



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Leslye Krutko

SUBJECT: SEE BELOW

DATE: May 21, 2009

Approved

Date

6-4-09

COUNCIL DISTRICT: 5
SNI AREA: Mayfair

SUBJECT: INTERIM RENTAL AFFORDABILITY AGREEMENT WITH TIERRA ENCANTADA DEVELOPMENT, LLC.

RECOMMENDATION

It is recommended that the City Council adopt a Resolution authorizing the Director of Housing to execute an Interim Affordability Restriction with Tierra Encantada Development, LLC, to allow for the temporary rental of the for-sale affordable units at Tierra Encantada Townhomes, located near the corner of Alum Rock and McCreery Avenue.

OUTCOME

Approval of this recommendation will allow Tierra Encantada Development, LLC, to temporarily rent eight affordable residential units at its Tierra Encantada Townhome project ("Project") for an initial period of up to five years. Upon the improvement of the for-sale housing market, CHD will aggressively try to sell the units, at which time the proposed Interim Affordability Agreement would be rescinded and the underlying for-sale moderate-income recorded Affordability Agreement would apply.

BACKGROUND

On June 25, 2002, the City of San José Department of Housing made a loan commitment of \$4,000,000 to Community Housing Developers ("CHD" or "the Developer") for the acquisition and construction of the 93 unit Tierra Encantada Apartment project and the 12 unit Tierra Encantada Townhome Project. Since the final map for the rental project was not recorded at the closing of that project's financing, the City's deed of trust reflected both the \$3,600,000 City loan for the rental project and a \$400,000 acquisition loan for the for-sale parcel.

Upon completion of the rental project in November 2005, staff released and reconveyed the for-sale parcel from the \$4,000,000 deed of trust, and recorded a separate deed for \$400,000.

Date: May 21, 2009

Subject: Interim Rental Restriction for Tierra Encantada Townhomes

Page 2

Construction on the second phase of the twelve unit townhome project began in 2006. Upon completion of the townhomes in 2008, the City's \$50,000 per-unit commitment would be rolled over into second mortgage loans for low- or moderate-income first-time homebuyers. On June 17th, 2008, the City Council approved an additional \$200,000 to be used for up to \$50,000 in per-unit second mortgage financing for the remaining four units, in an effort to sell the units and entice new homebuyers

In addition to the second mortgage commitments, the City also secured an additional \$360,000 in grant funds through the State's Building Equity and Growth in Neighborhoods (BEGIN) Program, a proposition 1C general obligation bond approved by California voters in 2006. Under the terms of the BEGIN program, low- or moderate income homebuyers would be eligible to borrow up to \$30,000 in deferred repayment second mortgage loans per household, bringing the total available City subsidy amount to up to \$80,000 per income restricted-unit.

ANALYSIS

The current for-sale housing market has been challenging, given the tightening of credit and lending standards and buyer concerns about the overall housing market. CHD began marketing the project for sale in March 2008, but by December 2008 it had slowed its sales efforts and ceased its heavy marketing campaign due to an inability to attract buyers. The developer now desires to continue to "soft market" the units for-sale, while being allowed to temporarily rent the affordable units at Tierra Encantada, until the for-sale housing market improves.

The Housing Department recommends approval of the Developer's request to temporarily rent the units for several reasons. Most importantly, there is little advantage in forcing CHD to continue to try to sell the units and bring more housing stock into the current market, which is now over-supplied. The units may take years to sell, and the current home prices will not generate enough cash to retire the developer's construction lender debt. Further, CHD has been negotiating loan modifications with its lenders through the use of extended loan maturity dates and revised loan interest rates. The projected rental income from the project would help cover the interim debt service payments.

Proposed Rental Limits

Eight of the twelve townhomes are currently income restricted to moderate-income households, as consideration for early city financing. In order to maintain both the overall number of restricted units and to ensure consistency with the targeted rent levels with past City financed rental housing, the Department of Housing is recommending that the Interim Rental Restriction be approved, as shown below:

# Units	Income Target	Income Ranges (2-5 person household)	Maximum Monthly Rent (3-4 bedroom units)
1	50% AMI	\$42,450-\$57,300	\$1,326-\$1,433
3	60% AMI	\$50,640-\$68,340	\$1,583-\$1,709
4	80% AMI	\$67,900-\$91,650	\$1,583-\$1,709
4	Unrestricted	N/A	\$2,000 (estimated)

Consistency with City's Current Inclusionary Housing Requirement

Approving these rent levels will also satisfy the City's current Inclusionary Housing requirement for the provision of affordable units for low- and very-low income households in rental housing projects. Further, this request is consistent with the City Council approved temporary conversions from other for-sale projects to temporary rentals, including the Globe and Skyline at Tamien. These were approved in June and September 2008 respectively.

In addition, this project offers large units located near Alum Rock Avenue - a major transit corridor in the City. The proposed project would benefit larger families in need of affordable rental units.

Upon conversion back to for-sale housing, CHD would still sell the units in accordance with its existing Affordability Restriction. Finally, the total years of affordability would increase by the term of the rental period, resulting in longer affordability than would otherwise be obtained under the terms of a 45- year ownership restriction

Approving the request to allow for the temporary rental of affordable for-sale housing units would require the use of an Interim Affordability Agreement. The Housing Department will record a new rental restriction and subordinate the existing underlying moderate-income for-sale affordability restriction. Key provisions of the proposed Interim Affordability Restriction would include:

- Rental of the eight affordable units would be allowed for a period of up to five years. The Director of Housing would have the authority to extend this term for up to an additional five years, if necessary. The underlying 45-year for-sale restriction would take effect upon the expiration or termination of the interim rental restriction;
- The Developer may terminate the Interim Rental Restriction at any time during the term provided that the owner (1) give a minimum of 90 days' advance notice to the tenants of the affordable units prior to the commencement of the marketing of those units for sale, and (2) does not violate or prematurely terminate any lease agreement between the owner and tenant of an occupied designated affordable unit;
- The Developer agrees to take any actions necessary to legally avoid legal Relocation obligations. In the event there are resulting obligations, the Developer shall be responsible for them. The City will not bear any cost or responsibility for relocation.

Impact on the Project's Second Mortgage Funding

If staff's recommendation is approved, the project's existing funding commitments for mortgage assistance would be temporary reallocated to projects with a demonstrated need of additional City financing. Prior to the proposed conversion back to a for-sale project, the developer would notify Housing Department staff that its' project based acquisition loan of \$400,000 shall be retired and City loan proceeds will be rolled into second mortgage promissory notes between the City and the future new homeowners. The BEGIN grant contract from HCD would be disencumbered and returned to the State.

EVALUATION AND FOLLOW-UP

The Housing Department regularly posts Housing Production reports on the status of inclusionary and city financed affordable housing projects to its website, www.sjhousing.org. If approved, an Interim Affordability Agreement will be signed and the Housing Production report will be updated to reflect the change in tenure.

POLICY ALTERNATIVES

To arrive at this proposal, Staff considered the following options:

Alternative #1: *Do not approve an Interim Rental Affordability Restriction and require the developer to market and sell the designated affordable units.*

Pros: These affordable for-sale housing units would continue to be available to moderate-income homebuyers in the Mayfair SNI Area.

Cons: These new for-sale housing units in San José are bringing further for-sale housing units into an already saturated local housing market. These currently empty homes have no direct benefit to the community. In addition, the Developer continues to accrue carrying costs related to the overall projects' required debt service that impacts the financial viability of the organization.

Reason for not recommending: The proposed Interim Affordability Agreement will immediately bring new affordable rental units into the tight current rental market. It will provide much needed relief for larger lower-income households, while still preserving affordable homeownership opportunities for moderate-income homebuyers in future years. Further, this proposal to seek a temporary change in tenure will assist the developer in restructuring their existing debt, and help minimize the risk of project foreclosure.

PUBLIC OUTREACH/INTEREST

This action does not meet any of the criteria below. However, the developer held a publicly noticed community meeting on March 24th, 2009, at Tierra Encantada Apartments. No one spoke

Date: May 21, 2009

Subject: Interim Rental Restriction for Tierra Encantada Townhomes

Page 5

in favor of or in opposition to the project. In addition, this memo will be posted to the City Council Agenda for June 16, 2009, via the City's website.

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater.
- 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.
- Criterion 3:** Consideration of proposed changes to service delivery, programs, or staffing that may have impacts to community services and have been identified by staff, the Board or Council, or a community group that requires special outreach.

COORDINATION

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

COST SUMMARY/IMPLICATIONS

Not Applicable.

BUDGET REFERENCE

Not Applicable.

CEQA

CEQA: Resolution No. 26679, PDC02-029.


LESLYE KRUTKO
Director of Housing

For questions, please contact LESLYE KRUTKO, Director of Housing, at 408-535-3851.