



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Leslye Krutko

SUBJECT: SEE BELOW

DATE: November 17, 2008

11-20-08

COUNCIL DISTRICT: 3
SNI AREA: 13th Street

SUBJECT: REQUEST TO RECLASSIFY \$200,000 OF EXISTING FUNDING COMMITMENT TO A PREDEVELOPMENT LOAN FOR THE CORNERSTONE AT JAPANTOWN PROJECT, FORMERLY KNOWN AS 10TH & HEDDING

RECOMMENDATION

It is recommended that the City Council adopt a resolution reclassifying \$200,000 of the project's existing funding commitment to a predevelopment loan to Cornerstone at Japantown, L.P., or its designated affiliate, to finance predevelopment costs for the 53-unit Cornerstone at Japantown townhomes located at 851 and 899 North 10th Street, to be made available to extremely low-, very low-, and low-income households.

OUTCOME

Approval of the recommended action will facilitate the construction of 52 rental housing units affordable to extremely low- (ELI), very low- (VLI), and low-income (LI) residents of San José. The Cornerstone at Japantown is located at 851 and 899 North 10th Street, San José.

BACKGROUND

On May 7, 2008, CORE Affordable Housing LLC ("Sponsor") submitted a Notice of Funding Availability (NOFA) application for a funding commitment of \$6,300,000 for the development of the Cornerstone at Japantown project.

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On June 24, 2008, the City Council adopted a resolution approving a funding commitment of up to \$6,300,000. The City closed its acquisition loan on September 30, 2008, enabling the project's partnership, Cornerstone at Japantown, L.P., to purchase the land.

In addition to the City loan, the Sponsor applied for an allocation of 9% Low-Income Housing Tax Credits to the California Tax Credit Allocation Committee (TCAC) and is currently on the waiting list for an allocation. As a number of California projects that had received allocations in the September allocation round are not proceeding, there is a good likelihood that Cornerstone will obtain a commitment.

ANALYSIS

A substantial amount of predevelopment "soft costs" are incurred by developers prior to the start of construction. Such costs include: fees for architectural, engineering and environmental review consultants to prepare drawings and documents necessary to file applications for land use entitlements and building permits; the application fees for those entitlements and permits; appraisals; market studies; miscellaneous consultant fees; and the sponsor's overhead costs to administer all of the above.

The Housing Department has a Predevelopment Loan Program that provides nonprofit affordable housing developers with loans up to \$100,000 at favorable interest rates. These loans can be approved by the Director of Housing under the Director's Delegated Authority from the City Council.

The Housing Department does not usually provide Predevelopment loans to for-profit developers of affordable housing, such as CORE. Traditionally, for-profit developers front their own predevelopment costs, or borrow short-term loans at higher interest rates (called "mezzanine debt"). These obligations are repaid at the closing of construction loans. However, because of the uncertainty of the market, many conventional lenders are no longer originating mezzanine debt for for-profit developers that enables projects to keep moving forward. Without the certainty of predevelopment funding, projects are unable to move through the entitlement process, which is a necessary precursor to apply for State funding such as tax credits. As a result, many projects, such as the Belovida at Newbury Park development, will not be able to move forward unless there is funding assistance for the earlier stages of development.

The ability for many for-profit developers to fund their own predevelopment expenses has also been curtailed by the current real estate market. For instance, CORE is partially reliant on the for-sale portion of their business to generate revenues that are used for multifamily predevelopment expenses. Because CORE has a substantial amount of its resources tied up due to units not selling as expected, this is causing a cash shortfall. As a result, developers like CORE must borrow the necessary predevelopment funding until a project's construction loans are closed and the predevelopment expenses can be repaid.

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CORE is requesting that \$200,000 of its current funding request, approved by the City Council on June 24, 2008, be reclassified and released before construction starts as a predevelopment loan. To reiterate, this request is not for additional funds. The predevelopment loan will be repaid with interest from the City's construction loan. If the project is successful in getting a tax credit award, CORE will need to close the construction loan within 150 days of award.

A condition of disbursement of the City's predevelopment loan will be the receipt of the 9% tax credits allocation from TCAC.

Specific business terms for the loan will be approved by the Director of Housing pursuant to the Director's Delegation of Authority ordinance, located in Chapter 5.06 of Title 5 of the San Jose Municipal Code.

EVALUATION AND FOLLOW-UP

The City Council will later be able to track the project's construction status through the Housing Department's quarterly construction report available on-line at the Department's website: <http://www.sjhousing.org/report/quarter.html>.

POLICY ALTERNATIVES

To arrive at this recommendation, staff considered the following options:

Alternative #1: Deny CORE's request for a predevelopment loan.

Pros: The City's risk for a predevelopment loan is greater than for construction or permanent loans.

Cons: CORE's inability to borrow the project's predevelopment funding from commercial lenders will postpone this project indefinitely. No additional funding from the City is required, just an earlier disbursement of money that has already been committed to this project. Staff will negotiate business terms that give the City adequate security for these funds prior to closing the construction/permanent loan, which will repay the predevelopment obligation with interest.

Reason for not recommending: The City could facilitate the development of Cornerstone in order to help meet the demand for housing affordable to ELI, LI, and VLI families in exceptionally large units, helping the City to fulfill its affordable housing goals.

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 meets none of the criteria set forth above. Nonetheless, this Council report will be posted to the City's website for the December 9, 2008 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

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|----|---|--|
| 1. | AMOUNT OF RECOMMENDATION: | \$200,000 |
| 2. | COST ELEMENTS OF AGREEMENTS:
Predevelopment Soft Costs | \$200,000 |
| 3. | SOURCE OF FUNDING: | Low- and Moderate-Income Housing Fund (Fund 443) |
| 4. | FISCAL IMPACT: | No ongoing fiscal impact. |

BUDGET REFERENCE

No budget impact because no additional funds are being requested.

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CEQA

CEQA: Mitigated Negative Declaration (PDC07-025).


LESLYE KRUTKO
Director of Housing

Attachments

For questions, please contact LESLYE KRUTKO, DIRECTOR OF HOUSING,
at 408-535-3851.

