



# Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Leslye Corsiglia

**SUBJECT:** SEE BELOW

**DATE:** May 24, 2011

5/31/11

**COUNCIL DISTRICT:** 6  
**SNI AREA:** Burbank/Del Monte

**SUBJECT: REQUEST TO ALLOW THE ASSIGNMENT AND ASSUMPTION OF THE OUTSTANDING LOAN BALANCE FROM THE SAN CARLOS TOWNHOMES PROJECT TO THE SAN CARLOS SENIOR APARTMENTS PROJECT IN ORDER TO COMPLETE THE AFFORDABLE HOUSING PROJECT, LOCATED AT 1523-1533 WEST SAN CARLOS STREET**

## RECOMMENDATION

It is recommended that the City Council adopt a resolution:

- 1) Approving a request to allow the assignment and assumption of an outstanding loan in the original amount of \$4,851,000 ("Townhomes Loan"), made to San Carlos Town Homes, LLC for the San Carlos Townhomes Project ("Townhomes Project") to San Carlos Willard Associates, L.P., ("The Partnership") or its designated affiliate, in the form of new construction/permanent loan documents, to fund the development costs for the 95-unit San Carlos Senior Apartments project ("Senior Project") located at 1523-1533 West San Carlos Street;
- 2) Approve a change in the affordability mix for the Senior Project from 99 affordable unit serving households earning up to 30% Area Median Income ("AMI") to 94 affordable units with 29 units serving households earning up to 30% AMI, 31 units serving households earning up to 40% AMI and, 34 units serving households earning up to 50% AMI, and one unrestricted manager's unit and;

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- 3) Extending the term of the existing loans on the Townhomes Project/Senior Project loans, and;
- 4) Authorizing the Director of Housing to negotiate and execute all documents to effectuate these transactions and to extend the term of the loans as appropriate.

**OUTCOME**

Approval of the recommended action will allow this development to proceed without additional funding from the City as had been previously expected. The outstanding \$4,830,000 commitment approved by the City will be rescinded. The assignment of the outstanding Townhomes Loan to the Senior Project will allow the developer to complete the project's financing structure and restart the development process that will eventually provide 94 very low- and extremely low-income households and one unrestricted manager's unit. It will also provide a plausible long-term strategy to eventually repay the City outstanding balance on the townhome property.

**BACKGROUND**

On June 25, 2002, the City Council approved a conditional grant of up to \$4,775,000 for the acquisition and predevelopment of the Senior Project; a loan in the amount of \$4,113,600 for the acquisition and construction funding of the Townhomes Project; and a future loan in the amount of \$4,830,000 for the construction and permanent funding of the Senior Project, to CORE Development, Inc. and ROEM Development Corporation, or their designated affiliate, for the acquisition and development of a 100-unit San Carlos Senior Apartment affordable rental housing project and 30 units of for-sale townhomes located on a 3.19-acre site at 1523-1533 West San Carlos Street.

In 2007, the City of San José approved a loan to the Townhome Project in the amount of \$4,851,000. This loan was used to retire the existing \$4,113,600 loan and included capitalized interest from the initial loan. In addition, the City also amended the conditional grant agreement to require the Senior Project to remit all rents received from the existing tenant on the property to pay down the principal balance of this newly created loan. The outstanding balance of the loan is \$2,973,833.58.

In May 2009, the City of San José advanced and created new loan documents for the release of \$536,238 to reimburse the Townhomes Project their fair share of off-site infrastructure costs. During the period of 2002 to 2010, of the total \$4,775,000 conditional grant, \$4,514,929 has been disbursed and remains the outstanding balance of this conditional grant.

## ANALYSIS

The initial project was conceived and was processed through the entitlement process as one development with two distinct projects planned on the site. However, the project was not able to proceed due to a long-term lease that a commercial tenant had on the Senior Project site and the developer's inability to obtain financing. Subsequently, the developer requested funding to proceed with the for-sale townhomes component of the project. The City Council approved a construction loan in March, 2007. Construction of the units was subsequently completed and the units were placed on the market in November 2008. The final sale was completed in June 2009.

Unfortunately, these units came onto the market at a time when the for-sale market was very weak. The severe economic recession brought about by the implosion of the housing market caused the units to take much longer to sell than originally anticipated and at a price substantially less than originally projected. As a result, the Townhomes Project suffered a loss of \$2,973,833.58. This deficit is commensurate with the losses experienced throughout the residential housing market and is not a result of cost overruns or other factors attributable to the developer. The project development expenditures were within the budget approved by the City. The projected sales figures were established by an independent market study completed at the time the budget was approved by the City.

Recently, the commercial tenant voluntarily terminated his lease on the Senior site. This prompted the developer to revisit financing for the affordable rental component of the project. Over the past two years, market conditions have changed significantly. Most notably, construction labor and materials costs have decreased substantially. In addition, Tax Credit Equity pricing has improved. Interest rates on loans also remain fairly low and predictable. These factors present a potential solution to the Townhomes Loan situation and provide a means for the Senior Project to proceed. The developer has verified that the Planned Development Permit is still valid. As a result of these factors, the Senior Project can move forward without any additional commitment of funds and can be competitive within the 9% TCAC competition.

The Senior Project can assume the balance of the Townhomes Project loan and apply the loss to costs associated with Site Improvements and Off-Site Improvements because the purpose of the original Townhomes Loan was to pay for streets, sidewalks, lights, landscaping, and improvements to utilities, as well as for the payment of a capitalized land lease. Tax credit regulations and the City's current loan agreement require that City Council approve the assignment of any debt obligation. Additionally, because of the financing challenges faced by the developer, the term of the original loans must be extended.

Approval of the recommended assignment will produce three distinct benefits for the City. First, this increased debt assists the Senior Project in its competitiveness for a 9% TCAC allocation by increasing the amount of public subsidy in the project. Second, the City will have this loan amount secured by a Deed of Trust, which currently is not the case. And finally, the City will receive repayment through residual receipts. While residual receipts are not a guaranteed source

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of funds, the proposal does provide a plausible means to repay the City the outstanding balance of \$2,973,833.58 over 18 years.

In order for the assignment of the debt to be acceptable, there must be a direct connection between the two projects. The fact that none of the Conditional Grant documents were amended to split out the Townhomes Project supports this contention. Additionally, the Senior Project paid down the principal balance by using rental proceeds from the Senior Project's tenant. The developer also needs to show a bona fide use for the Assignment of the Debt. This can be accomplished if previously incurred project costs are not fully reimbursed by the City and the ground lease payment are included as project costs, which were not part of the original business terms.

As consideration for approving the assignment of the Townhomes Loan to the Senior Project, the Developer, San Carlos Town Homes, LLC, would forego the receipt of the up to \$800,000 developer fee which will decrease the amount of the outstanding debt on the project. Additionally, the City's share of the agreed upon split of the project's residual receipts will be increased from 50 % to 65%. As previously mentioned, this would result in the eventual repayment of the City loan.

In order to ensure that the Senior Project can begin immediately without additional funding from the City of San José, the developer has proposed changing the project's unit affordability mix from 99 affordable units serving households earning up to \$24,850 annually (30% AMI) to 94 affordable units with 29 units serving households earning up to \$24,850 annually (30% AMI), 31 units serving households earning up to \$33,125 annually (40% AMI) and, 34 units serving households earning up to \$41,400 annually (50% AMI).

As previously stated, the City Council approved total acquisition/predevelopment financing of \$8,888,600 on June 25, 2002. This financing had two components. \$4,113,600 was to be provided from the 20% Housing Fund for the townhome portion of the project and \$4,775,000 was committed to the Senior Project in the form of a conditional grant from the 20% Supplemental/ELI Reserve Fund. The 20% Supplemental/ELI Reserve Fund was funded with 80% Redevelopment funds and created to finance Extremely Low Income (ELI) Units.

Under the current proposal, 29 of the 94 units will remain affordable to ELI households while 65 units will be affordable to tenants with annual incomes at 40% and 50% of AMI. The Department has determined that a mix of affordability is preferable to having a project with only ELI units. Having units with modestly higher rents provides some additional funding for maintenance and operation of the development.

As consideration for the change in unit affordability, the developer has agreed to additional terms that will be of tremendous benefit to the City. Site control will be transferred from the developer to the San Jose Financing Authority ("SJFA"). The developer would enter into a Ground Lease Agreement with the SJFA. This ensures long-term affordability for the City because it will hold fee simple title to the land. The expected term of the ground lease will be no less than 55 years

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and no more than 99 years. The transfer of this asset to the City of San José is of tremendous value to given the location of the project and the surrounding neighborhood. The developer would retain a leasehold interest on the land so long as it retains ownership of the building and improvements.

In addition to the benefits previously mentioned, the City will be able to rescind its commitment of \$4,830,000 in additional funding for the project should the 9% tax credit application be approved. Assignment of the outstanding Townhomes Loan to the Senior Project will allow the developer to restructure the project's financing and restart the development process without any additional funding from the City. The Affordability Restrictions would need to be amended to allow for 30%, 40% and 50% AMI households.

It should be noted that the developer's application for 9% Tax Credit financing by the California Tax Credit Allocation Committee may not be approved in the first application attempt. If the first attempt is unsuccessful, the developer plans to resubmit the project in subsequent application cycles. In the interim, the developer will continue to explore other sources of financing. Should project financing not obtained within twenty-four months of this recommended City Council action, the Housing Department will pursue other means for addressing the shortfall from the Townhomes project and the development of this site.

There are two additional factors that should also be considered regarding this project. First, the State of California is considering major reforms to Redevelopment Law. One of the potential changes involves financial penalties for properties funded with Redevelopment Funds that have not been developed over a significant period of time. This elevates the need to move this project forward. The second factor is the aging population. By 2040, San José expects more than 182,000 new residents to be added to the 65+ age category—the highest growth rate of any age group. A large number of these individuals will be on fixed incomes and require affordable housing.

**Economic Development Benefits**

The 95-unit Project will benefit San José economically. First, the Developer will pay City fees of approximately \$1,260,679 in building and permitting fees and an additional \$116,472 in school district fees in order to proceed with the development process. The Developer will additionally pay approximately \$10,450 in City fees for the related offsite improvements. It should be noted that the Developer has already paid \$536,238 in offsite improvements that benefitted improvements to West San Carlos and related utilities.

Second, total local impacts for communities in the area are defined as benefits of the direct construction activity itself as well as the impact of local residents who earn money from the construction activity and spend part of it within the area. According to a 2009 study by the National Association of Homebuilders (NAHB) on the economic benefits to local areas for multifamily low income housing tax credit-funded construction, 94 units of senior housing are

estimated to generate over \$7.6 million of local benefits in the first year and approximately \$2.5 million each year thereafter.

Third, according to the NAHB metrics, it is also anticipated that proceeding with and completing the development of the Project will create 143 local jobs in San José in the first year, directly and indirectly, and 36 local jobs each year thereafter.

### **CONCLUSION**

Staff and the Developer believe that a solution has been found that allows for the Town Home project to be fully reconciled and closed and the Senior Project to move forward, while preserving project affordability and saving the City the cost of providing previously approved funding. Accordingly, Staff recommends adoption of these recommendations.

Specific business terms will be approved pursuant to the Director's Delegation of Authority ordinance, located in Chapter 5.06 of Title 5 of the San José Municipal Code.

### **EVALUATION AND FOLLOW-UP**

The Housing Department posts quarterly reports on the status of its subsidized construction projects to its website [www.sjhousing.org](http://www.sjhousing.org). If approved, the San Carlos Senior Apartments project would be included in these reports.

### **POLICY ALTERNATIVES**

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

**Alternative #1:** *Deny The Partnership's request for assignment of the Townhomes Loan to the to San Carlos Willard Associates, L.P. for the Senior Project.*

**Pros:** The City would be able to seek another proposal for development of an affordable housing project.

**Cons:** Given the current affordability restriction that was funded with Low and Moderate Housing Funds, it would be highly unlikely that the City would receive an alternative proposal for the project for the same cost to the City. A new project would likely require additional subsidies from the City. Since that is not feasible, the property would remain vacant indefinitely and would potentially incur financial penalties for violation of Redevelopment Law.

**Reason for not recommending:** The City would be required to provide additional funding to the project, and/or face financial penalties for failure to comply with Redevelopment Law.

### **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 none of the criteria set forth above. Nonetheless, this Council report will be posted to the City's website for the June 14, 2011, City Council Agenda.

### **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 for 2005-10* in providing family units for very low- and extremely low-income households.

### **COST SUMMARY/IMPLICATIONS**

Approval of the recommended action will allow the City to rescind its prior commitment of \$4,830,000 in funding for the project should the developer's 9% Tax Credit application be approved. It allows for the assigned loan to be secured by a Deed of Trust and the City will receive repayment through residual receipts.

### **BUDGET REFERENCE**

No budget impact because no additional funds are being requested.

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**CEQA**

CEQA: Exempt, PD04-103.

/s/

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Director of Housing

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

