Not a project.

  
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Director of Housing