



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Jacky Morales-Ferrand

**SUBJECT:** SEE BELOW

**DATE:** May 5, 2020

Approved

Date

5/7/20

**COUNCIL DISTRICT: 1**

**SUBJECT: REFINANCING CONDITIONS FOR EL PASEO APARTMENTS**

## RECOMMENDATION

Adopt a resolution:

- (a) Consenting to the refinancing and subordination of the existing City loan and the City grant for the El Paseo Apartments, a 98- single room efficiency unit affordable apartment development (Project) located at 4980 Hamilton Avenue (Property) to a new Fannie Mae-backed senior loan in the amount of approximately \$6,500,000, including the withdrawal of no more than \$2,282,170 in refinancing proceeds by the Property's owner, El Paseo Apartments, L.P. (Owner), an affiliate of the San José-based nonprofit developer First Community Housing (Sponsor);
- (b) Allowing the Owner to receive half of the refinancing proceeds in the amount of \$1,141,355; and
- (c) Authorizing the Director of Housing to negotiate and execute amendments to the City's existing loan documents on the Project, in order to enable refinancing of the Project's senior loan and partial repayment of the City Loan in the amount of \$1,141,355.

## OUTCOME

Approval of this action will authorize the Owner of El Paseo Apartments to refinance the Property's existing senior loan, to pay down \$1,141,355 on the City's existing loan balance, and to use \$1,141,355 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 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—El Paseo Apartments—and allows First Community Housing to take \$2,282,170 in cash out of the transaction fifty-percent (50%) of which will be used to paydown the City’s loan on the property. With the remaining fifty-percent (50%), 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**

### Property

El Paseo (El Paseo or Project) is a 98 single-room-efficiency affordable apartment located at 4980 Hamilton Avenue. First Community Housing (FCH or Sponsor) is the developer and sponsor of El Paseo Apartments, L.P., a California limited partnership (Borrower or Owner). Built in 2004, El Paseo has 98 studio apartments. Overall, ten apartments are required to be affordable to households at 30% of the Area Median Income (AMI), 87 are affordable at 50% AMI and one unrestricted manager’s unit. Given these income restrictions and unit sizes, maximum resident incomes for each type of apartment range from approximately \$30,750 to \$51,250, with monthly rents ranging from \$769 to \$1,281.

The Project was originally financed with: equity derived from the sale of low-income housing tax credits (LIHTCs) of \$5.312 million; a City loan of \$4,019,475; a City conditional grant of \$999,200 for the 30% AMI units and a senior City-issued bond loan of \$9.6 million.

The City’s loan has a current balance of \$5.970 million and is paid by 70% of annual net cash flow after payment of expenses, bears 4% simple interest, and is due in full at maturity on April 1, 2044. Both the City’s loan and grant were funded with 20% redevelopment funds, and the City’s affordability restriction expires in November 2058.

### Refinancing Request

In February 2020, FCH has proposed to refinance El Paseo to take advantage of the current low interest rates to augment its financial strength. The proposal is to obtain a new senior loan of \$6.5 million, which would be used to pay off the existing senior loan balance of approximately \$3.745 million, to pay fees and closing costs, make minor repairs to the Property, increase replacement reserves as required by the new senior lender in the amount of \$472,290 and make a partial payment of \$1,141,355 to the City.

Also, FCH would use \$1,141,355 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 of \$6.5 million will bear an interest rate of approximately 3.24% with a maturity of 10 years, with required monthly payments of principal and interest in the amount of \$28,253 based on a 30-year amortization. The existing senior loan is held by Citibank, with monthly payments of \$35,000, at 6.25% interest rate and matures on April, 2034. The City would need to subordinate its existing deed of trust to the new senior loan, and would need to slightly delay the exercise of its remedies in the case of noncompliance under its affordability restrictions through the senior lender's enforcement of a standstill agreement.

## **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 are silent regarding 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 CHDO (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 subsidized 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 El Paseo for the foreseeable future.

### *Physical Assessment of the Property*

FCH will spend approximately \$100,000 in pillar repairs and replacements and energy upgrades. The Property is in good physical condition and has no deferred maintenance issues. The \$100,000 will be funded from the refinancing proceeds.

### *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 Jose. 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 \$1,141,355 is necessary to meet their liquidity requirements and to ensure adequate staffing.

The El Paseo 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 \$1,141,355 partial payment on the City loan towards building new apartments in San José. At maturity in 10 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 El Paseo Apartments project 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, Borrower has agreed to give the City the following:

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; and
3. A payment of \$1,141,355 to pay down the balance on the existing City loan.

### 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 El Paseo Apartments affordable housing development. These actions will result in the preservation of 97 affordable apartments by making critical repairs and energy upgrades on the Property, strengthen FCH's financial liquidity in order to meet requirements of lenders and investors for sixteen forthcoming affordable developments in San José, pay down the balance of the existing City loan and extend the term of the City Affordability Restriction by 17 years.

## **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 El Paseo property and to take a distribution of funds from that refinancing*

**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 El Paseo's reserves for the physical maintenance of the Property and setting aside reserves to fund debt service payments in the event of revenue losses, 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 El Paseo 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 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 May 19, 2020 meeting.

**COORDINATION**

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

**FISCAL/POLICY ALIGNMENT**

These actions allow FCH to move forward with development of 1696 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 its loan on the property in the approximate amount of \$1,141,355. 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**

Not a Project, File No. PP17-008, Agreements/Contracts (New or Amended) resulting in no physical changes to the environment.

/s/  
JACKY MORALES-FERRAND  
Director, Housing Department

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

Attachment

# ATTACHMENT

