



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: September 11, 2019

Approved

Date

9/12/19

COUNCIL DISTRICT: 3

**SUBJECT: APPROVAL OF AN INCREASE IN THE INCOME AND RENT LIMITS
IN THE EVENT OF A FORECLOSURE AND ADDITIONAL
AMENDMENTS FOR SECOND STREET STUDIOS**

RECOMMENDATION

Adopt a resolution:

- (a) Authorizing an increase to rents and income up to 60% AMI (low income) for new tenants in the event of foreclosure or expiration of subsidy contracts for the Second Street Studios development, provided the City has determined the increase is needed for feasibility of the development and allowed by other funds and authorizing the Director of Housing to negotiate and execute loan documents, amendments, and all other documents related to these changes; and
- (b) Authorizing the Director to negotiate and execute amendments to the HOME restriction and HOME Agreement, as needed, to ensure compliance with Housing and Urban Development (HUD) HOME Investment Partnerships Program regulations and guidance.

OUTCOME

Approval of the recommended actions will enable the Developer, First Community Housing (FCH), to convert their construction loan to a permanent loan with a new permanent loan lender, allowing for the continued development and operation of the Second Street Studios Development.

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BACKGROUND

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 Second Street apartments. In September 2008, FCH applied formally 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 also waited for a City funding commitment during the State's dissolution of redevelopment. Eventually, the market recovered and the City accumulated sufficient revenue to fund new developments.

Second Street Studios is a permanent supportive housing development located at 1140 South Second Street that recently completed construction and is fully occupied. This 135-unit affordable apartment building occupies four floors above 8,815 square feet of community-serving commercial space. Of the 135 apartments, there are 128 studio apartments, six one-bedroom apartments, and one two-bedroom manager's apartment. Abode Services provides individualized case management to the formally homeless residents.

On June 17, 2014, the City Council approved a City construction/permanent loan (Loan) of up to \$8,000,000, which amount included a predevelopment loan of \$500,000, to FCH or its legal affiliate for 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. It 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.

Soon after construction closing, the project began to incur unanticipated expenses. The costs were related to the redesign of the site. This resulted in additional planning, architectural and engineering costs. These additional expenses caused the developer to reallocate the existing budget to meet the demands of the additional costs. As a result of the shortfall in budget, on June 12, 2018, City Council approved an additional \$1,500,000 in HOME funds for the development.

ANALYSIS

Changes to Affordability Limits

Second Street Studios is due to convert their current construction financing into the permanent loan phase of the project in October of 2019. The development's current permanent lender, California Community Reinvestment Corporation (CCRC), will be exiting as the permanent lender. Boston Private has agreed to step in and be the permanent lender. As the new lender, Boston Private is requesting the City to amend the language of the current recorded Affordability Restriction that will allow the AMI levels for non-HOME units to increase to 60% AMI, in the event of foreclosure or the loss of their subsidy contract with HUD, and the Housing Authority of Santa Clara County, the subsidy administrator. This change is referred to as "float up" provisions in the loan agreement.

Over the construction period, unanticipated additional costs totaling \$3,261,200 was needed to be financed for the permanent financing structure. Boston Private, is willing to fund these additional costs. Staff is supportive of Boston Private serving as the new permanent lender and their willingness to provide the additional funding necessary for the development., In exchange for stepping in to this role, negotiations have been made to allow rents to "float up" in the case of foreclosure or loss of subsidy.

New Permanent Lender

Boston Private Bank & Trust Company opened in May 1987 as a Massachusetts chartered trust company with one office located in Boston's financial district. In 1995, the Bank moved to its headquarters to another location in Boston, while opening 10 additional banking offices in the Greater Boston area, as well as expanding to the Los Angeles and the San Francisco Bay Area. Boston Private currently has a total of 22 banking offices nationally, which includes a local office located at 60 S. Market St, in downtown San Jose. Boston Private provides personalized and customized banking and investment services including, Commercial lending – including Community Development lending, or Low Income Housing Tax Credit and New Market Tax Credit financing, Deposit and cash management, Residential mortgage, Investment management and trust, and Other Community Investment programs.

Boston Private's experience in Community Development Financing in California

Since the inception of their Community Development tax credit lending in California in 2014, Boston Private has closed 16 transactions totaling \$144.8MM, which includes 11 construction-to-permanent transactions (Low Income Housing Tax Credit), one permanent transaction (Low Income Housing Tax Credit), two construction-to-permanent (New Market Tax Credit) and two loan participations.

California transactions and Partnerships include:

- **Developers:** East LA Community Corporation, Visionary Home Builders, The Pacific Companies, Valued Housing, Levy Associates, Concerned Citizens of South LA, Figueroa Economical Housing Development Corporation
- **Tax credit syndicators:** WNC, Inc. (Wilfred N. Cooper), Alliant Capital, R4 Capital, CREA, LLC.
- **New Market Tax Credit Investors:** JP Morgan Chase and Capital One
- **Participant Lenders:** Silicon Valley Bank and CIT Bank

Boston Private has a team dedicated to Low Income Housing Tax Credit financing with a that can provide local market knowledge and decision-making. Boston Private has demonstrated success working with affordable housing developers in both Massachusetts and California. Boston has an efficient underwriting and approval process, and holds two Loan Committee meetings each week in which development projects are presented for every credit/loan approval. Boston Private collaborates closely with borrowers, soft lenders, and equity investors throughout the life of each loan.

Additional Changes to Home Related Documents

In June of 2018, the City Council approved an increase in the amount of City Funding for the Second Street Studios development from \$16,915,713 to \$18,415,713, a difference of \$1,500,000. The source for the additional funding was the HOME Investment Partnerships Program funds, resulting in an increase in the amount of HOME units for the development. The Department has determined that updates need to be made to the HOME Affordability Restriction and possibly the HOME Agreement, in order to meet the applicable HUD requirements.

Due to these issues, the Housing Department is requesting that the Director of Housing be given the authority to negotiate, amend, and execute all documentation related to the HOME Investment Partnerships Program funding requirements.

EVALUATION AND FOLLOW-UP

The Director will execute an amended term sheet in connection with these approvals and the delegated approvals. 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 Loan and Grant business terms would be summarized in those Memos. In addition, the Housing Department posts a Quarterly Production report on the status of its affordable properties undergoing rehabilitation or construction to its website, www.sjhousing.org. If the recommended actions are approved and Second Street Studios apartments successfully closes on its permanent financing, an update would be included in the production report.

POLICY ALTERNATIVES

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

Alternative: *The City Council could deny the Housing Department's recommendation to modify the development's AMI levels*

Pros: 100% of the development's units are income-restricted to ELI and VLI households for the term of both the Affordability and HOME Restrictions.

Cons: The Development's permanent lender may decide to not move forward with permanent financing for the Second Street Studios development. The development would have a \$3,261,200 funding gap.

Reason for not recommending: The proposed action will help to meet the continuing demand for deep affordable housing that is affordable to the lowest income households.

PUBLIC OUTREACH

This memorandum will be posted on the City's website for the September 24, 2019 City Council Agenda.

COORDINATION

Preparation of this report was 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 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 action is consistent with the City's Consolidated Plan 2015-2020, adopted by City Council on May 5, 2015, to provide homes for very low- and extremely low-income households; and with Goal H-2 of the City's Housing Element 2014-2023, adopted by City Council on January 27, 2015, to "increase, preserve, and improve San Jose's affordable housing stock."

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CEQA

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

/s/

JACKY MORALES-FERRAND

Director of Housing

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