



# Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Leslye Krutko

**SUBJECT:** SEE BELOW

**DATE:** July 21, 2009

Approved

*Leslye Krutko*

Date

*7/21/09*

**COUNCIL DISTRICT:** 3  
**SNI AREA:** N/A

**SUBJECT: APPROVAL OF A LOAN INCREASE OF UP TO \$6,209,579, INCLUDING CAPITALIZATION OF UP TO \$1,186,000 OF INTEREST TO BE ACCRUED, FOR THE FOURTH STREET APARTMENTS PROJECT LOCATED AT 1460 NORTH FOURTH STREET**

## RECOMMENDATION

It is recommended that the City Council adopt a resolution:

1. Approving an increase in the construction/permanent funding of up to \$6,209,579 to First Community Housing ("FCH"), or its designated affiliate, for the development of the North Fourth Street Family Apartments project ("Project") to be built at 1460 North Fourth Street and made available to extremely low-income ("ELI"), very low-income ("VLI"), and low-income ("LI") families.
2. Approving the capitalization of up to \$1,186,123 in interest to be accrued on the City's construction loan, bringing the total City construction/permanent funding up to \$13,894,579.

## OUTCOME

The City Council's approval of the recommended actions will facilitate the development and construction of 100 affordable rental housing units affordable to San José families with incomes between \$19,450 and \$72,060. The City will own the underlying land and lease it to the project.

Approval of these recommendations at the August 11, 2009 meeting is critical for the developer to demonstrate local funding approval for the project to the California Tax Credit Allocation Committee ("TCAC") by the State's August 17, 2009 deadline to evidence local approvals.

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**BACKGROUND**

Project Approval History

On March 20, 2007, the City Council approved a funding commitment of up to \$9,875,000 to FCH, or its designated affiliate, for the development of the subject project to be made affordable to ELI, VLI and LI households.

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.

On May 12, 2009 the City Council approved the early release of up to \$4,000,000 of the previously approved construction loan commitment of up to \$9,875,000, to FCH. The \$4,000,000 construction funding released early was used on June 26, 2009 to repay an Opportunity Fund land acquisition loan and accrued interest totaling \$1.5 million, to repay a Housing Trust Fund predevelopment loan of \$500,000, to repay the Sobrato Foundation's predevelopment loan of \$500,000, and to reimburse FCH in an amount up to \$1.5 million in already-incurred early development costs based on submission of invoices.

Project Description

The subject site, located at 1460 North Fourth Street, will offer 100 income-restricted units in a nine-story steel-frame building when complete. Among the units will be 35 set aside for developmentally disabled households. Thirty-five (35) units in the Project will be affordable to ELI households at or below 25% of the Area Median Income ("AMI"), 40 units will target those at or below 50% of AMI, and 25 units will target those at or below 60% of AMI.

Project Progress

The project has all land use entitlements and has been fully designed, as construction had been anticipated to start in Fall 2008.

However, the project has encountered significant delays. One cause of the Project's long timeline was the project's inclusion in the EIR to support the North San José Development Plan. The second cause of delay has been the adverse impact of the broader financial crisis on this Project's funding commitments.

There are three main reasons why the Project's financing gap has increased during the delays:

1. The decrease in the supply of, and pay-in prices for, low-income housing tax credit equity in the last two years.
2. The change in senior financing resulting from the California Housing Finance Agency's (CalHFA's) discontinuation of its low-priced tax-exempt loan product in Fall 2008.

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3. Accumulating interest charges.

First, the tax credit equity market has experienced a severe downturn in the past two years. Estimated equity pay-in prices have decreased approximately 27 cents on the dollar since the City first underwrote and approved this Project. This change has decreased the projected amount of equity for this Project by approximately \$2.2 million.

Second, the State of California's fiscal situation has curtailed CalHFA's ability to issue bonds and provide its committed funding. CalHFA's tax-exempt loan product was discontinued in Fall 2008 due to financial market instability, forcing FCH to seek financing from private banks. Their probable conventional lender is willing to make a construction loan that is lower than CalHFA's amount by approximately \$7.2 million, a permanent loan amount that is lower by approximately \$3.5 million, and charge more than \$538,000 in higher fees. This reflects both changes in the market as well as CalHFA's previous low pricing.

Third, interest charges have continued to accrue for acquisition and predevelopment funding during the delays. These charges may total more than \$290,000 if construction closes in December 2009 as planned.

Summary of the Proposed Transaction

The project will continue to be financed by a tax-exempt bond issuance. Now that the Project is not utilizing CalHFA, the City sponsored a new bond application to the California Debt Limit Allocation Committee (CDLAC) in June 2009. Pending CDLAC's and the City Council's approval, the City will issue the bonds. Bank of America has made a commitment to purchase the bonds and loan the proceeds for construction and permanent phases.

Due mainly to the Project's many soft cost increases, FCH is seeking an increase of \$6,209,579 in the City loan amount. If this request is approved, up to \$1,186,123 in accrued interest may be capitalized into the permanent loan. The resulting permanent loan amount is \$13,894,579, not including the cost of the subject land, \$2.19 million. The City plans to own the land and lease it to the project.

ANALYSIS

Despite FCH's best efforts, a significant financing gap exists in this Project. Staff recommends that the City Council approve the requested funding increase for the following reasons.

First, FCH is actively seeking ways to balance the budget. FCH has actively value engineered the project and has reduced net hard costs by \$340,000 while still maintaining the project's green features. It successfully increased its State Infill Infrastructure Grant award amount by \$100,000 and obtained \$175,370 in CalReuse funds. FCH is seeking \$8.8 million in federal Stimulus funds through the State in order to backfill State Multifamily Housing Program (MHP) funds if they are not available. FCH also plans to seek \$1 million in Federal Home Loan Bank

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Affordable Housing Program funding, which would commensurately reduce the City's loan if obtained. There are no other available sources of funds that are appropriate for FCH to seek.

Second, a rejection or deferral of the approved gap amount risks the MHP award. As the Project was awarded in 2007, the award has already been extended. It is not clear that the State would be willing to extend the commitment further if the Project does not proceed in the near future.

Third, the project continues to align well with the City's policy priorities. It will provide ELI and VLI units near transportation routes. The project offers thirty-five long-term units for developmentally disabled residents in a mainstreamed setting. The project will help the City to meet its legal obligations under State Redevelopment Law that will be created in North San José as development progresses there. It also offers innovative green features, including FCH's first accessible green roof. Its Build It Green score is anticipated to exceed 145 points, which could make it exceed FCH's award-winning Gish Apartments for its level of green technology.

Fourth, FCH has agreed that the City can own the site, leasing it back to the borrowing entity for the project through a long-term lease. This arrangement will be the first time the Housing Department has implemented a long-term ground lease structure. Therefore, the City will be able to exercise greater control over the project in the future than it would for a typical project.

Finally, this Project is an extreme example of how the downturn in financial markets can hurt an affordable housing project. FCH has taken the necessary steps to help salvage the Project's possibilities despite great adversity caused by market changes. However, FCH has been caught in this downturn. Their small company's financial viability would be significantly harmed were this project not to proceed.

As consideration for making the recommended loan increase and forgiving construction period interest, the City will receive 30 additional 30% AMI units in the Curtner Studios project, which is also owned and operated by FCH. See the Curtner Studios memo under a separate item on the City Council's August 11, 2009 Meeting Agenda.

Accordingly, the Housing Department recommends that the City Council approve a loan increase of up to \$6,209,579, including the capitalization of up to \$1,186,000 in accrued construction period interest for the Project, at the August 11, 2009 meeting. Specific construction/permanent loan 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**

Assuming North Fourth Street receives a tax-exempt bond allocation from CDLAC in September 2009, Staff will return to the City Council in late 2009 to ask permission to issue the bonds.

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**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:** It is important for legal reasons that the City integrate affordable units into North San José. This project's proximity to light rail, its high density, its provision of permanent special needs apartments, and focus on green building features align very well with the Department's funding priorities.

The project will be financially feasible with a strong likelihood of moving forward by the end of 2009 if the City commits these funds. On the other hand, delaying or rejecting this commitment risks the permanent loss of almost \$8.8 million in State funds already committed to the Project, seriously damaging the project's likelihood of ever proceeding. Further, the City has already disbursed \$5,477,304 for land and predevelopment costs; therefore, enabling the Project to proceed by making this commitment will protect the City's funds already invested.

**Reason for not recommending:** The proposed project will help to meet the demand for transit-oriented housing that is affordable to ELI and VLI households, will help the City to fulfill its affordable housing goals in North San José, will be an exemplary "green" building in accordance with the Mayor's Green Vision, and will serve the developmentally disabled population.

**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 project meets Criterion 1: Requires Council action on the use of public funds equal to \$1 million or greater. This Memorandum will be posted on the City's website for the August 11, 2009 City Council meeting.

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

**COST SUMMARY/IMPLICATIONS**

1. **COST OF PROJECT:**

| <b><u>CONSTRUCTION USES</u></b>               | <b><u>AMOUNT</u></b> |
|---|----------------------|
| Property Acquisition, Entitlements & Offsites | \$3,034,684          |
| Hard (Construction) Costs                     | \$28,150,000         |
| Soft (Financing & Other) Costs                | \$17,736,589         |
| <b>TOTAL</b>                                  | <b>\$48,921,273</b>  |

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

| <b><u>USES</u></b>             | <b><u>AMOUNT</u></b> |
|--------------------------------|----------------------|
| Hard & Soft Construction Costs | \$12,708,456         |
| Capitalized Interest           | \$1,186,123          |
| <b>TOTAL</b>                   | <b>\$13,894,579</b>  |

In addition, the City plans to acquire the land beneath the building and lease it to the Project.

| <b><u>USES</u></b>   | <b><u>AMOUNT</u></b> |
|----------------------|----------------------|
| Property Acquisition | \$2,190,000          |
| <b>TOTAL</b>         | <b>\$2,190,000</b>   |

3. **SOURCES OF FUNDING:** Fund 443 - Low- and Moderate-Income Housing Fund.

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

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**BUDGET REFERENCE**

While the project commitment amount will increase by \$6,209,579, this figure includes the non-cash interest due to the City which will be capitalized into the permanent period. The amount of new cash needed for this commitment is \$5,023,453.

| Fund # | Appn. # | Appn. Name                        | Total Appn.  | Amt. for Contract | 2009-2010 Proposed Operating Budget Page* | Last Budget Action (Date, Ord. No.) |
|--------|---------|-----------------------------------|--------------|-------------------|---|-------------------------------------|
| 443    | 0070    | Loans, Grants & Site Acquisitions | \$65,000,000 | \$13,894,579      | XI-53                                     | N/A                                 |

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

**CEQA**

CEQA: Addendum to Final EIR for the North San José Area Development Policy, Resolution No. 72768, File No. PCD06-022.

  
LESLYE KRUTKO  
Director of Housing

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

Attachments



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Attachment 1

Site Map

1470 North Fourth Street



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**ATTACHMENT 2**  
**Revised Anticipated Project Timeline**  
**North Fourth Street Apartments**

|  |                |
|--|----------------|
| Site Acquisition by FCH  | January 2006   |
| Application to TCAC for Low-Income Housing Tax Credits           | June 2009      |
| Application to CDLAC for Bond Allocation                         | June 2009      |
| Estimated City Council Approval of Additional Funding Commitment | August 2009    |
| Estimated Award of CDLAC Bond Allocation                         | September 2009 |
| Estimated Award of TCAC Low-Income Housing Tax Credits           | September 2009 |
| Estimated Bond Closing   | December 2009  |
| Estimated Date of Construction Loan Closing                      | December 2009  |
| Estimated Start of Construction                                  | January 2010   |
| Estimated Date of Construction Completion                        | August 2011    |
| Estimated Conversion to Permanent Period                         | January 2012   |