



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Jacky Morales-Ferrand
Margaret McCahan

SUBJECT: SEE BELOW

DATE: January 25, 2019

Approved

Date

1/25/19

COUNCIL DISTRICT: 3

**SUBJECT: APPROVAL OF A LOAN COMMITMENT TO SATELLITE
AFFORDABLE HOUSING ASSOCIATES, FOR THE DEVELOPMENT
OF THE 226 BALBACH PROJECT, A NEW AFFORDABLE
APARTMENT COMMUNITY**

RECOMMENDATION

- (a) Adopt a resolution approving up to a total commitment of up to \$11,623,320 in Low and Moderate Income Housing Asset Funds ("LMIHAF") for a Construction-Permanent Loan to Satellite Affordable Housing Associates, or an affiliated development entity ("SAHA" or "Developer"), and capitalization of up to \$533,320 in construction period interest for the 226 Balbach project ("Project"). The property located at 226 Balbach Street ("Site") is a City-owned property, that is being developed to offer 86 affordable, rent restricted, apartments, and one unrestricted manager's unit;
- (1) Authorizing the Director of Housing to negotiate and execute loan documents, amendments, and all other documents related to City financing for the Project; and,
 - (2) Approving a loan-to-value ratio of greater than 100% for this loan.
- (b) Adopt the following 2018-2019 Appropriation Ordinance Amendments in the Low and Moderate Income Housing Asset Fund:
- (1) Decrease the Housing Project Reserve appropriation in the amount of \$11,623,320;
and
 - (2) Increase the Committed Project Reserve appropriation in the amount of \$11,623,320.

OUTCOME

Approval of the recommended actions will enable the Developer, SAHA, to assemble financing to build a new affordable development at the site. The project will provide affordable housing for 86 extremely low-income, very low-income, and low-income households in San José. See **Attachment A** for the Project Overview and Site Map.

BACKGROUND

In November of 2014, the Housing Department initiated a competitive process to identify potential operators and developers with demonstrated experience in creating supportive housing communities in urban areas. Through this effort, three development teams were deemed qualified to create supportive housing solutions within the Downtown Core, and Satellite Affordable Housing Associates (“SAHA”), was chosen as one of the three qualified developers.

On September 22, 2015, the City Council authorized the Director of Housing to negotiate and execute a purchase and sale agreement to acquire the property from the Successor Agency to the Redevelopment Agency (“SARA”), for a future affordable housing development. On October 22, 2015, sale of the property was unanimously approved by the Oversight Board for the appraised value of \$2,400,000, and the Housing Department completed the acquisition in August of 2016 using Low and Moderate Income Housing Asset Funds. Once the site was acquired by the Housing Department, SAHA was chosen to develop the Project site.

On June 2, 2017, the City Council authorized the Director of Housing to Negotiate and Execute an Exclusive Negotiation Agreement (“ENA”) and a Predevelopment loan in the amount of \$200,000, for the potential development of the Site. On September 27, 2017, the Director of Housing executed the ENA and Predevelopment loan with SAHA, allowing the Developer to move forward with development activities to build affordable housing at the property.

In August of 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-income, very low-income, and low-income individuals and families. The NOFA prioritized projects that provided housing for homeless individuals, that achieved cost effectiveness, that are ready to apply to the California Tax Credit Allocation Committee (“CTCAC”) for a round within 18 months of the NOFA deadline and that leveraged additional non-City sources of financing including financing from the Affordable Housing and Sustainable Communities (“AHSC”) program, specifically. The NOFA guidelines stated that the maximum loan amount will be \$125,000 per unit.

In response to the NOFA, SAHA submitted a proposal for \$10,875,000, or \$125,000 per unit in funding for the construction of the project. It should be noted, that the Developer has requested that the current predevelopment loan and interest be capitalized into the construction loan, therefore increasing construction funding for the project by approximately \$215,000 (estimated

interest until April 2020). The Developer has also requested that the construction loan interest be capitalized into the permanent loan funding request, increasing the overall funding request by an additional estimated \$533,320. In general, The NOFA guidelines stated that funding would be allocated at \$125,000 per unit, however, the capitalized interest and predevelopment loan costs will be added to this funding request, increasing the per unit subsidy to \$133,000 per unit. Future NOFA guidelines will provide additional clarity regarding the inclusion of capitalized interest and predevelopment loan costs in the NOFA application. Please see **Attachment B** for Construction/Permanent Sources for the Project.

SAHA is also pursuing additional supplemental construction and permanent funding sources for the Project, including:

- **City of San José Tax-Exempt Multi-Family Housing Revenue Bonds (“City Bonds”)** Should the Developer receive a commitment to move forward with the Project, the Developer plans to apply for tax credit funding at the July 2019 allocation meeting for the California Debt Limit Allocation Committee (CDLAC). Under a separate memo to City Council, Housing seeks approval to issue the City Bonds for the March 2019 submission to the California Debt Allocation Committee (“CDLAC”). Awards are anticipated to be announced by CDLAC in October 2019.
- **Affordable Housing and Sustainable Communities (“AHSC”) Program:** The City Council agenda also includes a request for approval to apply for funding from the AHSC program as a co-applicant with the Developer, SAHA, for Housing and Transportation Improvements for the area surrounding the site. Approval of the recommended action in this memorandum is necessary for the Developer to submit an application to the Strategic Growth Council (“SGC”) for the AHSC program.
- **Federal Home Loan Bank (FHLBank), Affordable Housing Program (AHP):** The FHL Bank’s Affordable Housing Program (AHP) is designed to address local housing needs and is administered regionally by member FHL Banks. The Developer will be applying for an allocation of approximately \$860,000 in funding from the AHP program.

ANALYSIS

The Project will be an 87-unit eight story development with six stories of residential with a 1st floor common areas and parking structure. The Housing Department recommends a total loan commitment to the Developer, in the amount of \$11,623,320, to fully effectuate the Project. The funding commitment will include up to \$11,090,000 for construction funding (including capitalization of predevelopment), and up to \$11,623,320 for permanent financing. The City's Construction-Permanent Loan commitment is necessary at this time, as the commitment will allow the developer to pursue other public and private funding sources for the Project, which will include an application submittal for the *Affordable Housing Sustainable Communities*

(AHSC) grant and loan program. The application for the AHSC program is due February 11, 2019 and the Developer will require a funding commitment from City Council to apply.

Previously Approved Predevelopment Loan and Exclusive Negotiation Agreement

In June of 2017, the Housing Department made a predevelopment loan in the amount of \$200,000 and executed an Exclusive Negotiation Agreement. This action was taken to assist the developer with the predevelopment costs associated with the development the site, and to assure the developer that the City would negotiate solely with SAHA, for the development of the project. As part of the recommendation, the Housing Department seeks to have the previously approved and funded predevelopment loan and the accrued interest (**Attachment B**), included into the amount that will be allocated for funding during the construction period.

Construction-Permanent Loan

The Housing Department recommends that City Council approve a Construction-Permanent Loan amount of up to \$11,623,320 from LMIHAF, with up to \$11,090,000 for the construction financing. The City's Construction-Permanent Loan commitment will represent approximately 23% of the total financing for the Project. The construction financing will be up to \$11,090,000 for the construction period, and up to \$11,623,320 for permanent financing. The requested amount during the construction period will include \$10,875,000 in funding for construction, the previously approved predevelopment loan of \$200,000, and the predevelopment loan's accrued interest of approximately \$15,000.

The final permanent loan will also include funding from the construction period, and any interest that accrues. The amount of accrued interest from the construction period is estimated to be \$533,320, for a 27-month period. The City's loan will be structured consistent with its underwriting guidelines and policies and are to be repaid through a share of the project's net cash flow. Final loan terms will be underwritten, negotiated, and determined as the project approaches construction loan closing. As this is a City-owned property, a Ground Lease will also be negotiated with the Developer. The City loan will be evidenced by a Deed of Trust recorded against the leasehold interest. See **Attachment B** for a summary of the construction/permanent sources for the Project.

By the authority delegated under section 5.06.335 of the Municipal Code, the Director of Housing will negotiate additional terms and execute documents for these loans in accordance with the City Council's approval, if granted, for this Project. If the Developer is unsuccessful in securing augmented funding for the Project (primarily AHSC funds), the Housing Department may return to the City Council for consideration of an increase of construction-permanent financing.

Accordingly, the Housing Department will require the Developer to seek additional funding sources, such as a Low-Income Housing Tax Exempt Bond and tax credit allocation and the

Affordable Housing Program (“AHP”) funding. See **Attachment B** Construction/Permanent Sources for the Project.

Loan-to-Value Ratio

While the projected value is not known at this time, an appraisal that will be prepared for the senior lender before construction closing is expected to result in a combined loan-to-value ratio (“LTV”) that significantly exceeds 100%, which is the City’s LTV policy threshold. The 100% LTV policy was intended to reduce the City’s risk of loss associated with its loans; however, the deep affordability of the Development increases the need for public subsidies, while decreasing the project’s market value, leading to an increased LTV. An elevated LTV is not uncommon for public lenders in the affordable housing industry. Projects that have a high LTV are considered acceptable by City staff, if the project’s projected operating income is expected to be at least 1.15 times the permanent mortgage debt service payments, as is the case in this project. This standard is a common standard for assessing the financial feasibility of affordable housing developments.

The security for a City loan with a high LTV is that the development will be constructed and begin permanent operations during the period in which the City receives loan repayments as a portion of project net cash flow. This is particularly true for affordable housing developments, as the use of public funds creates requirements for affordably-restricted apartments, and a contractual cash flow share for projects. Therefore, a site cannot be easily liquidated if a proposed project does not proceed. This approval will enable the project to move forward with obtaining tax credits, financing from a senior lender, and an investor, therefore enhancing the City’s repayment potential. For these reasons, a Loan-to-Value over 100% is warranted.

Affordability Unit Mix/Area Median Income Levels

The Developer has proposed the following unit mix: 18 apartments restricted to ELI households at 30% of AMI, 38 restricted to Very Low-Income households at 50% of AMI, and 30 restricted to Low-Income households at 60%, for a total of 86 restricted units, and one unrestricted manager’s unit. The Project will serve the goal of providing affordable housing for within the Downtown Core and residents working within the Arts and Culture communities, as well as providing housing at rental rates affordable to residents that work in the restaurant industry, school bus drivers, emergency medical technicians, and/or substitute teachers. The below table demonstrates the unit sizes and a breakdown of affordability restrictions for the 87 units:

Unit Size	Up to 30% AMI		% of	Up to 50% AMI		% of	Up to 60% AMI		% of	Total
	Units	Max Income	Units	Max Income	Units	Max Income	Units	Max Income	Units	
0-BD	11	\$27,950	13%	5	\$46,550	6%	3	\$55,860	3%	19
1-BD	5	\$31,950	6%	29	\$53,200	33%	20	\$63,840	23%	54
2-BD	2	\$35,950	2%	4	\$59,850	5%	7	\$71,820	8%	13
Unrestricted Mgr Unit	NA	NA		NA	NA		NA	NA		1
Total	18			38			30			87

Artist Outreach

Housing at Project will be open to families and smaller households that are income qualified and that meet the Developer's leasing criteria. The Developer has been working closely with the Office of Cultural Affairs to market the property to artists and those working within the cultural arts industry in San José. There will be no set-aside units for this project, but the developer would like to ensure that individuals involved in San José's vibrant Arts community can continue to afford to live in the City. The Developer will continue to work with both the Office of Cultural Affairs and the Housing Department to create a marketing effort aimed at attracting those that work within the Arts and Culture industry.

Next Steps

If the developer is able to obtain all necessary funding commitments for the Project, they will apply for a Low-Income Housing Tax-Exempt Bond Allocation in July of 2019. Construction is estimated to initiate by March of 2020, and conclude in July 2021. See **Attachment D** for the Anticipated Development Timeline.

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 Municipal Code; therefore, final loan business terms would be summarized in those memos. 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 the project successfully closes construction financing, it would be included in these Quarterly Production Reports. The Project is currently included in these reports as a perspective affordable housing development.

POLICY ALTERNATIVES

The Housing Department considered the following alternative before making these recommendations for this affordable housing development.

Alternative #1: *The City Council could deny the requested funding commitment.*

Pros: The requested funds could be used for other affordable housing developments.

Cons: The City is facing a tremendous need for affordable housing. Locating suitable sites near transit and services, at a reasonable price, is difficult, making it more challenging for the City to help create housing options for very-low and low-income individuals.

Reason for not recommending: The 226 Balbach development is a viable opportunity to serve residents from a wide range of income levels, of whom may potentially include downtown workers. Also, the City would lose its current investment to date with the of the predevelopment loan.

PUBLIC OUTREACH

Satellite Affordable Housing Associates (SAHA) implemented a comprehensive outreach plan to engage with the community to provide information, answer questions, and better understand the concerns of the neighborhood residents and businesses. SAHA hosted a total of nine neighborhood or community meetings from December 2017 to November 2018. SAHA held two Open Houses open to the wider community. SAHA also held smaller Community Action Committee meetings with members of the Market Almaden Neighborhood Association, House of Pizza owners, City of San José representatives, and other San José residents. SAHA also met with an Artist Focus Group and the San José Downtown Design Committee. These meetings addressed a wide many of topics such as project design, services, resident population, and property management.

This memorandum will be posted on the City's Council Agenda website for the February 5, 2019 Council Meeting.

COORDINATION

Preparation of this report has been 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.

FISCAL/POLICY ALIGNMENT

This expenditure is consistent with the following policy documents: *The City's Envision 2040 General Plan and the 2014-23 adopted Housing Element*, in that it will help the City meet its Regional Housing Allocation needs, the City's current Housing Investment Plan of increasing San José's supply of affordable housing, and the City's 2015-20 HUD Consolidated Plan in that it will provide rental affordable apartments to low- and extremely low-income households.

COST SUMMARY

1. ESTIMATED COSTS:

Uses	<u>Amount</u>
Predevelopment Loan Capitalization	\$200,000
Predevelopment Interest (Estimated through April 2020)	\$15,000
Construction Loan	\$10,875,000
<u>Construction loan Interest</u>	<u>\$533,320</u>
Estimated Costs	\$11,623,320
 Total "Up To" Permanent Loan Amount	 \$11,623,320

2. SOURCE OF FUNDING: Low and Moderate Income Housing Asset Fund (346).
3. FISCAL IMPACT: No ongoing fiscal impact.

BUDGET REFERENCE

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

Fund #	Appn #	Appn. Name	Total Appn	Recom. Budget Action	2018-2019 Adopted Operating Budget Page	Last Budget Action (Date, Ord. No.)
346	8437	Housing Project Reserve	\$81,800,000	(\$11,623,320)	X-55	10/16/2018 Ord. No. 30172
346	8520	Committed Projects Reserve	\$14,784,212	\$11,623,320	X-55	10/16/2018 Ord. No. 30172

CEQA

Addendum to the Downtown Strategy 2040 Environmental Impact Report (EIR) (Resolution No. 78942), the Envision San José 2040 General Plan Final Program EIR (Resolution No. 76041), Envision San José 2040 General Plan Supplemental EIR (Resolution No. 77617), and Addenda thereto; and does not involve new significant impacts beyond those analyzed in the above EIRs, File No. SP18-024.

The Balbach project is currently scheduled to go to Planning Director's Hearing on January 30, 2019.

/s/
JACKY MORALES-FERRAND
Director, Housing Department


MARGARET MCCAHAN
Budget Director

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

Attachment A: Project Overview and Site Map
Attachment B: Construction/Permanent Sources for the Project
Attachment C: Anticipated Development Timeline

ATTACHMENT A

226 Balbach Ave Apartments Project Overview and Site Map



Developer	Satellite Affordable Housing Associates
Borrowing Entity/Limited Partnership	TBD
Architect	Leddy Maytum Stacy Architects
Service Provider	Satellite Affordable Housing Associates
Property Management	Satellite Affordable Housing Associates

Address	226 Balbach Avenue
Urban Village Plan	Downtown Core
Development Type	New Construction
Construction Type	8 STORY, CONC. STRUCT. FRAME, AFFORDABLE, MULTIFAMILY RES. W/ 1ST FLR. PARKING GARAGE + COURTYARD @ 2ND FLR. PODIUM
Parking Type Residential Parking Spaces/Ratio	Bike & Car-On Grade Podium .5 per unit=44
Housing Type	Affordable Housing
Lot size	.375 Acres (16,342 SF)
Units	86 units and 1 two-bedroom manager unit
Density	87 Units/.375 Acres 223 Units/Acres
Gross Building Area Parking Space Residential Space	92,000 SF
Prevailing Wages?	Yes
Developer's Compliance History	First loan between the SAHA and City

ATTACHMENT A - Continued

226 Balbach Ave Site Map



ATTACHMENT B

226 Balbach Apartments Construction/Permanent Sources Plan for the Project

CONSTRUCTION SOURCES

SOURCES OF FUNDS - CONSTRUCTION		
<u>SOURCE</u>		<u>AMOUNT</u>
Tax-Exempt Perm Bond		\$30,073,944
City of San Jose		\$10,875,000
Predevelopment Loan & Accrued/Deferred Interest (CSJ)		\$215,000
Affordable Housing Program		\$860,000
Land Donation (CSJ owned site lease)		\$2,400,000
Deferred Cost through Construction		\$2,575,258
Deferred Developer Fee		\$795,000
Capital Contributions		
	General Partner	
	Limited Partners	\$4,516,432
Total Sources		\$52,310,634

PERMANENT SOURCES

SOURCES OF FUNDS - PERMANENT		
<u>SOURCE</u>		<u>AMOUNT</u>
Tax-Exempt Perm Bond		\$4,690,981
HCD AHSC Loan		\$10,793,418
City of San Jose		\$11,090,000
Accrued/Deferred Interest (CSJ)		\$533,320
Affordable Housing Program		\$860,000
Land Donation (CSJ owned site lease)		\$2,400,000
Deferred Developer Fee		\$795,000
Capital Contributions		
	General Partner	\$705,000
	Limited Partners	<u>\$20,442,915</u>
Total Sources		\$52,310,634

ATTACHMENT C

226 Balbach Apartments Anticipated Development Timeline

Apply for AHSC Funding	February 2019
Apply for CDLAC/TCAC	October 2019
Bond Allocation Award	December 2019
Submit Construction Drawings for Building Permits	January 2020
Close Financing	May 2020
Start Construction	May 2020
Complete Construction	September 2021