COUNCIL AGENDA: 11/2/10
ITEM: 4.1

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Leslye Krutko
Jennifer A. Maguire

SUBJECT: SEE BELOW

DATE: October 14, 2010

Approved

Date 10/19/10

COUNCIL DISTRICT: 3
SNI AREA: N/A

SUBJECT: APPROVAL OF A TEMPORARY REVOLVING LOAN TO RECEIVE AND DISBURSE TAX CREDIT ASSISTANCE PROGRAM ("ARRA/TCAP") FUNDS FROM THE CALIFORNIA TAX CREDIT ALLOCATION COMMITTEE ("CTCAC") TO FIRST COMMUNITY HOUSING'S AFFILIATE, FOR THE FOURTH STREET APARTMENTS PROJECT LOCATED AT 1460 NORTH FOURTH STREET

RECOMMENDATION

It is recommended that the City Council adopt a resolution:

1. Authorize the Director of Housing to administer up to $8,789,846 in the form of a revolving loan to First Community Housing's ("FCH") designated limited partnership in order to pass through up to $8,789,846 in ARRA/TCAP awarded for the development of the North Fourth Street Apartments project ("Project") to be made available to extremely low-income ("ELI"), very low-income ("VLI"), and low-income ("LI") families.

2. Adopt the following Appropriation Ordinance and Funding Source Resolution amendments in the Low and Moderate Income Housing Fund:

   a) Increase the appropriation to the Department of Housing for the Loans, Grants and Site Acquisition project in the amount of $6,592,385; and

   b) Increase the estimate of Earned Revenue by $6,592,385.

OUTCOME

The City Council's approval of the recommended actions will allow the City to receive and then disburse additional funding up to $8,789,846 to FCH's legal affiliate for the construction of the Fourth Street Apartments project. Funds were authorized by the federal American Recovery and Reinvestment Act of 2009 ("ARRA") and are administered by the California Tax Credit Allocation Committee ("CTCAC"). FCH will incur the construction costs, invoice for the reimbursements, and receive the reimbursement of ARRA/Tax Credit Assistance Program (TCAP) funds from CTCAC. Once FCH receives funding from CTCAC, FCH will repay the initial costs provided by the City. The approval of this action will ensure that the Project can retain its ARRA/TCAP award, which is needed to fund construction costs. It does not change the City's existing commitment amount of its own funds to this Project.

BACKGROUND

The City Council approved funding for this Project, including the issuance of tax-exempt bonds in June 2010. The Project is located four blocks from light rail, plans to achieve a Build it Green score exceeding 150 points or a LEED Silver designation, and will serve 99 lower-income families, 35 of which will include developmentally-disabled residents, and one unrestricted manager's unit. The total City construction/permanent loan amount approved for this Project is up to $13,894,579 exclusive of land, which will be owned by the City and leased to the Project for up to 75 years. The total commitment amount for the project including land is $16,084,579.

After a long delay due to difficulty in assembling financing sources because of problems in the financial markets, the City issued tax-exempt bonds for this project in June 2010. The project is now under construction and is expected to be completed in late 2011.

In 2007, the Project received a Multifamily Housing Program ("MHP") permanent subordinate loan commitment of $8,789,846 from the State Department of Housing and Community Development. Because of uncertainty regarding the State's timely funding of its existing loan commitments due to the State's financial crisis in 2008 and 2009, conventional lenders and investors have generally required a backstop for State loan commitments for the past two years. To obtain such a backstop, FCH pursued ARRA/ TCAP funds that were authorized by the federal American Recovery and Reinvestment Act of 2009 ("ARRA") and are administered by the California Tax Credit Allocation Committee ("CTCAC"). The Project was awarded ARRA/TCAP funds on August 26, 2009 and has met all requirements to use ARRA/TCAP funds.

In addition to being used as a permanent loan backstop for the MHP permanent loan commitment, the ARRA/TCAP funds are also allowed to be used during construction. Assuming the MHP funds are available when needed at conversion to the permanent period financing, the ARRA/TCAP funds will be repaid by MHP. If not, the ARRA/TCAP funds remain allocated to the project, fulfilling its role as an MHP backstop.

CTCAC has requirements that ARRA/TCAP funds be disbursed to reimburse incurred construction costs. They also must flow through a project funder that has already paid for incurred costs. The regulations limit ARRA/TCAP loan disbursements to three—40% following construction loan closing as justified by costs, an additional 35% at 50% completion (or February 1, 2011, whichever comes first), and the remaining 25% between stabilized occupancy and conversion to permanent financing. There is no flexibility in the funding mechanism or the disbursement schedule. If program regulations are not followed, the ARRA/TCAP funds for that disbursement are lost, which would create a project funding gap.

ANALYSIS

This action does not change the City's approved commitment amount of its own funds to this Project. It only requests technical changes that enable the flow-through of federal Stimulus funds from the State to the Project.

Because the City has to-date funded approximately $6.5 million in hard and soft construction costs (exclusive of land costs) through its predevelopment and interim construction loans for this Project, at least a portion of the ARRA/TCAP funds must flow through the City. There are no other funders that have provided significant early financing to the project.

When ARRA/TCAP reimbursement funds are disbursed to the Borrower and subsequently transferred to the City, they must be credited towards the City Loan's principal balance. The funds will become co-mingled, as is required under that program's definition of being "used."

The City's funds would be, in effect, replenished by ARRA/TCAP and then redisbursed for new construction uses; there would be one 'revolution' of funds. For this reason, a revolving loan approval and system set-up is required.

The City's financial management system cannot accommodate a revolving loan without special approvals and set-up. The financial management system limits aggregate disbursements for a loan to the amount reflected in the loan agreement, regardless of actual loan balance and amounts that should be available—which will be going up with the ARRA pay-ins, and then down as those funds are also expended.

This request to approve a revolving loan facility decreases the City's risk. First and foremost, given that the City is the funder that must accept and pass through the ARRA/TCAP funds, failure to accommodate this requirement would result in the $8.8 million in ARRA/TCAP funds being recaptured by CTCAC, producing a large shortfall in the construction budget. There is no other source that could fill that gap. It is anticipated that approximately 75% of the $8.8 million allocation would be spent and reimbursed in 2010-2011 while the remaining 25% will be spent and reimbursed in 2011-2012. Second, by crediting ARRA funds to the City's loan balance, the City's early expenditures would be significantly reduced, and overall project risk would be shared with another source of funds. Third, the City issued tax-exempt bonds for this project. The use of ARRA/TCAP was assumed at closing. To risk this award in any way would seriously jeopardize the bonds' status as well as those of other funders' commitments.

In order to reduce risk and exposure to the City in this transaction, the City and the limited partnership will enter into a Cost Reimbursement Agreement ("Agreement") that documents the permitted business terms regarding use of the $8,789,846 in ARRA/TCAP funds, including the following limitations:

1) Total Exposure to the City – The City's loan balance at any one time, including credits and debits applied for the flow-through of ARRA funds, may not exceed $13,894,579, the total construction/permanent loan commitment to this Project. This condition is expected to be easily met.
2) Duration of the Agreement – The revolving of ARRA/TCAP funds will be time-limited, so this approval will terminate at the time of the project's conversion to its permanent period financing or October 31, 2012, whichever is sooner.

For these reasons, the Housing Department recommends approval of the change of the City's loan construction/permanent loan to a revolving loan for a limited time, as well as the appropriations actions that permit receipt of the ARRA/TCAP funds, for the Fourth Street Apartments project.

Specific revolving loan business terms and any associated document modifications will be approved by the Director of Housing through the City's Delegation of Authority as permitted under Chapter 5.06 of the San José Municipal Code.

EVALUATION AND FOLLOW-UP

If this action is approved, the City Council will later be able to track the project's construction status through the Housing Department's quarterly construction report available on-line at the Department's website: http://www.sjhousing.org/report/quarter.html.

In addition, business term changes will be summarized in quarterly reports to the City Council regarding the Director's use of her Delegation of Authority.

POLICY ALTERNATIVES

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

Alternative #1: ***Deny the request to establish a revolving loan***

Pros: Considerable staff time to implement this recommended solution would be saved.

Cons: The project is currently financially feasible and under construction. The City has committed funds and helped stimulate job creation, which will continue to be supported by this action. It is estimated that a tax credit project of this size and type will create 151 local jobs in the first year and, directly and indirectly, create another 38 jobs per year every year thereafter because of multiplier effects. Rejecting this recommendation to establish a revolving loan facility for the project would risk the permanent loss of almost $8.8 million of ARRA/ TCAP funds already committed to the Project, making it impossible to complete the project on schedule. Also, disrupting the federal funds would seriously jeopardize the project's other funding sources, including tax-exempt bonds that the City issued for the Project. Further, the City has already disbursed $8.7 million for land and construction costs; therefore, enabling the Project to proceed by establishing this revolving loan fund will protect the City's funds already invested and spread risk among funding sources.

Reason for not recommending: The Project is already committed, closed and under construction. Taking this action to solve technical issues will enable it to retain almost $8.8 million in one-time federal funds in order to complete construction.

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 action meets Criterion 1: Requires Council action on the use of public funds equal to $1 million or greater. However, the appropriated funds, as recommended as part of this memorandum, are only the pass-through of federal funds to the project and the adjustment of the City's appropriations to accommodate this pass-through. It does not involve an increase in the City's funds committed to the project. This memorandum will be posted on the City's website for the November 2, 2010 City Council agenda.

COORDINATION

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

FISCAL/POLICY ALIGNMENT

This action 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. **AMOUNT OF RECOMMENDATION:** **$8,789,846**

2. **COST OF PROJECT:**

CITY'S EXISTING COMMITMENT	**AMOUNT**
Construction/Permanent Loan to fund Hard & Soft Construction Costs	$12,708,456
Land Acquisition (now held by City)	$2,190,000
Capitalized Interest (up to)	$1,186,123
TOTAL	$16,084,579

Subject of this Memorandum:

CITY'S REVOLVING LOAN TO PASS THROUGH ARRA/TCAP	
Construction Costs:	
ARRA 2010-2011	$6,592,385
ARRA 2011-2012	$2,197,461
TOTAL	**$8,789,846**

TOTAL CITY COMMITMENT + ARRA PASS-THROUGH:	$24,874,425
Previous Years' Expenditures and Encumbrances	($16,084,579)
REMAINING COMMITMENT FOR REVOLVING LOAN	$8,789,846

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

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

BUDGET REFERENCE

The table below identifies the fund and appropriation proposed for the action recommended as part of this memorandum.

Fund #	Appn. #	Appn. Name	Total Appn. Needed	2010-2011 Proposed Operating Budget Page	Last Budget Action (Date, Ord. No.)
Funding Recommended					
443	0070	Loans, Grants and Site Acquisition	$6,592,385*		

*Only $6,592,385 of the $8,879,846 is recommended for appropriation as part of this memorandum to reflect the portion of funding that is expected to pass through the City in 2010-2011. Recommendations to appropriate the remaining amount, $2,197,461, will be brought forward for Council approval as part of the 2011-2012 budget process.

CEQA

CEQA: Addendum to Final EIR for the North San José Area Development Policy, Resolution No. 72768, File No. PDC06-022.

/s/

LESLYE KRUTKO
Director of Housing

JENNIFER A. MAGUIRE
Budget Director

I hereby certify that there will be available for appropriation in the Low and Moderate Income Housing Fund in the Fiscal Year 2010-2011 moneys in excess of those heretofore appropriated therefrom, said excess being at least $6,592,385.

JENNIFER A. MAGUIRE
Budget Director

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