



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: October 22, 2020

Approved

Date

10/29/2020

COUNCIL DISTRICT: 9

**SUBJECT: APPROVE REFINANCING CONDITIONS FOR CRAIG GARDENS
SENIOR APARTMENTS**

RECOMMENDATION

Adopt a resolution to:

- a. Consenting to the refinancing and subordination of the existing City loan for the Craig Gardens Senior Apartments, an 89 one-bedroom unit affordable apartment development (“Project”) located at 2580 S. Bascom Ave. (“Property”) to a new Freddie Mac-backed senior loan in the amount of approximately \$8,204,000 including the withdrawal of no more than \$2,547,110 in refinancing proceeds by the Property’s owner, Craig Gardens, L.P. (“Owner”), an affiliate of the San José-based nonprofit developer First Community Housing (“Sponsor”); and
- b. Authorizing the Director of Housing to negotiate and execute amendments to the City’s existing loan documents on the Project, in order to establish a rent burden reserve in the amount of \$400,000 to be funded from the proceeds of the refinance and to enable refinancing of the Project’s senior loan and partial repayment of the City Loan interest in the amount of \$1,073,555.

OUTCOME

Approval of this action will authorize the Owner of Craig Gardens Senior Apartments to refinance the Property's existing senior loan, to pay down \$1,073,555 of interest on the City's existing loan, and to use up to \$1,073,555 to bolster the financial strength and liquid net worth of First Community Housing, the Property's local nonprofit Sponsor. In addition to the paydown of the City's existing interest on the loan, the City will benefit by extending its Affordability Restrictions by 17 years and strengthening the loan documents by adding new provisions and covenants to adhere to current City underwriting guidelines.

EXECUTIVE SUMMARY

This action allows the City to subordinate its deed of trust to a new senior loan for an existing restricted affordable rental property, Craig Gardens Senior Apartments ("Craig Gardens"), and allows First Community Housing to take \$2,147,110 in cash out of the transaction fifty-percent of which will be used to pay down a portion of the interest on the City's loan on the property. With the remaining fifty-percent, First Community Housing will strengthen its financial liquidity in order to meet requirements of lenders and investors for sixteen forthcoming developments in San José.

BACKGROUND

Craig Gardens Senior Apartments provides 89 one-bedroom apartment units and is located at 2580 S. Bascom Avenue. First Community Housing ("FCH" or "Sponsor") is the developer and sponsor of Craig Gardens, L.P., a California Limited Partnership ("Borrower" or "Owner"). Craig Gardens was built in 2002 and provides 89 one-bedroom units. The table below provides detail on the level of affordability for the Project.

Number of Units	AMI Level	Annual Income for 2-Person Household	Monthly Rent
9	30% AMI	\$ 37,900	\$ 849
37	45% AMI	\$ 56,800	\$ 1,274
43	50% AMI	\$ 63,200	\$ 1,416

The Project was originally financed with (1) equity derived from the sale of low-income housing tax credits; (2) a City loan of \$4,790,000; and (3) a senior City-issued bond loan of \$7.1 million.

The City's loan has a current balance of \$6,650,099.36^a, consisting of \$4,790,000 in principal and \$1,860,099.36 in interest, and is paid by 70% of annual net cash flow after payment of expenses, bears 3% simple interest, and is due in full at maturity on December 1, 2043. The City

^a As of October 13, 2020

loan was funded with 20% redevelopment funds. The affordability restrictions expire on September 19, 2057.

Refinancing Request

In June of 2020, FCH proposed to refinance Craig Gardens to take advantage of the current low interest rates. The proposal is to obtain a new senior loan which would pay off the original loan balance, allow the Limited Partner to exit, pay the associated refinancing fees, establish various reserves allow FCH to make repairs to the property and make a partial payment to the City. See table below for proposed Sources and Uses:

Sources	
New Senior Loan: Bank of America Merrill Lynch	\$8,204,000
Total Sources	\$8,204,000
Uses	
Payoff existing Senior Loan (Bank of America)	\$3,072,470
Prepayment Premium	\$813,517
Refi/Third Party Fees	\$110,000
Fees & Deposits	\$22,259
Origination Fee (1.00%)	\$81,830
Legal Fees - Buy out	\$26,778
Costs Associated with LP Exit	\$1,065,000
TCAC Required Repairs	\$200,000
Replacement Reserves	\$50,000
Principal & Interest Reserve	\$215,037
City of San José Requested Rent Burden Fund	\$400,000
Total Uses	\$6,056,890
Cash Available	\$2,147,110
50% to City of San José	\$1,073,555
50% to FCH	\$1,073,555

Also, FCH would use \$1,073,555 in refinancing proceeds to strengthen its financial position. The funds would be held to meet investors' liquid net worth requirements to support financing on sixteen forthcoming San José affordable developments and would pay for staff and predevelopment costs on these deals.

The proposed new senior loan with Bank of America in the amount of \$8,204,000 will bear an interest rate of approximately 3.28% with a maturity of 10 years, with required monthly payments of principal and interest in the amount of \$35,839.58 based on a 30-year amortization. The City would need to subordinate its existing deed of trust to the new senior loan.

ANALYSIS

While the Delegation of Authority under Chapter 5.06 of the City's Municipal Code permits the Director to approve the proposed transaction, staff elected to bring this action before the City Council in order to approve the proposed action to take out cash that will be split between making a payment on the existing loan to the City and providing funding to FCH. The City's current Underwriting Guidelines do not allow developer to take cash out as part of a refinance without City Council approval.

Value of First Community Housing to San José

First Community Housing shares the City's mission of creating, maintaining and preserving housing affordable to low-income residents in San José, and has demonstrated consistency with the City's policy priorities. FCH is designated as the only local Community Housing Development Organizations in San José which means they are committed to developing a pipeline of projects in the City. FCH has its headquarters in San José and seventeen out of 23 of its existing affordable developments are located in San José. It has shifted the focus in all sixteen of its forthcoming San José developments' to prioritize housing the City's unsheltered residents. FCH is in good standing, has no issues of material non-compliance on any of its existing deals with the City; it has submitted its financial documents for review by the City; and, it plans to retain the sole ownership stake in Craig Gardens for the foreseeable future.

Physical Assessment of the Property

FCH will spend approximately \$200,000 in upgrades & repairs. The Property is in good physical condition and has no deferred maintenance issues. The \$200,000 will be funded from the refinancing proceeds. The expected list of upgrades & repairs to the Property are as follows:

- Hot water system upgrades
- Exit signage & emergency lighting
- Security camera installation
- GFCI replacement in all tenant bathrooms & kitchens
- Resealing of all balconies and decks

Limited Partner Exit

When the partnership was established Newport Partners Management and Newport Fund 2001 A, L.P. ("Investor") were included in the ownership structure, however, with the proposed refinance of the property, it will enable Craig Gardens, L.P. to have the funds to pay for the Investor to exit the partnership.

Rent Burden

A recent analysis conducted by City Housing Department staff in 2020 indicated that 55% of the tenants at Craig Gardens Senior Apartments are rent burdened and pay greater than 50% of their income towards rent. Rent burdened residents are more likely in senior housing developments. The reason for this is due to the fact that seniors are generally on a fixed-income and do not have potential to earn more income on an annual basis. At the same time, the area median income for the San José area has increased over 20% over the past five years. As the area median income increases, the rents also rise, leaving many seniors paying a greater portion of their income on rent. Additionally, tenants may elect to move into a higher rent apartment through an appeals process because paying the higher rent may still be less than paying market rent for a similar apartment.

In order to address this issue, City staff worked with FCH to develop a five-year plan to address the rent burden issue with the following:

1. A Rent Burden Reserve of a minimum of \$400,000 be set from the proceeds of the refinancing. No other funds will be deposited into the reserve. This reserve shall be held by the City of San José with bi-annual disbursements at the consent of the City of San José Housing Staff subject to approval of the Rent Burden Reserve Report mentioned in item #5.
2. FCH and property management company commit to not evicting tenants for non-payment of rent as long as they have an approved payment plan (with reduction in rent).
3. Payment plans will be offered to all tenants paying greater than 50% of their income in rent.
4. Management Company will work with tenants on a payment plan where the tenant will not pay more than 50% of their income in rent.
5. FCH will provide a Rent Burden Reserve report bi-annually to the City and the reserve will also be noted in the audit. With bi-annual disbursements approved by City Housing Department Staff to cover the loss of income due to the reductions in tenant rent for tenants who are currently renting a 45% or 50% AMI unit and are paying over 50% of their income in rent.
6. FCH and their property management company will review and approve all payment plans with rent reductions.

These actions will minimize the rent burden issues at this senior development and will ensure the long-term stability of the current Craig Gardens residents.

Financial Review of the Proposed Structure

FCH currently has full site control and land use entitlements for sixteen affordable rental developments that will produce an additional 1,696 new apartments in San José. North San Pedro/Iamesi Apartments, and Leigh Avenue Senior Apartments, are currently in the construction stage with a combined number of 199 new apartments, adding to FCH's existing 1,191 apartments in San José. Potential lenders and investors for these developments have requirements that developers' liquid assets be \$1-1.5 million in order to mitigate their lending and investing risks. Staff's analysis of the FCH corporate financials and its future projections of cash assets concluded that the \$1,073,555 cash out from the Craig Gardens refinance is necessary to meet their liquidity requirements and to ensure adequate staffing.

The Craig Gardens proposal results in a net positive financial benefit to the City. The senior loan LTV is 39% and the combined LTV is 84%, with a debt coverage ratio of 1.20, meeting the City's parameters. Both LTV and DCR—measures of loan safety—are improved relative to the original loan underwriting in 2000. The combined LTV will be somewhat higher with the new loan than that for the existing loan prior to closing. However, because the senior loan is conservatively underwritten, the size of the loan does not present additional risk to the City. The payments on the new senior loan will lower annual new debt service payments by \$80,964, which will in turn increase the Property's annual net cash flow. In addition, the City can use the \$1,073,555 partial payment on the City loan interest towards building new apartments in San José. At maturity in ten years, the senior loan will need to again be refinanced in order to retire the full principal amount. The financial projections show that such refinancing can comfortably be achieved at that time.

The City loan will subordinate to the senior loan. The City's affordability restrictions will not be subordinated to the new debt. However, the City may agree to a brief 'standstill' period, giving a senior lender 2-3 months and right to cure any default conditions that might exist before the City would exercise its remedies.

Consideration

This action gives FCH the City's consent to refinance the Craig Gardens Apartments development and also delegates to the Director of Housing the authority to negotiate and execute all documents necessary to authorize and complete the financing transaction. As consideration for making the recommended changes, the City is requesting the following from the Borrower:

1. An extension of the Property's term of affordability by an estimated seventeen years;
2. Edits to the City's documents to reflect the Housing Department's current practices, including enhanced operating covenants for the Borrower and payment of annual monitoring fees to recover City staff costs;
3. A payment of \$1,073,555 to pay down the interest on the existing City loan; and
4. An establishment of a Rent Burden Reserve to provide bi-annual subsidies to lower monthly rents for qualifying tenants who are paying more than 50% of their income in rent.

CONCLUSION

Staff supports these actions of consenting to refinancing of the existing senior loan and allowing the Owner to receive one half of the cash out from the refinancing proceeds of the Craig Gardens Senior Apartments affordable housing development. These actions will result in the preservation of 89 affordable apartments by making repairs and upgrades on the Property, strengthening FCH's financial liquidity in order to meet requirements of lenders and investors for sixteen forthcoming affordable developments in San José, pay down the interest on the existing City loan and extend the term of the City Affordability Restriction by 17 years. This refinance would also enable the City and FCH to establish a Rent Burden Reserve, through which up to 50 low-income seniors could see a reduction of \$150-\$560 in their monthly rent payments.

EVALUATION AND FOLLOW-UP

The Housing Department produces a quarterly Information Memorandum regarding the use of the Director of Housing's Delegation of Authority under the Municipal Code. Final amended City loan and business terms would be summarized in those Memos.

CLIMATE SMART SAN JOSE

The recommendation in this memo has no effect on Climate Smart San José energy, water, or mobility goals.

POLICY ALTERNATIVES

In developing the recommendations set forth in this memorandum, the following alternative was considered:

Alternative #1: Deny the Borrower's request to refinance the Craig Gardens property

Pros: Allowing an owner to take cash out of refinancing proceeds before repaying its City loan in full does not maximize the City's loan repayments.

Cons: Maximizing the City's loan repayments is only one of the City's objectives. Not permitting the Borrower to take cash out of the refinancing would jeopardize FCH's ability to successfully close financing on 1696 new affordable apartments in 16 developments within the City of San José, 444 of which will serve the homeless and formerly homeless veterans— one of the City's highest priorities at this time. Failure to allow the refinancing would preclude the ability to increase Craig Gardens' reserves for the physical maintenance of the Property and setting aside reserves to

fund debt service payments in the event of revenue losses, a rent burden reserve to assist with lowering rents for rent burdened seniors and would preclude the owner from taking advantage of current low interest rates. Further, preventing the Borrower's cash distribution would leave more equity in the property, which would have no immediate benefit to the City.

Reason for not recommending:

It is warranted to permit the refinancing of the Craig Gardens property with a cash out distribution to the Borrower/Sponsor because it would resolve several issues without additional risk to the City. Denial of this request would leave issues of property repairs, allow the rent burden situation to continue without a viable method to address the situation and the Borrower's financial strength unresolved without any other readily available solutions.

PUBLIC OUTREACH

This Memorandum will be posted on the City Council Agenda website for the November 10, 2020 meeting.

COORDINATION

Preparation of this report was coordinated with the City Attorney's Office and the City Manager's Budget 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

These actions allow FCH to move forward with development of 1,696 new apartments for homeless and formerly-homeless, including veterans—one of the City's highest priorities. Further, these actions are consistent with the City's *Envision 2040 General Plan, the 2014-23 Adopted Housing Element* and with the City's *2015-20 HUD Consolidated Plan* in that they will help to preserve existing affordable housing opportunities for very low- and extremely low-income households through lengthened and strengthened affordability restrictions.

COST SUMMARY/IMPLICATIONS

Approval of the recommended actions would allow the City to receive a pay down of interest on its loan on the property in the approximate amount of \$1,073,555 and establish a Rent Burden Reserve which will be held by the City of San José with bi-annual disbursements subject to City approval of rent burden reports. No additional City funds are being disbursed for this transaction.

The anticipated revenue will be deposited in the Low and Moderate Income Housing Asset Fund (Fund 346) and will be used to fund affordable housing developments.

CEQA

Categorically Exempt, File No. ER20-211, CEQA Guidelines Section 15301, Existing Facilities.

/s/
JACKY MORALES-FERRAND
Director, Housing Department

For questions, please contact Rachel Vander Veen, Housing Deputy Director at (408) 535-8231.

Attachment – Property Location Map

Attachment

Property Location

