



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Leslye Krutko
Jennifer A. Maguire

SUBJECT: SEE BELOW

DATE: July 13, 2009

Approved

Date

7/16/09

COUNCIL DISTRICT: 3

SNI AREA: Rincon De Los Esteros

**SUBJECT: APPROVAL OF A LOAN INCREASE OF UP TO \$717,000,
COMMITMENT OF HOME FUNDS, AND FORGIVENESS OF UP TO
\$125,000 OF ACCRUED INTEREST FOR THE 90 ARCHER STREET
APARTMENTS PROJECT LOCATED AT 90 ARCHER STREET**

RECOMMENDATION

It is recommended that the City Council adopt a resolution:

1. Approving an increase in the construction/permanent funding of up to \$717,000, bringing the total City construction/permanent funding up to \$5,297,000, to Charities Housing Development Corporation ("Charities"), or its designated affiliate, for a land acquisition/predevelopment/construction/ permanent loan for the development of the 42-unit 90 Archer Street Apartments project ("Project"), located at 90 Archer Street, to be made available to extremely low-income ("ELI") and very low-income ("VLI") households.
2. Approving the forgiveness of up to \$125,000 in accrued interest on the City's predevelopment and acquisition loans.
3. Committing the use of \$1,800,000 of HOME Investment Partnership ("HOME") program funds, previously committed to Charities for the future development of a rental housing project to lower-income households, as a project-specific award of funds to the 90 Archer project.

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4. Approving the following Appropriation Ordinance amendments in the HOME Investment Partnership Program Fund (Fund 445) for FY 2009-2010:
 - a. Increase the Loans and Grants appropriation by \$417,656.
 - b. Decrease the Unrestricted Fund Balance by \$417,656.

OUTCOME

Approval of the recommended actions will result in the construction and development of 42 rental units, with 16 units affordable to households with incomes at or below 30% of Area Median Income (AMI), 25 units affordable to households with incomes at or below 50% AMI, and one unrestricted managers' unit.

Approval of these recommendations at the August 4, 2009 City Council meeting is critical for the developer to demonstrate local funding approval for the project to the California Tax Credit Allocation Committee ("TCAC") by the August 17, 2009 deadline.

BACKGROUND

Project Approval History

On June 24, 2008, the City Council approved a funding commitment of up to \$1,800,000 of HOME Investment Partnership ("HOME") program funds to Charities, a Community Housing development Organization ("CHDO"), for the future development of a rental housing project affordable to lower-income households. See below for more background on the federal HOME program funds.

On December 9, 2008, the City Council approved a funding commitment of up to \$4,580,000 to Charities Housing or its designated affiliate, for a land acquisition/predevelopment/construction/permanent loan for the development of the 42-unit 90 Archer Street Apartments project, to be made available to ELI and VLI households.

On March 10, 2009, the City Council approved a change in the unit affordability mix for the project that allowed a broader unit affordability range of 30-45% Area Median Income ("AMI") to increase the pool of potential tenants qualified to reside in the project and to streamline property management operations.

On May 11, 2009, Charities requested the recommended loan increase and accrued interest forgiveness.

Project Description

The subject site is located at 90 Archer Street, one block East of North First Street at the intersection of Kerley Drive. The Project is designed to serve primarily as workforce housing for

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residents employed in low-wage occupations. There will also be six units set aside for homeless, severely mentally ill clients of the County of Santa Clara's Mental Health Department ("MHSA"). These residents will receive support services from providers that partner with the County Mental Health Department.

The Project will contain 41 studio apartments and 1 two-bedroom unrestricted manager's unit. Sixteen units in the project will be affordable to ELI households at or below 30% AMI, and 25 units will be for households at or below 45% AMI. The residential portion of the development will be located in one, three-story building constructed on a podium above an at-grade parking garage. The project site is located two blocks from a light rail stop along North First Street, and its transit orientation supports sustainable development patterns in the City. Demand for units is expected to be strong given the Project's affordability and its proximity to light rail.

Summary of the Proposed Transaction

The total estimated Project cost is \$16,121,837. The previously approved City loan of \$4,580,000 was used to acquire the site at 100% of its cost for \$3,700,000, with the remaining \$880,000 being drawn for predevelopment expenses.

Charities has requested a loan increase from the City because overall development costs for the project have increased by over \$1.5 million. Increases in project costs were caused by increases in financing costs and a newly-discovered need for environmental remediation. The applicant should be able to cover some of these costs through other sources, including a new \$205,000 Federal Home Loan Bank Affordable Housing Program (AHP) loan. Despite the AHP loan, additional City funding of \$717,000 and the forgiveness of up to \$125,000 in accrued interest is necessary to fully close the funding gap for development of the project.

If the recommended loan increase is approved, the entire \$5,297,000 will remain outstanding during the construction and permanent phases.

In addition to the proposed City loan, Charities applied for 9% Low-Income Tax Credits from TCAC in June 2009, and will seek a conventional construction loan. Because the project offers rents that are significantly lower than the market, the project cannot support a significant amount of conventional permanent debt. The permanent financing of the project will include the loan from the City of San José, federal HOME funds from the County of Santa Clara, State MHSA funds awarded through the Santa Clara County Office of Affordable Housing, AHP funds, federal stimulus funds through the State "TCAP" program, deferred developer fee, and limited partner equity from the sale of the Tax Credits. Of the project's total funding, \$2,171,157 will be provided by federal HOME funds—\$1,800,000 through the City of San José, and \$371,157 through the County of Santa Clara. The City will be funding 15 HOME units and the County will be funding 3 HOME units.

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HOME Funds

As discussed above, in June 2008, the City awarded \$1.8 million in federal HOME funds to Charities Housing as a CHDO, for use on a to-be-determined affordable housing development. The City of San José is an entitlement jurisdiction that receives annual funding allocations from the U.S. Department of Housing and Urban Development for the HOME Program. The City can reserve HOME funds for a CHDO provided that the CHDO uses the funds to develop affordable housing on a particular project within five years of the date the allocation was received by the City. New construction of affordable rental housing has been established by the City Council as one of its priority uses for HOME funds in the Consolidated Plan and the Annual Action Plan; therefore, HOME is therefore eligible for award to a CHDO for this purpose. Charities is the City's only CHDO at this time. Further, a project-specific award of HOME funds is possible only after completion of the federally required environmental review under the National Environmental Policy Act ("NEPA"). The NEPA was completed on June 26, 2009.

ANALYSIS

Increase in Construction/Permanent Financing and Interest Forgiveness

The requested loan increase is required due to the turmoil in the banking/tax credit sectors, as well as the need for additional environmental remediation and site work. Turmoil in the banking sector and tax credit equity market has resulted in more stringent underwriting of workforce housing developments, decreasing equity amounts paid for tax credits, and severe competition for equity partners (who serve as project limited partners for the first 15 years of the project). Tighter underwriting by lenders and equity investors have resulted in requirements for higher project operating reserves. This will add over \$350,000 in new costs to 90 Archer. The tax credit equity pay-in price per dollar of credits declined from \$0.87 to \$0.72 since the project was originally approved, adding over \$1,400,000 to project costs.

These market conditions are outside the control of Charities, which seeks expert professional advice from a sophisticated consulting company, California Housing Partnership Corporation, which specializes in obtaining complex affordable housing financing for its clients. Charities and its consultant are making the best possible effort to cope with current market challenges.

In order to offset this loss of funding, Charities is also requesting \$1,275,012 in Tax Credit Assistance Program ("TCAP") from TCAC. This Program makes available new federal Stimulus funds to augment the current smaller equity investments into projects.

The project also encountered higher-than-expected costs associated with soil remediation due to residual pesticides associated with the site's past agricultural use and soil stabilization related to the liquefaction potential. This requires the off-haul of surface soils on the site and pressure grouting a portion of the site, estimated at a combined cost of approximately \$375,000. There were also other increases in project construction costs; however, the applicant is able to cover

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these costs by seeking other sources such as an AHP loan. However, an additional gap remains unfilled.

Staff has confirmed that an additional \$717,000 in City funding, and the forgiveness of \$125,000 already due to the City in the form of interest payments on the acquisition and predevelopment loans, is necessary to fully close the funding gap for development of the 42-apartment community.

Loan Business Terms

Current projections indicate that it is very unlikely that the project will be able to pay back a significant portion of the City loan's principal and interest. However, this is to be expected for several reasons. First, the project has few units so expenses are proportionally higher per unit because efficiencies cannot be realized when spread over a larger number of units. Second, because units are all studios, rents are lower than would be derived from a project with larger units but the same targeting mix. Third, while the Housing Department's funding requires a minimum of 25% of units to be restricted to ELI rents, this project offers 38% of units at ELI rents, thereby greatly reducing rental revenues.

Because of these reasons, charging the project the standard 4% interest rate for the City's construction/permanent loan would create substantial financing and taxation issues when the Limited Partnership is dissolved in or before year 15 of project operations. Therefore, using the authority to set business terms which is delegated to the Director of Housing by the City Council, a feasible interest rate will be negotiated. This rate may be as low as 0%.

On the other hand, there is no ability for the project to support a conventional permanent loan given its low rental revenues. Therefore, the City's affordability restrictions and deed of trust are in senior lien positions. The City has already recorded 55-year affordability restrictions on the site, which will ensure that the site will provide these ELI and VLI rents in the long term. Given its seniority, the City will be able to exercise greater control over the project in the long-run than it would for a typical project.

As consideration for making the recommended loan increase and forgiving accrued acquisition and predevelopment interest, the City will receive an additional five years of affordability for the entire project. Upon dissolution of the Limited Partnership after the required 15-year holding period, Charities intends to exercise its option to purchase the property from the partnership. Upon closing of the recommended City loan increase, Charities has agreed to enter into an agreement with the City to extend the term of affordability from 55 years to 60 years and increase the interest rate on the permanent loan to 4% after year 15 of project operations.

Because Charities has a strong track record of serving San José's residents in need, the Housing Department asked Charities to become a CHDO. Because of this status, the likelihood that Charities will be a viable entity capable of assuming ownership in Year 15 is greater than for another small organization with a similar financial profile but without City support.

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With these recommended changes and considering all factors, Staff has determined the project to be financially feasible.

Use of HOME Funds

Federal HOME regulations permit HOME to be used to construct affordable housing units. The City has already made a loan of 20% funds to Charities for predevelopment and land acquisition.

The 90 Archer project has already completed its NEPA study; therefore, the reserved \$1,800,000 funding commitment can be committed to this project. In addition, the City is well within the 5-year HOME regulatory deadline to commit additional CHDO funds to a specific project.

Staff therefore seeks permission to use HOME funds for the project, committing a total of \$1.8 million in HOME funds to this project.

Recommendation

Accordingly, the Housing Department recommends that the City Council approve a loan increase of up to \$717,000, a project-specific award of previously committed \$1,800,000 of HOME funds, and the forgiveness of up to \$125,000 in accrued interest for the project at the August 4th meeting.

Specific business terms will be approved by the Director of Housing through the City's Delegation of Authority ordinance in Chapter 5.06 of the San José Municipal Code.

EVALUATION AND FOLLOW-UP

The Department posts quarterly reports on the status of its subsidized construction projects to its website, www.sjhousing.org. If approved, the 90 Archer Street Apartments project would be included in these reports.

POLICY ALTERNATIVES

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

Alternative #1: *Deny the requested funding commitment.*

Pros: The funds being requested could be used for other affordable housing projects and programs.

Cons: The proposed funding commitment complies with the Department's funding priorities and has been judged financially feasible. Additionally, there is continued strong demand for housing close to transit that is affordable to ELI and VLI working individuals and families.

Reason for not The proposed project will help to meet the demand for transit-oriented

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recommending: housing that is affordable to ELI and VLI working individuals and will help the City to fulfill its affordable housing goals. The project's location in North San José will also help to meet the need for 1,600 affordable housing units that will be required in the First Phase of 8,000 residential housing units to be built under area's development policy.

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)**

None of these criteria apply to the requested loan increase and accrued interest forgiveness. Nevertheless, Charities has conducted a significant amount of outreach to the neighborhood in coordination with the District 3 Council Office. Charities presented project information at three neighborhood meetings in August and September 2008, and staffed a table at the Rosemary Gardens Neighborhood Association annual picnic in September 2008.

COORDINATION

This report has been coordinated with the Office of the City Attorney and the Department of Planning, Building and Code Enforcement.

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, 2009-10* in providing households units for very low- and extremely low-income households.

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COST SUMMARY/IMPLICATIONS

1. **COST OF PROJECT:**

<u>CONSTRUCTION USES</u>	<u>AMOUNT</u>
Property Acquisition & Entitlements	\$3,715,000
Hard (Construction) Costs	\$6,623,000
Soft (Financing & Other) Costs	\$5,010,297
TOTAL	\$15,348,297

2. **COST ELEMENTS OF CITY LOAN AMOUNT:**

<u>USES</u>	<u>AMOUNT</u>
Property Acquisition & Entitlements	\$3,715,000
Construction Costs	\$1,582,000
TOTAL	\$5,297,000

3. **SOURCES OF FUNDING:** Fund 443 - Low- and Moderate-Income Housing Fund.
Fund 445 – HOME Investment Partnership Program Fund.

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

BUDGET REFERENCE

Fund #	Appn. #	Appn. Name	Total Appn.	2009-2010 Proposed Operating Budget Page*	Last Budget Action (Date, Ord. No.)
443	0070	Loans, Grants & Site Acquisitions	\$65,000,000	XI-53	N/A
445	0070	Loans and Grants	\$1,382,344	XI-44	N/A

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

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CEQA & NEPA

CEQA: Resolution No. 72768 and Addendum thereto, File No. PDC06-085.

NEPA: Environmental Assessment-Finding of No Significant Impact.



LESLYE KRUTKO
Director of Housing



JENNIFER A. MAGUIRE
Budget Director

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

Attachments



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ATTACHMENT 1
Anticipated Project Timeline
90 Archer Street Apartments

Application to County of Santa Clara (MHSA)	December 2008
City Council Approval of Funding Commitment	December 2008
Site Acquisition	December 2008
Application to TCAC for Low-Income Housing Tax Credits	June 2009
Award of MHSA Funding	August 2009
Award of TCAC Low-Income Housing Tax Credits	September 2009
Estimated Date of Construction Loan Closing	December 2009
Estimated Start of Construction	December 2009
Estimated Date of Construction Completion	February 2011
Estimated Conversion to Permanent Period	Late 2012

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ATTACHMENT 2
Subject Site Map
90 Archer Street Apartments

