CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Jacky Morales-Ferrand
Jim Shannon

SUBJECT: **SEE BELOW**

DATE: June 1, 2020

Approved D. DSyL

Date 6/4/20

COUNCIL DISTRICT: 10

SUBJECT: APPROVAL OF A LOAN COMMITMENT TO EDEN HOUSING, INC. FOR THE DEVELOPMENT OF AN AFFORDABLE APARTMENT COMMUNITY LOCATED AT 5647 GALLUP DRIVE AND 1171 MESA DRIVE TO BE KNOWN AS GALLUP-MESA APARTMENTS

RECOMMENDATION

Adopt a resolution:

(a) Approving a total commitment of $5,250,000 in Low and Moderate Income Housing Asset Funds ("LMIHAF") and $500,000 in Affordable Housing Impact Funds ("AHIF") for a Construction-Permanent Loan totaling $5,750,000 to Eden Housing, Inc. ("Developer") for a new 46 unit affordable housing development to be located at 5647 Gallup Drive and 1171 Mesa Drive ("Site"), in order to offer rent- and income-restricted apartments for extremely low-income, very low-income and low-income households ("Project"),

(b) Authorizing the Director of Housing to negotiate and execute loan documents and all other documents regarding City construction and permanent financing for the Project;

(c) Approving a loan-to-value ratio of greater than 100% for this loan;

(d) Approving the following affordability mix for the Project in order to allow more flexibility without compromising the intent of providing affordable and permanent supportive housing: 15 units will be income-restricted at 25% of Area Median Income ("AMI"); one unit will be income-restricted at 30% of AMI; 11 units will be income-restricted at 40% of AMI; 12 units will be income-restricted at 50% of AMI; two units will be income-restricted at 60% AMI; four units will be income-restricted at 80% AMI; and one unit will be an unrestricted manager's unit; and

(e) Authorizing the Director of Housing to enter into a Ground Lease with the Developer of the City-owned properties located at 5647 Gallup Drive and 1171 Mesa Drive for a term of seventy-five (75) years for the purpose of constructing and operating the Project.

(f) Adopt the following Fiscal Year 2019-2020 Appropriation Ordinance Amendments in the Low and Moderate Income Housing Asset Fund:
   (1) Decrease the Housing Project Reserve appropriation by $5,050,000; and
   (2) Increase the Committed Projects Reserve appropriation by $5,050,000.

(g) Adopt the following Fiscal Year 2019-2020 Appropriation Ordinance Amendments in the Multi-Source Housing Fund:
   (1) Decrease the Housing Project Reserve appropriation by $500,000; and
   (2) Establish the Committed Projects Reserve in the amount of $500,000.

OUTCOME

Approval of the recommended actions will enable the Developer, Eden Housing, Inc., to assemble financing to build a new affordable development on City-owned property located at 5647 Gallup Drive and 1171 Mesa Drive in San José. *See Attachment A – Project Overview and Site Map.*

EXECUTIVE SUMMARY

In response to the $100 million Notice of Funding Availability last year, Eden Housing applied for a funding commitment in the amount of $5,750,000 to develop 46 apartments for extremely-low-, very low-, and low-income individuals and families. This development plans to use the City's Low and Moderate Income Housing Asset funds, Affordable Housing Impact Funds, Santa Clara County Measure A Affordable Housing Bond funds and Federal Tax Credits. Approval of this funding commitment allows the developer to apply to the California Tax Credit Allocation Committee and California Debt Limit Allocation Committee for allocations.

BACKGROUND

San José lacks enough affordable housing to meet residents' needs, with a severe shortage of adequate, affordable housing for extremely low-, very low-, low-income, and moderate-income households.

Need for Affordable Housing

The cost of living in San José is among the highest in the country. Renters must earn $53/hour ($109,520/year) to afford the average effective monthly rent for a 2-bedroom apartment of

$2,738[1]. Yet the median household income in the City of San José in 2018 dollars is estimated at $104,234.[2]. In San José more than 50% of renters pay more than 30% of their gross income on rent with 25% of those households "severely cost-burdened," meaning that residents are paying more than half of their gross income on housing.[3] This leaves the household with insufficient income to pay for their other needs such as food, clothing, medical care and transportation.

Innovative Housing Solution

In alignment with the comprehensive plan to address this housing shortage, the City is increasing affordable housing by both piloting new ideas and integrating best practices in affordable housing development. As an example, the proposed development of a new 46-unit affordable housing development at 5647 Gallup Drive and 1171 Mesa Drive ("Site") combines proven development approaches with the latest thinking on sustainable communities. The Site is intended to offer rent- and income-restricted apartments for extremely low-income, very low-income and low-income households in a manner which spurs the creation of a vibrant intergenerational community supported with ready access to integrated supported services. Specifically, the Site occupants will be composed of transitional age youth, seniors and families, and all will have access via the Site to wellness programs-exercise classes, yoga, meditation, nutrition presentations, food delivery programs, financial education-presentations and programs in debt reduction and savings plan strategies.

Its innovative management and services plan focuses on developing a sense of community around mentorship and healthy living through a commitment to resident engagement. At the heart of the development is an indoor/outdoor community space that will be open to community residents and provides a variety of high quality spaces for meaningful interaction, mentorship and programming to help ensure the residents succeed.

Development History

In August 2018 the City released a $100 million Notice of Funding Availability ("NOFA"). This NOFA made funding available for housing developers to submit written proposals for affordable multifamily rental housing projects providing housing for extremely low-, very low- and low-income individuals and families.

In response to the recent $100 million NOFA released by the City, the Developer submitted a proposal and received a tentative conditional award for the Project. The Project was deemed eligible for 23 project-based vouchers ("PBVs") from SCCHA, supportive services from the County, a Santa Clara County Office of Supportive Housing loan in the amount of $7,000,000 and a subsidy commitment request to the City Council, as described in this memorandum. The

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[1] Based on Q4 2019 Costar average rents; income calculation assumes rents are 30% of income, 40-hour work week and a single income household. Accessed via City of San Jose website on May 22, 2020.

[2] US Census data

[3] Economic Roundtable November 2019 report: Outcomes from Rent Stabilization in San Jose. Accessed May 22, 2020.

23 PBVs are tied to the 23 units that will be reserved for transitional age youth, (Youth). In addition, the remaining units will be made available to a mix of seniors and families.

In June 2017, the City Council authorized the Director of Housing to negotiate and execute an Exclusive Negotiation Agreement ("ENA") between the City and Developer for the potential development of the City-owned property located at 5647 Gallup Drive and 1171 Mesa Drive with an affordable housing development; and negotiate and execute documents for a predevelopment loan to the Developer in an amount not to exceed $200,000. This resulted in the execution of an ENA and predevelopment loan agreement between the City and Developer. This provided the site control and funding that Eden Housing needed to proceed with a development concept and plans for the Site.

Funding for the Development

The Project has also applied for and received Senate Bill (SB) 35 Streamlined Ministerial Approval Process from the Planning Department. SB 35 is aimed at addressing the State's housing shortage and high housing costs. Specifically, it requires the availability of a Streamlined Ministerial Approval Process for developments in jurisdictions that have not yet made sufficient progress towards their affordable housing goals for above-moderate and lower income levels as mandated by the State. Eligible developments must satisfy all objective planning standards of the law. The Project has been deemed qualified as a SB 35 development. by the Planning, Building, and Code Enforcement Department. In addition, the Project qualified for a State Density Bonus request of 35% as it will have at least 58% of the units restricted to Very Low-Income households (27 households). This allows for a density bonus of 35% resulting in 46 total units instead of the initial anticipated 41 units serving the same three population groups.

The Developer has secured and applied for additional construction/permanent funding sources for the Project, including:

- **Measure A Affordable Housing Bond ("Measure A") - *Secured***
  On September 26, 2017, the County issued a Notice of Funding Availability ("NOFA") for the Measure A Affordable Housing Bond, a $950 million general obligation bond that will create new affordable rental and homeowner housing opportunities. The Developer applied for Measure A funds on August 23, 2019 and received an award on October 22, 2019 when the County Board of Supervisors appropriated $7,000,000 in Measure A funds for the Project in.

- **State HCD Multifamily Housing Program ("MHP") Program – *Applied For***
  Eden Housing submitted a request to State HCD for an allocation of MHP funds in the amount of $9,816,000 on March 2, 2020. Early indications from State HCD are that the proposed project has scored well, although final approval announcements are not anticipated until late June 2020.

In order to secure a Tax Credit Allocation from the California Tax Credit Allocation Committee and California Debt Limit Allocation Committee needed to develop the Site, the Developer must obtain a City loan commitment, with revised assumptions for loan-to-value ("LTV") ratio and affordability mix, as described in this memorandum.

ANALYSIS

City Loan Commitment

The Housing Department recommends the total loan commitment to the Developer of $5,750,000 to fully fund the Project. This funding commitment encompasses $200,000 of predevelopment funding that was previously approved by City Council and $5,550,000 in new funding.

Construction-Permanent Loan and Ground Lease

The Housing Department recommends that City Council approve a Construction-Permanent Loan amount for up to $5,250,000 from LMIHAF and $500,000 from AHIF. The City's Construction-Permanent Loan commitment is necessary because it will enable Eden Housing to pursue other public and private funding sources for the Project. Eden Housing applied for the Housing Department's $125,000 maximum per unit subsidy to finance a portion of the Project's Total Development Cost of $37,768,894 ($821,085 per unit). City Council approval of $5,750,000 will leverage an additional $32,019,893 in financial resources to the City of San José for the development of affordable housing. As noted above, the Developer has already obtained County Measure A funding for the Project on October 22, 2019. Accordingly, the Housing Department will require the Developer to seek additional funding sources, such as a competitive State Low Income Housing Tax Credit award to augment the federal award, and Affordable Housing Program funds from the Federal Home Loan Bank. The City's Deed of Trust will be recorded against the City's leasehold and made subordinate to senior leasehold financing. *See Attachment B – Construction/Permanent Sources for the Project.*

The Developer will enter into a Ground Lease for a term of 75 years or up to 99 years as may be needed to satisfy a true debt test. At the end of the term, the Project and improvements will revert to ownership by the City. The Ground Lease term shall begin at or prior to the close of construction financing. Due to the Developer's ownership of the improvements for the term of the lease, the Project will not be subject to the City's project labor agreement, although prevailing wages will be required consistent with the Municipal Code.

By the authority delegated by Council under the resolution accompanying this report and also under section 5.06.335 of the Municipal Code, the Director of Housing will negotiate additional terms and execute documents for these loans in accordance with the City Council's approval, if granted, for this Project. If the Developer is unsuccessful in securing additional funding for the Project, the Housing Department may return to the City Council for consideration of additional construction-permanent financing.

California Debt Limit Allocation Committee (CDLAC/) & California Tax Credit Allocation Committee (TCAC) Environment

There are two types of Low Income Housing Tax Credits (LIHTC): 9% credits and 4% credits. All projects will fall into either 9% category or the 4% category depending how the project is financed. The Internal Revenue Code (IRS) delegates TCAC the authority to allocate a "limited pool" of 9% low-income tax credits. There are two major differences between the 9% and 4% tax credit programs. The amount of equity generated is greater for the 9% program. However, the 9% has limited availability and is therefore competitive. The 4% has been traditionally a noncompetitive source with a sufficient supply. Many developers have transitioned their business model from 9% transactions, to tax-exempt private activity bonds and 4% transactions to ensure more certainty. TCAC scores developer applications and award the credits to the projects that will best fulfill the region's housing needs.

In California, the demand for private activity bonds is outpacing supply. This is causing issues for developers who rely on tax exempt bonds to help finance the construction or rehabilitation of affordable housing. This has resulted in an oversubscription of private activity bonds making it difficult to qualify for the 4% tax credit. In summary, the 4% tax credit option has become "competitive" and is disrupting the affordable housing industry. CDLAC is now using its competitive scoring system to award projects an allocation.

As a result, this caused the Developer, to develop different options and financing strategies causing a dual track 9% and 4% application approach to increase their probabilities of securing either type of Low Income Housing Tax Credits. In either scenario, City Council's funding approval is required to apply and secure a tax credit allocation.

Loan-to-Value Ratio

To determine an estimated LTV ratio for the City's Construction-Permanent Loan, the Housing Department is in the process of obtaining an appraisal being prepared by a third-party appraiser which will be completed shortly. The City's LTV policy requires that the LTV ratio not exceed 100% in order to limit the City's risk of potential loss associated with a loan. However, the deep affordability of the Project increases the need for public subsidies and decreases the Project's market value. This increases the possibility of an increased LTV ratio.

In the event that securing the already approved Predevelopment Loan and the proposed Construction-Permanent Loan on the Site results in an LTV ratio that exceeds the City's LTV policy threshold, the Housing Department recommends approval of an LTV ratio for the Project that is greater than 100%. A higher LTV ratio is considered acceptable because the Project's operating income is expected to be at least 115% of the permanent mortgage debt service payments. This formula is a common standard of financial feasibility and will be used by the senior permanent lender.

Affordability Unit Mix/Area Median Income Levels

Since approval of a Predevelopment Loan in June 2017 which consisted of 41 units with a mix of seniors, families with foster care youth, and transitional age youth, the Developer has proposed a new 46 unit affordability mix, as follows:

Proposed Income and Rent Mix

Number of Apartments	Area Median Income	Income Range	Bedroom Size	Rents
16	Extremely Low-Income 25-30% AMI	$27,625 - $42,625	Studios (9) 1-bedroom (5) 2-bedroom (1)	$690.63 - $1,065.63 monthly
23	Very Low-Income 40-50% AMI	$44,240 - $71,100,	Studios (7) 1-bedroom (14) 2-bedroom (2)	$1,106 - $1,777.50 monthly
2	Low-income 60% AMI	$75,713	2-bedroom	Up to $1,892.83 monthly
4	Low-income 80% AMI	$121,150	3-bedroom	Up to $3,028.75 monthly
1	Unrestricted manager unit	N/A	2-bedroom	N/A

In addition, sixteen (16) studios and seven (7) 1-bedrooms totaling twenty-three (23) apartments will be set aside as permanent supportive housing units for the chronically homeless which will be receiving services from a County contracted provider The Housing Department recommends that this adjustment to the general parameters for the Project be approved by City Council because it will position the Project to be more competitive for alternative funding sources, yet will not compromise the intent of providing affordable and supportive housing for vulnerable residents. *See Attachment C – Unit and Proposed Income Mix.*

Allowance for Rents to Increase in Case of Foreclosure

The LMIHAF affordability restrictions will not be subordinated to the senior loan, so the LMIHAF restrictions will allow an increase in the Development's rents and income up to 60% AMI (low income) for all tenants in the event of a foreclosure, to the extent the City has determined such increase is needed for feasibility of the Development.

Development Financing Timeline

The following table outlines the financing timeline for the Project. Construction is expected to start in January 2021 and will be ready for initial lease up in Spring 2022.

DEVELOPMENT TIMELINE	DATE
Project awarded to Eden Housing (Exclusive Negotiations Agreement)	September 2007
2018 City NOFA Selection Award	February 2019
County Funding and Project Based Section 8 Voucher Award	March 2020
Planning Permit	May 2020
City of San José Funding Commitment (Anticipated)	June 2020
Construction Start Date	January 2021
Construction End Date	April 2022

CONCLUSION

The Developer is determining whether to apply for an allocation of 9% tax credits (Application is due July 1, 2020) or 4% tax credits with tax exempt bonds (Application is due August 21, 2020). As discussed above, the Developer applied for State HCD funding through the MHP program on March 3, 2020. Awards for this funding source will be announced in late June 2020. If Eden Housing is awarded an allocation of MHP funds for the Project, they will apply for 4% Low Income Housing Tax Credits and a Tax-exempt Bond Allocation on August 21, 2020. If the Project is unsuccessful in obtaining an award of MHP funds, there will still be time for the Project to apply for an allocation of 9% tax credits on July 1, 2020. Construction would initiate in January 2021 and conclude in April 2022. *See Attachment D – Anticipated Development Timeline.*

EVALUATION AND FOLLOW-UP

The Housing Department produces quarterly Information Memoranda regarding the use of the Director of Housing's Delegation of Authority under the Municipal Code; therefore, final loan business terms would be summarized in those Memos. In addition, the Housing Department posts periodic reports on the status of its affordable properties undergoing rehabilitation or construction to its website, www.sjhousing.org. If the recommended actions are approved and Gallup-Mesa Apartments successfully closes construction financing, it would be included in these Quarterly Production Reports.

CLIMATE SMART SAN JOSE

The recommendation in this memo aligns with one or more of Climate Smart San José energy, water, or mobility goals. Eden Housing will provide high density housing along a transit corridor.

POLICY ALTERNATIVES

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

Recommendation #1

Alternative #1:	***The City Council could deny the request for funding to the Developer for the Project.***
Pros:	The funds being requested could be used for other affordable housing developments.
Cons:	The City will lose an opportunity to provide housing for homeless individuals and families currently residing in San José.
Reason for not recommending:	The proposed Project will help to meet the demand for deeply affordable housing that is affordable to transitional age youth, seniors and families. The Project will help the City fulfill its affordable housing goals.

Recommendation #2

Alternative #1:	***The City Council could deny the request to modify the Project's affordability mix reverting to the original mix described in the May 22, 2017 memorandum.***
Pros:	The Project would serve more individuals and families in income ranges from 25-80% AMI.
Cons:	The Project would become ineligible for the already approved County Measure A funding and less competitive for MHP funding.
Reason for not recommending:	The Developer would have to forfeit its County Measure A funding. There would be a funding gap created by the loss of Measure A support. This would delay the project further or make it financially infeasible without additional funding from the City.

PUBLIC OUTREACH

Prior to City Council's approval of the Project's entitlements, the Developer implemented a comprehensive outreach plan to engage with the community to provide information, to answer questions, and to better understand the concerns of the neighborhood residents and businesses. The Developer hosted a total of two neighborhood or community meetings on April 27, 2017 and March 13, 2018, attended by more than 30 community members, addressing a wide array of topics such as Project design, services, and property management. In addition, this memorandum will be posted on the City's Council Agenda for the June 9, 2020 meeting.

COORDINATION

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

COMMISSION RECOMMENDATION/INPUT

This item was not heard by the Housing and Community Development Commission, as approvals of affordable development financing do not fall under the functions, powers, and duties of the Commission delineated in Section 2.08.2840 of the San José Municipal Code.

FISCAL/POLICY ALIGNMENT

This expenditure is consistent with the following policy documents: *The City's Envision 2040 General Plan* and the *2014-23 adopted Housing Element* in that it will help the City meets its Regional Housing Needs Allocation; the City's current *Housing Investment Plan* in that it increases San José's supply of affordable housing; the *City's 2015-20 HUD Consolidated Plan* in that it will provide rental apartments affordable to very low- and extremely low-income households; and the *Community Plan to End Homelessness* approved by the City Council in February 2015 in that it is providing supportive housing for formerly homeless residents.

COST SUMMARY/IMPLICATIONS

1. AMOUNT OF RECOMMENDATION:

USES	UP TO AMOUNTS
Predevelopment Loan (previously approved)	$200,000
Construction-Permanent Loan	$5,550,000
TOTAL	$5,750,000

2. SOURCE OF FUNDING: $5,250,000 from Low and Moderate Income Housing Asset Fund (Fund 346) and $500,000 from Multi-Source Housing Fund (Fund 448)

3. FISCAL IMPACT: Funding in the amount of $200,000 has been previously appropriated in the Low and Moderate Income Housing Asset Fund for predevelopment activities; the balance from this fund is recommended as part of this memorandum to be placed in a Committed Projects Reserve appropriation ($5,050,000). Action is also recommended to allocate an additional $500,000 from the Multi-Source Housing Fund to a Committed Projects Reserve. Once the project is ready to proceed, funds will be moved from the reserve to a live appropriation in accordance with the project schedule. There is no on-going fiscal impact as a result of this action.

BUDGET REFERENCE

The table below identifies funds and the appropriations proposed to fund the actions recommended as part of this memorandum.

Fund #	Appn #	Appn. Name	Total Appn	Recom. Budget Action	2019-2020 Operating Budget Page	Last Budget Action (Date, Ord. No.)
346	8437	Housing Project Reserve	$80,720,000	($5,050,000)	X – 56	2/11/2020, Ord. No. 30361
346	8520	Committed Projects Reserve	$9,350,000	$5,050,000	X – 56	1/14/2020, Ord. No. 30355
346	0070	Housing Loans and Grants	$63,839,960	$200,000	X – 56	1/14/2020, Ord. No. 30356
448	8437	Housing Project Reserve	$5,856,258	($500,000)	X – 72	10/22/2019, Ord. No. 30325
448	New	Committed Projects Reserve	N/A	$500,000	N/A	N/A

CEQA

Exempt per Public Resources Code section 21080(b)(1) and CEQA Guidelines section 15369 Ministerial Project pursuant to Government Code Section 65913.4, File No. ER20-109.

/s/
JACKY MORALES-FERRAND
Director, Housing Department

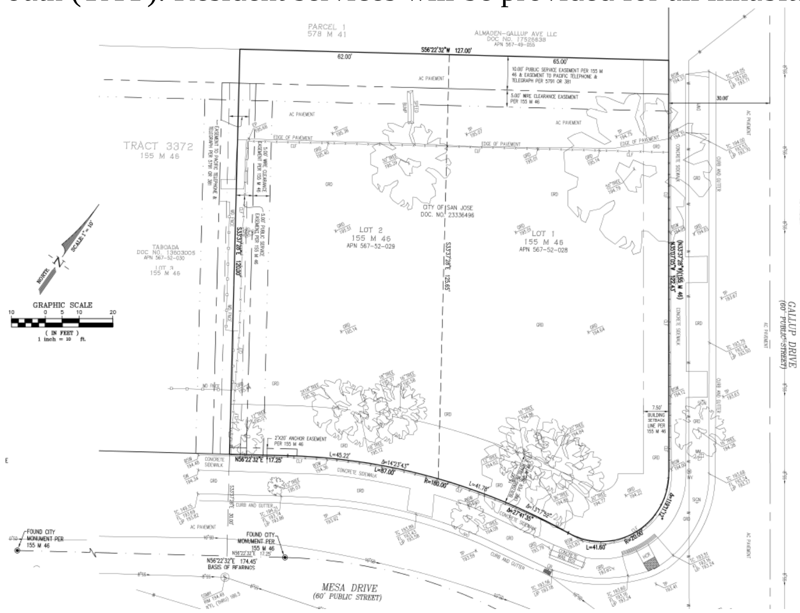
Jim Shannon
JIM SHANNON
Budget Director

For questions, please contact Deputy Director, Rachel VanderVeen (408) 535-8231

Attachment A: Project Overview and Site Map
Attachment B: Construction/Permanent Sources for the Project
Attachment C: Unit and Proposed Income Mix
Attachment D: Anticipated Development Timeline

Attachment A
Project Overview and Site Map

Ground up development of 46 income-restricted, residential units. Project will consist of podium parking, community space, resident services office, outdoor terrace, elevator, and on-site laundry facilities. Intended residents will be "inter-generational," comprising seniors, families, and Transition Age Youth (TAY). Resident services will be provided for all inhabitants.



Attachment B
Construction/Permanent Sources for the Project

Sources - Permanent	
Conventional loan	2,744,000
County of Santa Clara	7,165,915
City of San Jose	5,916,924
Donated Land	3,770,000
LP Contribution	17,997,579
GAP	0
Total	37,594,418

Sources - Construction	
Conventional Construction Loan	18,049,879
City of San Jose	5,916,924
Santa Clara County	7,000,000
Donated Land	3,770,000
Deferred Costs	1,219,653
Partner Contribution	1,637,962
Total	37,594,418

Uses	
Acquisition Costs	3,800,000
Hard Costs – Unit Construction	20,357,812
Hard Costs – Misc	5,262,188
Soft Costs	7,767,474
Financing Fees	406,944
Total	37,594,418

Attachment C
Unit and Proposed Income Mix

	Amount	Vouchers
Studios	16	16
1 Bedrooms	19	7
2 Bedrooms	6	-
3 Bedrooms	5	-
Total	46	23

AMI Level	Amount
25% AMI	15
30% AMI	1
40% AMI	11
50% AMI	12
60% AMI	2
80% AMI	4
Manager Unit	1
Total	46

Unit Type	Amount	AMI	Vouchers
Studios	9	25%	9
	7	40%	7
1 Bedroom	4	25%	4
	1	30%	1
	4	40%	2
	10	50%	-
2 Bedroom	1	25%	-
	2	50%	-
	2	60%	-
3 Bedroom	1	25%	-
	4	80%	-
Manager Unit	1	N/A	-
Total	46		23

Attachment D
Anticipated Development Timeline

Submit MHP Application	3/2020
Submit 9% TCAC Application	7/2020
Submit 4% Joint TCAC/CDLAC Application	8/2020
Building Permit Received	10/2020
Lender Bidding Completed	10/2020
Close Construction Financing	12/2020
Begin Construction	1/2021
Complete Construction	4/2022
Commence Leasing	4/2022
Stabilization	10/2022
Conversion	10/2022
PIS/8609	4/2023