

# SUPPLEMENTAL



## Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Leslye Corsiglia

**SUBJECT:** SEE BELOW

**DATE:** June 13, 2011

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6-13-11

**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**

### SUPPLEMENTAL

#### REASON FOR SUPPLEMENTAL

The Department received questions regarding this project from a citizen interested in this project. The questions and answers are included as an attachment as they provide additional information regarding the project. There is no change to the recommendation.

#### ANALYSIS

Attached to this document are questions received from Terri Balandra on June 7, 2011. The responses were completed and sent to Ms. Balandra on June 10, 2011. The responses provide clarification regarding the issue of potential penalties, tax credit application assertions by the developer, and include additional information regarding the project.

HONORABLE MAYOR AND CITY COUNCIL

June 13, 2011

**Request to Allow Assignment of Outstanding Loan from the San Carlos Townhomes Project to the San Carlos Senior Apartment Project**

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**COORDINATION**

Preparation of this report has been coordinated with the City Attorney's Office.

/s/

LESLYE CORSIGLIA

Director of Housing

Attachment

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

## ATTACHMENT

City Council Agenda, Item #4.1, File # PD04-103

**1) Does this new current action, including but not limited to the proposed “transfer of debt”, “change in the affordability mix”, and project duration, fully comply with all relevant laws and the State Attorney General’s interpretation and application there of?**

ANSWER: Yes. We work closely with the City Attorney’s Office on all projects, including this one, to ensure that all legal requirements are met.

• **Will the taxpayers be at risk for any future penalties?**

ANSWER: No penalties will be levied if the project goes forward. Current State redevelopment law would not impose financial penalties if the San Carlos Seniors Seniors project cannot be developed due to lack of financing. References in the 5/24/11 memo to potential penalties referred to drafts of proposed legislation only. It cannot be determined at this time whether any change to current redevelopment law would produce penalties for this project, or what a source of payment for penalties would be.

• **If so, what is the taxpayer/City liability?**

ANSWER: As mentioned, there are no penalties anticipated or certain at this time.

• **Would any Redevelopment Law violations, come out of the General Fund or Housing Fund?**

ANSWER: There are no redevelopment law violations with this project. See above.

**2) On your 05/24/2011 Memorandum, page 4, you stated that in 2002, \$4,775,000 was committed to the Senior Project in the form of a conditional grant from the 20% Supplemental/ELI (Extremely Low Income) Reserve Fund – and, that the 20% Supplemental/ELIFund was funded with 80% RDA funds and created to finance ELI units.**

• **How much of that \$4.775 million was given to the Developers?**

ANSWER: Of the total \$4,775,000, \$4,405,069 has been funded through the course of formal draw requests from July 2002 to July 2010. The commitment was not to the development companies themselves, but to the development partnership to be used solely for the purposes defined by this funding commitment.

• **How much of that Senior Project Grant was spent on the townhomes?**

ANSWER: None of the ELI grant for the Seniors project was spent on the Townhomes. The grant funds paid for the Seniors project’s share of predevelopment expenses and the land beneath the proposed Seniors project only.

• **Does the expenditure of RDA Special ELI Funds on the Townhome Project, fully comply with all the original Grant conditions and all applicable Laws?**

ANSWER: No RDA ELI grant funds were spent on the Townhomes Project.

**3) In regards to the 2007 San Carlos Townhome project \$20.18 million budget, is \$638,000**

**each - a reasonable budget cost, per unit - to build 32 townhomes that the developer originally contractually projected, to sell in 2007, in the \$595K to \$729K range?**

ANSWER: Our numbers reflect a closing Total Development Cost budget for the Townhomes of \$20,151,000 and a final Total Development Cost, after project savings, of \$18,851,000. Subtracting out the amount of common infrastructure improvement cost and relocation consultant cost that was attributed to the Seniors project of \$536,238, and the proportion of Commercial space responsible for paying offsite infrastructure costs of \$67,197, the total development cost was \$18,247,565. Therefore, the per unit cost comes out to about \$570,000 per unit. Our construction consultant determined that the cost was reasonable for this project's design and materials.

**4) What is the projected cost, per unit, of the Senior Project?**

ANSWER: \$382,979 is the total projected cost per unit.

**5) Could you please provide the spreadsheet that shows the costs, cash flow, and rate of return (ROI) for the next 10 years, on this project?**

ANSWER: The detailed financial projections are in draft format and are dependent upon receiving a firm letter of commitment for funding from a lender and an investor for the sale of tax credits. Because tax credits are not yet committed, the projections are based upon current industry data and assumptions that may or may not be in place at the actual time of closing. The developer's financial projections will not contain ROI data in any version, including the final version of the proforma. ROI's are based upon each individual investor's own goals and this data is neither produced nor tracked by the Developer.

**• If it's of such importance and so beneficial to San Jose taxpayers, please provide the supporting factual data, to back up your claims of benefits to the City.**

ANSWER: The City Council memo states the economic benefit to the City. The calculation of economic benefit is based on the NAHB study which can be found at on the Housing Department's website at <http://www.sjhousing.org/public.html> under Affordable Housing General Information. There is also considerable benefit to the City in providing housing for its lower-income residents. Lower income seniors are expected to be a growing demographic in the coming years. The need for housing is described in detail in the City's Consolidated Plan, its Housing Element, and has been discussed as part of the 2040 General Plan.

**6) Is this new proposed "assignment/assumption" of the \$4.851 million Townhomes Loan, another new loan for \$4.851 million to build the Senior Project?**

ANSWER: The \$4.851 million is the face value of the original existing loan for the Townhomes project. The loan has been paid down according to the terms and provisions of the loan documents, but the actual balance of this loan that will be moved from the Townhomes project to the Senior project is \$2,973,833.58. As stated in the City Council memo, this is a transfer of debt from one project to another.

**• If not, are you expecting the Developers to apply to the State Tax Credit Application Board - to ask for a second set of Tax Credits, on the same original \$4.851 million - that may have originally already received tax credits on?**

ANSWER: No. The developer has never applied for Low Income Housing Tax Credits for the Seniors project, nor for Townhomes project (which is not eligible for a LIHTC award). The developer will be seeking 9% LIHTCs for the Seniors project based on the new financing structure.

- 7) It is my understanding, in this economic climate, that the State is requiring developer applicant's Cities to have "more skin in the game", before they approve a competitive Developer's Tax Credit application. Is this transference of debt, (from one LLC to another LLC), a way to accomplish this – without the actual outlaying of more taxpayer dollars?**

ANSWER: One of the criteria evaluated by the California Tax Credit Allocation Committee (TCAC) when reviewing applications for Federal and State Tax credits is the amount of local funding in a project. The developer has represented that TCAC and the investor should permit transfer of the debt from the Townhomes project as qualifying debt to the Senior Project.

- 8) The presence of the commercial tenant (Mieneke Muffler), has caused much of the problem/delay you state as reasons that this new accommodation is needed, yet the presence of this tenant was a known fact from the beginning. Why, and under whose recommendation to Council, was this project allowed to proceed, in the face of this known fact?**

ANSWER: The Senior Project has a chance to proceed now because the Developers now have site control with no existing tenants on the property and the project is financially feasible with all financing identified. The Department evaluates projects for feasibility when the Developer presents a finance plan that balances Sources and Uses. Development projects often proceed with existing tenants in place. Other commercial tenants that were originally on this site indeed were successfully relocated. However, Commercial Relocation is structured based on both Relocation Law and a negotiated process when a tenant has an existing lease in place. In this case, the tenant could not reach a Settlement Agreement to relocate and the Developer could not force the tenant to relocate. In both instances, the Developer cannot offer just any dollar amount for the tenant to relocate. While several settlement amounts were discussed between the developer and Meineke's owners, the formula for determining a relocation payment under law is based upon actual moving and relocation expenses, the cost for re-establishing its business in a new location, and Goodwill. All of these factors, except Goodwill, are known dollar amounts based upon actual expenses and receipts. However, Goodwill is based upon a number of factors, including the valuation of the business itself. In this instance, a Goodwill settlement amount could not be reached. It is important to note that law dictates that this methodology be applied and completed in order for payments to be approved project costs, which was never possible in the past.

- 9) Under whose recommendation to Council, was the initiation of obtaining approval for dividing this project in two, and proceeding with the construction of the Townhome Development?**

ANSWER: The proposal to bifurcate the project was proposed by the developer in 2005 to the Planning Department, which approved the request. The Housing Department staff therefore also supported the recommendation and City Council approved this recommendation in order to keep the Townhome project moving forward.

- 10) Please justify why you feel that a private Developer's "risk", is a taxpayer's liability/cost? – especially in an Economic Downturn that affects everyone?**

ANSWER: In any development project where the City lends funds to address a public purpose, there are risks to both the City and the Developer. Both the developer and the City's interests in this project have been negatively impacted due to the downturn in the for-sale market. This experience is not confined to San José, but has undoubtedly been experienced by many other jurisdictions that were also caught in this economic downturn.

- 11) Regarding Agenda Item 4.1 , (c) : "Extending the term of the existing loans on the Townhomes Project/Senior Project loans", and (d) : "Authorize the Director of Housing to**

**negotiate and execute all documents to effectuate these transactions and to extend the terms of the loans as appropriate.”**

**Do Items (c) & (d), give you even more power than your Delegation of Authority, to personally make all financing decisions, without any oversight? – or, without any further Council approval?**

ANSWER: It is standard practice for the City Council to delegate the authority to approve the specifics of loan terms to the Housing Director within certain parameters. The detail on the specific terms approved the Director are reported on a periodic basis through a report entitled “Report on the Activities Undertaken by the Director of Housing and the Director of Finance Under the City Council’s Delegated Authority” which are distributed to City Council and posted on the Housing Department website.

**12) Is the loan term in question 11 above, (d) “... to extend the terms of the loans as appropriate” mean : that this agreement has an open-ended loan extension date, with no firm time frame and no real stated date?**

ANSWER: The City Council memo references a twenty-four month term for the Senior Project to close on the construction loan and begin construction. It is the goal to start the project as soon as possible. However, this is dependent on the ability of the developer to obtain all necessary financing for the project.

- **Can a Resolution to a contract be “enforceable”, if there is no stated “date”?**

ANSWER: The loan documents that will be executed by the Director of Housing under the authority delegated by the City Council will have a specific term.

- **Is this contractually appropriate, and has this been approved by our legal department?**

ANSWER: Yes, the City Attorney has been involved in the preparation of the City Council memo and will be documenting the loan in conformance with approved business terms and with law.

- **What will be the impact on the City’s finances if the loan is never repaid?**

ANSWER: The Housing Fund will have \$2,973,833.58 less to spend on future affordable housing projects.

**13) Is it true, that the last time the Housing Dept went through a City Audit, was in 1997?**

ANSWER: The Housing Department is audited on an annual basis by the City’s external auditor, Macias Gini and O’Connell. This audit reviews all financial transactions in the Comprehensive Annual Financial Report (CAFR) and also includes a Single Audit, which reviews use of federal funds used for Housing programs. You can review these reports at the following link: <http://www.sanjoseca.gov/auditor/External.asp>

The Housing Department is audited periodically by multiple agencies as well. Based on the number of funding sources the Department administers, there are typically several audits proceeding at any one time. The most recent audit was completed by the State Controller in March 2011. This audit reviewed the multi-family, homeownership, and rehabilitation programs managed by the Housing Department. The Controller found no significant problems with the management of the Department and its programs. You can review this report using the following link: [http://www.sco.ca.gov/Press-Releases/2011/03-2011\\_RDA\\_Review.pdf](http://www.sco.ca.gov/Press-Releases/2011/03-2011_RDA_Review.pdf)

- **Wasn't this before most of the RDA/Housing Dept "Affordable Housing" projects were built?**

ANSWER: No. The Department was created in 1988.

- **Weren't many, (or all), financed by City Loans that were generated by the Housing Dept?**

ANSWER: Most restricted affordable housing projects in San Jose are funded in part by loans from the City of San Jose's Housing Department.

- 14) If the 9% Tax Credit application is not approved, do I understand that the City has committed to give the developers an additional \$4.83 million to build the Senior Development?**

ANSWER: The City has already committed to give the developers an additional \$4.83 Million if it is needed to finance the Senior Development. Should this Council action be approved, the outstanding \$4.83 Million commitment approved by the City will be rescinded. If the 9% tax credit application is not approved, the developer may seek alternative financing but may also request the City to consider a new commitment in order to move the project forward. That approval is subject to staff's review and City Council approval of the project finances to ensure that the City's interests are addressed.

- 15) At the bottom of page 3, of your 05.24.2011 Memorandum, you state: "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, improvements to utilities... etc." Farther down, the last two sentences on the page states: "And finally, the City will receive repayment through residual receipts." (Seniors rents, paid over 18 years?)**

- **Will the developer pay back the City the outstanding balance of approx \$3 million, by paying for all the first items, and maintaining them over 18 years, - as well as paying the City loan off - through the Senior Project rents, as stated on the first sentence of page 4?**

ANSWER: Yes, the proposed solution requires payments of residual receipts, which provides a plausible means to repay the City outstanding balance over time.

- **Will the rents really cover all that?**

ANSWER: It should, although not in the initial years of the project.

- **If the Developers default or reneges on any of their commitments, what recourse for the City will be specified in the new loan documents?**

ANSWER: As with all developments financed by the City, the City has the ability to call the loan in default and require the Developer cure the default or be subject to remedies that are typical and customary in all loan transactions.

- **Will the taxpayers be responsible for the maintenance of this building in perpetuity, if the Developers default?**

ANSWER: No. An event of default by the Developer does not necessarily mean that the City will take possession of the building. There are multiple parties involved, including lenders and investors, who can cure an event of default and continue to operate the rental community as it was originally intended.

**16) If the outstanding balance of the loan that the Developers owe, is \$2,973,833.58, why is the new proposed Resolution amount \$4.85 million?**

ANSWER: The \$4.85 million face amount of the loan was used to clearly identify which original loan was being assumed. The Developer of the Senior Project will only assume the outstanding balance of the debt.

• **If the developers don't get their 9% Tax Credits, will the City be then giving them an additional \$1.85 million "more", towards the Senior Development – to equal \$4.85 million?**

ANSWER: No. If 9% tax credits are not ultimately received by the project, other methods for financing the project will have to be developed and pursued.

**17) In your proposed Resolution, why aren't there any specific new contractual obligations attached? Such as interest rate, repayment schedule, penalties, a real extension date, and key Developer and City Obligations... Shouldn't these obligations be known before this proposed Resolution is added to an existing contract?**

ANSWER: No. It is not feasible to work out the details for myriad scenarios until all of the funding is in place. The details such as interest rate and maturity are part of the business terms that will be finalized under the Director's delegation of authority closer to the time of construction closing, if the Seniors project is successful in obtaining its other funding sources.

**18) What are the terms of the ground lease with the San Jose Financing Authority? - mentioned on the bottom of page 4.**

ANSWER: The specific terms have not been negotiated. The length of the term of the ground lease is likely to be 75 years as that is what we have used in other ground leases. At the end of this term, the City takes possession of the property and the improvements.

• **Where can the taxpayers/Public access this document?**

ANSWER: The ground lease has not been drafted or executed. Once it is completed, it is subject to the Public Records Act and can be made available upon request.

**19) Under Economic Development Benefits, at the bottom of page 5: "All the development fees paid to the City, by the Developer". Could these "Development Fees paid to the City", ultimately be coming from the \$4.83 million that the City is committing, - if the Developer cannot secure the 9% tax credit from the State?**

ANSWER: If the 9% tax credit application is not approved, and the developer has to secure other sources of funding - including \$4.83 Million from the City, then yes, the funds from the City will be part of the total source of funds for the project that will pay all aspects of the project, including the fees. In order for a project to be competitive for tax credits, it has to be ready to promptly begin construction after an award; therefore, much of the design work and the fees for review must be completed ahead of time—regardless of whether the 9% award is obtained.

• **If the Developers can't secure the 9% tax credit, how are all the Development Fees considered a benefit to the City?**

ANSWER: Regardless of whether the project is funded by 9% tax credits, or other funding sources including Housing funds, development fees are considered a benefit to the City

because they help fund the infrastructure and staff necessary to support this and other projects. This supports local businesses and provides revenue to the City.

**20) If project financing is not obtained within 24 months of this Council Action, you state: ... “the Housing Dept. will pursue other means for addressing the shortfall from the Townhomes project and the development of this site”. Please explain the “other means for addressing the shortfall”.**

ANSWER: One potential option would be for the City take ownership of the land from the developer. The other option would be to sue the partners of the Townhome project.

**21) Our neighborhood has been involved with this project since 2001. You state a potential State major reform of Redevelopment Law “involves financial penalties for properties funded with Redevelopment Funds that have not been developed over a significant period of time”.**

• **Please define the Redevelopment Law’s “significant period of time”, and the City Department responsible for the decisions that caused this delay.**

ANSWER: The proposed legislation is not approved and is subject to change. The current law defines that as 10 years, though this can be appealed to the State if there are mitigating circumstances. No City Department was responsible for the delay. The project delay was caused by the financial markets which made financing extremely difficult and the fact that the commercial tenant had an existing lease and the developer and the commercial tenant were unable to come to an agreement.

**22) If known, please state the Redevelopment Law penalty “dollar amount”, and would this penalty amount come out of budget of the General Fund, Housing Fund, or RDA Fund (if any)?**

ANSWER: Current Redevelopment Law would not impose a penalty on the Seniors project. Pending legislation contains a penalty provision paid from the 80% Fund for certain land not developed timely that is purchased with 20% Housing Funds. However, this site was not purchased with 20% Housing funds so that provision would not apply. As explained above, it is not possible to know what future legislation may or may not dictate.

**23) Based on this project delay, greatly attributed to the City not requiring that a commercial tenant be relocated first, before any City money was released, has the City adopted a firm law? - One that states that no affordable housing project will move forward, until all tenant relocation has taken place? – or do you, the Housing Director still get to make that call, under your full Delegation of Authority ordinance, approved by Council?**

ANSWER: When a Developer acquires a property, they have all the rights of a land owner. If the City of San Jose is providing funding for a project, the Developer is obligated to present a Relocation Plan prepared and obtain approval by a legislative body, such as City Council. The developer can proceed with relocation with other funds, outside of using City of San Jose funds regardless of timing. It does not make sense to relocate tenants until such time as the project is fully financed and ready to proceed.

**24) Did you make the original call, to move forward on the start of this development, without the commercial tenant’s removal – on the Developer’s assurance that it will be done quickly?**

ANSWER: When this project was first approved, it was expected that the relocation would be handled in an expeditious fashion, and that happened with other businesses on site. That did not happen with one tenant. There are a lot of unanticipated issues that arise in development,

from finding archeological treasures, to discovering environmental problems. Not all of these can be anticipated at the time of initial investment.

**If so, please justify why you thought it was in the City's, (and taxpayers), best interest to do so, at that time.**

ANSWER: The Department's mission is to provide affordable housing. Its main source of funds is the Low and Moderate Income Housing funds that it gets via State Redevelopment Law. The Department chose to work cooperatively with its grantee in pursuit of the fulfillment of its mission and its funding source.