



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Leslye Krutko

SUBJECT: SEE BELOW

ATE: April 20, 2009

Approved

Date

4-21-09

COUNCIL DISTRICT: 3
SNI AREA: N/A

SUBJECT: RELEASE A PORTION OF THE CITY'S CONSTRUCTION FUNDING FOR REIMBURSEMENT OF DEVELOPMENT COSTS FOR THE NORTH FOURTH STREET FAMILY APARTMENTS PROJECT

RECOMMENDATION

It is recommended that the City Council adopt a resolution approving the release of up to \$4,000,000 of the previously approved construction loan commitment of up to \$9,875,000, to First Community Housing, or its designated affiliate, for the development of the North Fourth Street Family Apartments project to be built at 1470 North Fourth Street and made available to extremely low-income (ELI), very low-income (VLI) and low-income (LI) families.

OUTCOME

The City Council's approval of the recommended actions will facilitate the construction of 100 rental housing units affordable to San José families with incomes between \$18,475 and \$73,440. The City will take possession of the site and wait until the other construction and permanent funds are obtained before releasing the remainder of the City's loan proceeds.

BACKGROUND

On March 6, 2007, the City Council approved a PD rezoning for the development of the 100-unit North Fourth Street Family Apartments project to be constructed at 1470 North Fourth Street. On March 20, 2007, the City Council approved a funding commitment of up to \$9,875,000 to First Community Housing ("FCH"), or its designated affiliate, for the development of the subject project to be made affordable to ELI, VLI and LI households. Of this commitment amount, \$1,095,000 was used to provide 50% of the acquisition cost of the site.

On April 10, 2008, the Director of Housing approved a \$100,000 predevelopment loan to the Sponsor to partially fund pre-construction "soft costs." On June 24, 2008, the City Council approved a \$400,000 increase in the predevelopment loan, for a total of \$500,000. This predevelopment loan amount is part of the total City commitment amount of \$9,875,000.

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The project has all land use entitlements and has been fully designed, as construction had been anticipated to start in fall 2008. However, this project has commitments for two types of State funding awards from the State Department of Housing and Community Development-- Multifamily Housing Program ("MHP") and Infill Infrastructure Grant (IIG) funds. Given the State's financial crisis, HCD has been unable to perform on its written obligation to provide financing under awards for both of these programs. As a result, the project's potential lenders and tax credit investors are unable to make commitments while the State funding is pending and its timing is unknown.

This project also has obtained construction and permanent loan commitments from the California Housing Finance Agency ("CalHFA"). However, given the distress in the bond markets and the State's financial crisis, CalHFA has been unable over the past few months to issue the tax-exempt bonds through which it finances its loan tax-exempt program. FCH has instead had to find conventional financing opportunities.

Further, FCH had obtained a 50% land acquisition loan from the Opportunity Fund. The approximate current balance of the Opportunity Fund's land loan is \$1.5 million. In addition, FCH had obtained a \$500,000 predevelopment loan from the Housing Trust Fund of Santa Clara County and a \$500,000 predevelopment loan from the Sobrato Foundation.

Had the project not been delayed, construction funding would have repaid FCH the other early project costs it has covered of approximately \$1.1 million. Without this source of repayment, FCH's overall liquidity has been strained.

In an effort to preserve the substantial resources invested in the project to date by the Sponsor, FCH first approached the City in December 2008 to request an advance of the \$9,875,000 in construction funds already committed to the project.

Staff's proposal is to advance \$4.0 million of the total commitment for the following uses:

1. Repay the Opportunity Fund's land acquisition loan of \$1.5 million
2. Repay the Housing Trust Fund predevelopment loan of \$500,000
3. Repay the Sobrato Foundation's predevelopment loan of \$500,000
4. Reimburse FCH in an amount up to \$1.5 million in already-incurred early development costs based on submission of invoices.

In return, the City will move into first position as the project's only acquisition/predevelopment lender and take possession of the land. There are no additional funds being requested as part of this recommendation.

ANALYSIS

This action is recommended for several reasons.

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First, the North Fourth Street project has a very high likelihood of proceeding. The Housing Department recorded 55-year affordability restrictions on September 18, 2007, which makes it financially infeasible for anything except affordable housing to be built on the site. The project's construction plans and specifications are complete. State funding commitments have already been obtained for this project on this site, which are not transferable. In addition, because the project is located near transit, will feature many innovative green building elements such as a green roof, and is sponsored by an experienced developer with a good track record for performance, it has a better chance of obtaining private sector financing than would a project without these characteristics.

Second, the Department believes it is in the City's best interest to repay the project's outstanding loans in order to move into the first position as the only lender on the property's title. If the State funding continues to be delayed indefinitely or does not occur, or if FCH is unable to obtain the remainder of its financing for the project, approval of the recommended action will allow the City to take back the property and convey development rights to another affordable developer to complete the building. While this is clearly not the Housing Department's preference, these actions are legally possible given the City's rights as first lienholder. In addition, at the closing of the project's construction financing, the City already had contemplated taking ownership of the land and leasing it back to FCH to build the development. Implementing this ground lease structure gives the City more control of the property in the long-term, which is a policy objective of the Housing Department. Taking control of the land in the near-term would have the side benefit of simplifying the construction closing.

Third, it is anticipated that the financing for the project will be reestablished within the next few months as the State continues to issue revenue bonds and implements its recovery plan. The State reportedly plans to issue \$3 billion in bonds in late April or early May, \$1 billion of which will be directed to housing projects with existing commitments. North Fourth Street is expected to be high on the State's priority list as a funding candidate given its two existing State funding commitments.

Fourth, all of the expenses that FCH would pay with the early disbursement were already anticipated to be paid by City loan proceeds after the close of the construction financing. When all private sources of construction financing are committed, the City will then close its entire construction loan commitment. Until then, the proposed early advance of construction funds will allow vendors providing development services to the project to be paid and will support local businesses.

Fifth, the City will obtain adequate security for the recommended partial release of its construction funding. The site carries a Deed of Trust on the site, valued at \$1,095,000 recorded September 18, 2007 and evidenced by an updated appraisal performed by Carneghie, Blum and Partners on April 15, 2009. The City will obtain an assignment of all plans, specifications and development documents related to the project to secure the remainder of the amount to be disbursed.

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Sixth, by helping to move this project forward, the City of San José will also benefit. City fees of \$112,533 have already been paid by the developer and an additional \$1,018,821 of required City fees and \$240,877 of school district fees will be paid in order to proceed with the development process. It is anticipated that proceeding with and completing the development of this project will create 231 jobs in San José over two years. FCH anticipates using building material suppliers in Santa Clara County. Support for FCH is also support for a local business, as FCH is headquartered in San José and builds 80% of its projects here. In addition, the project will house several displaced residents from the recently-closed Agnews Center for developmentally disabled adults. It would be optimal to continue to house these residents in San José so as to minimize the disruption of their medical and social support networks.

Finally, FCH is one of the top affordable housing developers based in San José with over 15 years of affordable housing development experience. FCH is the City's most active provider of affordable special needs housing and is a nationally-recognized green building developer. FCH has been awarded the Gold Nugget Merit Award for Sustainable/Green Project of the year in 2004 for its El Paseo Studios project, its Craig Gardens Senior Housing project was named Best in Seniors Housing by the National Association of Home Builders and FCH's Gish Apartments recently was awarded LEED Gold certification by the United States Green Building Council. FCH is an important part of the local affordable housing development and delivery network and their continued organizational viability is important to the City of San José.

In summary, the Sponsor's request for an advance of \$4,000,000 of previously committed City funds is reasonable given that it will help keep the previously-approved project moving forward. FCH has spent over \$3,884,000 from other funding sources invested in the project and approval of this recommendation will allow them the time to restructure the financing of the project and protect the viability of an important local nonprofit company.

EVALUATION AND FOLLOW-UP

In order to be eligible for a State tax-exempt bond allocation and State tax credits, the project will also need to close its financing gap. This gap was caused by the unavailability of CalHFA low-cost financing and adverse changes in equity pricing during the project's delay caused by the State's financial crisis. Therefore, staff will return with a request to the City Council in early August 2009 for additional funding for the project.

POLICY ALTERNATIVES

Alternative #1: Deny First Community Housing's request for an early release of a portion of the City's committed funding.

Pros: The City funding committed to this project could be retained by the City until construction starts and the City could earn interest on the funds. The City would also be in a less financial risky position in the low likelihood that the project does not precede for a considerable amount of time.

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Cons: Not reimbursing FCH for costs already incurred on this project would jeopardize their ability to move other projects as well, which would significantly damage FCH's financial health. A bridge loan from a commercial lender instead of the City, if it were available, would increase the project's overall costs, thereby increasing the amount of long-term City funding required. The proposed solution strengthens the City's position by becoming the site's owner, allowing greater long-term control over the project.

Reason for not recommending: The short-term advance of committed funding at favorable interest rates will keep overall project costs at a minimum, thereby reducing the amount of total City funding needed for this affordable housing project. This advance will help the viability of one of the City's experienced nonprofit affordable housing developers, and will result in the City's ownership of the site's land.

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)

COORDINATION

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

FISCAL/POLICY ALIGNMENT

This expenditure is consistent with the City's *2007-2012 Five-Year Housing Investment Plan*, adopted by the City Council in June 2007, in that it is furthering new construction of ELI, VLI and LI family units.

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COST SUMMARY/IMPLICATIONS

1. AMOUNT OF RECOMMENDATION: up to \$4,000,000

2. COST ELEMENTS OF PROJECT:

Land
Hard Costs
Soft Costs
TOTAL up to \$4,000,000

3. SOURCE OF FUNDING: Housing Loans, Grants and Acquisition (Fund 443)

4. FISCAL IMPACT: No ongoing fiscal impact

BUDGET REFERENCE

Fund #	Appn. #	Appn. Name	2006-2007 Total Appn.	Amt. for Contract	2006-2007 Adopted Operating Budget (Page)	Last Budget Action (Date, Ord. No.)
443	0070	Loans, Grants and Site Acquisitions	\$45,034,364	\$9,875,000	XI-46	6/27/06, 27801

CEQA

CEQA: Addendum to Final EIR for the North San Jose Area Development Policy, Resolution No. 72768, File No. PDC06-022.


LESLYE KRUTKO
Director of Housing

Attachment 1 – Location Map

For questions please contact LESLYE KRUTKO, DIRECTOR OF HOUSING,
at 408-535-3855

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Attachment 1

Site Map

1470 North Fourth Street

