COUNCIL AGENDA: 5/10/05
ITEM: 4.3

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Leslye Corsiglia
Director of Housing

SUBJECT: SEE BELOW

DATE: April 25, 2005

Approved

Date 4.26.05

COUNCIL DISTRICT: 9
SNI AREA: N/A

SUBJECT: AUTHORIZATION TO SUBORDINATE AN EXISTING CITY LOAN TO A NEW FIRST DEED OF TRUST MORTGAGE FOR HILLVIEW GLEN APARTMENTS

RECOMMENDATION

It is recommended that the City Council adopt a resolution approving the subordination of the City's existing permanent loan of $6,000,000 to a new senior loan of $12,000,000 to be made by the California Housing Finance Agency (CalHFA) to refinance the 138-unit Hillview Glen Apartments project located at the southeast corner of Pearl and Hillsdale Avenues.

BACKGROUND

On December 8, 1992, the City Council approved an acquisition/construction/permanent loan in the amount of $6,000,000 to the Hillview Glen Limited Partnership for the development of the Hillview Glen Apartments, located at the southeast corner of Pearl and Hillsdale Avenues in San José. CORE Development, Inc. and Eden Housing, Inc. are the co-managing general partners, and the Related Companies of California is the tax credit investor.

Soon after the project was completed in 1994, the project began experiencing water intrusion problems. The project owners performed limited construction repairs intended to prevent additional water penetration and to restore apartment interiors to original condition. In addition, the owners engaged with RGA, an environmental engineering company whose staff are OSHA-trained in mold testing, to conduct exploratory testing on the construction and environmental conditions to determine the source of the problems and to identify strategies for remediation. In March of 2002, the owners filed suit against the builder, Yamaoka Builders, and various subcontractors for construction defects, and in February 2005, the developer finalized negotiations with the builders' insurers and agreed to a settlement for construction defects totaling $6,842,577.

Beginning in 2001, the Hillview Glen owners suspended re-rental of units in order to ready the property for substantial rehabilitation to completely eradicate the source of the water penetration and eliminate mold conditions. Starting in the Spring of 2003, the project owners sent legal notification to all remaining residents at the time of lease renewals disclosing the known presence of mold and encouraging them to consult health and legal professionals to determine the advisability of renewing their lease. All residential units at the development are currently vacant.

The total development cost for the rehabilitation project, including complete renovation, refinancing and all related costs, is $19,572,525. In order to fund the substantial rehabilitation, the developer and the tax credit equity investor have arranged a refinancing structure featuring a $12,000,000 30-year, 6.75% first deed of trust mortgage provided by CalHFA. CalHFA loan proceeds will be used to pay off the existing first deed of trust mortgage in the amount of $5,500,000 from the California Community Reinvestment Corporation (CCRC). Together with the proceeds from the litigation settlement and with other available funds, the new first loan will allow owners to complete mold remediation on the property and to enhance the physical condition of the affordable housing units to make them more competitive in the local real estate market. The ownership team has requested that the City agree to subordinate to this first mortgage, which is an increase of $6,500,000 over the original permanent loan of $5,500,000 from CCRC.

ANALYSIS

In order to restore the units at Hillview Glen to a marketable condition, substantial rehabilitation must be performed to address the construction defects and mitigate the source of the water penetration, as well as all existing and latent mold conditions. In order to ensure the continued eligibility for Low Income Housing Tax Credits awarded to the projects for original construction, all units must be restored to a habitable condition by December 31, 2005.

The revised sources and uses proposed for the project's rehabilitation and permanent period are presented below:

Sources

Cal HFA perm loan	12,000,000
Insurance settlement proceeds	6,842,577
Cash flow	729,948
Total sources	**19,572,525**

Uses

Remediation	400,205
Pay off CCRC loan	5,064,762
Reimbursement of previous costs	5,260,212
Total rehabilitation hard costs	6,980,000
Architectural, Engineering & Survey	118,000
CalHFA loan costs	371,500
Legal fees	25,000
Contract & reports costs	38,500
Contingencies & Reserves	701,946
Other costs (permits, insurance, etc)	314,600
Construction overhead & profit	297,800
Total uses	**19,572,525**

An increase in potential rental income, and the dramatic increase in valuation due largely to escalation in local property values since the project was first constructed, together presently allow the project to qualify for a larger first mortgage loan. CalHFA has issued a draft commitment letter for a permanent loan in the amount of $12,000,000 with competitive terms, and is prepared to close its loan at the end of May 2005. Combined with the proceeds from litigation, substantial rehabilitation can be completed without an increase in the City's loan.

While the City will be subordinate to a larger first loan, this refinancing and substantial rehabilitation will reposition the property and will eradicate its mold conditions in order to allow this project to produce a positive cash flow with payments to the City. The City's contribution as a percentage of the overall amount of the project's sources will also drop with the refinancing, creating greater leverage of the City's funds.

The property's updated appraisal, prepared by the Sturgis-Bright Appraisal Group on February 8, 2005 and amended by letter on March 18, 2005, indicates an unrestricted value of $21,000,000 and a restricted value of $15,500,000. The combined Loan to Value (LTV) for the project, including both the CalHFA loan as well as the City's existing loan, is 116% based on the restricted rents valuation. This LTV exceeds the Director of Housing's Delegation of Authority, thus this request is being brought to the City Council for approval.

Affordability restrictions on the project remain unchanged, with 124 units made affordable to very low-income households at or below 50% of Area Median Income, and 13 units made affordable to low-income households at or below 60% of Area Median Income. Other terms and conditions of the permanent loan also will remain unchanged.

OUTCOME

Approval of the action to subordinate the City's loan to a new CalHFA loan would enable the rehabilitation and mold remediation to be performed on this project in order to restore affordable housing units for lower-income renters in the City of San José.

PUBLIC OUTREACH

Not applicable.

COORDINATION

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

COST IMPLICATIONS

None.

CEQA

Not a project.

LESLYE CORSIGLIA
Director of Housing