



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Leslye Krutko

**SUBJECT:** SEE BELOW

**DATE:** April 28, 2008

Approved

Date

5-1-08

**COUNCIL DISTRICT:** Citywide  
**SNI AREA:** N/A

**SUBJECT:** AMENDMENTS TO THE "CONTRACT AUTHORITY OF THE DIRECTOR OF HOUSING, CITY MANAGER AND DIRECTOR OF FINANCE" ORDINANCE

## RECOMMENDATION

It is recommended that the City Council:

1. Adopt an ordinance amending Chapter 5.06 of the San Jose Municipal Code – "Contract Authority of the Director of Housing, City Manager and Director of Finance" – to modify the Director of Housing's delegated authority by: eliminating the maximum amount of predevelopment loans that can be made to nonprofit housing developers by the Director; and authorizing the Director to make commitments of project-based second mortgages.
2. Adopt a resolution to increase the maximum amount of predevelopment loans that can be approved by the Director of Housing from \$100,000 to \$500,000; and set a \$500,000 limit on the amount of project-based second mortgages that can be committed by the Director of Housing to any one for-sale development.

## OUTCOME

The City Council's approval of the recommended action will increase the capacity of nonprofit housing developers to produce affordable housing and will allow the City to quickly respond to the requests from for-sale homebuilders for financial assistance to low- and moderate-income homebuyers.

## BACKGROUND

In 1990, the City Council adopted an ordinance which delegated to the Director of Housing specified authorities in the administration of the City's comprehensive affordable housing

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program (known as the "Delegation of Authority" ordinance), codified in Title 5 of the Municipal Code.

Amendments to the Delegation of Authority were made in 1993, 2000, 2002 and 2007. The more significant amendments added authorities allowing the Directors of Finance and Housing to undertake certain actions in connection with the issuance of tax-exempt bonds for financing affordable rental housing projects and allowing the City Manager to determine, within defined parameters, various terms and conditions of loans and grants previously approved by the City Council. The City Manager subsequently delegated the latter authority to determine terms and conditions of Council-approved loans and grants to the Director of Housing.

Recently, the Housing Department has encountered situations, outlined below, which suggest that two additional amendments to the Delegation of Authority ordinance are in order.

## **ANALYSIS**

### **Predevelopment Loans**

In 1991, the City Council approved a Predevelopment Loan Program for nonprofit developers needing funding for pre-acquisition activities necessary to evaluate potential sites for affordable housing projects and to assemble the necessary documentation and prepare plans to support applications for land use entitlements. The 1991 Program placed a \$100,000 limit on loans that could be approved by the Director. At that time, this was a reasonable level of funding for the kind of activities that the Program funds. Until recently, the Department had not considered increasing the loan limit because Community Development Block Grant (CDBG) was the allowable funding source available to the Housing Department for this purpose and the amount of CDBG funds available was relatively small.

However, predevelopment funding is no longer an eligible activity under CDBG regulations and the Department is now funding such loans from the Inclusionary In-Lieu Fee revenue. With this source of funds, it is appropriate that the City consider increasing the maximum loan amount to a level which will be useful to project sponsors. The Department believes that \$500,000 is an appropriate amount in the current development-cost environment.

The Director may approve a predevelopment loan only after consulting with the Councilmember representing the site where the potential future project is located. Because predevelopment loans are mostly intended to assist the developer apply for necessary land use entitlements, the loans can necessarily pre-date the public notification and public hearing processes associated with those entitlements. Thus, the Councilmember is afforded the opportunity to have a noticed public meeting held so that residents and property owners in the neighborhood surrounding the proposed development site are apprised of the predevelopment loan application that has been filed.

Predevelopment soft costs are an eligible category for funding from the City's regular construction/permanent loans on a reimbursement basis. Predevelopment loans are simply a

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mechanism for advancing some of that funding to nonprofit sponsors earlier in the development process. The predevelopment loan is repaid by the other sources used to fund the City's construction/permanent loan (e.g., the 20% Fund or the HOME Fund) when the latter loan closes.

Predevelopment loans exceeding \$15,000 are required to be secured, typically by an assignment of the developer's purchase-and-sale agreement with the current property owner. Once the developer has acquired the site, the appropriate security for the loan becomes a deed of trust on the property. Because the City will now fund the developer's entire land acquisition cost, it is likely that the loan-to-value ratio for a predevelopment loan where the City is also funding acquisition will exceed 100%.

Based on input received from the City's affordable housing development partners, the Department believes that the increase in the predevelopment loan will expedite and facilitate additional affordable housing development.

#### **Commitment of Project-Based Second Mortgage Assistance**

The Housing Department recently recommended that City Council approve the commitment of a small number of second mortgages to several for-sale developments. These commitments were requested by homebuilders because of sluggish new homes sales and because the City's silent second mortgages make homes affordable to low- and moderate-income households who are otherwise priced out of the ownership housing market.

The City could respond more quickly and efficiently to homebuilders' needs for expanding the potential pool of buyers for their product – an especially critical issue given the stagnation in the new-home sales market – if the need to seek City Council approval in every case could be avoided. To this end, the Department recommends that the Director of Housing be authorized to make commitments up to \$500,000 for second mortgages at individual ownership housing projects. Commitments of project-based second mortgages exceeding \$500,000 would still require approval by the City Council.

The Housing Department will follow its standard practices and guidelines for homebuyer programs in administering this delegated authority.

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

Actions taken by the Director of Housing and Director of Finance pursuant to the provisions of the Delegation of Authority ordinance are reported in quarterly informational memoranda to the City Council. Additionally, individual City Councilmembers will be notified of applications for predevelopment loans and second mortgage commitments in their districts. In cases where the predevelopment loan would precede the public notification and public hearing process for land use entitlements, Councilmembers have the opportunity to have a public meeting held on the proposed development.

## POLICY ALTERNATIVES

**Alternative #1:** *The City could decline to increase the amount of predevelopment funding that the Director of Housing can provide to nonprofit, affordable housing developers.*

**Pros:** Limiting the amount predevelopment loans to \$100,000 will reduce the amount of affordable housing funding at risk.

**Cons:** The \$100,000 loan limit puts smaller nonprofit developers at a competitive disadvantage with for-profit and larger nonprofit developers in successfully developing affordable housing.

**Reason for not recommending:** Achieving the City's ambitious affordable housing production objectives will be facilitated by the participation of the largest number of developers, including the smaller nonprofits which need more predevelopment financing at favorable rates than other developers.

**Alternative #2:** *The City Council could decline to authorize the Director of Housing to make relatively small commitments of project-based second mortgages.*

**Pros:** The City Council would retain the authority to make City commitments of project-based second mortgages.

**Cons:** Preparing and agendaing reports recommending City Council action is a time-consuming process, taking a minimum of five weeks before the Council can act.

**Reason for not recommending:** Reacting in timely manner to requests for financing assistance for low- and moderate-income homebuyers provides better service delivery to the homebuilding industry.

## 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)

On April 22, 2008, the Housing Department sent electronic notifications to the Department's list of affordable housing developers and other stakeholders of the Department's intent to recommend an increase in the maximum amount of predevelopment loans to \$500,000 and establish a streamlined program for making project-based, forward commitments of second-

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mortgage financing. Additionally, this report will be posted on the City Council agenda website for the May 6, 2008 meeting.

### **COORDINATION**

Preparation of this report was coordinated with the City Attorney's Office.

### **FISCAL/POLICY ALIGNMENT**

This expenditure is consistent with achieving the production goals set forth in the City's 2007-2012 *Five-Year Housing Investment Plan*, adopted by the City Council in June 2007.

### **CEQA**

CEQA: Not a project.

  
LESLYE KRUTKO  
Director of Housing

For questions please contact Jacky Morales-Ferrand, Assistant Director of Housing,  
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