



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: May 31, 2018

Approved

D. D. S. L.

Date

6/1/18

COUNCIL DISTRICT: 3

SUBJECT: APPROVAL OF AN INCREASE TO THE EXISTING AMOUNT OF HOME FUNDING FOR THE CONSTRUCTION-PERMANENT LOAN COMMITMENT FOR THE SECOND STREET STUDIO APARTMENTS PROJECT

RECOMMENDATION

Adopt a resolution approving an increase to the existing City Council-approved construction-permanent loan commitment to First Community Housing for the Second Street Studios project by \$1,500,000 in HOME Investment Partnership Funds from \$16,915,713 to a maximum of \$18,415,713.

OUTCOME

Approval of the recommended actions will enable the developer, First Community Housing (FCH), to complete the Second Street Studio's project which will provide 135 affordable apartments to house a vulnerable homeless population. A \$1,500,000 increase in the loan amount will allow FCH to pay remaining soft cost items related to the project and successfully bring the project to a timely completion. The Housing Department proposes that these additional funds be allocated from the HOME Investment Partnership Fund. This will increase the amount of required HOME units in the project from 58 units to 68 units.

BACKGROUND

Second Street Studios, an affordable multifamily rental development located at 1140 South Second Street, is currently under construction. When completed, it will be a permanent supportive housing development with case management provided by Abode Services. This 135-unit affordable apartment building will occupy four floors above 8,815 square feet of

community-serving commercial space. Of the 135 apartments, there will be 128 studio apartments, six one-bedroom apartments, and one two-bedroom manager's apartment.

FCH, a nonprofit affordable housing developer based in San José since 1986, has been working on this project since 2006. In August 2008, the City Council approved the Planned Development Zoning (PDC07-086) for the development. In September 2008, FCH formally applied to the City's Housing Department for a funding award. However, difficulties in the financial markets at that time froze funding awards by the State of California, delaying many affordable projects already in process. This project was further delayed in obtaining a City funding commitment due to the State's dissolution of redevelopment in 2012. Eventually, the market recovered and the City accumulated sufficient revenue to fund new developments.

On June 17, 2014, the City Council approved a construction/permanent loan of up to \$8,000,000, which included a predevelopment loan of \$500,000, to FCH or its legal affiliate for the development of the Second Street Studios apartments. On September 15, 2015, the City Council approved a \$6,452,000 increase to the construction/permanent loan for a total of up to \$14,452,000. Council also approved the early disbursement of \$5,000,000 to refinance an existing acquisition loan. The construction/permanent loan for Second Street Studios closed in December of 2016, and the project began construction in January of 2017. The project is currently on track to complete construction by October of 2018 and FCH has initiated the lease up process to obtain tenants for the apartments.

The Second Street Studios project was originally designed to be a mixed-use affordable housing development. The original design had a range of unit sizes including 24 studios set-aside for tenants with chronic illnesses. However, at the request of the Housing Department, FCH agreed to redesign the project to include mostly studio apartments, with the entire property dedicated to 100% permanent supportive housing. At the time of the redesign, FCH determined that the project would benefit from modular construction rather than the original stick built design. Modular construction was determined to be a faster and more cost-efficient way to accommodate the proposed design changes.

ANALYSIS

Tax credit equity is a primary source of funding for affordable housing developments. The presidential election of November 2016 caused uncertainty within the tax credit investor market, due to an anticipated change to the U.S. tax code. The anticipated lowering of the corporate tax rate lowered the price that investors were willing to pay for tax credits equity. When the Second Street Studios project was ready to finalize its financing in December of 2016, the project was subjected to a last minute change in the equity pricing. This created a \$4,024,627 shortfall. The project's planned financing and development budget was restructured to accommodate the equity shortfall. The Housing Department, under the Director's delegation of authority, addressed a portion of that shortfall at closing with a \$2.5 million increase in time for closing. However,

there was still approximately \$1,500,000 that remained unfunded. It was determined at closing that the additional shortfall might be addressed through project cost savings.

As previously mentioned, the project was originally designed to be a mixed-use affordable housing development. At the request of the Housing Department FCH agreed to redesign the project to include mostly studio apartments, with the entire property dedicated to 100% permanent supportive housing. The design and use changes increased many soft cost line items including architecture, engineering, and planning.

The Housing Department has verified that the cost savings are insufficient to close the remaining budget gap that have occurred due to the unanticipated drop in tax credit equity pricing, and the additional redesign costs. The developer has advanced approximately \$476,100 of the \$1,500,000 in unfunded costs, and have \$1,023,000 in remaining expenses. The unfunded costs are critical budget items that will need to be funded to bring the project to a timely and successful completion. A description of the unfunded expenses is provided in Attachment A.

The addition of \$1,500,000 to the development increases the City's total construction-permanent from \$16,915,713 to \$18,415,713. This equates to a per unit cost of \$136,413 for each of the 135 apartments. Given that this is a permanent supportive housing (PSH) project, this is well within the norm of existing and anticipated costs for this type of development. Developments with 100% of the units dedicated to homeless households could be anticipated to require a City subsidy of between \$140,000 and \$200,000 per unit.

The Housing Department is recommending that the City's HOME Investment Partnership funds be used as the source for the additional \$1,500,000 to the project. The use of HOME is recommended as the funding source because the Department has a balance of HOME funds that must be used for affordable housing purposes. HOME funds must be spent within a year of being committing to a project, which can limit the number of projects that it can fund. In the case of the Second Street Studios project, the construction should be completed within a year. Therefore, this project is suitable for the use of HOME funds. This action will increase the existing contribution of HOME funds from \$8,000,000 to \$9,500,000. A timeline for the development is provided as Attachment B.

EVALUATION AND FOLLOW-UP

The Department posts quarterly reports on the status of its subsidized construction projects to its website, www.sjhousing.org. Second Street Studios apartment development is included in these reports.

POLICY ALTERNATIVES

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

Alternative #1: Deny the requested funding commitments.

- Pros:** The additional HOME funds requested could be used for other affordable housing developments within the City of San José.
- Cons:** The proposed funding increase will facilitate reimbursement of project costs ensuring completion of a 100% 135-apartment supportive housing development that will assist in providing permanent housing for homeless individuals and couples. The City is already committed to the development.
- Reason for not recommending:** The proposed development will help address the urgent demand for homeless housing. Failure to reimburse funding for actual project costs could jeopardize project completion and put the City's existing investment at risk.

PUBLIC OUTREACH

Community meetings were held on February 20, 2008, September 16, 2008, and on February 11, 2015. The 2008 meetings were held in the process of FCH's applications for the development's original Planned Development Zoning and Planned Development Permits. The purpose of the meetings was to present information and to hear neighbors' comments. The original land use entitlements were approved at public meetings in late 2008. The community meeting held at the Spartan Keyes Community Center on February 11, 2015, was to present the planned development again since it had been several years since the last presentation to the neighbors. There were approximately 20 neighborhood residents in attendance, and the plan was well-received. The residents supported a mix of uses with retail on the ground floor.

This memorandum will be posted on the City's website for the June 12, 2018 City Council Agenda. FCH will hold a public meeting on September 9, 2018, to discuss its 100% supportive housing project with the neighborhood.

COORDINATION

This report has been coordinated with the Office of the City Attorney and the City Manager's Budget Office.

COMMISSION RECOMMENDATION/INPUT

This item was not heard by the Housing and Community Development Commission, as business terms of multifamily affordable housing loans do not fall under the functions, powers, and duties of the Commission, as delineated in Section 2.08.2840 of the San José Municipal Code.

FISCAL/POLICY ALIGNMENT

This expenditure is consistent with: the City's *Envision 2040 General Plan*, *The 2014-23 Adopted Housing Element* in that it will help the City meet its Regional Housing Needs Allocation; the City's current *Housing Investment Plan* in that it increases the supply of affordable housing; the City's *2015-20 HUD Consolidated Plan* in that it will provide apartments that will be affordable for 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 homeless residents.

COST SUMMARY/IMPLICATIONS

1. **COST OF DEVELOPMENT:**

<u>DEVELOPMENT USES</u>	<u>AMOUNT</u>
Site Acquisition	\$5,232,903
Hard (Construction) Costs	\$41,657,854
Soft (Financing & Other) Costs & Reserves*	\$12,151,079
TOTAL	\$59,041,836

*Note: Includes all predevelopment costs

2. **COST ELEMENTS OF CITY LOAN AMOUNT:**

<u>USES</u>	<u>AMOUNT</u>
Refinance of Land Acquisition Loan	\$5,232,903
Hard/Soft Costs & Reserves	13,182,810
TOTAL	\$18,415,713

3. **SOURCE OF FUNDING:** Low and Moderate Income Housing Asset Fund (346) \$8,915,713 and HOME Investment Partnership Fund \$9,500,000 (445).

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

BUDGET REFERENCE

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

Fund #	Appn #	Appn Name	Current Total Appn	Amt for Contract	2017-2018 Adopted Operating Budget Page	Last Budget Action (Date, Ord. No.)
445	0070	Housing Loans and Grants	\$3,807,000	\$1,500,000	1001	5/1/2018 Ord. No. 30097

CEQA

Mitigated Negative Declaration, File No. PDC07-086, adopted 8/26/2008.

/s/
JACKY MORALES-FERRAND
Director of Housing

For questions, please contact Jacky Morales-Ferrand, Director of Housing, at (408) 535-3855.

Attachments: Attachment A - Additional Funding Budget
Attachment B - Development Timeline

ATTACHMENT A
Additional Funding Budget

MASTER BUDGET		INCREASED COST	
	ORIGINAL BUDGET		PROPOSED BUDGET
ARCHITECTURE DESIGN & SUPERVISION	\$2,200,000	\$279,700	\$2,479,700
ENG, SOILS SURVEY, TESTING	\$161,000	\$67,500	\$228,500
RELOCATION	\$200,000	\$150,000	\$350,000
TAXES DURING CONSTRUCTION	\$90,000	\$60,000	\$150,000
LOCAL DEVELOPMENT & IMPACT FEES	\$633,842	\$60,000	\$693,842
BUILDING PERMITS & FEES	\$875,387	\$150,000	\$1,025,387
TESTING & INSPECTIONS	\$35,000	\$65,000	\$100,000
GREEN BUILDING CONSULTANTS	\$100,000	\$35,000	\$135,000
FURNISHING	\$69,941	\$387,800	\$457,741
LEGAL	\$90,000	\$30,000	\$120,000
ACCOUNT & COST CERT	\$15,571	\$15,000	\$30,571
MISC SOFT COSTS	\$0	\$100,000	\$100,000
SOFT COST CONTINGENCY	\$95,302	\$100,000	\$195,302
TOTAL SOFT COSTS	\$10,935,336	\$1,500,000	\$12,151,079
TOTAL PROJECT COSTS	\$57,541,998	\$1,500,000	\$59,041,836

ATTACHMENT B
Development Timeline

City Council approval of Construction/Permanent Funding	August 2015
Additional Funding--DOA (\$2.5MM)	December 2016
Construction Loan Closing	December 2016
Estimated Date of Construction Completion	October 2018
Estimated Date of Property Lease Up	December 2018
Estimated Conversion to Permanent Financing	March 2019