COUNCIL AGENDA: 09-30-08
ITEM: 2.3

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Leslye Krutko

SUBJECT: SEE BELOW

DATE: September 9, 2008

Approved:

Date: 9-11-08

COUNCIL DISTRICT: 9
SNI AREA: None

SUBJECT: APPROVAL TO INCREASE THE CITY'S CONSTRUCTION AND PERMANENT LOAN COMMITMENT IN AN AMOUNT UP TO $725,000, AND APPROVAL OF THE RELOCATION PLAN FOR THE HILLSDALE TOWNHOUSES PROJECT LOCATED AT 1626-1656 HILLSDALE AVENUE, SAN JOSE

RECOMMENDATION

It is recommended that the City Council adopt a resolution:

1. Approving an increase to the City's construction and permanent loan commitment to Mid-Peninsula Housing Coalition ("MPHC"), or its designated affiliate, in an amount up to $725,000, for a total loan commitment of $5,000,000 for the rehabilitation and permanent financing of 48 rental townhome units, the Hillsdale Townhouses project, located at 1626-1656 Hillsdale Avenue; and

2. Approving the Hillsdale Townhouses project's Relocation Plan dated September 2007, prepared by Overland, Pacific & Cutler, Inc.

OUTCOME

Approval of the recommended actions will enable Mid-Peninsula Housing Coalition, the project's Sponsor, to finalize its permanent financing, to proceed with the project's rehabilitation, and to permanently relocate current over-income tenants so that the 48 rental townhomes can be restricted to serve to San José residents with incomes at or below 25%, 50%, and 60% of Area Median Income (AMI).

BACKGROUND

Project Funding Commitment

On September 18, 2007, the City Council approved an acquisition/construction/permanent funding commitment of up to $4,275,000 to Mid-Peninsula Housing Coalition (MPHC) for the acquisition and rehabilitation of the Hillsdale Townhouses project, located at 1626-1656 Hillsdale Avenue at the corner of Hillsdale and Meridian Avenues in San José's Cambrian neighborhood. Built in 1965, the property consists of 48 rental townhomes in 16 adjacent buildings. While all units now have two bedrooms and 1.5 baths, MHPC's rehabilitation will create some two- and three-bedroom units and make 17 of the units affordable to residents with incomes at or below 30% of Area Median Income (AMI), 18 units affordable to residents with incomes at or below 50% AMI, and 12 units affordable to residents with incomes at or below 60% AMI.

In April 2008, MPHC asked the City permission to change the project's financial structure from 4% tax credits with tax-exempt bonds and State Multifamily Housing Program (MHP) financing to 9% tax credits. Given the highly competitive nature of the MHP program, MHPC was concerned about the likelihood of obtaining the financing commitment and determined 9% credits to be more likely achievable. In addition, the State Tax Credit Allocation Committee recently increased projects' Threshold Basis Limits which allows the Sponsor to increase the scope of the rehabilitation from $50,000 per unit to $75,000 per unit. The change will allow MHPC to receive more tax credit equity than previously estimated and complete additional improvements that will enhance the long-term viability of the project.

The change in financial structure from 4% credits/bonds to 9% tax credits produced a funding gap that prompted MHPC to request a permanent loan increase of $490,771 from the City. Therefore, on April 8, 2008, the Director of Housing, through the Delegation of Authority ordinance, approved an increase to the permanent loan commitment from $3,784,229 to $4,275,000. This request maintained the construction loan amount at $4,275,000.

Since April, MHPC has further finalized its project budget. It was successful in obtaining 9% tax credits for the project, but was unsuccessful in obtaining $470,000 in competitive Federal Home Loan Bank Affordable Housing Program (AHP) funding. Finalization of the project's budget has also resulted in development costs that are $580,000 higher than expected due to higher financial consultants' fees and the addition of more energy efficiency improvements. It also shows a $160,000 increase in interest costs and a corresponding decrease of in the project's conventional permanent loan commitment. However, other sources of funding—tax credit equity, operating income, and $42,000 in deferred developer fee—have increased by approximately $225,000. The net impact on the budget is a shortfall of $725,000.

On June 25, 2008, the Housing Department received a formal request from MPHC requesting a $725,000 funding increase for the project's construction and permanent loan. If approved, the City would provide MPHC with a construction and permanent loan of $5,000,000.

Relocation Plan

As this project involves the acquisition of an existing rental property and the imposition of new affordability restrictions, some current residents will have incomes too high to meet the project's new income restrictions and will need to be relocated. Substitute units in the area will be found for them and the difference between current rent and future rent paid in conformance with State and federal guidelines.

In accordance with the City's requirements, MHPC engaged Overland, Pacific & Cutler ("OPC") to estimate relocation costs and create a formal Relocation Plan to ensure that legally required noticing and compensation to over-income tenants was done correctly. In accordance with State Relocation Law, the City Council must approve Relocation Plans when City funds are involved in an action that requires relocation of tenants.

ANALYSIS

Additional Financing

This additional funding request is a good example of the difficult nature of financing affordable housing projects—trying to access several layers of funding, many of which are awarded competitively and take months, or even years, to assemble. In that time, financial market conditions—such as interest rates—can change significantly.

The City is supporting MHPC's request for several reasons. First, MHPC has sought several sources of financing. They have investigated four different sources of gap funding to replace the AHP funds that were not obtained. None of the sources are viable for this project and the City is the last funding alternative. Second, MHPC is deferring a small portion of its developer fee to help plug the funding gap. Third, MHPC has worked hard to take advantage of recent changes in tax credit basis rules to significantly increase the scope of rehabilitation. This will enhance the quality of life for residents and likely increase the project's physical life substantially. Because of MHPC's strong reputation, it has been successful in obtaining competitive tax credit equity bids despite a climate of falling tax credit equity prices and severe decreases in the amount of tax credit equity available in the market.
Fourth, MHPC has committed to integrating more green building features than originally planned. This will minimize the project operating costs over time. The changes have also increased the project's common areas, which will result in a new laundry room and community facility space for a computer lab.

Finally, while the City's current requirements state that at least 10% of the units in an acquisition/rehabilitation project must be restricted to ELI households, this project significantly surpasses that threshold, offering 35% of the units for ELI families. If approved, this project would offer much-needed units for ELI and VLI large families.

All of these factors indicate that this project continues to be one that the City should support financially. The additional funding request is within the Director's Delegation of Authority to approve without City Council approval. However, as the Relocation Plan needs City Council approval, staff opted to seek City Council approval for the funding commitment as well.

In consideration for the additional funding requested, the City will receive an additional 8 years of affordability. Its Affordability Restrictions will be amended and rerecorded at the closing of the City's construction loan. Specific business terms will be approved by the Director of Housing through the City's Delegation of Authority ordinance in Chapter 5.06 of the San José Municipal Code.

Relocation

Since recordation of the City's affordability restrictions on November 1, 2007, MPHC has performed a census of the tenants to determine compliance with the restrictions. Overland, Pacific & Cutler (OPC), professional relocation consultants, created the plan for this project's relocation. Staff and the Office of the City Attorney have reviewed the Plan and recommend that the City Council approve the Relocation Plan. Staff will oversee MPHC's relocation of tenants, and ensure that relevant State and federal guidelines are met.

Relocation costs remain estimated at $371,300, as identified by OPC's initial costs study, and will be covered by City loan proceeds and tax credit equity. As required by State law, the City is ultimately liable to pay for all relocation costs as payable under State law if for some reason the project is unable to cover costs.

EVALUATION AND FOLLOW-UP

The units in this project contributed to the Department's Housing production in FY 2007-08 as reported by income category and Council District in the City's *Consolidated Annual Performance Evaluation Report (CAPER).* The relevant *CAPER*, which is created for submission to the U.S. Department of Housing and Urban Development each September, will be recommended for approval by the City Council in September 2008. The Department also provides reports to the City Council on the status of construction projects on a regular basis. If approved, the Hillsdale Townhouses project would be included in these reports.

POLICY ALTERNATIVES

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

Alternative #1:	***Deny the Additional Funding Request for Hillsdale Townhouses.***
Pros:	By not approving the requested loan increase, the City will have additional funds to support new construction of projects.
Cons:	The City has already disbursed acquisition loan proceeds and recorded affordability restrictions on the site, so it has a vested interest in ensuring this project is completed successfully. MHPC has successfully assembled financing for the project with the exception of the requested amount of $725,000, despite the very uncertain tax credit equity market. Further, MHPC has acquired additional tax credit equity to significantly expand the scope of the project's rehabilitation without cost to the City, which will result in better long-term living conditions for resident families.
Reason for not recommending:	The additional funds will enable rehabilitation to start and make this project a viable, attractive affordable housing project for San José families.

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)**

This item does not meet any of the above criteria, but this memorandum will be posted to the City's website for the September 30, 2008 City Council Agenda.

COORDINATION

This report has been coordinated with the Office of the City Attorney.

FISCAL/POLICY ALIGNMENT

This expenditure is consistent with the Housing Department's *Five-Year Investment Plan for Fiscal Years 2007/08-2011/12* in increasing the supply of affordable housing, and with the City's *Consolidated Plan, 2008*-09 in providing family units for very low- and extremely low-income households.

COST SUMMARY/IMPLICATIONS

3. **COST OF PROJECT:**

CONSTRUCTION USES	**AMOUNT**
Property Acquisition	$8,565,000
Hard (Construction) Costs	$5,054,400
Soft (Financing & Other) Costs	$3,542,556
TOTAL	**$17,161,956**

4. **COST ELEMENTS OF CITY LOAN AMOUNT:**

USES	**AMOUNT**
Property Acquisition	$5,000,000
TOTAL	**$5,000,000**

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	2008-2009 Adopted Operating Budget (Page)	Last Budget Action (Date, Ord. No.)
443	0070	Loans, Grants & Site Acquisitions	$90,000,000	$725,000	XI-53	6/24/08, 28349

REDEVELOPMENT PROJECT AREA FINDINGS

The Hillsdale Townhouses project is not located in a Redevelopment Project Area. Thus, it is required that the City make a finding, on behalf of the Redevelopment Agency, that any such project which utilizes redevelopment funds is a benefit to redevelopment areas. Since an affordable family project for extremely low- and very low-income families is identified as vital to support the City's economic growth, much of which is planned to occur in Downtown and industrial redevelopment project areas, staff recommends that the City Council find the Hillsdale Townhomes project to be of benefit to those redevelopment project areas.

CEQA

CEQA: Exempt, File No. PP07-179.

LESLYE KRUTKO
Director of Housing

For questions, please contact Leslye Krutko at 408-535-3851.

Attachment

ATTACHMENT 1

Anticipated Project Timeline

Potential City Council Approval of City Funding Commitment and Relocation Plan	September 2008
Estimated Start of Relocation	September 2008
Estimated Start of Rehabilitation	November 2008
Estimated Rehabilitation Completion	October 2009
Estimated Conversion to Permanent Period	Spring 2010