



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Jacky Morales-Ferrand
Jim Shannon

SUBJECT: SEE BELOW

DATE: June 9, 2022

Approved

Date

6/10/2022

COUNCIL DISTRICT: 3

**SUBJECT: ACTIONS RELATED TO THE DEVELOPMENT OF THE KELSEY
AYER STATION; A NEW AFFORDABLE APARTMENT COMMUNITY
LOCATED AT 447 NORTH FIRST STREET**

RECOMMENDATION

(a) Adopt a resolution:

- (1) Authorizing the Director of Housing to negotiate and execute lease riders to the ground lease in favor of the California Tax Credit Allocation Committee (TCAC), the California Housing Finance Agency (CalHFA), and the California Department of Housing and Community Development (HCD) and to execute lender's consents to these lease riders; and
- (2) Authorizing a change in the City loan terms to allow an increase in The Kelsey Ayer Station (Development) rents and income restrictions that are below 60% of Area Median Income (AMI) up to 60% of AMI for all tenants in the event of foreclosure, to the extent the City has determined such increase is needed for the feasibility of the Development and allowed by other funds.
- (3) Approving a loan increase of \$1,500,000 to the original \$12,825,000 for a total loan commitment of \$14,325,000.

(b) Adopt the following Fiscal Year 2022-2023 Appropriation Ordinance amendments in the Affordable Housing Impact Fee Fund:

- (1) Decrease the Housing Project Reserve appropriation by \$8,500,000; and
- (2) Establish a Housing Loans and Grants appropriation to the Housing Department in the amount of \$8,500,000.

OUTCOME

Approval of the recommended actions will enable The Kelsey Ayer Station, LP (Developer), to close the construction financing to build a new affordable development on property to be acquired by the City of San José (City) located at 447 North First Street, San José (Property), facilitate a change in City loan sources, and provide authority for future required lease riders.

BACKGROUND

On August 31, 2018, following the City Council's direction, the Housing Department issued a \$100,000,000 Notice of Funding Availability (NOFA) for the development of affordable housing for extremely-low-, very-low-, and low-income individuals and families. The NOFA prioritized projects that provided housing for homeless households that were cost effective and that leveraged additional non-City sources of financing.

In response to the NOFA, the Developer submitted a project proposal with a request for a commitment of funding in the amount of up to \$11,125,000 to provide 113 affordable units. Thirty-four of those units will be reserved for intellectually and developmentally disabled individuals; twenty-two of the units will be subsidized by a U.S. Department of Housing and Urban Development 811 Project Rental Assistance Demonstration program contract. All 34 units will be affordable (i.e., rent and income restricted) at up to 20% of the AMI and will include supportive living services. Further, there will be 31 units affordable to households at up to 50% of AMI, 22 units affordable to households at up to 60% AMI, and 26 units affordable to households at up to 80% AMI. Finally, there will be one studio manager's unit and one two-bedroom manager's unit, for a total of 115 units. The Development will also provide onsite service coordination.

The NOFA guidelines stated that the City would allocate funding at \$125,000 per unit, and the Development was originally awarded \$11,125,000. Prior to the initial City Council financing loan commitment, the project was delayed due to difficulties securing all additional non-City funding and a need to accommodate lower rents for the tenants. Therefore, the Developer requested an additional \$1,700,000 from the City to cover this gap, resulting in an initial City commitment of up to \$10,825,000 in Low- and Moderate-Income Housing Asset Funds and up to \$2,000,000 in Inclusionary Fee Funds for a total commitment of up to \$12,825,000 in construction and permanent financing. Additionally, consistent with the Ground Lease Policy in the City of San José's Housing Department Underwriting Guidelines, the City provided additional funding of up to \$3,100,000 from the Inclusionary Fee Fund to acquire the land prior to the close of construction funding and was authorized to acquire the Property, negotiate, and execute a ground lease or option to the Developer for a total term not to exceed 99 years.

On May 4, 2021, City Council approved a total commitment of up to \$15,925,000 with \$10,825,000 in Low- and Moderate-Income Housing Asset Funds and \$5,100,000 in Inclusionary Fee funds for a construction-permanent loan to the Developer, or an affiliated entity for the Development. Lastly, the Director of Housing was authorized to acquire the Property not to exceed the acquisition loan balance at the time of transfer; negotiate and execute loan documents, the documents related to acquisition, and ground leasing of the Property and all other documents, including amendments thereto, related to the City financing of the Development.

ANALYSIS

The Development will provide 113 fully inclusive mixed-ability, mixed-income housing including units intended for individuals with intellectual/development disabilities as well as individuals with a range of incomes in the Japantown/Ayer Station area of downtown San José. This memorandum summarizes the final structure of the financing including any changes that have been made since the Development's funding was last approved by the City Council.

Property Purchase

The City funding commitment of up to \$15,925,000 in construction/permanent and acquisition loans already includes the cost of land. Therefore, the cost for purchasing the Property does not require an additional commitment of City funds. Due to timing constraints, the purchase of the Property will be implemented through a purchase and sale agreement rather than through an acquisition loan and City exercise of option to purchase.

The Property purchase price will be disbursed prior to the closing of the loans for the acquisition and conveyance of the land to the City. The purchase price will be up to \$3,100,000, which reflects the original price paid by the Developer plus selected land carrying costs. The price is subject to an appraisal and is not to exceed the cost of land and other acquisition costs approved by the City Council. The purchase price will be subtracted from the City's total construction/permanent loan amount of \$15,925,000, leaving approximately \$12,825,000 to support construction costs. The construction/permanent proceeds will include an advance that will be disbursed prior to the closing of the loans for acquisition and conveyance of the land to the City.

Section 811 Rental Assistance Contract

The U.S. Department of Housing and Urban Development's Section 811 Supportive Housing for Persons with Disabilities program provides funds to state agencies for project rental assistance. Funding sources for the Development include a rental subsidy provided through CalHFA for 22 of the units restricted to 20% of AMI pursuant to the U.S. Department of Housing and Urban

Development 811 Project Rental Assistance Demonstration program contract. Consistent with the approach authorized for project-based Section 8 vouchers, under 25 CCR 6922 (d), only the tenant contribution paid under the contract will be considered as rent for the purposes of compliance with the affordability restriction.

Ground Lease

The City and Developer will enter into a Ground Lease for a term of 70 years, plus an option for a 15-year extension. This is a slight change to the lease terms discussed in the earlier memorandum, which provided for a longer option period if required by CalHFA. It is confirmed that CalHFA and HCD have no requirement for an extension beyond the 70-year term, but a 15-year extension option has been negotiated with the Developer, consistent with the prior City Council authorization for up to 99 years. At the end of the lease 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 San José Municipal Code.

Float Up Language

Approval of the recommended action will also allow the City documents for the Development to provide for an increase to rents and income restrictions up to, and no more than, 60% of AMI in the event of foreclosure to the extent the City has determined an increase is needed to ensure the Development's continued financial feasibility.

Lease Riders

Certain state agencies have additional requirements associated with their funding that apply when the City owns the land and ground leases it for the Development. TCAC requires the City as the owner of the land to record a lease rider after conversion to permanent financing and prior to TCAC's final approval of the Development's tax credits. The TCAC rider requires the City to provide warranties regarding, amongst other things, the current status of the City's title, and the current compliance of the Developer's physical improvements to the Property with local law, state law, federal law, and agreements with public entities. CalHFA and HCD will each require the recording of a rider with similar terms to the TCAC rider as part of the conversion to permanent financing. The Developer will be required to provide an updated title report and to execute an estoppel agreement prior to the execution of any of these riders to provide the City with sufficient basis for executing the riders.

Loan Increase

The Development originally applied for tax credits in mid-2021 but did not receive an allocation until late 2021. During that period the project experienced a 16% increase in construction costs, specifically raw material costs, taking away much of the cushion from the project's proforma for other unexpected increases. Since March 2022, interest rates have increased by 75 basis points, which reduced the permanent loan resulting in a financing gap. The \$1,500,000 will be used to fill the gap from the reduced permanent mortgage. Total City loan commitment in construction/permanent financing will be up to \$14,325,000 at a cost of approximately \$126,769 per unit.

Funding Source Change

The original funding sources identified for this development were \$10,825,000 in Low- and Moderate-Income Housing Asset Funds and \$5,100,000 in Inclusionary Fee funds. Subsequently, the spending plan for the Affordable Housing Impact Fee funds was updated to include \$8,500,000 in funding for the Development, as these resources have a spending deadline within five years of receipt; the Inclusionary Fee Funds have no timing restriction. The revised funding structure will include up to \$8,925,000 in Low- and Moderate-Income Housing funds and up to \$8,500,000 in Affordable Housing Impact Fee funds. The recommended appropriation action is intended to implement both the change in sources and the loan increase.

CONCLUSION

Adopting a resolution to approve these technical changes will allow the project to proceed in the final negotiations with other lender's requirements and close the transaction in June of 2022.

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 San José Municipal Code; therefore, final loan business terms would be summarized in those memoranda. 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 Development successfully closes construction financing, the Development would be included in these periodic reports.

CLIMATE SMART SAN JOSE

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

POLICY ALTERNATIVES

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

Alternative #1: The City Council could reject the Development proposal.

Pros: Additional development proposals with alternative development schemes could be evaluated.

Cons: The City will lose an opportunity to provide this affordable, inclusive, transit-oriented housing

Reason for not recommending: The proposed Development is a viable opportunity to meet the demand for deeply affordable housing for vulnerable individuals in an inclusive setting. The Development will help the City fulfill its affordable housing goals and will provide additional employment opportunities for 15 or more property management, supportive services, and case management positions.

PUBLIC OUTREACH

Prior to obtaining Senate Bill 35 approvals of the Development's entitlements in February 2020, the Development implemented a comprehensive outreach plan to engage with the community to provide information, answer questions, and better understand the concerns and character of the neighborhood, residents, and businesses. From January to July 2019, the Developer hosted a total of four neighborhood or community meetings attended by various advocacy groups and community members, addressing a wide array of topics regarding the Development. Many of the community's comments and suggestions were incorporated into the development.

This memorandum will be posted on the City Council Agenda website for the June 21, 2022 City Council meeting.

COORDINATION

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

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.

COST SUMMARY/IMPLICATIONS

1. Estimated Costs:

Uses	Amount
Acquisition Loan	\$ 3,100,000
Total Acquisition Loan Amount	\$ 3,100,000
Construction Loan	\$13,847,250
Interest	\$ 477,750
Total “Up To” Permanent Loan Amount	\$14,325,000
Total Funding Package	\$17,425,000

2. SOURCE OF FUNDING: Low- and Moderate-Income Housing Asset Fund (\$8.9 million) and the Affordable Housing Impact Fee Fund (\$8.5 million).
3. FISCAL IMPACT: Funding has been reserved in the amount of \$8,925,000 in the Low- and Moderate-Income Housing Asset Fund and \$8,500,000 in the Affordable Housing Impact Fee Fund. Budget actions are recommended in this memorandum to reallocate funding of \$8.5 million from the Housing Project Reserve to the Housing Loans and Grants appropriation within the Affordable Housing Impact Fee Fund. There is no ongoing fiscal impact to the General Fund as a result of this action.
4. The Property purchase price will be up to \$3,100,000, which reflects the original price paid by the Development plus selected land carrying costs. The price is subject to an appraisal and not to exceed the cost of land and other acquisition costs approved by the City Council. The purchase price will be subtracted from the City’s total construction/permanent loan amount of \$17,425,000, leaving approximately \$14,325,000 to support construction costs. The construction/permanent proceeds will include an advance that will be disbursed prior to the closing of the loans for the acquisition and conveyance of the land to the City.

BUDGET REFERENCE

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

Fund #	Appn #	Appn Name	Proposed 2020-2023 Total Appn	Rec. Budget Action	Amt for Contract	2022-2023 Proposed Operating Budget Page*	Last Budget Action (Date, Ord. No.)
346	0070	Housing Loans and Grants	\$20,688,057	\$0	\$8,925,000	896	N/A
452	8437	Housing Project Reserve	\$15,000,000	(\$8,500,000)	\$0	833	N/A
452	0070	Housing Loans and Grants	\$0	\$8,500,000	\$8,500,000	833	N/A

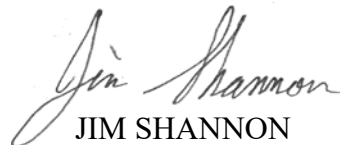
*The 2022-2023 Proposed Operating Budget is scheduled for approval on June 14, 2022 and adoption on June 21, 2022 by the City Council.

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; Not a Project, File No. PP17-003, Agreements/Contracts (New or Amended) resulting in no physical changes to the environment.

/s/

JACKY MORALES-FERRAND
Director, Housing Department



JIM SHANNON
Budget Director

The primary author of this memorandum is Isaac Orona, Development Officer. For questions, please contact Rachel VanderVeen, Deputy Director at (408) 535-8231.