



# Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Leslye Krutko

**SUBJECT:** SEE BELOW

**DATE:** February 9, 2009

Approved

Date

2-13-09

**COUNCIL DISTRICT:** 6  
**SNI AREA:** Burbank/Del Monte

**SUBJECT: REQUEST TO ALLOW EARLY DISBURSEMENT OF \$603,435 OF THE EXISTING FUNDING COMMITMENT FOR THE SAN CARLOS BOWL SENIORS PROJECT, LOCATED AT 1523-1533 WEST SAN CARLOS STREET**

## RECOMMENDATION

It is recommended that the City Council adopt a resolution i) approving a request for early disbursement of \$603,435 of the existing funding commitment to San Carlos Willard Associates, L.P., or its designated affiliate, to finance the shared offsite development costs for the 100-unit San Carlos Bowl Seniors rental project located at 1523-1533 West San Carlos Street, and ii) authorizing the Director of Housing to negotiate and execute all documents to effectuate this early disbursement.

## OUTCOME

Approval of the recommended action will enhance the financial security and capital available for loan repayments of the San Carlos Bowl Townhomes project, which is adjacent to the San Carlos Bowl Seniors project, both of which are located at 1523-1533 West San Carlos Street. The request will result in a planned but early disbursement for the San Carlos Bowl Seniors project, which will eventually provide 99 extremely low-income households and one unrestricted manager's unit.

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## **BACKGROUND**

On June 25, 2002, the City Council approved a conditional grant of up to \$4,775,000 to CORE Development Corporation and ROEM Development Corporation (collectively, Developer) for the acquisition and development of the 100-unit San Carlos Seniors rental housing project ("Seniors Project") located on part of a 3.19-acre site at 1523-1533 West San Carlos Street. On that date, the City Council also approved construction funding for the for-sale San Carlos Bowl Townhomes project ("Townhomes Project," marketed as Vista at San Carlos) on another part of the site, as well as \$750,000 in soft-second mortgage commitments for potential buyers.

On March 20, 2007, the City Council adopted a resolution approving a construction loan of up to \$4,766,000 for the Townhomes Project, and a total of \$1,600,000 in soft-second mortgage commitments for moderate-income buyers in 16 of its 32 units.

### Projects' Status

The Seniors Project has not yet started construction as negotiations with a commercial tenant on the site are ongoing. These negotiations are likely to be resolved in the near future. To proceed with the for-sale project development in Fall 2007, the Developer obtained permission from the Department of Planning, Building and Code Enforcement to bifurcate the development.

Construction on the Townhomes Project began in October 2007. The project is now 99% complete, and currently has 12 of its 32 units under contract. The project's sales rate exceeds that for other new for-sale projects in San José.

A significant contributor to the sales success is the presence of the City's soft-second mortgage commitment as well as State BEGIN funds that City staff obtained for the project. The amount of the City's soft-second mortgages was reduced to \$80,000 per unit via the Housing Director's Delegation of Authority in October 2008 to accommodate decreased need given declines in for-sale prices. BEGIN funds add another \$30,000 towards purchase prices for qualifying households.

### Financing Request

The senior lender on the Townhomes Project is Pacific National Bank, N.A. ("PNB"). As for-sale market prices have declined significantly since construction started on the Townhomes project, PNB is now seeking to reduce its repayment risk by restructuring the Townhomes loan commitment. It has liquidated \$1.3 million of its original \$15.3 million construction loan amount and is also seeking to maximize the additional cushion of net proceeds available in case sales take longer than anticipated.

The costs of certain improvements on and surrounding the site should rightfully be shared between the Seniors and Townhomes Projects. Costs for the Seniors Project included in the

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\$603,435 include improvements to the shared private road, a portion of curb and gutter work on perimeter roads, utilities access, and other site-related costs. In order to reimburse the Townhomes Project, thereby increasing the amount of funding available to that project, the Developer has requested that the City disburse a portion of its committed Seniors Project construction funds in advance of its future construction closing with other lenders and an equity investor.

### ANALYSIS

This action is being recommended for several reasons.

First, Housing Department staff has conducted significant due diligence to ensure that the \$603,435 in construction costs being requested to be disbursed are rightfully attributable to the Seniors Project, that they are within the expected scope of work, and that the costs are reasonable. The Housing Department's construction manager and an external consultant held multiple meetings with the developer and did detailed calculations on approximately 40 line items to divide costs between the projects by standards appropriate for each line item. Whether the work is compensated now or later, once construction of the Seniors Project proceeds, it was required as part of the site's entitlements and had to be done.

Second, the Seniors Project has a very high likelihood of proceeding. The Housing Department recorded 55-year Affordability Restrictions on the entire site in 2002, which makes it very difficult for anything except restricted affordable units to be built on that site. In addition, Entitlements for both projects were obtained under a single Planned Development Permit, PD 04-103, which makes it more likely that the planned rental project will proceed as scoped in order to meet the conditions of the permit. Further, negotiations with the existing commercial tenant are likely to conclude in 2009, which would allow construction of the Seniors Project to proceed in 2010 or 2011.

Third, the requested funds for the Seniors Project have been encumbered and remain available.

Fourth, the value of the Seniors parcel has risen substantially since the City originated its acquisition grant in 2002, allowing some latitude in the City's ability to fund and still be fully secured. An appraisal prepared on November 13, 2008, by The Fillmore Group for PNB indicates that the current as-is value of the Seniors site is \$4,570,000. The approximate value in 2002 was \$3.2 million. If this request is approved, a total of \$4,461,383 of the total commitment would be outstanding. The amount outstanding would be less than the current appraised value, so the City remains fully secured.

Finally, the action will result in a win-win-win situation for the Developer, PNB, and the City. As noted above, the expected ability of the Townhomes Project to pay back its lenders has been adversely affected by the weakness in the for-sale market. The Housing Department's second-position construction loan on the project is due in full at maturity; however, the drop in sales

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prices since construction closed in 2007 will produce far fewer revenues than needed to repay the City's loan in full. Staff will return to the City Council at a future date should any action be needed as a result of any shortfall. The City's potential loss on the Townhomes Project will be reduced commensurately with this early expenditure of the Seniors Project funds, improving the City's overall risk position in the Townhomes Project.

Further, by satisfying PNB's request, the Developer will avoid having to make cash payments to enable PNB to meet its underwriting objectives. Such payments could potentially put a significant financial strain on the Developer, as the current real estate market has left developers with relatively small cash balances. Financially strong developer partners are better able to maintain their existing affordable housing projects in case problems arise, which is preferable from Staff's perspective. And, as Staff believes that the Seniors Project must proceed, and this work had to have been performed, early disbursement produces only a minimal negative impact to the Housing Department's risk position in the Seniors Project.

Accordingly, Staff recommends adoption of these recommendations.

Business terms for the loan will include the City's recordation of a lien against the Seniors Project parcel in the amount of the request. Other specific business terms will be approved pursuant to the Director's Delegation of Authority ordinance, located in Chapter 5.06 of Title 5 of the San José Municipal Code.

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

There is no follow-up with the City Council needed regarding early disbursement, if approved, as it is part of the Department's normal course of business. If the expected shortfall in project revenues materializes, Housing Department Staff will return to the City Council with a request for loan forgiveness once the Townhomes Project units are sold and the final numbers are known.

### **POLICY ALTERNATIVES**

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

**Alternative #1:** *Deny CORE and ROEM's request for early disbursement of construction loan proceeds for the Seniors Project.*

**Pros:** If the Seniors Project does not proceed soon, the City will have disbursed funds with no resulting units being created in the near term.

**Cons:** The City's disbursement of funds at this time will reduce the City's potential losses on the Townhomes Project while helping the other parties in the deal as well. The funds are available and the uses were anticipated. The site's increased value fully supports the greater disbursement. Staff due diligence

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will ensure that early disbursement does not result in inadvertent overpayment for the improvements once the Seniors Project proceeds.

**Reason for not recommending:** The City could use an existing commitment of funds to help all parties involved in these projects without significantly increasing its risk.

### **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 March 3, 2009, 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 for 2008-09* in providing family units for very low- and extremely low-income households.

### **COST SUMMARY/IMPLICATIONS**

- |    |  |           |
|----|--|-----------|
| 1. | AMOUNT OF RECOMMENDATION:                          | \$603,435 |
| 2. | COST ELEMENTS OF AGREEMENTS:<br>Offsite Hard Costs | \$603,435 |

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3. SOURCE OF FUNDING: Multi-Source Housing Fund (Fund 448)

4. FISCAL IMPACT: No ongoing fiscal impact.

**BUDGET REFERENCE**

No budget impact because no additional funds are being requested.

**CEQA**

CEQA: Exempt, PD04-103.



LESLYE KRUTKO  
Director of Housing

For questions, please contact LESLYE KRUTKO, DIRECTOR OF HOUSING,  
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