COUNCIL AGENDA: 8/11/09
ITEM: 4.4

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Leslye Krutko

SUBJECT: SEE BELOW

DATE: July 20, 2009

Approved Deanna Santana Date 7/21/09

COUNCIL DISTRICT: 3
SNI AREA: N/A

SUBJECT: CHANGE IN THE UNIT AFFORDABILITY MIX AND FORGIVENESS OF UP TO $475,000 OF ACCRUED INTEREST FOR THE KINGS CROSSING APARTMENTS AFFORDABLE HOUSING PROJECT

RECOMMENDATION

It is recommended that the City Council adopt a resolution:

1. Approving a change in the affordability mix for the Kings Crossing Apartments ("Project"), a 94-unit affordable rental housing complex being developed by Charities Housing Development Corporation ("Charities"), or its designated affiliate, to be made available to extremely low-income ("ELI") and very low-income ("VLI") households, with 92 units affordable to households with incomes at or below 50% Area Median Income (AMI) and two unrestricted managers' units.

2. Approving the forgiveness of up to $475,000 in accrued interest on the City's acquisition/predevelopment loan.

OUTCOME

Approval of the recommended change in affordability mix will allow the Project to preserve 25 project-based Section 8 certificates obtained from the Housing Authority of the County of Santa Clara ("HACSC") for the Project. As required by the Section 8 Program, it will result in an increase in the maximum household income level of 25 units in the Project from 45% AMI to 50% AMI, which would allow households with incomes as high as $57,300 to occupy the Project.

Forgiveness of up to $475,000 in the City's accrued interest will help the Project's development budget to balance, allowing it to apply for tax-exempt bond financing from the State and maximizing its chances to attract conventional loans and equity investment.

Approval of these recommendations at the August 11, 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 TCAC's August 17, 2009 deadline for evidencing local funding commitments.

BACKGROUND

Project Financing

On March 18, 2008, the City Council approved a funding commitment of up to $5,315,000 of 20% Housing Funds and $5,250,700 of HOME Funds to Charities or its designated affiliate, for a total land acquisition/predevelopment/construction/permanent loan of up to $10,565,700 for the development of the affordable rental housing project located on a 1.22-acre portion of the new 25-acre master-planned Newbury Park community (the "Project"). The Project will consist of one-, two- and three-bedroom units and two unrestricted managers' units.

On April 21, 2009, the City disbursed $5,314,320 for the Project's acquisition loan closing. An additional $1,485,571 has been disbursed thus far for predevelopment expenses, for a total of $6,799,891 disbursed to date.

The Project has obtained commitments for $1,200,000 in Mental Health Services Act ("MHSA") funds, $4,495,840 in State Infill Infrastructure Grant ("IIG") funds, $350,954 in HOME funds through Santa Clara County, and $460,000 in the Federal Home Loan Bank's Affordable Housing Program ("AHP") funds. It also has obtained a conditional commitment of $9,971,950 in Multifamily Housing Program ("MHP") funds. Charities is seeking $1,838,030 in additional funding from federal stimulus funds through the State TCAP program (administered by TCAC), and expects to utilize tax-exempt bond proceeds in an approximate amount of $3,017,237 and approximately $12,980,631 in tax credit equity.

Project Description

The Project will be located adjacent to the proposed New San José Family Shelter, funding for which was approved by the City Council on March 11, 2008. Fifteen (15) units in the Project will be available for families graduating from the Shelter program, including eight units that will house special needs residents meeting the State's Multifamily Housing Program's Special Needs program criteria. In turn, families residing in the Project will have available to them a range of services from Family Supportive Services, Inc., developer of the New San José Family Shelter. The original approval included 10 units set aside for homeless, severely mentally ill clients of the County of Santa Clara's Mental Health Department.

Charities has requested a change in the unit affordability levels for the Project to adhere to Section 8 regulations. The chart below summarizes the current and proposed restricted affordability levels:

Current Affordability Restriction Levels	Number of Units Currently Restricted	Number of Units Proposed to be Restricted	Difference in Number of Units	Percentage of Units as Proposed
≤ 15% AMI	10	10	0	11%
≤ 25% AMI	19	19	0	20%
≤ 30% AMI	13	13	0	14%
≤ 45% AMI	50	25	-25	27%
≤ 50% AMI	0	25	+25	27%
Manager's Unit (unrestricted)	2	2	0	2%
TOTAL	**94**	**94**	**0**	**100%**

<u>Project Progress</u>

The Project's construction funding has been significantly delayed due to economic conditions and the State's funding delays. As described in the land acquisition loan request to the City Council in March 2008, the expected timeline was that Charities would be able to start construction in January 2009. The earliest they now could start construction is December 2009—a delay of 11 months.

This delay is largely due to the State's financial difficulties. The anticipated MHP award date had been in mid 2008, while the State's final commitment occurred officially on July 13, 2009—a delay of more than one year. This delay occurred due to the State's inability to issue final commitments without a source of bond funds that had already been raised in the financial markets. Without certainty as to when the MHP funds could be disbursed at the start of the Project's permanent period, lenders have been unwilling to issue a firm construction commitment, thereby freezing the Project's progress.

On June 30, 2008, the Project received a preliminary commitment from the State for $4,495,840 in IIG program funding. In December 2008, the State froze disbursements for many committed obligations, including the IIG program. IIG funds are to be used early in the construction period, for infrastructure costs during construction. While the commitment for Kings Crossing's IIG was firm, the uncertainty as to when the IIG funds would be available for disbursement also created uncertainty as to when construction could start.

The State delays, in turn, created three other problems. First, it delayed Charities' and the City's application to the California Debt Limit Allocation Committee (CDLAC) for a tax-exempt bond allocation, as there is a hard deadline by which projects must start construction once a bond allocation is awarded. Second, the delay caused the Project to be caught in a market downturn for tax credit equity. As pay-in prices have decreased approximately 20 cents on the dollar since the City first underwrote and approved the Project, the projected amount of equity decreased by approximately $3.6 million. Third, despite accessing several other sources of funds, the City's acquisition/predevelopment loan interest has been accruing, contributing to the funding gap for the Project.

ANALYSIS

Affordability Change

HACSC is the recipient for all federal project-based Section 8 vouchers for Santa Clara County. Charities was successful in obtaining 25 project-based Section 8 vouchers from HACSC for this Project. For at least the first 10 years of the Project's operation, 25 of the units proposed to be restricted at 50% AMI will receive Project-based Section 8 subsidies. The total rents received on the units with Section 8 vouchers will be the fair market rent established by the U.S. Department and Urban Development. The vouchers pay for the difference between 30% of the residents' monthly income, including utilities, and fair market rents.

The County of Santa Clara has a 50% AMI requirement for projects to obtain project-based Section 8 vouchers in order to maximize the pool of potential tenants qualified to reside in the projects. The City must agree to the requested change to retain the project-based Section 8 vouchers for this Project.

There are several benefits for the City in making the requested change. First, the project-based Section 8 subsidy provides valuable operational income which will assist in keeping the Project financially viable. Second, the City indirectly benefits from the additional rent revenues derived from the vouchers. The revenues will likely support almost $839,000 in conventional debt for the Project, which in turn holds down the City's permanent gap loan amount. Third, the broader unit affordability range of 15-50% AMI has the side benefit of increasing the pool of potential tenants qualified to reside in the Project.

Interest Forgiveness

Despite Charities' strong efforts in assembling funding sources for the Project, there remains a small funding gap for this Project. Charities cannot obtain the remaining uncommitted financing, and start construction, without filling this gap.

The City does not have cash available to fill the funding gap at this time. However, by forgiving up to $475,000 in accrued interest on the City's existing loan, it will help to address the project gap without the need for additional cash. Reducing the Project's interest burden will reduce the financial strain on the Project and will positively affect its financial viability.

As consideration for making the recommended change in the unit affordability mix and forgiving accrued acquisition/predevelopment loan interest, the City will receive an additional five years of affordability for the entire Project. Charities has agreed to enter into an agreement with the City to extend its recorded term of affordability from 55 years to 60 years.

EVALUATION AND FOLLOW-UP

Assuming Kings Crossing receives a tax-exempt bond allocation from CDLAC in September 2009, Staff will return to the City Council in November 2009 to ask permission to issue the bonds.

POLICY ALTERNATIVES

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

Alternative #1:	***Deny the requested change in affordability restriction levels and the forgiveness of accrued interest on the City's acquisition loan.***
Pros:	The City would maintain its right to collect up to $475,000 in interest.
Cons:	If the City does not alter its affordability restrictions, it will result in the loss of 25 Project-based Section 8 certificates. This would reduce Project cash flow and would create a new financing gap of approximately $839,000. Maintaining the City's right to collect its accrued interest leaves the project's development budget out of balance, with no likely additional sources available to fill the gap. This gap would then jeopardize the possibility of progress on a project for which the City has already disbursed approximately $6.8 million.
Reason for not recommending:	The City should change its restrictions so as to preserve project-based Section 8 subsidy. This is a valuable source of income which will assist in keeping the Project financially viable. Forgiving a relatively small amount of accrued interest will also help to protect the City's existing investment in this project.

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 change in Project's unit affordability mix or the forgiveness of interest. This Memorandum will be posted to the City's website for the August 11, 2009, Council Agenda.

COORDINATION

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

FISCAL/POLICY ALIGNMENT

This recommendation 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

The recommended action will have no new cost implications to the City of San José.

CEQA

CEQA: Resolution No. 74196, File No. PDC07-015.

LESLYE KRUTKO
Director of Housing

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