

COUNCIL AGENDA: 1/14/20

FILE: 20-040

ITEM: 4.3

Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Jacky Morales-Ferrand
Jim Shannon

SUBJECT: SEE BELOW

DATE: December 18, 2019

Approved

D. D. S. L.

Date

12/18/19

COUNCIL DISTRICT: 6

SUBJECT: APPROVAL OF A LOAN COMMITMENT TO DANCO COMMUNITIES OR ITS AFFILIATE FOR THE DEVELOPMENT OF WEST SAN CARLOS PERMANENT SUPPORTIVE HOUSING, A NEW AFFORDABLE APARTMENT COMMUNITY LOCATED AT 750 WEST SAN CARLOS STREET

RECOMMENDATION

(a) Adopt a resolution:

- (1) Approving a total commitment of up to \$9,875,000 in Low and Moderate Income Housing Asset Funds for a Construction-Permanent Loan to Danco Communities, or an affiliated entity for the West San Carlos Permanent Supportive Housing, a new affordable development to be located at 750 West San Carlos Street, in order to offer rent- and income-restricted apartments for 80 extremely low-income, very low-income, and low-income households, and one unrestricted manager's unit;
- (2) Authorizing the Director of Housing to negotiate and execute loan documents, amendments, and all other documents related to City financing for the Project;
- (3) Approving a loan-to-value ratio of greater than 100% for this loan; and
- (4) Authorizing the City Loan terms to allow an increase in the Development's rents and income up to 60% of the area median income (or low-income threshold) for new tenants in the event of the expiration or termination of subsidy contracts, and for all tenants in the event of a foreclosure, to the extent the City has determined such increase is needed for feasibility of the Development.

(b) Adopt the following 2019-2020 Appropriation Ordinance Amendments in the Low and Moderate Income Housing Asset Fund:

- (1) Decrease the Housing Project Reserve appropriation in the amount of \$9,875,000; and
- (2) Increase the appropriation to the Housing Department for Housing Loans and Grants in the amount of \$9,875,000.

OUTCOME

Approval of the recommended actions will enable the Developer to assemble financing to build a new affordable development at 750 West San Carlos Street in San José (*Attachment A*). This development will provide affordable housing for 80 households in San José, including 40 apartments for formerly homeless individuals. This funding commitment will result in a total of 1,805 affordable housing units completed, under construction, or entitled since January 2018 that will be counted towards the Mayor and the City Council's 10,000-unit goal, including a total of 725 units that will be set aside for formally homeless persons.

EXECUTIVE SUMMARY

In response to the \$100 million Notice of Funding Availability (NOFA) last year, Danco applied for a funding commitment in the amount of \$9,875,000 to develop 80 apartments for extremely-low-, very low-, and low-income individuals and families. This development plans to utilize funds from the City's Low and Moderate Income Housing Asset funds, Santa Clara County Measure A Affordable Housing Bond funds, Tax-Exempt Multi-Family Housing Revenue Bonds and state tax credits. Approval of this funding commitment will allow the developer to move forward with an application to the California Debt Limit Allocation Committee.

BACKGROUND

On August 31, 2018, following the City Council's direction, the Housing Department issued a \$100 million NOFA for the development of affordable housing for extremely-low income, very low-income, and low-income individuals and families. The NOFA prioritized developments that provided housing for homeless households that achieved cost effectiveness, and that leveraged additional non-City sources of financing, such the Low Income Housing Tax Credits program.

In response to the NOFA, the Developer submitted a development proposal with a request for a commitment of funding in the amount of up to \$9,875,000 to provide 80 affordable units of one and two bedrooms, which include 40 units for permanent supportive housing. These units will have Project Based Vouchers. There will be 40 units at 25% area median income (AMI), which will have Project Based Vouchers, 20 units at 50% AMI, and 19 units at 60% AMI. There will also be a two-bedroom manager's unit, for a total of 80 units. The Development will receive supportive services from Santa Clara County, and on-site service coordination from LifeSTEPS or an equivalent, and a property management company acceptable to the City.

On August 20, 2018, the Developer formed the partnership, San Jose W San Carlos, LP and utilized a \$9,300,000 loan from the County, coupled with a loan of \$1,000,000 from Destination HOME to purchase the Site and provide for predevelopment costs. The County will purchase the property prior to the construction loan closing. The City and County have agreed that the

Developer will enter into a long-term ground lease with the County, as owner of the Site, in order to ensure the long-term affordability of the Development.

The Developer will also pursue, or has obtained, additional supplemental construction and permanent funding sources for the West San Carlos Supportive Housing development, including:

- **City of San José Tax-Exempt Multi-Family Housing Revenue Bonds (“City Bonds”)**
On November 22, 2019, the Director of Finance held a Tax Equity and Fiscal Responsibility Act hearing regarding the issuance of tax-exempt multifamily housing revenue obligations in an amount not to exceed \$35 million to finance the construction of the Development.

The Developer is applying for an allocation of \$35 million in tax-exempt multifamily housing revenue bonds to, in part, finance the Development. Under this memorandum to City Council, Housing seeks approval to issue the City Bonds for the January 2020 submission to the California Debt Allocation Committee. Awards are anticipated to be announced by the Committee in March 2020. Once the awards are made, staff will seek authorization from the City Council to issue the bonds.

- **Measure A Affordable Housing Bond**
On September 26, 2017, the County issued a NOFA for the Measure A Affordable Housing Bond, a \$950 million general obligation bond that will create new affordable rental and homeowner housing opportunities. In June 2018, the Board of Supervisors appropriated \$9,300,000 in Measure A funds. The County will seek to acquire the fee interest in the property and execute a ground lease with the developer.

To date, the County has committed \$282,780,000, in Measure A and No Place Like Home Funds, in 23 affordable housing developments in six cities. **Attachment C** has a complete listing of the affordable housing developments funded by the County.

ANALYSIS

The 80-unit Development will be a seven-story affordable supportive housing development with six stories of residential over one story of parking. As noted above, the Developer has already been successful in securing approval of an allocation of Measure A funding from the County for the Development in June 2018 and has applied to the Multifamily Housing Program in August of 2019. The City’s Construction-Permanent Loan commitment to the Developer of up to \$9,875,000 is necessary at this time because it will enable Danco to pursue other public and private funding sources for the Development.

Construction-Permanent Loan

The Housing Department recommends that the City Council approve a Construction-Permanent Loan amount for up to \$9,875,000 from Low and Moderate Income Housing Asset Funds equating to \$123,437 per unit, lower than the NOFA's \$125,000 maximum threshold per unit subsidy. Capitalized interest from the construction phase is included in the financing for this Development because the City funds will be utilized as both a construction and permanent financing. The construction loan and principal cannot exceed the maximum permanent loan amount of \$9,875,000. The City's Construction-Permanent Loan commitment will represent approximately 16% of the total financing for the Development. The City's loan will be structured consistent with its underwriting guidelines and policies and will be repaid through a share of the Development's net cash flow. Final loan terms will be underwritten, negotiated, and determined as the Development approaches construction loan closing. The final loan terms will be documented through the Director's Delegation of Authority.

The County's Measure A funds will fund in part its purchase of the land from the Developer. The County will own the land and lease it to the Developer. The City's Deed of Trust will be recorded against the County's leasehold. See **Attachment B** for a summary of the construction/permanent sources for the Development.

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 development. If the Developer is unsuccessful in securing augmented funding for the Development, the Housing Department may return to the City Council for consideration of additional construction-permanent financing.

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 Development's market value, leading to an increased LTV. An elevated LTV is not uncommon for public lenders in the affordable housing industry. Developments that have a high LTV are considered acceptable by City staff, if the Development's operating income is expected to be at least 1.15 times the permanent mortgage debt service payments, as is the case in this Development (at 1.20). This 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 Development 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 developments. Therefore, a site cannot be

easily liquidated should a proposed Development not proceed. This approval will enable the Development 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 proposes to build the following unit and income mix:

UNIT SIZE	Extremely Low-Income UP TO 25% AMI		Very-Low UP TO 50% AMI		Low-Income UP TO 60% AMI		TOTAL
	Units	Max Income	Units	Max Income	Units	Max Income	
1 Bed	28	\$35,150	15	\$58,550	14	\$70,260	57
2 Bed	12	\$39,550	5	\$65,850	5	\$79,020	22
Managers Unit	N/A	N/A	N/A	N/A	N/A	N/A	1
Total	40		20		19		80

****Maximum incomes limits are based upon HCD occupancy guidelines of 1 person per bedroom, plus 1.**

This unit mix will help meet priorities expressed by the City Council as it includes 40 permanent supportive housing units for the chronically homeless and it will position the Development to be competitive for alternative funding sources. It will further serve the goal of providing affordable housing for residents working in the restaurant industry, school bus drivers, emergency medical technicians, substitute teachers, and other trades and professions with incomes below the affordability levels outlined above.

Allowance for Rents to Increase in Case of Foreclosure

The affordability restriction will not be subordinated to the senior loan, so the restriction will allow an increase in the Development's rents and income up to 60% AMI (the low-income threshold) for all tenants in the event of a foreclosure, to the extent the City has determined such increase is needed for feasibility of the Development.

Next Steps

If Danco is able to obtain all necessary funding commitments for the Development, they will apply for Low Income Housing Tax Credits and a Tax-exempt Bond Allocation in January 17, 2020. Construction would initiate in July 2020 and conclude in June 2021. **Attachment D** provides an anticipated development timeline for the Development.

CONCLUSION

A City Council consent to the loan commitment to Danco Communities and the City's issuance of tax-exempt Bonds will facilitate the development of the Development that will serve households of extremely low income, very low- income and low income, and include supportive case management services as provided by the County.

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 memoranda. In addition, the Housing Department posts periodic reports on the status of its affordable properties undergoing rehabilitation or construction to its website, www.sjhousing.org. If the recommended actions are approved and the Development successfully closes construction financing, it would be included in these Quarterly Production Reports.

CLIMATE SMART SAN JOSE

The recommendation in this memo aligns with one or more of Climate Smart San José energy, water, or mobility goals. The construction of the West San Carlos affordable housing development supports high density development along a transit corridor.

POLICY ALTERNATIVES

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

Alternative #1: *The City Council could deny the request for funding to the Developer for the Development.*

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

Cons: The City will lose an opportunity to provide housing for extremely low income individuals and other households currently residing in San José.

Reason for not recommending: The proposed Development will help to meet the demand for deeply affordable housing that is affordable to the most vulnerable homeless individuals and families. The Development will help the City fulfill its affordable housing goals. If the following aforementioned are not the City's goals, then the above would be reasons to not recommend.

PUBLIC OUTREACH

Prior to City Council's scheduled meeting for January 14, 2020, Danco implemented a comprehensive outreach plan to engage with the community to provide information, to answer questions, and to better understand the concerns of the neighborhood residents and businesses. In January 2020, the Developer will host a neighborhood/community meeting, attended by neighborhood associations, local faith-based organizations, various advocacy groups and community members, addressing a wide array of topics regarding the Development.

This memorandum will be posted on the City's Council Agenda website for the January 14, 2020 Council Meeting.

COORDINATION

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

COMMISSION RECOMMENDATION/INPUT

This item was not heard by the Housing and Community Development Commission, as approvals of affordable development financing do not fall under the functions, powers, and duties of the Commission delineated in Section 2.08.2840 of the San José Municipal Code.

FISCAL/POLICY ALIGNMENT

This expenditure is consistent with the following policy documents: *The City's Envision 2040 General Plan* and the *2014-2023 adopted Housing Element* in that it will help the City meet its Regional Housing Needs Allocation; the City's current *Housing Investment Plan* in that it increases San José's supply of affordable housing; the *City's 2015-2020 HUD Consolidated Plan* in that it will provide rental apartments affordable to very low- and extremely low-income households; and the *Community Plan to End Homelessness* approved by the City Council in February 2015 in that it is providing supportive housing for formerly homeless residents.

COST SUMMARY/IMPLICATIONS

1. AMOUNT OF RECOMMENDATION: \$9,875,000
2. SOURCE OF FUNDING: Low and Moderate Income Housing Asset Fund (Fund 346).
3. FISCAL IMPACT: Funding in the amount of \$9,875,000 has been reserved in the Low and Moderate Income Housing Asset fund and is recommended as part of this memorandum to be appropriated to the Housing Loans and Grants appropriation to

encumber and draw upon when construction is initiated in Summer 2020. There is no on-going fiscal impact as a result of this action.

BUDGET REFERENCE

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


Fund #	Appn #	Appn. Name	Total Appn	Recom. Budget Action	2019-2020 Adopted Operating Budget Page	Last Budget Action (Date, Ord. No.)
346	8437	Housing Project Reserve	\$84,000,000	(\$9,875,000)	X-55	10/22/2019, 30325
346	0070	Housing Loans and Grants	\$53,964,960	\$9,875,000	X-55	10/22/2019, 30325

CEQA

Statutorily Exempt, Public Resources Code Section 21080(b)(1), Ministerial projects proposed to be carried out or approved by public agencies.

/s/

JACKY MORALES-FERRAND
Director, Housing Department


JIM SHANNON
Budget Director

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

Attachment A: Development Overview and Site Map
Attachment B: Construction/Permanent Sources for the Development
Attachment C: County of Santa Clara – Measure A No Place Like Home Funding
Attachment D: Anticipated Development Timeline

ATTACHMENT A

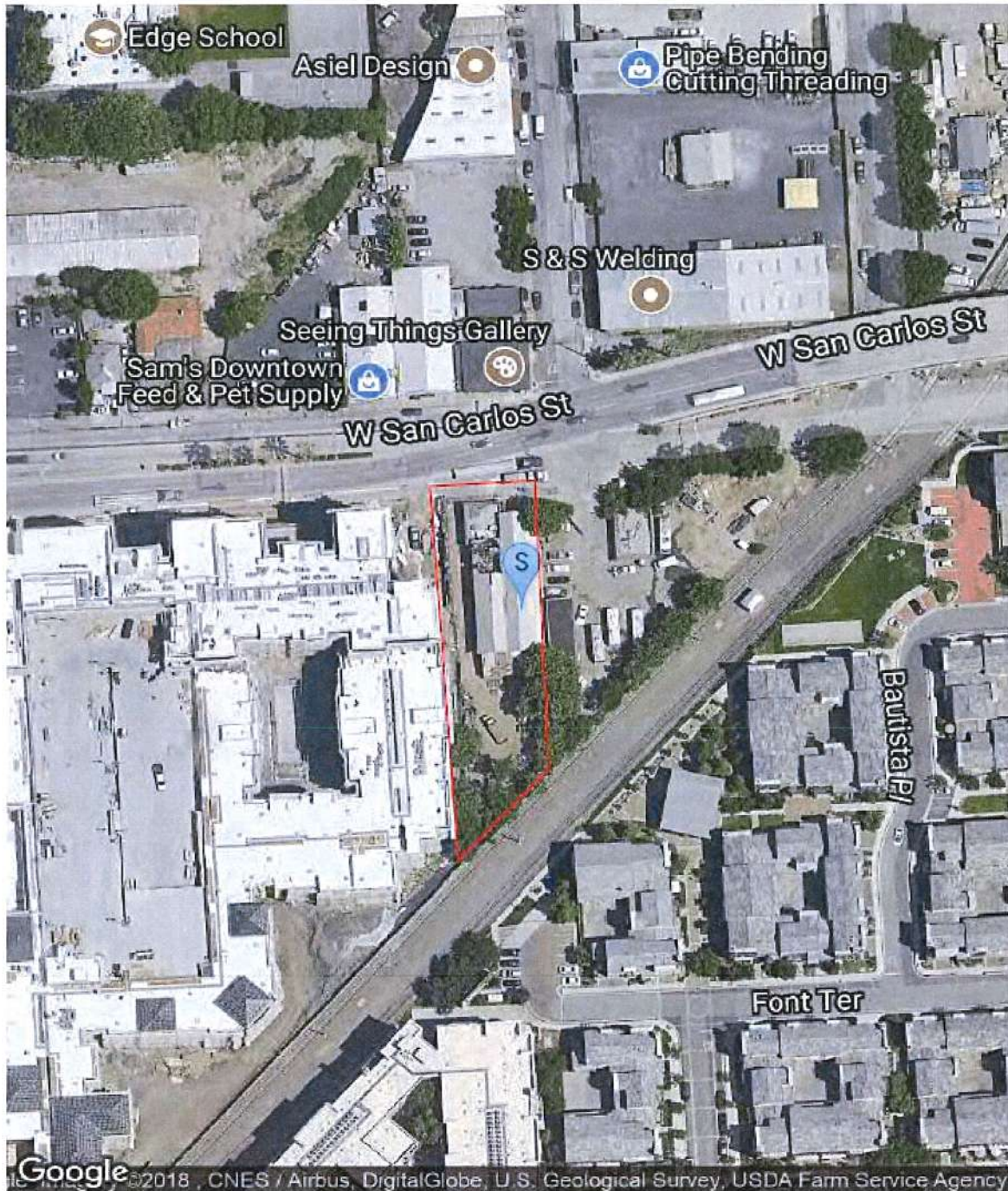
West San Carlos Permanent Supportive Housing Site Map



ATTACHMENT A - Continued
West San Carlos Permanent Supportive Housing
Site Map

AERIAL PHOTOGRAPH

SJC180386



ATTACHMENT B

West San Carlos Permanent Supportive Housing Construction/Permanent Sources Plan for the Development

Construction Sources

Sources and Uses - Construction	
<u>Sources</u>	
Pacific Western Bank Construction Loan (PAB)	\$ 34,200,000
City of San Jose Funds	\$ 9,875,000
Tax Credit Equity	\$ 3,333,092
MHP Funds	\$ -
County Measure A Funds	\$ 3,350,000
County Acquisition Funds	\$ 5,912,500
State Credits	\$ 1,992,219
Deferred Costs	\$ 1,232,719
Deferred Developer Fee Note	\$ 2,928,022
Cash	\$ -
Total Sources	\$62,823,552
<u>Uses</u>	
Land Cost / Acquisition /PreDev Interest	\$ 5,912,500
New Construction	\$42,710,403
Architectural Fees	\$ 1,350,000
Construction Interest & Fees	\$ 2,730,455
Permanent Financing	\$ 334,320
Legal Fees	\$ 100,000
Reserves	\$ 561,413
Appraisal	\$ 10,000
Other Project Costs	\$ 5,381,438
Developer Costs.	\$ 3,733,022
Total Uses	\$62,823,551

ATTACHMENT B - Continued

West San Carlos Permanent Supportive Housing Construction/Permanent Sources Plan for the Development

Permanent Sources

Sources and Uses - Permanent	
<u>Sources</u>	
Pacific Western Bank Permanent Loan (PA)	\$ 14,978,000
City of San Jose Funds	\$ 9,875,000
Tax Credit Equity	\$ 16,665,462
MHP Funds	\$ 848,475
County Measure A Funds	\$ 3,350,000
County Acquisition Funds	\$ 5,912,500
State Credits	\$ 9,961,093
Deferred Costs	\$ -
Developer Note	\$ 1,233,022
Cash	\$ -
Total Sources	<u>\$ 62,823,552</u>
<u>Uses</u>	
Land Cost / Acquisition /PreDev Interest	\$ 5,912,500
New Construction	\$ 42,710,403
Architectural Fees	\$ 1,350,000
Construction Interest & Fees	\$ 2,730,455
Permanent Financing	\$ 334,320
Legal Fees	\$ 100,000
Reserves	\$ 561,413
Appraisal	\$ 10,000
Other Project Costs	\$ 5,381,438
Developer Costs.	\$ 3,733,022
Total Uses	<u>\$ 62,823,552</u>

ATTACHMENT C

COUNTY OF SANTA CLARA – MEASURE A AND NO PLACE LIKE HOME FUNDING

Housing Development	City	Total # of Units	Supportive Housing	County Investment
The Veranda	Cupertino	19	6	\$1,000,000
Villas on the Park	San Jose	84	83	\$7,200,000
Crossings on Monterey	Morgan Hill	39	20	\$5,800,000
Gateway Senior Apartments	Gilroy	75	37	\$7,500,000
Leigh Avenue Senior Apartments	San Jose	64	63	\$13,500,000
Evans Lane Community Village	San Jose	61	30	\$12,000,000
North San Pedro Apartments	San Jose	135	109	\$7,200,000
Page Street Apartments	San Jose	82	27	\$14,000,000
Quetzal Gardens	San Jose	71	28	\$9,830,000
Corvin Apartments	Santa Clara	145	80	\$29,000,000
Blossom Hill Development	San Jose	147	49	\$19,100,000
Alum Rock Family Housing	San Jose	87	43	\$15,650,000
West San Carlos Apartments	San Jose	80	40	\$9,300,000
Sango Court Apartments	Milpitas	102	40	\$16,000,000
Gallup & Mesa	San Jose	46	23	\$2,400,000
Agrihood Sr. Apartments	Santa Clara	165	54	\$23,550,000
Auzerais	San Jose	130	64	\$13,200,000
Roosevelt Park	San Jose	80	40	\$14,400,000
Markham I	San Jose	153	40	\$7,000,000
Markham II	San Jose	152	50	\$7,200,000
Curtner Studios	San Jose	179	111	\$14,950,000
Gallup Mesa	San Jose	46	23	\$7,000,000
425 Azerais	San Jose	130	64	\$26,000,00
TOTAL UNITS		2,272	1,124	\$256,780,000

ATTACHMENT D

West San Carlos Permanent Supportive Housing Anticipated Development Timeline

Apply for CDLAC/TCAC	January 17, 2020
Bond Allocation Award	March 2020
Close Financing	May 2020
Start Construction	July 2020
Complete Construction	June 2021