COUNCIL AGENDA: 12/16/08
ITEM: 4.2

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Leslye Krutko

SUBJECT: SEE BELOW

DATE: November 24, 2008

Approved

Date 12-2-08

COUNCIL DISTRICT: 3, 7
SNI AREA: N/A

SUBJECT: APPROVAL FOR THE DIRECTOR OF HOUSING TO NEGOTIATE AND EXECUTE AN AGREEMENT BETWEEN EHC LIFEBUILDERS (EHC) AND ITS CREDITORS AND OTHER RELATED ACTIONS

RECOMMENDATION

It is recommended that the City Council adopt a resolution:

a. Authorizing the Director of Housing ("the Director") to Negotiate and Execute a Forbearance and Release Agreement between EHC, Comerica Bank, the County of Santa Clara, and the City in order to facilitate the sale of the identified EHC properties;

b. Authorizing the Director of Housing to Negotiate and Execute a conditional grant agreement with Mid-Peninsula Housing Corporation in an amount not to exceed $1.4 million for the transfer of existing affordability restrictions at EHC's Gifford Avenue, 5th Street, and East Younger Avenue properties to Mid-Peninsula's Country Hills property, located at 124 Rancho Drive, to be paid from the proceeds of the sale of property;

c. Approving the Relocation Impact Statement and Last Resort Housing Plan for EHC's Markham Terrace property at 2112 Monterey Road;

d. Approving the Relocation Impact Statement and Last Resort Housing Plan for EHC's properties at Gifford Avenue, 5th Street, and East Younger Avenue;

e. Authorizing the Director of Housing to expend up to $2.1 million for the relocation of tenants at the Markham Terrace site;

f. Authorizing the Director of Housing to expend up to $400,000 in short-term operational assistance to replace the loss of rental income at Markham Terrace during tenant relocation;

g. Authorizing the Director of Housing to negotiate and execute an amendment to the existing agreement with Associated Right of Way Relocation consultants by $450,000, from $129,000 to $579,000 to implement the EHC relocation plans; and,

h. Authorizing the Director of Housing to Negotiate and Execute a $500,000 predevelopment loan to Charities Housing Development Corp. (Charities Housing), or its designated affiliate, for the redevelopment of the Markham Terrace site.

OUTCOME

There are several outcomes that will result from this action. First, this action will enable EHC to take the final steps necessary to strengthen its financial position and reduce its debt by selling several of its real estate assets. Second, the City will ensure that one of its largest providers of homeless shelter and services, and the nonprofit that runs the County's cold weather shelters, will continue to operate. Lastly, the City will be repaid what it has invested in these properties, will ensure that there is not a reduction in the number of affordable units available to lower-income persons, and will ensure that people currently living in the affordable units are relocated according to State relocation law.

BACKGROUND

EHC Lifebuilders (EHC) is the largest provider of homeless shelter and services in Santa Clara County. In September 2007, EHC announced that the organization would be restructuring its operations to stabilize its financial standing. Since that time, EHC has reduced its operating budget by approximately 50% from $13 million to just under $7 million and reduced staffing by approximately 44% with remaining staff taking salary cuts. In addition, 16 Federal and State contracts were eliminated or transferred to other providers.

Since the beginning of 2008, EHC has been successful in raising $2 million in operating support to continue providing services to the homeless community. A Public-Private Funders Collaborative, led by the Packard Foundation, was established to raise these funds and determine how they would be used to strengthen EHC's operations. The funds raised have been used for a variety of capacity building activities: board development, staff development, fund development, and financial management. This Collaborative has met several times over the past 14 months to review EHC's progress in implementing these activities.

The nonprofit has taken considerable steps to improve its financial processes and procedures. EHC's recently released audit found no material deficiencies, and was issued as an unqualified opinion, meaning that the financial statements were found to be in conformance with generally accepted accounting principles.

As part of its financial restructuring plan, EHC has evaluated its real estate holdings. EHC must sell some of its properties in order to reduce debt and allow it to focus on its core service – providing temporary shelter and services to the homeless. During the past several months, the Housing Department has been working with EHC to develop an asset sale and loan repayment plan that will address a large portion of its outstanding debt.

This process has resulted in the creation of a draft Forbearance and Release Agreement between EHC and its creditors. This document is the creditors' binding agreement that it will not foreclose on its loans with EHC, provided that certain obligations are met by EHC and its partners. Should the City not approve the agreement, several possible negative outcomes could occur. A senior lender could foreclose on the properties, wiping out the City's loans. EHC could declare bankruptcy, which could have a similar result, and which could also result in the loss of affordable units. In either case, the homeless population would lose access to vital shelter and services that are now provided by EHC. It might then be necessary for the City to step in to provide shelter and services, if another provider could not be found. By taking this action the City will retain its financial interests and negate the prospect of having to provide direct services, or provide additional funds for homeless services.

This memorandum summarizes the provisions of the asset sale plan and presents recommended actions required by City Council to facilitate the sale of EHC real estate holdings and ensure successful implementation of the Forbearance and Release Agreement.

ANALYSIS

EHC has a number of financial obligations that need to be addressed through the sale of real estate assets. These are listed below.

- A $3,600,000 loan with the City of San Jose on EHC's Markham Terrace property.
- $1,175,387 in unsecured interest owed to the City of San Jose on three collateral properties
- A $294,000 CDBG rehabilitation loan that the City owes to HUD.
- $176,755 in unsecured debt with Santa Clara County on two collateral properties.
- A $125,000 loan with the Santa Clara County on Markham Terrace.
- A HUD grant to EHC in a remaining amount of $75,825.
- A $53,800 obligation to the Veterans Administration on Markham Terrace.
- A Bank of the West Loan with an approximate balance of $582,000 on Markham Terrace.
- A $3,400,000 term loan with Comerica Bank (Comerica).
- A $1,100,000 line of credit and $600,000 bridge loan with Comerica.

Eight Collateral Properties for Comerica Term Loan

A number of EHC's outstanding obligations are tied to eight properties that serve as collateral for the $3,400,000 Comerica Term Loan. The City has $1,175,387 in unsecured interest on these properties in the form of conditional loans that would be jeopardized if Comerica were to

foreclose on the Term Loan. In addition, the City would be responsible for repaying the CDBG loan in the amount of $294,000 to HUD.

The City has affordability restrictions on six of the eight properties. Additionally, the terms of the City's conditional loans require that they be repaid if the units are not maintained for affordable housing use prior to the end of the affordability term. If Comerica were to foreclose on the loan, the City would likely lose the funds invested in the properties, though it could enforce the affordability restrictions and require Comerica to maintain the units as affordable for the entire term. As part of the forbearance plan, it is recommended that EHC sell the eight collateral properties ("the collateral properties") listed below.

1. 1077 N. Fifth Street - six unit apartment building with 2-1bd/1ba and 4-2bd/1ba units.
2. 1081 N. Fifth Street - four unit apartment building with 2-1 bd/1ba and 2-2bd/1ba units.
3. 1085 N. Fifth Street - six unit apartment building 2-1bd/1ba and 4-2bd/1ba units.
4. 1089 N. Fifth Street - seven unit apartment building with 7-1bd/1ba units.
5. 282 East Younger - six unit apartment building with 2-1bd/1ba and 2-2bd/1ba units.
6. 323-325 Gifford Avenue – single-family residence and a duplex with 2 studio/1ba units.
7. 327 Gifford Avenue - single-family residence with 1-3bd/1ba unit.
8. 329 Gifford Avenue - single-family residence and 1 bedroom studio apartment.

The City and EHC attempted to market the collateral properties to other affordable housing developers. However, due to the expense associated with managing small properties that are scattered throughout the City, no offers were made to purchase the assets. In order to make the property more attractive to potential buyers, the existing restrictions and obligations on the properties need to be removed. Initial interest has been expressed by investors for all eight of the identified properties.

In addition to the City's affordability restrictions, obligations on these properties include: a $294,000 CDBG loan; a $75,825 HUD grant; the City's $ 1,175,387 in unsecured debt; and, $176,755 in unsecured debt and interest with the County. Besides addressing the Comerica Term Loan debt, sale of these properties satisfies the CDBG loan and the HUD grant. The proceeds will also repay the City $1,175,387 in unsecured debt that will be used to fund the transfer of affordability restrictions to another site. The sales proceeds will also pay for the relocation of existing tenants as required by existing law. The $176,755 in unsecured County interests will be repaid from the sale proceeds.

Transfer of Affordability Restrictions to Country Hills Apartments

Mid-Peninsula Housing Corporation (Mid-Pen) has agreed to accept the transfer and placement of the affordability restrictions from the collateral properties to its Country Hills apartment complex, located at 124 Rancho Drive. This existing 152-unit apartment building, owned and operated by Mid-Pen, currently has 60 restricted and 92 unrestricted units. The restricted units were previously funded by a Housing Department loan.

In exchange for accepting the affordability restrictions, Mid-Pen will receive a $1,398,300 conditional grant from the Housing Department. Terms of the conditional grant require that the length of affordability on the transferred restrictions be extended from 22 to 50 years and that the units are affordable to households earning 50% of area median income or less. The Housing Department is requesting that the City Council authorize the Director of Housing to negotiate and execute an agreement with Mid-Pen subject to these terms. This transaction will be funded through the sale of the eight collateral properties.

Relocation of Tenants at the Comerica Term Loan Collateral Properties

In addition to moving the affordability restrictions, sale of the collateral properties at market rate prices entails relocation of the existing tenants. Five of the eight properties are currently occupied by 15 tenants. In accordance with relocation law, a draft Relocation Plan was developed by Associated Right of Way Services, Inc. (ARWS). ARWS has calculated the estimated cost to relocate the tenants from the EHC properties to comparable housing to be between $170,000 and $205,000. In order to facilitate the property sales, the City may need to front the relocation costs. These costs will be repaid from the proceeds of the property sales.

The Draft Relocation Plan for the eight properties was made available for public comment for the required 30-day public review period. The Plan, which is available at www.sjhousing.org/public.html, may now be adopted by the City Council. Adoption by the City Council is necessary in order for the tenant relocation and disbursement of relocation benefits to occur.

Sale of Markham Terrace Property

EHC also has a line of credit for $1,100,000 and a bridge loan of $600,000 with the bank. These two loans are corporate obligations of EHC that are not tied to a specific property. However, EHC has determined that it must sell its Markham Terrace property at 2112 Monterey Road in order to satisfy the two Comerica loans and other debts tied to the site. The Markham Terrace property contains a 95-unit development and a commercial restaurant. The 95 unit development was built as a motel in 1970 and converted to a Single Room Occupancy (SRO) affordable to Extremely Low- Income tenants in 1995. The restaurant is leased to a private business entity with the basement used as a meeting room for the Markham Terrace tenants.

Besides the unsecured Comerica loans, EHC has a number of secured loans on Markham Terrace. These are listed below.

- A $3,600,000 loan from the City on Markham Terrace
- A loan from Bank of the West with a current outstanding balance of approximately $534,844
- A $125,000 obligation to the County
- A $53,682 obligation to the Veterans Administration

EHC has entered into a purchase and sales agreement with Charities Housing Development Corp. (Charities Housing) for the sale of the Markham Terrace site in the amount of $6.3 million.

The debts owed Comerica, Bank of the West, and the Veterans Administration will be repaid from the sale of the property to Charities Housing. Both the City and County's Office of Affordable Housing have tentatively agreed to allow Charities Housing to assume their respective loans that remain on Markham Terrace. The real estate appraisal recently completed on this site substantiates that there is enough value in the Markham Terrace site to justify the sales price, repay the outstanding debts on the site, and support the ability of Charities Housing to assume both the $3,600,000 City loan and the $125,000 County debt. The City supports the sale of Markham Terrace for several reasons including the fact that the sale will protect the City's financial interest in the property. In order to facilitate the sale of the property, the City will be paying for the tenant relocation costs. Any remaining sales proceeds will be applied toward the relocation of Markham Terrace tenants and potential redevelopment costs.

Markham Terrace Redevelopment

In determining an appropriate price for the sale of the Markham Terrace property to Charities Housing, staff facilitated completion of a detailed structural assessment. Through this process, it was determined that the residential component had significant building issues that make it impractical to renovate the existing building. Therefore, the Housing Department and Charities Housing concluded it would be a much better long-term investment to pursue a complete demolition, redesign, and reconstruction of the structure. The City and Charities Housing are currently reviewing possible alternatives for the redevelopment of the site. Housing Department staff will return to City Council with two separate recommendations. The first will be a recommendation to provide acquisition financing to Charities Housing for the purchase of the Markham Terrace site. Subsequent to that action, Staff will bring forward a recommendation that Low and Moderate Income Housing Fund (20% funds) be committed to help finance the redevelopment of a new affordable housing project on the Markham Terrace site. The amount of the request will not be determined until Charities Housing and Housing Department staff have determined the best project and financing scenarios for this location.

Predevelopment Loan for Charities Housing

Charities Housing has requested predevelopment funding to initiate project design and permitting approval. The Housing Department is recommending that City Council approve a predevelopment loan to Charities of up to $500,000 in order to expedite the exploration of potential redevelopment of this site. The Department typically does not request funding for preliminary planning activities prior to the applicant's attainment of land use entitlements and the City Council's approval of site acquisition funding because the land use decision has not been fully vetted through the public hearing/approval process. However, in this case the site already has recorded affordability restrictions that dictate that it be used as an affordable housing site through the year 2050 – whether through rehabilitation of the existing structure or potential development of another project.

Relocation of Markham Terrace Tenants

The existing Markham Terrace tenants will need to be relocated. As mentioned, the City will be fronting the tenant relocation costs to facilitate the sale of the property. As a requirement of the sales agreement, all tenants need be relocated prior to the close of the real estate transaction. For this reason, the relocation needs to begin as soon as possible.

In accordance with relocation law, a draft Relocation Plan for the property was prepared by ARWS. The Plan was made available to the Markham Terrance occupants, the commercial tenant, and the public on October 18. The Plan is posted on the Housing Department website (www.sjhousing.org/public). The estimated cost for tenant relocation benefits is between $1.4 and $2.1 million. The Housing Department is requesting that City Council adopt the draft Relocation Plan at this time and authorize the Director of Housing to spend up to $2.1 million for the relocation of Markham Terrace tenants.

Short-term Operational Assistance for Markham Terrace

The project currently has Project-Based Section 8 assistance from HUD's Moderate Rehabilitation Program. The contract with HUD expires at the end of January 2009. Housing staff has worked with HUD and the Santa Clara County Housing Authority to secure Tenant-Based Section 8 Housing Vouchers for all current Markham Terrace residents that opt to take the housing voucher instead of monetary relocation assistance. The Tenant-Based vouchers may not be available until June 2009. The rent subsidy is needed to operate the facility. In order to allow the relocation to start immediately and provide continued funds to operate the project, the Housing Department is recommending that it be authorized to commit up to $400,000 to temporarily substitute for the Project-Based revenue that is going away at the end of January. As mentioned, once the new Tenant-Based vouchers are provided, the City will be reimbursed.

Payment of Relocation Consulting Costs

In addition to the tenant relocation costs, the Plan must be implemented by the City's relocation consultant. Specific services that will be provided by ARWS to implement the Plan include: helping tenants find appropriate replacement housing; determining tenant relocation benefit amounts and payment schedules; delivering benefits checks to tenants, tracking payments; and, ensuring relocation occurs in accordance to relocation law. Therefore, Staff is requesting that the City Council authorize the Director of Housing to negotiate and execute an amendment to the existing agreement between the City and ARWS to modify the scope of work and increase the compensation by $450,000, from $129,000 to $579,000. This figure will also cover the implementation of the Relocation Plan for the eight collateral properties previously mentioned.

Terms of the Draft Forbearance and Release Agreement

As part of the Housing Department's collaborative effort with EHC, Comerica Bank, and the County to resolve EHC's financial obligations, a draft Forbearance and Release Agreement has been prepared. The Agreement details a repayment sequence, establishes property sale price

targets, and addresses how proceeds get distributed if actual property sales prices come in lower or higher than estimated. The Agreement also establishes a timeframe for performance that requires Comerica's cooperation and forestalls any actions to foreclose upon those properties secured by Comerica loans. It is anticipated that the sale of the eight Comerica Term Loan collateral properties and Markham Terrace will fully satisfy EHC's debt obligations to Comerica and will pay for the following items.

- Real estate sales commissions, escrow fees, loan closing costs and transfer taxes
- $294,000 CDBG rehabilitation loan that the City owes to HUD
- HUD grant to EHC in a remaining amount of $75,825
- Tenant Relocation for the eight properties
- Transfer of all the affordability restrictions on the Comerica loan collateral properties
- The $534,844 Bank of the West Loan
- The City's $1,175,387 in unsecured interest on three collateral properties
- The $53,682 obligation to the Veterans Administration
- The County's unsecured loan of $176,555 for two collateral properties

As mentioned, the City's $3.6 million loan and the County Office of Affordable Housing's $125,000 in secured debt for Markham Terrace will be assumed by Charities Housing.

Staff from the County's Office of Affordable Housing have been involved in negotiating terms of the draft Forbearance and Release Agreement in order to protect their financial position in two of the eight collateral properties. The County staff is recommending that the Board of Supervisors approve adoption of the draft Forbearance and Release Agreement on December 9. Staff recommends that the City Council authorize the Director of Housing to negotiate and execute a Forbearance and Release Agreement that incorporates the terms presented in this memorandum. The City Council approval should not be subject to the action taken by the Board of Supervisors since the County's interests are minimal and unsecured. Should the Board of Supervisors fail to approve the Forbearance and Release Agreement, the City would continue to work with EHC and Comerica to implement the document.

EVALUATION AND FOLLOW-UP

At the end of six months, the Director of Housing will provide the City Council with a status report on the recommendations approved by City Council via this memorandum. The report will include an update on the implementation of the Forbearance and Release agreement, progress on the sale of the Comerica Term Loan collateral properties, and the progress in relocating the tenants for both the collateral properties and Markham Terrace development.

POLICY ALTERNATIVES

The Housing Department considered the following alternative before recommending that the Director be given authority to execute the agreement with EHC and its creditors.

Alternative #1: ***The City does not approve the Forbearance agreement which results in EHC's inability to resolve its financial obligation with Comerica Bank and its other creditors.***

Pros: None identified.

Cons: EHC would not be able to pay its debts to Comerica which could lead the bank to take further actions that could lead EHC into Bankruptcy. If EHC was forced to file for bankruptcy protection, the bank could pursue EHC corporate assets including funds that EHC has received from foundations and public entities to operate the cold weather shelters. The City and County would likely assume additional funding obligations for providing homeless services. By approving the Forbearance Agreement, the City has much greater likelihood of recovering its investment. The City may potentially have to pursue protracted actions to enforce its affordability restrictions on six of the eight collateral properties.

Reason for not recommending: The proposed plan satisfies the financial concerns of all parties involved, allows EHC to avoid bankruptcy, and aligns EHC's real estate portfolio with its core mission and objectives.

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 Criterion 1: Requires Council action on the use of public funds equal to $1 million or greater. This Council report will be posted to the City's website for the November 18, 2008, City Council Agenda.

COORDINATION

Preparation of this report has been coordinated with the Redevelopment Agency and the City Attorney's Office.

FISCAL/POLICY ALIGNMENT

This proposed plan is consistent with the City's Ten-Year Plan to End Chronic Homelessness, Destination Home, and the Housing Department's *Five-Year Investment Plan, Fiscal Years 2007/08-2011/12*, as adopted by City Council in June 2007.

COST SUMMARY/IMPLICATIONS

1. **COST OF PROJECT:**

Transfer of affordability restrictions to Mid-Peninsula Housing	$1,400,000
Payoff of CDBG Loan to HUD	294,000
Relocation of tenants at the Eight Collateral Properties	205,000
Relocation of Markham Terrace tenants	2,100,000
Short-term Operational Assistance for Markham Terrace	400,000
Relocation oversight for both relocation plans	450,000
Predevelopment Loan to Charities Housing	$500,000
TOTAL	$5,349,000

2. **SOURCE OF FUNDING:** Fund 443—Low- and Moderate-Income Housing Fund.

3. **FISCAL IMPACT:** No ongoing fiscal impact.

BUDGET REFERENCE

Fund #	Appn. #	Appn. Name	Total Appn.	Amt. For Contract	2007-2008 Adopted Operating Budget (Page)	Last Budget Action (Date, Ord. No.)
443	0070	Housing Loans, Grants & Site Acquisitions	$90,000,000	$5,349,000	XI - 53	6/24/08 28349

CEQA

EXEMPT File No. PP08-270

LESLYE KRUTKO
Director of Housing

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