



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: August 16, 2018

Approved

D. D. S. L.

Date

8/16/18

SUBJECT: APPROVAL OF THE MULTIFAMILY UNDERWRITING GUIDELINES

RECOMMENDATION

- (a) Accept the staff report on the proposed underwriting guidelines and update regarding the upcoming Notice of Funding of Availability; and
- (b) Adopt a resolution approving the Underwriting Guidelines proposed by the Housing Department for use in underwriting and structuring affordable housing transactions.

OUTCOME

Approval of the proposed Underwriting Guidelines will establish clear requirements to address risk and project feasibility related to underwriting affordable housing development. Clear requirements will generate a higher level of predictability, enhanced customer service and efficient lending practices for those dedicated to building affordable housing in the City of San José. It will also establish principles for Notices of Funding Availability (NOFA) which implements the Affordable Housing Investment Plan for the production and preservation of new and existing affordable housing opportunities.

BACKGROUND

The Housing Department will use the Underwriting Guidelines to communicate with developers, borrowers, and other lending institutions regarding the expectations of the City with respect to key project financing, development and operating parameters that constrain affordable housing development. The Underwriting Guidelines will also be used by the department to evaluate projects that are submitted to the City in response to Notices of Funding Availability, when issued. They are key for establishing the appropriate allocation of risks, rewards and benefits in affordable housing development among the several stakeholders involved in financing affordable housing.

The City's Underwriting Guidelines were last updated in October 2006. There have been major changes in the affordable housing development industry since that time including changes in financial markets, tax law, the lending and investment industry, the construction industry and in the San José housing market itself. The Housing Department has sought to address the impact of such changes in the proposed Underwriting Guidelines, ensuring that projects serve the City's interests as well as considering the interests of other project stakeholders. The Housing Department has also found that ambiguities in the earlier Underwriting Guidelines have led to more time spent negotiating transactions with developers. It is the goal of the Housing Department to provide greater clarity and consistency in the negotiation of transactions. The Underwriting Guidelines will help to accomplish this goal and potentially reduce the necessary to underwrite an affordable housing development.

The Mayor and the City Council adopted a goal of building 10,000 affordable units over the next five years. On June 12, 2018, the City Council approved a five-year Affordable Housing Investment Plan that summarizes the Housing Department's strategy to meet the housing goal given existing funding. The City Council also approved funding priorities for the upcoming NOFA that includes the following:

- Projects ready for immediate construction (project readiness);
- The provision of supportive housing for homeless individuals and families;
- Project cost effectiveness (keeping project costs as low as possible); and
- The leverage of Affordable Housing and Sustainable Communities funding.

While additional resources are sought to meet this goal, the proposed Underwriting Guidelines will seek to make the most effective use of existing funds. They will also ensure that the City's project underwriting aligns with the affordable housing industry.

The Department held several outreach meetings with developers to elicit feedback on underwriting policy proposals as well as to discuss how the City could work with developers more effectively. The feedback from these meetings was used to refine the Underwriting Guidelines consistent with City goals.

ANALYSIS

The Director of Housing has the authority under the municipal code to adopt Underwriting Guidelines, but in the interest of communication with the Council and public this important step in implementing the Affordable Housing Investment Plan, staff is presenting the Underwriting Guidelines to City Council.

The Housing Department, while currently constrained by limited funding sources, wants to fund affordable projects as quickly and efficiently as possible as funds are made available.

Establishing Underwriting Guidelines facilitates the funding of affordable housing in the following two ways:

- **Clarity for Developers** – The development community can structure projects to meet the expectations of the City at early stages in the development process.
- **Expedited Closing Process** – As projects are structured in similar terms to meet the City's expectations, the documentation and closing process may be expedited.

Components of the Underwriting Guidelines

The proposed Underwriting Guidelines are focused on clarifying a number of policy and underwriting areas. Some the key points in the proposed Underwriting Guidelines (**Attachment**) are summarized below:

1. **Loan Terms (page 8)**: The Underwriting Guidelines establish a maximum City gap loan amount of \$125,000 per unit. This amount is higher than the average of our existing portfolio. This latter amount has, however, increased over time. In our current cost environment with higher land and construction costs, very few developers are expected to completely finance their projects with only a City gap loan. It is expected that developers will combine the City's \$125,000 with funds from another source (e.g., Santa Clara County's Measure A funds) and tax credits to meet the full capital requirements of a project. Alternatively, this cap will serve as incentive for greater cost efficiency for projects that only qualify for City funds.
2. **Tax Credit Allocation Committee (page 7)**: A major component of nearly all affordable housing transactions is the use of Low Income Housing Tax Credits awarded by the California Tax Credit Allocation Committee ("TCAC"). Projects using the credits must therefore must comply with TCAC regulations. An overwhelming request of the development community was that the City as much as possible mirror its underwriting standards with those of TCAC. The Department has done this to allow greater consistency in project underwriting and structuring.
3. **Ground Lease Policies (page 19)**: The Department has proposed policies directed towards ensuring that newly constructed affordable housing projects are built on land owned by the City and leased back to the project developers. This ensures that if an affordability restriction ever expires on a City affordable housing project, the land will continue to be dedicated to affordable housing. This will be effected primarily through a purchase and lease back option granted to the City and agreed to at the time the City provides a commitment of financing to a project. In some cases, the County of Santa Clara will also seek ground leases on projects within the City of San José

4. Project Development Costs (page 10): The Department is proposing to place reasonable limits on development costs where possible. While it is difficult for the City to control general market construction costs or land costs, the City has always placed limits on contractor profits and overhead and developer fees. The Department is proposing new developer fee limits that are mostly in line with those of TCAC, although somewhat more restrictive (e.g., for projects over 100 units). The Department, in an effort to incent the generation of cost savings, is also proposing a policy of sharing 25% of project cost savings with contractors and developers for a two-year trial period. Other development costs will be subject to Department review and compared with the costs of other affordable housing developments.
5. Form of Subordination (page 23): Subordination agreements control which lender or lienholder is senior and which is junior ("lien priority"). Senior lenders can eliminate junior lender's interests through foreclosure. The City often agrees to be junior to a new project's commercial lender to ensure project feasibility. These Underwriting Guidelines now provide that such subordinations be limited to affecting a change in lien priority when the City agrees to subordinate its loan documents to a commercial lender. When it does so, it will do so on a standard City form, unless the lender wishes to negotiate its own standard form document with the City. This is a similar approach to that of the Los Angeles and San Francisco housing departments. It is needed now because over the years these agreements have become lengthy and onerous, with many undesirable terms including those that amend the City's loan documents which are drafted through protracted negotiations.
6. Affordability Restriction Subordination (page 23): The main purpose of the City's affordable housing lending program is to create "deed-restricted" housing with affordability restrictions. Thus, if these restrictions were foreclosed by a senior lender, it could have a significant impact on both the affordability and the residents of the project. Nonetheless, it has been common in the past for the City to subordinate the priority of its affordability restrictions to a first lender's deed of trust in both new construction and in refinancing transactions. Also, historically, the City has been in a position to work with the Senior lender to cure such a default before it could go to actual foreclosure. However, with the end of Redevelopment funding, the City's ability to cure is greatly reduced putting the affordability restrictions at greater risk. Due to these changed circumstances, the subordination of the City's affordability restrictions is not recommended under the Underwriting Guidelines. However, the Department understands there may circumstances where it is appropriate (e.g. long term affordability is not impaired by subordination) or necessary. In these cases, the Underwriting Guidelines are designed to minimize risk of losing the affordability restrictions while retaining the City's rights in a default or foreclosure situation.
7. Operating Expenses (page 20): The assumptions used to underwrite certain operating expenses can vary greatly from project to project. These can reduce the amount of project operating funds available to service senior debt payments (which increases the amount of gap financing needed from the City) and it reduces the amount of project cash flow available to repay the City's loans. The City has identified some key operating line items on which to

provide greater restraint and guidance. These include: property management fees, resident services coordination, replacement reserve funding, and operating reserve expenditures.

8. Developer Fees (page 16): The City is relying primarily on TCAC's limitations on fees payable to developers out of project capital sources. However, the Department is proposing to limit these further at the upper end of the TCAC limits. Further, The City is also proposing that developer fees that are deferred and paid out of project cash flow will only be payable out of a developer's share of residual receipts. They cannot be paid ahead of the City's share of net cash flow/residual receipts.
9. Permanent Supportive Housing (page 25): The City acknowledges that the management of Permanent Supportive Housing is distinct from the management of affordable housing due to the challenges facing many of the residents as they transition from being unsheltered to a new home. The Housing Department proposes a policy to work collaboratively with its project sponsors and government partners (e.g., Santa Clara County Office of Supportive Housing and Santa Clara County Housing Authority) to achieve the regional goal of making homelessness in San Jose a rare, brief, and non-recurring experience. The City Underwriting Guidelines include standards to assist in ensuring the quality of life for these residents and their neighbors. These include: 24/7 on-site management (including property management, front desk, security or other personnel) reduction in barriers to entry consistent with State of California Housing First requirements, enhance coordination among property management and supportive service providers and that staff are appropriately trained to properly manage Permanent Supportive Housing facilities. While the availability of supportive services will be made available to all formerly homeless residents, these services are optional to the residents.

The policy recommendations are intended to address the incremental shifts in the existing structures related to the affordable housing industry and to process improve the performance of existing policy practices for underwriting purposes. The Housing Department's objective is that the proposed policy modifications will translate to clearer guidance to the development community, produce more affordable housing opportunities and reduce the risk exposure to the City of San José.

Update Regarding the Notice of Funding Availability

The Housing Department will issue a NOFA after approval by the City Council of these proposed underwriting guidelines. Since the discussion with the City Council regarding the NOFA, staff has determined that a priority should also be given to proposed affordable housing developments on City-owned land. The City is subject to statutory requirements to develop these properties within specific timelines. Assigning priority to these projects will ensure that the development of these projects can proceed on schedule. Each of these properties will need to meet the minimum threshold requirements of the NOFA. Additionally, priority will be given to proposed projects that leverage outside funding sources (including Affordable Housing and Sustainable Communities), resulting in project cost savings.

EVALUATION AND FOLLOW-UP

City Council will be informed of project specific data and underwriting recommendations when the Housing Department pursues approval of funding commitments for the development of affordable housing and San José. Such project data and funding commitments will also be reported in the quarterly production report.

PUBLIC OUTREACH

The Housing Department met with a wide range of stakeholders while developing the proposed Underwriting Guidelines. Staff held a series of Developer Roundtables to present the Department's policy findings and recommendations, and to obtain feedback and endorsement from developers, property managers and local government agencies (e.g., Santa Clara County Office of Supportive Housing and Santa Clara County Housing Authority). Furthermore, the proposed Underwriting Guidelines will be posted on City of San José Housing Department's website.

This memorandum will be posted on the City's Council Agenda Website for the August 28, 2018, Council Meeting.

Public Outreach Meetings:

NAME	DATE	TIME	LOCATION
Developer Roundtable I	10/26/17	1:00 - 5:00	MLK Library
Developer Roundtable II	12/14/17	2:00 – 4:00	MLK Library
CSJ/County of Santa Clara/Housing Authority	2/9/18	2:00 – 3:00	City Hall

COORDINATION

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

COMMISSION RECOMMENDATION/INPUT

This item was not heard by the Housing and Community Development Commission, as reviewing the specific terms for underwriting affordable housing developments do not fall under the functions, powers, and duties of the Commission described in Section 2.08.2840 of the San José Municipal Code.

HONORABLE MAYOR AND CITY COUNCIL

August 16, 2018

Subject: Approval of the Multifamily Underwriting Guidelines

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COST SUMMARY/IMPLICATIONS

This memorandum does not commit the City to any specific expenditures.

CEQA

Not a Project, File No. PP17-009, Staff Reports, Assessments, Annual Reports, and Informational Memos that involve no approvals of any City action.

/s/

JACKY MORALES-FERRAND
Director, Department of Housing

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

Attachment - Multifamily Underwriting Guidelines

Housing Department - Project Development
Affordable Housing Gap Financing

SUMMARY OF MULTIFAMILY UNDERWRITING GUIDELINES

Program Description	The mission of the City of San José's (City's) Housing Department is to strengthen and revitalize our community through housing and neighborhood investment. As a part of this mission and the execution of its housing element plan, the City supports the new construction and rehabilitation of housing for extremely low-, very low-, and low-income individuals and families with various policies and programs. The primary program administered by the Housing Department is the provision of gap financing for affordable and permanent supportive housing projects. The underwriting for this program is guided by these general policies and guidelines, as well as specific guidelines that may be included in Notices of Funds Available (NOFAs) issued from time to time.	
General Loan Terms		
	Pre-development	<p>Amount: Max of \$1,000,000</p> <p>Term: 12 to 24 months, with two six-month extensions</p> <p>Rate: Up to 4% simple, accrued interest may be capitalized</p> <p>LTV: If property owned by sponsor or developer, up to 100% total LTV of the City loan plus all senior debt, based on the As-is value of the property</p> <p>Security: Deed of trust (DOT) required if property owned by sponsor or developer; repayment guarantee for all loan amounts over \$250,000 from project sponsor and assignment of plans & specifications</p> <p>Other: Option for City to purchase may be required (See Ground Lease Policy)</p>
	Acquisition	<p>Amount: Based on actual costs and LTV limitations</p> <p>Term: 12 to 36 months, with two six-month extensions</p> <p>Rate: Up to 4% simple; accrued interest may be capitalized</p> <p>LTV: Up to 100% total LTV of the City loan plus all senior debt, based on the As-is value of the property</p> <p>Security: DOT required; may require repayment guaranties from project Sponsor</p> <p>Other: Option for City to purchase may be required (See Ground Lease Policy)</p>
	Construction	<p>Amount: Up to \$125,000 per unit + prior and construction capitalized interest (See Loan Repayment Policy)</p> <p>Term: 12 to 36 months, with two six-month extensions</p> <p>Rate: Up to 4% simple; accrued interest may be capitalized</p> <p>Security: DOT required; completion guaranty from project sponsor</p> <p>Other: Option for City to purchase may be required (See Ground Lease Policy)</p>
	Permanent	<p>Amount: Up to \$125,000 per unit + prior capitalized interest (See Loan Repayment Policy)</p> <p>Term: 30-55 years</p> <p>Rate: AFR, compounded daily, using the actual number of days of the year</p> <p>Recourse: Non-recourse to the borrower in permanent phase</p> <p>Security: DOT required</p>
General Affordability Restrictions	Affordability restrictions will reflect the policies and regulations of the funding sources used by the City and NOFAs may require additional affordability restrictions. These affordability requirements will be documented with an Affordability Restriction (AR) that will only be subordinated to any document with a power of foreclosure in a manner consistent with these City Underwriting Guidelines.	
Subordination of DOT and AR	If required for feasibility, and in a form acceptable to the City, the City will subordinate its DOT to a senior construction and permanent loan (see Subordination Agreement Requirements). Except where provided below and in the Ground Lease Policy, the City will not subordinate its AR. In lieu of subordinating the AR, the City may allow a 60-day standstill and a float-up of affordability levels up to 60% AMI upon foreclosure (as required for feasibility). In some cases, the City may, in its sole discretion, allow subordination of the AR if it is required by a senior lender whose loan product is the only available product that allows financial feasibility; any such subordination must be in a form acceptable to the City (see Subordination Agreement Requirements).	

Ground Lease	All new construction developments seeking gap financing will be subject to a City option to purchase and a ground lease back to the developer. (See Ground Lease Policy for details).									
Total Development Budget Savings	Total project cost savings shall be determined in an accounting report prepared by a third party certified public accountant and shall show Project Development Costs and Project Sources Income (as defined in the loan documents) through the date of the report as well as estimated through the Conversion Date and project Form 8609 filing with TCAC. Total project cost savings will be shared per Total Development Budget Savings Policy in 6.5.									
Developer Fee	The City supports general consistency with TCAC’s developer fee policy. Please see Developer Fee Policy for details. If necessary for feasibility, a portion of the developer fee may be deferred and structured as a loan (with interest subject to TCAC limits and City policy) repayable from the developer’s share of residual receipts.									
Operating Expenses	Minimum operating expenses shall be generally consistent with those set by TCAC per region and project type (does not include property taxes, replacement reserves, depreciation or amortization expense, or the costs of any service amenities). Maximum operating expenses to be approved by City in its sole discretion based on its portfolio, surveys and/or developer information (developer to provide basis/comparable data for all estimated expenses if appraisal not available).									
Reserves	All reserves outlined below must remain with the project when the investor exits the owner entity.									
	Capitalized Operating Deficit Reserve	Minimum is the TCAC guideline of 3 months of OERDS (operating expenses, reserves and debt service), but this may be higher if required by the syndicator or other lender.								
	Replacement Reserves	<ul style="list-style-type: none">• New construction: minimum \$250/unit per annum and maximum \$350/unit; may be determined by a 20-year replacement schedule• Rehabilitation: minimum \$300/unit per annum and maximum \$400/unit; 20-year replacement schedule required based on a physical needs assessment• Exceptions may be granted for other financing requirements (e.g. permanent supportive housing (PSH), MHSA, NPLH, HCD, etc.)								
	Rental Subsidy Transition Reserve	The City will accept reasonable rental subsidy reserves if required by the Senior Lender.								
Resident Services Coordination	Resident services coordination expenses will be limited to the following:									
	<table><tr><th>Units Restricted to:</th><th>Maximum Allowed Per Unit / Per Year</th></tr><tr><td>0 – 30% AMI</td><td>\$575</td></tr><tr><td>31 – 49% AMI</td><td>\$475</td></tr><tr><td>50 – 60% AMI</td><td>\$325</td></tr></table>		Units Restricted to:	Maximum Allowed Per Unit / Per Year	0 – 30% AMI	\$575	31 – 49% AMI	\$475	50 – 60% AMI	\$325
Units Restricted to:	Maximum Allowed Per Unit / Per Year									
0 – 30% AMI	\$575									
31 – 49% AMI	\$475									
50 – 60% AMI	\$325									
Services in Supportive Housing	It is expected that expenses for supportive services for permanent supportive housing units (restricted to formerly homeless and chronically homeless individuals and families with a range of special needs) and the Transition In Place / Rapid Re-housing units shall be paid by a separate funding source other than project income.									
Senior Loan Debt Service Coverage Ratio	1.15x to 1.20x in the first stabilized year based on projected eligible income and expenses (pending Senior Lender approval), but in any event no less than 1.00x throughout the compliance period unless the total estimated deficit is covered by reserves, as approved by the City.									
Loan Repayment	Please see Permitted Expense and Residual Receipts Policy for the calculation of Net Cash Flow. Generally, the City requires 50% of Net Cash Flow for Residual Receipts payments, but this share may be higher when other gap financing lenders are involved in the project. Prepayment is subject to City approval.									
Contact Information	City of San José Housing Department - Project Development Program (408) 535-3860 housing@sanjoseca.gov									

The City of San José, in its sole discretion, may, at any time and without prior notice, terminate the program, amend or waive compliance with any of its terms, or reject any or all proposals for funding.



Housing Department
Affordable Housing Gap Financing

MULTIFAMILY UNDERWRITING GUIDELINES

August 2018



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1. BACKGROUND

The mission of the City of San José's (City's) Housing Department is to strengthen and revitalize our community through housing and neighborhood investment. As a part of this mission and the execution of its housing element plan, the City supports the new construction and rehabilitation of housing for extremely low-, very low-, and low-income individuals and families with various policies and programs. The primary program administered by the Housing Department is the provision of gap financing for multifamily affordable and permanent supportive housing projects. The underwriting for this program is guided by these general policies and guidelines, as well as specific guidelines that may be included in Notices of Funds Available (NOFAs) issued from time to time. Specifically, these guidelines cover gap loans financed with funding from the Low and Moderate Income Housing Asset Fund (LMIHAF). The NOFAs will specify terms and conditions that will apply to the funding sources being used for the NOFA. NOFA may include specific additional requirements based on specific funding sources. Per Section 5.06.230 of the City's Municipal Code, these Guidelines and others may be developed and issued by the Director of Housing from time to time.

2. PURPOSE

The purpose of this document is to provide developers and other stakeholders with clear and transparent underwriting policies, guidelines, and requirements that drive project financing projections in the very early stages of predevelopment. It is intended that this will encourage smooth underwriting and negotiations in further stages of development, loan approval and loan closing. These guidelines may be supplemented with specific NOFAs, an asset management manual, recapitalization manual and a bond manual.

3. BASIC ELIGIBILITY

3.1 Eligible Sponsors	<ul style="list-style-type: none"> • Sponsors (Sponsors) may be non-profit and for-profit housing corporations, joint ventures, limited liability companies, and partnerships • Sponsors must have documented experience owning and operating affordable housing projects or partner with an entity that has the required experience • All transactions that use low-income housing tax credits require a developer with a non-profit managing general partner
3.2 In Good Standing with the City	<ul style="list-style-type: none"> • All Sponsors' other projects must be compliant with all requirements of City loan documents, if any
3.3 Eligible Uses of Funds	<ul style="list-style-type: none"> • Predevelopment expenses • Acquisition • Demolition/rehabilitation/construction financing • Permanent financing
3.4 Bond Issuer	<ul style="list-style-type: none"> • On projects with tax-exempt bonds, the City is required to be the Issuer • Please see the City's POLICY FOR THE ISSUANCE OF MULTIFAMILY HOUSING REVENUE BONDS, Policy Number 1-16 for details
3.5 Demonstration of Minimizing Gap Financing	<ul style="list-style-type: none"> • Because the City's gap financing resources are limited, developer partners are required to aggressively pursue other funding sources to the fullest extent possible to both minimize the City's gap loan as well as ensure the long-term feasibility of the project • Specifically, developer partners must obtain commercial loans sized with the highest loan-to-value and lowest debt service parameters that are commercially available in the market place as well as demonstrate their efforts to obtain other subordinate loans or grant financing
3.6 California Tax Credit Allocation Committee (TCAC)	<ul style="list-style-type: none"> • Under several specific policies, the City generally follows TCAC requirements • However, in the event that the TCAC requirements change, the City reserves the right to maintain policy as is or make changes as appropriate per its authority under Section 5.06.230 of the municipal code

4. FINANCING OPTIONS AND FEES

<p>4.1 Predevelopment Loan</p> <p>Amount</p> <p>Term</p> <p>Rate</p> <p>Loan-to-value</p> <p>Security</p> <p>Other</p>	<p>Maximum of \$1,000,000</p> <p>12 to 24 months, with two six-month extensions</p> <p>Up to 4% simple, accrued interest may be capitalized</p> <p>If property owned by sponsor or developer, up to 100% total LTV of the City loan plus all senior debt, based on the As-is value of the property</p> <p>Deed of trust (DOT) required if property owned by sponsor or developer; repayment guarantee for all loan amounts over \$250,000 from project sponsor and assignment of plans & specifications</p> <p>May be required to provide an option to purchase to the City (See Ground Lease Policy)</p>
<p>4.2 Acquisition Loan</p> <p>Amount</p> <p>Term</p> <p>Rate</p> <p>Loan-to-value</p> <p>Security</p> <p>Other</p>	<p>Based on actual cost and LTV limitations</p> <p>12 to 36 months, with two six-month extensions</p> <p>Up to 4% simple; accrued interest may be capitalized</p> <p>Up to 100% total LTV of the City loan plus all senior debt, based on the As-is value of the property</p> <p>DOT required; may require repayment guaranties from project Sponsor</p> <p>May be required to provide an option to purchase to the City (See Ground Lease Policy)</p>
<p>4.3 Construction Loan</p> <p>Amount</p> <p>Term</p> <p>Rate</p> <p>Security</p> <p>Other</p>	<p>Up to \$125,000 per unit + prior and construction capitalized interest (see Loan Repayment) [Note Family units may be more expensive]</p> <p>12 to 36 months, with two six-month extensions</p> <p>Up to 4% simple; accrued interest may be capitalized</p> <p>DOT required; completion guaranty from project sponsor</p> <p>May be required to provide an option to purchase to the City (See Ground Lease Policy)</p>
<p>4.4 Permanent Loan</p> <p>Amount</p> <p>Term</p> <p>Rate</p> <p>Recourse</p> <p>Security</p>	<p>Up to \$125,000 per unit + prior capitalized interest (see Loan Repayment)</p> <p>30-55 years</p> <p>AFR, compounded daily, using the actual number of days of the year</p> <p>Non-recourse to the borrower in permanent phase</p> <p>DOT required</p>
<p>4.5 Fees</p>	<ul style="list-style-type: none"> • City fees are generally set by an annual budget process intended to reflect costs incurred, and adjusted annually each July • Current fees are available from the Housing Department contact and may be further outlined in the City's term sheet – these fees may include the following: <ul style="list-style-type: none"> ○ Loan Origination Fee ○ Loan Conversion Fee ○ Multi-Family Loan Servicing Fee ○ Multi-Family Affordability Restriction Monitoring Fee • Other fees for restructuring, refinancing, payoffs, etc. may also apply

5. LOAN TERMS AND CONDITIONS

5.1 Loan Repayment	<ul style="list-style-type: none"> • Interest on Predevelopment, Acquisition and Construction Loans may be capitalized if requested prior to council funding approval • Please see <u>Permitted Operating Expense and Residual Receipts Policy</u> for the calculation of Residual Receipts for Permanent Loans • Generally, the City requires 50% of Net Cash Flow (defined <u>here</u>) for Residual Receipts payments • Prepayment is subject to City approval
5.2 General Affordability Restrictions	<ul style="list-style-type: none"> • The City's affordability level requirements will reflect the policies and regulations of the funding sources used by the City (e.g. LMIHAF, HOME, inclusionary in lieu fees, etc.) and the NOFA, if any • Affordability requirements will be documented with a recorded Affordability Restriction (AR) that will not be subordinated to any document with a power of foreclosure (see <u>Ground Lease Policy</u> for policy on subordination of Leasehold Restrictions) unless it is consistent with the City's subordination guidelines (see <u>Subordination Agreement Requirements Policy</u>) • Lenders must agree to City form AR which will include operating and reporting covenants as well as approval rights • Affordability Restrictions will carry a 55-year minimum term and the affordability restriction will survive the payoff of any City loans
5.3 Subordination of DOT	<ul style="list-style-type: none"> • If required for feasibility, and in a form acceptable to the City, the City will subordinate its DOT to a senior construction and permanent loan (see <u>Subordination Agreement Requirements Policy</u>)
5.4 Subordination of Affordability Restriction	<ul style="list-style-type: none"> • Except where provided below and in the <u>Ground Lease Policy</u>, the City will not subordinate its AR • In lieu of subordinating the AR, the City may allow a 60-day standstill and a float-up of affordability levels up to 60% Area Median Income (AMI) upon foreclosure (as required for feasibility) • In some cases, the City may, in its sole discretion, allow subordination of the AR if it is required by a Senior Lender (Senior Lender) whose loan product is the only available product that allows financial feasibility; any such subordination must be in a form acceptable to the City (see <u>Subordination Agreement Requirements</u>)
5.5 Ground Lease	<ul style="list-style-type: none"> • See the <u>Ground Lease Policy</u> for more details • To ensure the long-term affordability and viability of publicly funded housing, the City may require the Borrower to execute an option to purchase in connection with its loans, subject to a ground lease back to the borrower for new construction projects that have not yet received a gap financing commitment from the City (projects with existing City loans are not subject to this policy) • The term shall be between 55-99 years • Annual rent to be specified in Notices of Funding Availability • All other lenders must agree to the form lease, which is available on the department's website
5.6 Land Use Entitlements	<ul style="list-style-type: none"> • For Construction/Permanent Loans, the applicant must demonstrate that the proposed project has all discretionary land use entitlements prior to the City issuing a funding commitment
5.7 Environmental Reports	<ul style="list-style-type: none"> • For real estate secured loans, a current Phase 1 ESA for the City's benefit is required (must be dated within 180 days of the DOT recording)

6. UNDERWRITING GUIDELINES – DEVELOPMENT

6.1 Developer Fee	<ul style="list-style-type: none"> • Please see <u>Developer Fee Policy</u> for definitions and policies • If necessary, a portion of the Developer Fee may be deferred and structured as a loan with interest subject to TCAC limits and City policy • Both principal and interest on any Deferred Developer Fee shall be paid out of the developer's share of Net Cash Flow
6.2 Rent Levels	<ul style="list-style-type: none"> • Underwritten rents shall be at least 10% below market rents for all project units
6.3 Rehabilitation Projects	<ul style="list-style-type: none"> • An acceptable 15- to 20-year capital needs assessment that includes a replacement reserve analysis is required • Minimum of \$30,000/unit in hard costs for resyndication projects (market rate properties converting to affordable will be exempt from this policy) • The project must have a rehabilitation or replacement plan for all major systems and components of property with a useful life of 15 years or less • If the relocation of tenants is anticipated, a relocation plan prepared by a qualified consultant is required prior to funding authorization
6.4 GC Contract	<ul style="list-style-type: none"> • GC contracts shall be a Cost Plus a Fee with a Guaranteed Maximum Price (standard AIA A102) on all projects, with the stipulation that all savings go to the Owner • GC contracts under \$250,000 are not subject to this policy, but the construction contract will still need to be approved by the City • Contracts must be in the most recent AIA form including a clearly-defined scope of work, a detailed construction budget, and a schedule acceptable in form to the City • All materials and workmanship must have at least a one-year warranty; the roof must be covered by a manufacturers' NDL 20-year roof guaranty • City specific exhibits must be included in GC contract
6.5 Total Development Budget Savings	<ul style="list-style-type: none"> • Total project cost savings shall be determined in an accounting report prepared by a third party certified public accountant and shall show Project Development Costs and Project Sources Income (as defined in the loan documents) through the date of the report as well as estimated through the Conversion Date and project Form 8609 filing with TCAC • Total project cost savings shall be disbursed first to cover reductions in the tax credit equity contribution amounts if any and then to pay interest and principal on the City loan • The City will consider sharing cost savings with other soft lenders that fund during construction and share in construction risk • For the first two years after adoption, The City will consider sharing project cost savings with both contractors and developers in an amount up to 25% of the total; contractors may be allowed to retain up to 25% of construction cost savings after close out and certification of construction costs; of the remaining 75% of the remaining construction cost savings and 100% of overall project cost savings, the City may share up to 25% with the developer if needed to fund deferred developer fees. The Director of Housing may extend this provision

6. UNDERWRITING GUIDELINES – DEVELOPMENT

6.6 Contractor Profit, Overhead and General Conditions	<ul style="list-style-type: none"> As generally consistent with TCAC regulations, the developer should clearly identify and break out hard construction costs, contractor profit, general requirements, and contractor overhead (a detailed breakdown of general requirements should be included in the schedule of values included in the GC contract) in the City's proforma Contractor profit cannot exceed the following amounts of the total contract (includes demolition, off-site work, site work, structures, general requirements, contractor overhead, contractor profit, prevailing wages, general liability insurance, and performance & payment bond): 6% for contract amounts under \$10 million, 5% for any contract amount between \$10 million and \$15 million, and 4% for any contract amount over \$15 million Combined contractor overhead and general conditions cannot exceed 8% of the total contract as defined above General conditions may not include the purchase of capital items with an expected life of over 12 months If actual costs needed to support the builder's presence on the site total less than 8%, the project budget must reflect only actual costs Contractors' liability insurance and bonding should be a separate construction budget line and not included in contractor overhead or general requirements As generally consistent with TCAC, contractor profit, general requirements and contractor overhead cannot total more than 14% of the cost of construction (per TCAC's calculation as included in City proforma)
6.7 GC Performance and Payment Bonds	<ul style="list-style-type: none"> The City will require a performance & payment bond from the general contractor for at least the full amount of the proposed contract from a surety approved by the City (and licensed in California with an AM Best rating acceptable to the City) No exceptions will be granted for projects that are subject to the Ground Lease Policy The City of San Jose must be named as obligee on the bonds, and the bonds must be acceptable to the City in form and substance
6.8 Change Orders	<ul style="list-style-type: none"> Copies of all change orders shall be provided to the City, whether positive or negative Prior written City approval of any change order must be obtained if <ul style="list-style-type: none"> the cost of such change exceeds \$25,000 the aggregate amount of all changes exceeds \$75,000 regardless of cost, if such change is a material change in structure, design, function, or exterior appearance of the project regardless of cost, if such change would cause any line item to be increased or decreased by 5% or more, including the hard cost contingency regardless of cost, if such change could delay the completion of the project General contractor markups on change orders are limited to the percentage of profit allowed in the contract and subcontractors are limited to 15% maximum markup on change orders
6.9 Hard Cost Contingency	<ul style="list-style-type: none"> Minimum of 5% for new construction projects and 10% for rehabilitation projects, but the City may require more Hard costs are defined as all contract sums as described above
6.10 Soft Cost Contingency	<ul style="list-style-type: none"> Minimum of 3% for all projects Soft costs are defined as costs not directly related to the acquisition of land, site improvements or construction of buildings, but are related to professional work such as architectural & engineering, financing, governmental fees and permits, reserves, etc.

6. UNDERWRITING GUIDELINES – DEVELOPMENT

6.11 Reasonable Development Costs	<ul style="list-style-type: none"> • In particular, architecture, survey, engineering and legal costs must be reasonable and within industry standards
6.12 Costs Excluded from Development Budget	<ul style="list-style-type: none"> • The City generally follows TCAC's exclusions, including the exclusion of nonresidential uses or land allocated for nonresidential uses (see <u>Commercial Space</u> for more details), unless otherwise required City funding sources • No payment for stored materials unless previously approved by the City • Design contingencies and allowances may be allowed but are subject to the City's approval
6.13 Section 8 or Rental Subsidy Transition Reserve	<ul style="list-style-type: none"> • Will accept if required by Senior Lender or investor, but the calculation methodology will be subject to the City's approval • Upon maturity of the Senior Loan (as defined in the loan documents), any unused reserves shall be repaid to the City • Reserve must remain with the project when the investor exits the owner entity
6.14 Capitalized Operating Reserve	<ul style="list-style-type: none"> • City policy mirrors TCAC's guideline of a minimum of three months of OERDS (operating expenses, reserves and debt service) • May be higher if required by the investor or lender • Reserve must remain with the project when the investor exits the owner entity
6.15 Rental Income During Construction	<ul style="list-style-type: none"> • Net rental income from operations during rehab or from lease-up prior to conversion to permanent loan shall be included as a source of construction funds and included in the calculation of project cost savings
6.16 Project Development Consultant	<ul style="list-style-type: none"> • City policy is generally consistent with the TCAC requirement that development consultant fees associated with project management work are included in the definition of developer fee
6.17 Prevailing Wage	<ul style="list-style-type: none"> • Prevailing wage is required by broader City policy, and requires preconstruction meeting for all contractors and payroll submissions • Davis Bacon wages are required for projects with federal funds
6.18 Other Budget Considerations	<ul style="list-style-type: none"> • Reimbursements to the project, such as CDLAC deposits and utility deposits, shall be used to pay other costs in the project budget if identified as both a source and use of funds in the project budget; otherwise, the refunded amounts can only be used to reduce the amount of the City's loan • City exemptions, if any, from ordinances, fees or taxes may be included as a source of funds if they are also classified as a use of funds (the Sponsor should consult with their tax advisor on the proper accounting and income tax treatment for these various items)
6.19 Relocation	<ul style="list-style-type: none"> • Any Sponsor proposing to acquire land or rehabilitate existing structures using City funds that may result in the displacement of tenants or businesses must fully comply with both state and federal relocation laws • Sponsor must provide an assessment of the potential displacement of tenants or businesses, including a detailed summary of tenants or businesses and estimated costs and timing of relocation, along with the name, resumé and contact information of the proposed qualified relocation consultant • Prior to acquisition, rehabilitation, demolition, or construction funding, the City must review and approve a relocation plan • In the event State or federal laws require the approval of the governing body, the relocation plan must be approved by the City Council

7. UNDERWRITING GUIDELINES - OPERATIONS

7.1 Revenue and Operating Expense Inflat	<ul style="list-style-type: none"> City policy generally mirrors TCAC policy 								
7.2 Commercial Space	<ul style="list-style-type: none"> Commercial spaces should be clearly excluded from City underwriting assumptions of housing units and follow all other applicable TCAC guidelines The financing plan for nonresidential space shall be provided to and approved by the City, and these costs must be listed separately Must be priced = or < Mkt per Sq. Ft. Master lease encouraged City funding sources may impose additional requirements 								
7.3 Vacancy Rate Assumptions	<ul style="list-style-type: none"> City policy generally mirrors TCAC policy: (5%) for family, seniors, and at-risk proposals, and ten percent (10%) for rapid rehousing, permanent supportive housing, other special needs and SRO 								
7.4 Total Operating Expenses	<ul style="list-style-type: none"> Minimum operating expenses shall be generally consistent with those set by TCAC per region and project type (does not include property taxes, replacement reserves, depreciation or amortization expense, or the costs of any service amenities) Maximum operating expenses to be approved by City in its sole discretion based on portfolio, surveys and/or developer information (developer to provide basis/comparable data for all estimated expenses if appraisal not available) 								
7.5 Replacement Reserves	<ul style="list-style-type: none"> New construction = minimum \$250/unit and maximum \$350/unit per annum; may be determined by a 20-year replacement schedule Rehabilitation = minimum \$300/unit and maximum \$400/unit per annum; must be determined by a 20-year replacement schedule based on a physical needs assessment Exceptions may be granted for other financing or project requirements Reserve must remain with the project when the investor exits the owner entity 								
7.6 Partnership and Asset Management Fees	<ul style="list-style-type: none"> Maximum Partnership and Asset Management Fees combined may not exceed \$30K with no inflator or \$25K with 3% annual inflator May only be paid after the payment of eligible operating expenses, reserves and debt service Any amounts in excess of maximum or accrued fees and interest must be paid from the developer's share of Net Cash Flow Only current fees up to the maximum amount are considered a permitted expense The Asset Management fee shall terminate when the limited partner exits the partnership 								
7.7 Resident Services Coordination	<ul style="list-style-type: none"> Resident services coordination expenses will be limited to the following AMI: <table border="1" style="margin: 10px auto; border-collapse: collapse; text-align: center;"> <thead> <tr> <th style="padding: 5px;">Units Restricted to:</th><th style="padding: 5px;">Maximum Allowed Per Unit / Per Year</th></tr> </thead> <tbody> <tr> <td style="padding: 5px;">0 – 30% AMI</td><td style="padding: 5px;">\$575</td></tr> <tr> <td style="padding: 5px;">31 – 49% AMI</td><td style="padding: 5px;">\$475</td></tr> <tr> <td style="padding: 5px;">50 – 60% AMI</td><td style="padding: 5px;">\$325</td></tr> </tbody> </table> 	Units Restricted to:	Maximum Allowed Per Unit / Per Year	0 – 30% AMI	\$575	31 – 49% AMI	\$475	50 – 60% AMI	\$325
Units Restricted to:	Maximum Allowed Per Unit / Per Year								
0 – 30% AMI	\$575								
31 – 49% AMI	\$475								
50 – 60% AMI	\$325								
7.8 Services in Supportive Housing	<ul style="list-style-type: none"> It is expected that expenses for supportive services for permanent supportive housing units (restricted to formerly homeless and chronically homeless individuals and families with a range of special needs) and the Transition In Place / Rapid Re-housing units shall be paid by a separate funding source other than project income. (see <u>SUPPORTIVE HOUSING POLICY</u>) 								

7. UNDERWRITING GUIDELINES - OPERATIONS

7.9 Property and Incentive Property Management Fees	<ul style="list-style-type: none"> Property Management Fees: A maximum of \$60 per unit per month for property management and \$10 per unit per month for compliance and accounting fees, but in any event no more than 7% Effective Gross Income (EGI) per TCAC regulations, unless the excess is paid out of the developer's share of Net Cash Flow Escalation will be tied to the annual increases in the AMI Incentive Property Management Fees may be payable out of developer's share of Net Cash Flow
7.10 Operating Reserve Withdrawals and Replenishment	<ul style="list-style-type: none"> Operating Reserve replenishment (if required by limited partner or TCAC) to be funded from developer's share of Net Cash Flow (see <u>PERMITTED OPERATING EXPENSE AND RESIDUAL RECEIPTS POLICY</u>)
7.11 Senior Loan Debt Service Coverage Ratio	<ul style="list-style-type: none"> 1.15x to 1.20x in first stabilized year based on projected eligible income and expenses (pending Senior Lender approval), but in any event no less than 1.00x throughout the compliance period unless the total estimated deficit is covered by reserves, as approved by the City

8. PROPERTY MANAGEMENT

8.1 On-Site Property Management	<ul style="list-style-type: none"> All projects must include, at a minimum, on-site management staff during normal business hours The City must approve the property's management agreement and related documents
8.2 Qualifications for Property Managers	<ul style="list-style-type: none"> Qualifications of the management entity must be submitted prior to the closing of the City's construction loan The proposed management firm, or a principal in the firm, is required to submit evidence of successfully managing at least five projects, each with over ten units and subject to a recorded regulatory agreement for at least three years prior to the loan application
8.3 Management Plan	<ul style="list-style-type: none"> A draft management plan, lease agreement, and related documents shall be submitted with the loan application, with a final approved prior to construction loan closing Once approved, neither the management plan nor the lease agreement may be changed without City approval
8.4 Security Plan	<ul style="list-style-type: none"> Developers must submit a security assessment and a plan for review and approval by the City (For example: Security Cameras.)
8.5 Supportive and/or Special Needs Housing	<ul style="list-style-type: none"> Property management for formerly homeless and chronically homeless individuals and families in permanent supportive housing will be managed in accordance with the City's PSH Policy (See <u>SUPPORTIVE HOUSING POLICY</u>) Property management for formerly homeless individuals and families in Rapid Re-Housing will be managed in accordance with the City's Transition in Place Guidelines. Properties with special needs occupancy will have a plan to address the needs of the population
8.6 Ongoing Compliance	<ul style="list-style-type: none"> All projects must be maintained in compliance with the City's standards in the Municipal Code and other standards that may be adopted by the Department and will be inspected by the Housing Department's inspectors periodically City staff will conduct compliance reviews of the project annually, or more often if necessary and project must comply with the City's reporting and record keeping requirements New projects must comply with the City's monthly lease-up reporting requirements outlined in the City's loan documents) until the property is placed in service

DEVELOPER FEE POLICY

9. DEVELOPER FEE POLICY

9.1 Eligibility	All developments seeking City funding or restructuring in conjunction with the new construction or rehabilitation of affordable housing properties will be subject to this policy. This includes recapitalization projects. This policy applies to any project that has not yet received its gap financing commitment from the City by the date of publication of the final policy.
9.2 Purpose	The purpose of this policy is to establish a guideline for the amount of development fees on affordable housing projects with City financing. Given the rent restrictions on affordable housing projects, affordable housing developers do not make the majority of their profit through project cash flow like developers of market-rate rental housing. Developer fees are recognized as a significant part of the income on which affordable housing organizations depend for their survival and growth. The low-income housing tax credit (LIHTC) program is the primary financing structure for almost all affordable housing. The California Tax Credit Allocation Committee (TCAC), the state organization that administers the LIHTC program, has established policy that allows developers to include a reasonable fee in a project's budget. The City supports general consistency with the TCAC policy, with a few modifications.

9.3 Definitions

9.3.1 Developer Fee	Developer Fee is defined the same as in the 5/16/2018 TCAC Regulations as follows: "All Funds paid at any time as compensation for developing the proposed project, to include all development consultant fees, processing agent fees, developer overhead and profit, construction management oversight fees if provided by the developer, personal guarantee fees, syndicator consulting fees, and reserves in excess of those customarily required by multi-family housing lenders."
9.3.2 Capitalized Developer Fee	Capitalized Developer Fee is the amount of Developer Fee that can be paid out of project development sources (i.e., a "project cost") up to and including permanent loan conversion and 8609 issuance (final limited partner contribution).
9.3.3 Deferred Developer Fee	Deferred Developer Fee is defined as the amount of Developer Fee payable out of the developer's portion of Net Cash Flow. In order to be included in tax credit basis, this amount must be payable within a time frame established by the project's tax counsel (typically around 12 years).
9.3.4 Contributed Developer Fee	Contributed Developer Fee is the amount of payable developer fee that can be contributed by a party other than the developing partnership (e.g., the partnership general partner). In order to be included in tax credit basis, this amount must be an equity contribution as defined by the project's tax counsel.
9.3.5 Excess Developer Fee	Excess Developer Fee is defined as the combination of the Deferred Developer Fee and Contributed Developer Fee.

9.4 Developer Fee in Basis and Capitalized Developer Fee

This policy generally mirrors the maximum limitations established in the TCAC Regulations Implementing the Federal and State Low Income Housing Tax Credit Laws in the California Code of Regulations Title 4, Division 17, Chapter 1 dated May 16, 2018 and as updated from time to time (TCAC Regulations) Section 10327(c)(2). However, the City reserves the right to further lower the Developer Fee in its sole discretion.

Project Type	Maximum Developer Fee	
	Capitalized Developer Fee in Project Budget	Project Basis
9.4.1 9% credits	<ul style="list-style-type: none"> The maximum allowable Capitalized Developer Fee mirrors TCAC Regulations: (subject to a 15% of basis or threshold basis limit) \$2,200,000 for new construction and \$2,000,000 for rehabilitation projects The City may require a lower Developer Fee in its sole discretion 	<ul style="list-style-type: none"> Mirrors TCAC Regulations: \$1,400,000 with higher amounts for projects in excess of 200 units
9.4.2 4% credits – New Construction	<ul style="list-style-type: none"> The maximum allowable Capitalized Developer Fee mirrors TCAC Regulations capped at \$2,500,000; any amount over this for additional units is subject to the City's underwriting and approval As per TCAC, all fees in excess of the Capitalized Developer Fee shall be Deferred Developer Fee or Contributed Developer Fee The City may require a lower Developer Fee in its sole discretion 	<ul style="list-style-type: none"> Mirrors TCAC Regulations: 15% of the project's unadjusted eligible basis
9.4.3 4% credits – Rehabilitation or Acquisition & Rehabilitation	<ul style="list-style-type: none"> The maximum Capitalized Developer Fee mirrors TCAC Regulations capped at \$2,500,000; any amount over this for additional units is subject to the City's underwriting and approval As per TCAC, all fee in excess of the maximum shall be Deferred Developer Fee or Contributed Developer Fee The City may require a lower Developer Fee in its sole discretion 	<ul style="list-style-type: none"> Mirrors TCAC Regulations: 15% of the project's construction basis and 5% or 15% of the project's acquisition basis
9.4.4 All other projects	<ul style="list-style-type: none"> For projects not using bonds and/or tax credits, such as small supportive housing developments or small rehabilitation projects, the maximum developer fee shall be determined on a per unit basis: \$30,000 per unit for the first 20 units \$20,000 per unit for units 21 through 40 \$15,000 per unit for units 41 and above 	N/A

9.5 Deferred Developer Fee

Any Deferred Developer Fee shall be paid from the developer's share of Net Cash Flow (typically 50% but further defined in the (Residual Receipts Policy). Any interest on Deferred Developer Fee shall also be payable from the developer's share of Net Cash Flow.

9.6 Allowable Developer Fee Payment Schedule

If reasonable and considered within market, the City will defer to the Senior Lender and/or investor for the Capitalized Developer Fee payment schedule.

9.7 Developer Fee Policy Example

The following is an example of a 120-unit 4% LIHTC new construction property:

- Developer Fee included in basis is \$4,000,000
- Capitalized Developer Fee is \$2,500,000
- Excess Developer Fee is \$1,500,000, and is payable through a combination of Deferred Developer Fee and Contributed Developer Fee (amounts to be determined through developer's tax counsel and/or tax consultants)
- The developer may pay the Deferred Developer Fee out of its share of Net Cash Flow

GROUND LEASE POLICY

10. GROUND LEASE POLICY	
10.1 Eligibility	All new construction developments seeking financing from the City will be subject to this policy. Specifically, this policy applies to any project that has not yet received its gap financing commitment from the City by the date of publication of the final policy.
10.2 Purpose	The purpose of this policy is to ensure the long-term affordability and viability of publicly funded housing.
10.3 Effecting Acquisition	<ul style="list-style-type: none"> • The City's acquisition loan documents will include an option to purchase the property on a City form, otherwise the City will purchase the property at least 30 days before construction loan closing • The ground lease back to the borrower on a City form shall be executed at the time of the City's exercise of option • Prior to the recording of the memorandum of lease, the City will record a 60% AMI affordability restriction on the fee, or amend the existing restriction • When the option is exercised, all financing secured against the fee will be reconveyed and secured against the leasehold • Sponsors are responsible for ensuring that their Senior Lender and investor accept the City's form lease and AR, which can be found on the department's website • Project entitlements will be required prior to the City taking ownership
10.4 Term	<ul style="list-style-type: none"> • Typically 55 years, but can be extended to coincide with term of permanent debt in connection with true debt test requirements; however, the term may not exceed 99 years • At expiration of term, or when the lease is otherwise terminated under the terms of the lease, title to the improvements shall revert to and vest in lessor without cost to lessor; or, lessor may require demolition
10.5 Annual Rent	<ul style="list-style-type: none"> • To be specified in Notices of Funding Availability
10.6 Affordability Restrictions	<ul style="list-style-type: none"> • General affordability restrictions at 60% AMI will be documented in an AR recorded against the fee interest • Project-specific leasehold affordability restrictions will be recorded on the leasehold interest and can be subordinated if necessary • HOME restrictions may not be subordinated
10.7 Assignment	<ul style="list-style-type: none"> • Except as provided in the Ground Lease, the Ground Lease may not be assigned without express written approval from the City
10.8 Title	<ul style="list-style-type: none"> • Security for any other loans can only be recorded against the leasehold interest and not fee interest • Lease Riders are only allowed where expressly required by regulations of State or federal agencies and must be negotiated with the City Attorney's Office and be approved by City Council

PERMITTED EXPENSE AND RESIDUAL RECEIPTS POLICY

11. PERMITTED EXPENSE AND RESIDUAL RECEIPTS POLICY

11.1 Eligibility	All multifamily projects will be subject to this policy, including any new projects as well as projects with existing City funding seeking an amendment, increase, recapitalization, restructure, or refinancing. However, terms of the existing loan documents will continue to apply unless amended.
11.2 Purpose	The objective of this policy is to clearly define permitted expenses and ineligible expenses for the determination of a project's Net Cash Flow and Residual Receipts payments (defined below).

11.3 Calculation of Project Gross Receipts

11.3.1 Gross Potential Rent	<ul style="list-style-type: none"> Rental rate per unit subject to affordability restrictions
11.3.2 Gross Potential Subsidy	<ul style="list-style-type: none"> Section 8, or other rental subsidy income, up to allowable limits (the amount of increment above tenant-paid rent)
11.3.3 Other Income	<ul style="list-style-type: none"> Other income collected from tenants or lessees such as parking, laundry, vending, fees and charges, forfeited deposits, etc.
11.3.4 Vacancy, Collection, Concessions Losses	<ul style="list-style-type: none"> Income lost due to tenants vacating the property and/or tenants defaulting (not paying) their lease payments (negative line item)
11.3.5 Project Gross Receipts	<ul style="list-style-type: none"> The sum of all of the above (also referred to as Effective Gross Income or EGI)

11.4 Project Permitted Expenses

Project Permitted Expenses shall mean all reasonable and necessary direct, out-of-pocket expenses and disbursements which sponsor shall pay during the calendar year because of or in connection with the ownership, operation, maintenance of the property as may be approved in writing by the City. Project Permitted Expenses shall not include depreciation, amortization, depletion and other non-cash expenses, and shall be determined on a cash basis method of accounting. No escalations of expenses shown in the Proforma shall be deemed approved in absence of the City's express written agreement.

11.4.1 Administrative Expenses	<ul style="list-style-type: none"> Marketing/advertising, computers/software licensing, audits, legal, dues/subscriptions, office supplies, telephone/internet, travel/mileage, bank charges/postage and training
11.4.2 Property Management Fees	<ul style="list-style-type: none"> A maximum of \$60 per unit per month for property management and \$10 per unit per month for compliance and accounting fees, but in any event no more than 7% EGI per TCAC regulations, unless excess is paid out of developer's share of Net Cash Flow Property Management Fees will cover services described above and those described in the City-approved management agreement
11.4.3 Salaries and Benefits	<ul style="list-style-type: none"> The cost of the direct part-time and full-time personnel that run the property, outside of the property management fee
11.4.4 Repairs and Maintenance	<ul style="list-style-type: none"> The cost of repairs and maintenance for the property, including grounds, elevator and trash
11.4.5 Utilities	<ul style="list-style-type: none"> Owner-paid electricity, water, sewer and gas
11.4.6 Taxes and Insurance	<ul style="list-style-type: none"> Property taxes and property insurance
11.4.7 Ground Lease	<ul style="list-style-type: none"> Must-pay portion of third-party ground lease if applicable and approved by the City

11.4 Project Permitted Expenses

11.4.8 Partnership Management and/or Asset Management Fees	<ul style="list-style-type: none"> Partnership and Asset Management Fees combined may not exceed \$30k with no inflator or \$25k with 3% annual inflator May only be paid after the payment of eligible operating expenses, reserves and debt service Any amounts in excess of these maximums shall be paid from the developer's share of Net Cash Flow The Asset Management fee shall terminate when the limited partner exits the partnership
11.4.9 City Approved Deposits to Reserves	<ul style="list-style-type: none"> City approved deposits into a reserve net of withdrawals used to fund City approved capital or operating items Approved withdrawals from approved reserves shall not be included as income or cash included in the Project Gross Receipts utilized to determine Net Cash Flow; replacement reserve withdrawals are a negative expense Deposits to replenish any operating reserve accounts are not a permitted expense
11.4.10 City Fees	<ul style="list-style-type: none"> The amount owed to the city, plus inflation factor, to reimburse the cost of asset management, including loan servicing and affordability restriction monitoring The schedule of fees to be determined in underwriting subject to the City's approved fee schedule
11.4.11 Resident Services Coordination and Supportive Services	<ul style="list-style-type: none"> See <u>Resident Services Coordination policy</u> and <u>Supportive Services policy</u> for allowable amounts for tenant services expense for resident services coordination and case management and other supportive services for permanent supportive housing
11.4.12 Other Operating Expenses	<ul style="list-style-type: none"> Expenses particular to the property and/or required by its financing partners should be disclosed in the proforma or approved budget, subject to the City's reasonable approval
11.4.13 Senior Loan Debt Service	<ul style="list-style-type: none"> Must-pay debt service May include trustee fees, bond administration fees, and other financial expenses if applicable and expressly approved by the City as a Project Permitted Expenses
11.4.14 Other Debt	<ul style="list-style-type: none"> Any pre-approved loans, advances or other obligations requiring repayment that are made to the Partnership, including GP and LP loans
11.4.15 Project Permitted Expenses	<ul style="list-style-type: none"> The sum of all expenses listed above and shown in the City's proforma

11.5 Permitted Adjustments

11.5.1 Purchase of fixed assets/ capital items	<ul style="list-style-type: none"> The cost of City-approved capital items (paid for from the replacement reserve are deemed permitted expenses (items typically funded by the replacement reserve)
11.5.2 Other adjustments	<ul style="list-style-type: none"> For example, prior year expenses or partnership loans if expressly approved by the City as a permitted expense
11.5.3 Project Permitted Adjustments	<ul style="list-style-type: none"> The sum of all expenses shown in the proforma and listed above

11.6 Expenses Expressly Not Permitted

Any operating costs or fees in excess of City policy, including but not limited to:

- Property Management Fee, including incentive management fees in excess of policy
- Partnership Management Fees and Asset Management Fees in excess of policy
- Resident Services Coordination in excess of policy
- Replenishment of Operating Deficit Reserve
- Deferred Developer Fee payments

11.7 Calculation of Net Cash Flow

Project Gross Receipts, less

Project Permitted Expenses, less

Project Permitted Adjustments =

Net Cash Flow (Net Cash Flow) used to make Residual Receipts payments

11.8 Residual Receipts Policy

Generally, the City shall require a payment of fifty percent (50%) of Net Cash Flow as a Residual Receipts payment per the calculation outlined above. However, if there is additional soft financing, the City may require the total share of Net Cash Flow for Residual Receipts payments to all Residual Receipts lenders to increase up to two-thirds ($\frac{2}{3}$). Of this $\frac{2}{3}$ of Net Cash Flow, the portion of Residual Receipts payments going to the City will be determined on a pro rata basis of the total gap financing. For example, if the project receives \$10 million in total gap financing, of which \$5 million is provided by the City, the City would receive 50% of the $\frac{2}{3}$ of Net Cash Flow owed to the gap lenders as its Residual Receipts payment.

The City's share of Net Cash Flow shall be applied as a Residual Receipt payment as follows: first to pay current interest on the Note, then accrued interest and charges, and thereafter the principal on this Note until such interest and principal are paid in full.

SUBORDINATION AGREEMENT REQUIREMENTS POLICY

12. SUBORDINATION AGREEMENT REQUIREMENTS POLICY

12.1 Eligibility	All new construction developments seeking financing from the City will be subject to this policy. Specifically, this policy applies to any project that has not yet received its gap financing commitment from the City by the date of publication of the final policy as well as projects seeking refinancing or resyndication.
12.2 Purpose	It is the City's intent to limit the effect of subordination of its loan documents to the establishment of lien priority and not to amend those documents by means of a subordination agreement. Additionally, as a public entity using public funds, the City will not agree to conditions that are inconsistent with funding source requirements or to conditions that unduly impair the City's rights or remedies.
12.3 Exceptions	An exception may be authorized where it is determined that a particular provision is requested pursuant to an express requirement in an applicable federal or State agency's statutory or regulatory documents.

12.4 Subordination Agreement Requirements

12.4.1 Policy	<ul style="list-style-type: none"> It is the City's preference that its Affordability Restrictions not be subordinated to senior debt and when the City does not subordinate it may agree to amend its restriction to acknowledge the senior debt and provide for cure rights Where the City agrees to subordinate, it shall be effected by the City form of subordination. The City may also, at its discretion, negotiate a general form subordination with a specific Lender. Any subordination must be acceptable to the City Attorney and must be consistent with requirements in 12.4.2-12.4.17
12.4.2 Right to Cure	<ul style="list-style-type: none"> The City shall have the right to cure defaults under the Senior Loan on the same terms as the Borrower
12.4.3 Reciprocal Standstill	<ul style="list-style-type: none"> Any standstill required by the Senior Lender shall be reciprocal
12.4.4 Remedies	<ul style="list-style-type: none"> Where the City agrees to subordination of its affordability restriction (i.e., under the <u>Ground Lease Policy</u>), the City shall be allowed to pursue its equitable or injunctive remedies under its affordability restriction without regard to any standstill and such enforcement shall not be a default of the Senior Loan
12.4.5 Limits on Senior Loan Modifications	<ul style="list-style-type: none"> Terms allowing subsequent modifications of the Senior Loan shall be subject to a prohibition on modifications to increase the principal amount (beyond protective advances), to increase the payment amounts, or to increase the interest
12.4.6 Limits on Reps & Warranties	<ul style="list-style-type: none"> The City will not warrant or represent that <ul style="list-style-type: none"> the City "approves" the Senior Lender documents the requirements under the Senior Lender's documents are the same as the City's requirements that the Senior Lender's requirements prevail in the event of a conflict, unless conflict is defined as a situation where the Borrower cannot comply with both requirements
12.4.7 No Waiver of Funding Requirements	<ul style="list-style-type: none"> The City will not agree to waive the requirements of its funding sources
12.4.8 No Consent to Foreclose	<ul style="list-style-type: none"> The City will agree to a requirement for notice to the Senior Lender, and a reciprocal standstill, but will not agree to obtain consent of the Senior Lender to foreclose on its junior deed of trust

12.4 Subordination Agreement Requirements

12.4.9 Comfort Letters	<ul style="list-style-type: none"> The City will provide “comfort” letters regarding the loan but will not provide estoppels on matters other than the amount of the outstanding loan and whether City notices of default have been sent
12.4.10 No Waiver of Findings	<ul style="list-style-type: none"> The City will not agree to waive findings and determinations of bankruptcy court
12.4.11 No Holding Funds in Trust	<ul style="list-style-type: none"> The City will not agree that it holds its funds received in trust for or subject to the consent of the Senior Lender
12.4.12 No Subordination to Regulations	<ul style="list-style-type: none"> The City will not agree to subordinate to regulations, policies and/or laws except to the extent this is expressly required by adopted pertinent State or federal regulations, the specific documents are attached, and the intended impact of the subordination to those documents is stated
12.4.13 Right to Charge Fees	<ul style="list-style-type: none"> The City will not agree to a limit on the City’s right to charge the fees required under its loan documents, as these fees are established after cost of service review and adoption by the City Council; the City will make its schedule of fees and charges available to senior lenders on request, but will not agree to waive or reduce its rights under the loan documents to repayment and/or fees for service
12.4.14 Future Refinancing	<ul style="list-style-type: none"> Any requirement to extend the terms of the subordination to future refinancing will be subject to the subordination and refinancing limits in the City loan agreement Where the City agrees to subordination of its affordability restriction (i.e., under the <u>Ground Lease Policy</u>) after loan repayment that agreement will not include consent to a requirement to extend the terms of the subordination to future refinancing
12.4.15 No Waiver of Jury Trial	<ul style="list-style-type: none"> The City will not agree to a waiver of jury trial or an attorney fees provision
12.4.16 No Waivers of Rights	<ul style="list-style-type: none"> A subordination may not modify or waive any right that the City may have in a non-lender capacity (e.g., lessor or regulatory)
12.4.17 No Senior Lender Right to Purchase	<ul style="list-style-type: none"> The City will not agree to a Senior Lender right of purchase for any City owned real property

SUPPORTIVE HOUSING POLICY

13. SUPPORTIVE HOUSING POLICY

13.1 Eligibility	<p>Supportive Housing is an evidence-based housing intervention that combines supportive services and housing that is affordable to families and individuals who are experiencing or have experienced homelessness. All developments that have Supportive Housing set-asides that seek financing from the City will be subject to this policy. This includes both Permanent Supportive Housing (PSH) and Transition In Place (TIP) units (sometimes referred to as Rapid Re-housing units).</p> <p>PSH is a type of housing program that provides permanent affordable housing and supportive services to individuals (and their families) who have disabling conditions. There is no limit to the length of stay and housing units are occupied by persons with lease agreements and have access to on-site or off-site services that are flexible, voluntary and individualized in order to assist an individual or family retain their housing, improve their health status, and maximize their ability to live, and, when possible, work in the community. PSH programs are typically prioritized for chronically homeless persons and families or other populations with significant health needs.</p> <p>TIP Units are intended for individuals and families who have experienced a brief period of homelessness and require a level supportive services. However, their service needs are substantially less than those of occupants of PSH units.</p>
13.2 Purpose	<p>It is the City's intent to work collaboratively with its project sponsors and government partners – particularly the Santa Clara County Office of Supportive Housing and the Santa Clara County Housing Authority – to achieve the regional goal of making homelessness in San Jose a rare, brief, and non-recurring circumstance by creating high quality Supportive Housing. The purpose of this policy is to facilitate the development and operation of high quality Supportive Housing utilizing national best practices and standards.</p>
13.3 Exceptions	<p>An exception may be authorized where it is determined that a particular provision is requested pursuant to an express requirement in an applicable Federal or State agency's statutory or regulatory documents.</p>

13.4 PSH Development Requirements

13.4.1 Section 8 or Subsidy Transition Reserve	<p>The City may allow – subject to City's underwriting – retention of [a Section 8 or subsidy transition] reserve beyond the maturity of the senior loan for the term of continuing affordability and services provision that ensures the units will be available to and occupied by homeless or chronically homeless individuals and families for that term.</p>
13.4.2 PSH Design Requirements	<p>The project design for PSH Units shall address the needs of the PSH population this will include space for the provision of supportive services and space for access/distribution of healthy food.</p>

13.5 PSH Property Management Requirements

13.5.1 Policy	<p>The City acknowledges that the management of Supportive Housing units is distinct from the management of affordable housing due to the challenges facing many of the residents as they transition from being unsheltered to a new home. Property management of Supportive Housing entails increased time needed to coordinate with supportive services and requires the capacity to carry out practices that:</p> <ul style="list-style-type: none"> • decrease barriers to entry into housing • ensure housing retention • address the increased wear and tear on the physical asset that may be associated with Supportive Housing • maintain high levels of communication with stakeholders including neighbors, law enforcement, regulatory agencies, and funders <p>The City expect the sponsor to enter into a memorandum of understanding or equivalent partnership agreement with a supportive services provider.</p>
13.5.2 Total Operating Costs	<p>The City acknowledges that the cost to manage PSH may be higher than the cost to manage affordable housing units and will consider the factors described in Section 13.5.1. above when reviewing operating budgets for PSH units. The City expects the sponsor to provide an explanation of increased operating costs relative to non-PSH affordable housing.</p>
13.5.3 On-Site Management	<p>Properties with 30% or more PSH units must provide 24/7 staffing coverage. The provision of 24/7 on-site management must be included in the Management Plan described in 13.5.5 below.</p>
13.5.4 Qualifications for Property Managers	<p>The management entity of properties with 30% or more PSH units must demonstrate that three of the five projects that evidence successful management pursuant to Section 8.2 above are PSH projects.</p>
13.5.5 Management Plan	<p>The management entity of properties with over 30% PSH units must include in their Management Plans, a description of: 1) target population to be housed, 2) property staffing including 24/7 on-site staff coverage, 3) tenant selection criteria and tenant screening policies that specify how barriers to entry to housing will be minimized, in compliance with State of California Housing First requirements, 4) a plan for coordinating with supportive services provider, 5) emergency and safety protocols, and 6) a plan for ensuring staff are trained, including training on property management in PSH, fair housing, and reasonable accommodations, and 7) a plan for the access/distribution of healthy food for residents.</p>

13.6 PSH Supportive Services Requirements

13.6.1 Policy	<p>The provision of supportive services is a core component of Supportive Housing. The City expects that the funding for these services will be paid by a separate source other than project income. The City is working collaboratively with Santa Clara County Office of Supportive Housing (County) to partner on PSH and TIP projects and by doing so, coordinate the deployment of the City's capital financing with County funding for supportive services. Supportive services are distinct from resident services coordination which may be funded as a property operating expense as described in Section 7.7 above. The City expects the supportive services provider to enter into a memorandum of understanding or equivalent partnership agreement with property management entity. The City will review and approve such memoranda and will reserve the right to enforce the provisions therein.</p>
13.6.2 Supportive Services Plan and Budget	<p>A supportive services plan must be submitted that describes services to be delivered, method of service delivery, expected outcomes, staffing ratios, and staff positions. The plan will be accompanied by a line item budget that includes sources and uses. The plan and budget will be submitted with the loan application, with a final plan approved prior to construction loan closing.</p>