



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Leslye Krutko

SUBJECT: SEE BELOW

DATE: July 13, 2009

Approved

Date

7/16/09

COUNCIL DISTRICT: 7
SNI AREA: N/A

**SUBJECT: APPROVAL OF A FUNDING COMMITMENT FOR SITE ACQUISITION
OF THE MARKHAM TERRACE APARTMENTS PROJECT**

RECOMMENDATION

It is recommended that the City Council adopt a resolution approving a funding commitment of up to \$6,280,000 of Low and Moderate Income Housing Funds (20% Funds) to Charities Housing Development Corporation (Charities Housing), or its legal affiliate, for a land acquisition loan to acquire the Markham Terrace property, located at 2112 Monterey Road, from EHC Lifebuilders (EHC).

OUTCOME

Approval of the recommended action will enable EHC to meet its obligations under the Forbearance Agreement approved by the City Council in January 2009 to repay its creditors from the proceeds of the purchase by Charities Housing. Approval also will allow Charities Housing to meet an acquisition deadline under its Purchase and Sale Agreement (Purchase Agreement) with EHC.

BACKGROUND

The Markham Terrace property consists of 2.86 acres improved with both a 95-unit SRO (single room occupancy) apartment project called Markham Terrace Apartments, constructed originally from 1950 to 1973, and a 5,000 square foot single-story restaurant building (Monterey Breeze) with 5,000 square foot basement office space built in 1970. On November 21, 2008, Charities Housing entered into a Purchase Agreement with EHC for the Markham Terrace property in the amount of \$6,280,000. The Housing Department supports Charities Housing's proposed purchase of the site.

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On January 27, 2009, the City Council approved the framework for the Forbearance Agreement with EHC and its Creditors to strengthen the financial position of EHC. The Forbearance Agreement was executed April 2, 2009. EHC debts owed to Comerica, Bank of the West, and the Veterans' Administration will be repaid from the sale of the Markham Terrace property. Both the City and County's Office of Affordable Housing have tentatively agreed to allow Charities Housing to assume their \$3,600,000 and \$125,000 loans, respectively, against the property.

ANALYSIS

In order to meet the terms of the Forbearance Agreement, the City needs to move forward with site acquisition loan approval and subsequent closing of the subject transaction. The acquisition loan proceeds will become the source of funds to distribute to the parties to the Agreement as noted on page 5 of this Memorandum.

The sale price of the property was confirmed by the Forbearance Agreement. The Housing Department received an appraisal dated September 20, 2007 prepared by Hulberg & Associates for EHC that values the property and improvements at \$11,750,000. The Forbearance Agreement was negotiated over a long period of time based on the distribution of this amount of proceeds expected from the sale, given the negotiated sales price of \$6.28 million. While the Housing Department would typically obtain a more current appraisal prior to closing of the loan in order to finalize the City's loan amount, it is recommended that this process be waived in this instance since the purchase price for the subject property is an integral part of the Forbearance Agreement and is necessary to the success of EHC and to the success of retaining this property for affordable housing.

Subsequent to approval and closing of the subject land acquisition financing, at a time at which the Housing Department has available funding, Staff will submit a recommendation to the City Council that funds be committed for construction and permanent financing of the development of a new affordable housing project on the Markham Terrace site. The specific amount of the request will not be determined until Charities Housing and Staff determine a development plan reflecting the optimal affordable family rental housing project and financing scenario for the subject location. An updated and more extensive appraisal correspondingly will be obtained in connection with that request at a later date.

There are currently affordability restrictions on the property that restrict occupancy to households earning 50% of Area Median Income or less, with rents correspondingly restricted. These restrictions will be continued until the City closes a new construction/permanent loan. At that time, revised affordability restrictions that are consistent with City sources of financing will be recorded.

Specific business terms for the acquisition 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 José Municipal Code.

It has been determined that the Markham Terrace tenants can continue to be relocated subsequent to the close of the land purchase.

EVALUATION AND FOLLOW-UP

Charities Housing's plan for the future development of the site will be brought to the City Council for approval of land use entitlements within the next few months. Although the uncertainty of availability of public and private sources of funding make it difficult to predict specific project timing, staff also expects to submit a recommendation for City construction and permanent project financing in the next 12 months.

POLICY ALTERNATIVES

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

Alternative #1: *Deny the requested funding commitment for the acquisition of the Markham Terrace site.*

Pros: The City would retain \$6,280,000 that it could apply to the purchase of another site.

Cons: If the site cannot be bought with reasonably-priced financing, no loan proceeds would be available for distribution as agreed under the Forbearance Agreement. 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 its cold weather shelters. The City and County would likely assume additional funding obligations for providing homeless services. The City may potentially have to pursue protracted actions to enforce its affordability restrictions on six of the eight collateral properties as described in the Forbearance Agreement if EHC creditors foreclose on these properties. By approving the requested funding, the City has much greater likelihood of recovering its investment.

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

Alternative #2: *Delay the requested funding commitment for the acquisition of the Markham Terrace site until entitlements are obtained for a new affordable housing project.*

Pros: The City would avoid the risk that entitlements for the contemplated affordable housing development would not be obtained after the City has financed land acquisition.

- Cons:** The City's timely approval of acquisition funding of Markham Terrace by Charities Housing is a key element to the validity of the Forbearance Agreement. Its time sensitivity was high enough that another party to the Agreement was at one time unwilling to sign before the City approved the acquisition loan. The Forbearance Agreement is beneficial to the City in that it not only protects its investment in the Markham Terrace property but also freezes interest accrual for EHC by all creditors to the Agreement. All parties to the Forbearance Agreement have acted in good faith to agree to an acceptable workout agreement, of which the City's timely land acquisition financing is a key part. Obtaining entitlements will require a General Plan Amendment and a Planned Development Rezoning that is expected to require up to eight months. A delay of this length could negatively impact EHC towards regaining financial stability. The Housing Department expects that entitlements will be obtained.
- Reason for not recommending:** A delay of the requested funding commitment could increase the City's risk of preserving the property for affordable housing and enabling EHC's financial stability.

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 Memorandum will be posted to the City's website for the August 4, 2009 Council Agenda.

Charities Housing has also begun outreach to the community. On December 17, 2008, Charities Housing held a noticed community meeting for the General Plan Amendment, file no GP08-07-04, to present the proposed affordable housing development. Representatives of the Departments of Planning, Building and Code Enforcement and Housing also attended the meeting. Four residents from the adjacent mobilehome park to the East generally supported the proposed development. They expressed concerns about resident safety, and maintaining visibility of the adjacent driveway to the south leading to the mobilehome park. An additional noticed community meeting will be held in the Spring for the Planned Development Rezoning.

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 2005-2010* in providing units for very low- and extremely low-income households.

COST SUMMARY/IMPLICATIONS

1. **SOURCES AND USES OF ACQUISITION FINANCING:**

<u>ACQUISITION SOURCES</u>	<u>AMOUNT</u>
City Loan to Charities Housing	\$6,280,000
TOTAL	\$6,280,000
<u>ACQUISITION USES</u>	<u>AMOUNT</u>
Gross Sales Proceeds to EHC	\$6,280,000

A summary of the Markham Terrace estimated distributions (to be controlled by the City) is as follows:

Gross sales proceeds from Markham Terrace:	\$6,280,000
Less:	
Sales Commission (est.)	<188,400>
Legal Fees	<60,000>
Documentary transfer taxes, closing, recording and escrow costs (est.)	<251,200>
EHC Reimbursement of engineering costs, consulting fees and related expenses	<150,000>
Bank of the West	<534,844>
Transfer Costs of affordability restrictions to Mid-Peninsula Housing	<1,398,000>
Relocation Costs (for 8 other collateral properties per the Forbearance Agreement)	<205,000>
20% Funds (to the City)	<1,175,387>
County CDBG Loan	<176,755>
VA Grant	<53,682>
HUD Grant	<75,825>
Net Remaining Proceeds	\$2,010,907

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Less:	
Comerica Payment	<1,010,907>
*Net Proceeds to City (est)	\$1,000,000

*Net Proceeds to City is solely owned and controlled by the City without obligation to other parties to the Forbearance Agreement.

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	2009-2010 Adopted Operating Budget (Page)*	Last Budget Action (Date, Ord. No.)
443	0070	Housing Loans, Grants & Site Acquisitions	\$65,000,000	\$6,280,000	XI-53	N/A

* The 2009-2010 Operating Budget was Adopted on 6/23/2009.

CEQA

Mitigated Negative Declaration File Nos. GP08-07-04 and PDC09-015.



LESLYE KRUTKO
Director of Housing

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

ATTACHMENT 1
Subject Site Map
Markham Terrace Apartments

