CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

COUNCIL AGENDA: 09-13-05
ITEM: 4.3

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Leslye Corsiglia

SUBJECT: SEE BELOW

DATE: August 24, 2005

Approved [signature] Date 8/30/05

COUNCIL DISTRICT: 7
SNI AREA: Tully/Senter

SUBJECT: MODIFICATION OF THE AFFORDABILITY REQUIREMENTS FOR VILLA SOLERA APARTMENTS

RECOMMENDATION

It is recommended that the City Council adopt a resolution approving an increase in the number of restricted affordable units at Villa Solera Apartments, located at the Northwest corner of Lucretia Avenue and Vintage Way ("Development"). The number of units restricted to residents at or below 60% of Area Median Income (AMI) would increase from 58 to 80, resulting in a total of 20 units restricted to tenants earning up to 50% of AMI and 80 units restricted to tenants earning up to 60% of AMI.

BACKGROUND

The subject 3.42-acre property, originally owned by the City, is located on the Northwest corner of Lucretia Avenue and Vintage Way. On June 27, 2000, the City Council selected Community Home Builders and Associates (CHBA) as the developer of the Villa Solera Apartments (formerly known as Roberts Avenue Family project).

On May 15, 2001, the City Council held a Tax Equity and Fiscal Responsibility Act of 1986 ("TEFRA") hearing and adopted a resolution expressing its intent to issue up to $14,000,000 in tax-exempt multifamily revenue bonds to finance the project. The project's financing structure determined at that time was a combination of tax-exempt bond proceeds from the City's bond issuance and 4% federal Low Income Housing Tax Credits administered through the State's Tax Credit Allocation Committee (TCAC). All 100 units—84 one-bedroom units and 16 two-bedroom units—were to be marketed to very low- and low-income households with a special marketing effort for teachers.

On June 25, 2002, the City Council approved business terms for a construction loan of up to $7,548,482 and a permanent loan of up to $5,800,000. On December 13, 2002, the Director of Housing approved an increase to the construction/ permanent loan amount by $1,160,000, from $5,800,000 to $6,960,000, to cover the financing gap created by a decrease in tax credit equity. This loan increase was to apply only to the permanent loan, as the construction loan amount remained unchanged. The City closed its construction loan on December 11, 2002 and the project completed construction in June 2004.

ANALYSIS

Villa Solera's tax credit partnership, Lucretia Avenue Partners, LP, consists of three entities: Affordable Housing Access, Inc., a California nonprofit public corporation, as Co-managing General Partner; CHBA, a California nonprofit public corporation, as Co-managing General Partner; and Montalvo Associates LLC, Administrative General Partner, for which James S. Morley is the Manager. The Partnership Agreement calls for CHBA to exit the partnership during the permanent period, at which time Affordable Housing Access and Montalvo Associates will become Co-managing General Partners. Therefore, James S. Morley, also the principal for JSM Enterprises, Inc. (JSM), is the party making this request to change the project's income targeting, for the reasons stated below.

The Development has been 95% leased for the past several months, but has been unable to meet lenders' and the investor's requirements to convert from the construction phase to the permanent phase. Specifically, the project rents have generated insufficient income to support the permanent loan amount as originally projected.

Given the recent decrease in rents in San Jose's residential real estate market, the project has had to lower rents significantly for the highest-rent units in the project, those targeted at 77% AMI. Anticipated rents for one-bedroom units had to be lowered from a high of $1,395 to $1,068, while projected rents for two-bedroom units had to be lowered from a high of $1,495 to $1,292. Even with reductions, these rent levels are approximately at market rate, as the average rent for one-bedroom units as of July 2005 was $1,108 per month, and the average rent for two-bedroom units was $1,184 per month. The sponsor's request is to revise the affordability levels of those units to match the actual rents received at 60% AMI levels. By lowering restrictions on those 22 units from 77% AMI to 60% AMI, the units become eligible for additional tax credit equity from the investor.

Accessing additional tax credit equity is necessary because the project's senior permanent debt must be reduced to an amount that is supportable by current rents. The sponsor intends to use the additional tax credit equity that would be generated from the 22 units newly-eligible for tax credits to redeem a portion of the outstanding tax-exempt bonds pursuant to the terms of the bond indenture so that the senior loan amount would be reduced, and the lender's and investor's conversion hurdles could be met as soon as possible. The additional tax credits would be awarded non-competitively as soon as all approvals are obtained, and conversion to the

permanent period would be anticipated for January 2006. This restructuring would make the project financially feasible without the City having to increase its contribution to the project.
If approved by the City Council, this change in targeting will result in 80 units being made available to tenants earning at or below 60% AMI—an increase of 22 units—and 20 units being made available to tenants earning at or below 50% AMI. Per California Redevelopment Law, income restrictions would be enforced for 55 years through an amended City Affordability Restrictions, given that all senior lenders subordinate to the amended restrictions. The City will also coordinate any approvals or consents required from other parties to this transaction, and will continue to ensure that the project is affirmatively marketed to teachers.

OUTCOME

Approval of the recommended action would permit JSM to restructure the project's financing, enabling the project to convert to permanent period financing without additional City subsidy and making the project financially feasible.

PUBLIC OUTREACH

JSM plans to hold a community meeting on September 12, 2005 to inform the neighborhood of the changes in the project and to answer any questions.

COORDINATION

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

COST IMPLICATIONS

None.

CEQA

Negative Declaration (PDC-SH 00-10-103).

LESLYE CORSIGLIA
Director of Housing