



# Memorandum

**To:** HONORABLE MAYOR  
AND CITY COUNCIL

**From:** Jacky Morales-Ferrand

**Subject:** SEE BELOW

**Date:** December 11, 2019

Approved

*D. D. Syl*

Date

*12/19/19*

**COUNCIL DISTRICT: 3**

**SUBJECT: PUBLIC HEARING ON THE SUMMARY REPORT PURSUANT TO CALIFORNIA HEALTH AND SAFETY CODE SECTION 33433 FOR THE GROUND LEASING OF CITY OWNED PROPERTY AT 500 ALMADEN AVENUE AND RELATED ACTIONS FOR THE ARYA AFFORDABLE HOUSING DEVELOPMENT**

## RECOMMENDATION

Hold a Public Hearing and adopt a resolution:

- (1) Accepting the summary of costs and findings of the Summary Report pursuant to Section 33433 of the California Health and Safety Code for the disposition of City property located at 500 Almaden Avenue (formerly 226 Balbach Ave) authorizing an option to ground lease for 65-years to Satellite Affordable Housing Associates or affiliate ("SAHA") for the Arya affordable housing project under the terms and conditions of the proposed leasehold restrictions, option and ground lease;
- (2) Authorizing the Director of Housing to negotiate and execute the option, the 65-year ground lease and extension option and related documents in connection with the development and financing of the Arya project, including lease amendments and lease riders which may be required by the California Tax Credit Allocation Committee ("TCAC"); and
- (3) Authorizing the City Manager or his designee to submit a joint application for the Arya project under the Infill Infrastructure Grant Program for new construction capital improvement projects in support of Qualifying Infill Projects or Qualifying Infill Areas.

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## **OUTCOME**

Approval of the recommended actions will enable the Developer, SAHA, to assemble financing to build a new affordable development ("Arya", formerly known as "Balbach") at the City owned property located at 500 Almaden Avenue (formerly 226 Balbach Ave) ("Site") (*Attachment A*). The Arya will provide 86 affordable housing for 18 extremely low income (30% Area Median Income (AMI)), 38 very low income (50% AMI), and 30 low (60% AMI) income households in San José. These units are already included in the 1,725 affordable housing units completed, under construction, or entitled that will be counted towards the Mayor and the City Council's 10,000-unit goal.

City Council's approval of the 33433 report and option would result in the Developer being able to apply for low income housing tax credits ("LIHTC" or "tax credits") and a tax exempt bond allocation in the January application. Consideration at the January 14, 2020 City Council meeting is necessary to meet the January 17, 2020 TCAC application deadline.

## **EXECUTIVE SUMMARY**

The Housing Department identified SAHA as a partner to develop an affordable housing development on this site. SAHA submitted an application under the City's recent Notice of Funding Availability for \$10,875,000 to develop an 87-unit affordable housing development. This request was approved by City Council. In order to meet requirements of the law to move forward with a City lease hold on the property, a public hearing must be held to review the economic impacts of the ground lease on the property. Approval of these actions will allow the developer to move forward with an application to the California Debt Limit Allocation Committee.

## **BACKGROUND**

In November 2014, the Housing Department initiated a competitive process to identify potential operators and developers with demonstrated experience in creating affordable housing in urban areas. Through this effort, three development teams were deemed qualified to create affordable housing within the Downtown Core and SAHA was chosen to develop the Arya Development.

On September 22, 2015, the City Council authorized the Director of Housing to negotiate and execute a purchase and sale agreement to acquire the Site from the Successor Agency to the Redevelopment Agency 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.

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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<sup>th</sup> 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 Site.

In October of 2018, the Housing Department issued a \$100,000,000 Notice of Funding Availability for the funding of affordable housing. In response to the NOFA, SAHA submitted a proposal for \$10,875,000 in funding for the construction of an 87-unit affordable housing project on the Site, or \$125,000 per unit.

On February 5, 2019, the City Council authorized two actions: 1) the authorization for the City to act as co-applicant for the Affordable Housing and Sustainable Communities grant and loan program; and 2) a funding commitment of up to \$11,623,320, in Low and Moderate Income Housing Asset Funds for a Construction-Permanent Loan to Satellite Affordable Housing Associates, or an affiliated development entity, and the capitalization of up to \$533,320 in construction period interest for the 226 Balbach Apartments Development ( now referred to as the Arya), a new affordable development to be developed on City-owned property located at 226 Balbach Street. The City Council authorized these two actions in order to offer 86 rent and income restricted apartments for extremely low, very low and low income individuals and families, and one unrestricted manager’s unit. The Development was successful in securing \$18,908,818 in funding for housing and transportation related improvements through the Affordable Housing and Sustainable Communities grant in July of 2019.

In November of this year SAHA requested \$400,000 in additional predevelopment funding. This amount will increase the overall funding commitment from \$11,623,320 to \$12,023,320. The increase will be granted under the Director’s Authority (Municipal Code Section 5.06.340) which allows an increase in the principal amount of a loan of up to 20% provided that conditions are met. The conditions of the Director’s approval will be documented prior to loan closing and will be included in the quarterly Delegation of Authority information memorandum.

## **ANALYSIS**

The analysis section of this memorandum will provide information related to: 1) Compliance with State Law; 2) Requirements for City Ground Lease; 3) State Infill Grant application; and 4) Next Steps. These recommendations will support the City and Developer’s efforts in moving the Arya development forward in the critical process of securing tax credit and bond financing for this future affordable housing development.

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## **Compliance with State Law**

In September of 2015, the City Council granted the Director of Housing the authority to acquire the Property from the Successor Agency to the Redevelopment Agency with funds from the Low and Moderate Income Housing Asset fund and in subsequent actions authorized funding for the development of the Arya as affordable housing.

Now in order to apply for tax credits and other funding, SAHA must obtain control of the Site by means of a ground lease or option to ground lease. In order to approve this transfer of site control, the City must first comply with Section 33433 of the California Health and Safety Code ("Section 33433").

Although redevelopment agencies have been dissolved, the redevelopment law still applies to Successor Housing Agencies such as the City as they develop and administer affordable housing assets financed by low and moderate income housing asset funds. The Housing Department used funds from the Low and Moderate Income Housing Asset fund to acquire the Site and thus the granting of an option to ground lease and the ground leasing of the Site may only be done in compliance with Section 33433. This requires that a copy of the proposed lease and a summary report disclosing the financial aspects of the transaction be prepared and made available for public inspection at least two weeks prior to the date of the public hearing.

A Summary Report Pursuant to Section 33433 ("33433 Report") was prepared by Keyser Marston analyzing the costs and benefits related to the disposition of the Property to the Developer under the Ground Lease. The 33433 Report was published in the Post Record on December 30, 2019 and January 6, 2020 as required under Section 33433. The 33433 Report is included as **Attachment B** to this report.

Section 33433 also requires that the City make a finding that the consideration to be received by the City for the Site, is not less than the fair market value or the fair reuse value of the Site.

As described above, the lease of the Site is to provide housing for low- or moderate-income persons. The Summary Report has found that given the deep affordability restrictions to be imposed on the Development by the City and the anticipated development costs, the fair reuse value of the Site is nominal. Upon the expiration of the affordability covenants and ground lease years, the City will hold title to the Property and will be able to sell it at a fair market value receive full consideration for the Site. Thus, the consideration to the City as described in the Summary Report is not less than the fair reuse value at the use and with the covenants and conditions and development costs authorized by the lease.

The authority for the Director of Housing to execute documents and amendments to the Lease is intended to reach all lease related documents and amendments that are substantially consistent

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with the business terms described in the Summary Report and the substantially final posted documents.

### **Requirements for the City Ground Lease**

The California Tax Credit Allocation Committee (TCAC) requires the City, as current owner of the land, to execute a lease rider prior to TCAC's final approval of the project tax credits. The lease rider is a document stating the terms of the City's ground lease that will allow for the investment of tax credits in the affordable housing development. The execution of the lease rider is expected to occur at or after conversion to permanent financing. The City has previously negotiated a form of lease rider with TCAC, the terms of which are described below. Although Chapter 5.06 of the San José Municipal Code authorizes the Director of Housing to amend loan documents if certain findings are made, the Director has no similar delegated authority to amend ground lease terms. Therefore, City Council authorization is required for the Director's execution of the TCAC Rider.

### **Terms of the TCAC Lease Rider**

The TCAC Rider requires the City to waive any provision in the Ground Lease in favor of the TCAC Rider. TCAC has agreed to limit that waiver to the terms that are expressly in conflict with or would prevent the Developer from being compliant with the TCAC Regulatory Agreement.

The TCAC Rider requires the City to provide warranties regarding, amongst other things, the current status of the City's title, and the current compliance of the Developer's physical improvements to the Property with state law, local law, federal law, and agreements with public entities. The TCAC Rider also imposes an ongoing requirement for the City to certify various items, including any information relating to the condition of the Property, within 30 days from any reasonable request from TCAC. However, TCAC has agreed to edit the TCAC Rider to allow the City to satisfy its duty with respect to warranties and certificates regarding the condition of the Property and physical improvements, based on estoppel certificates from the Developer.

The TCAC Rider replaces the transfer provisions in the Ground Lease with its own transfer provisions. This could subject the City to conflicting requirements. TCAC has agreed to a provision exempting City transfers required by a senior lender under the Ground Lease from the TCAC Rider's transfer provisions.

### **Conditions Required for Execution of the TCAC Rider**

Staff is seeking authorization for the Director to negotiate and execute a TCAC Rider substantially in the form of the draft TCAC Rider after approval to form by the City

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Attorney's Office and fulfillment of the following conditions: written consent of all lenders as is required for all amendments to the Ground Lease; updated Lessor's title policy as required for the TCAC Rider's representation regarding title; and agreement requiring the Developer to provide an estoppel certificate to the City during the term of the TCAC Rider.

### **State Infill Grant Application**

SAHA, along with the City of San Jose' as a co-applicant, plans to apply for funding from the State of California's Department of Housing and Community Development's Infill Infrastructure Grant Program. The Infill Infrastructure Grant Program is a competitive grant program that awards funding between \$500,000 and \$5-million. By providing financial assistance, the grant program supports infrastructure improvements to facilitate new infill housing development. The grant program serves to aid in new construction and rehabilitation of infrastructure that supports higher-density affordable housing in locations designated as infill. The Infill Infrastructure Grant Program application is due February 18, 2020. SAHA is seeking \$2.5-million for the Arya development.

### **Next Steps**

The Developer plans to apply for funding in the January 17, 2020 TCAC and the California Debt Limit Allocation Committee joint application. The developer will request an allocation of up to \$50,000,000 from the California Debt Limit Allocation Committee and an estimated \$5,075,000 in state tax credits from TCAC.

The Developer will apply for is committed to securing and closing all financial commitments for the Development by July 2020. If the Developer meets this goal, construction of the Development would begin shortly after. Assuming an 18-month construction timeline, it is anticipated that the Development will complete construction by December 2021.

### **CONCLUSION**

Staff recommends approval of the recommendation to hold a public hearing and accept the 33433 report; accept the TCAC Lease Rider terms; and support the Qualifying Infill Projects or Qualifying Infill Areas application. This will allow the Arya development to move forward seeking the funding necessary to finance the development of 86 new affordable apartments in San José.

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## **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](http://www.sjhousing.org). If the recommended actions are approved and The Arya successfully closes construction financing, it would be included in these 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.

## **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 Arya 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

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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 January 14, 2020 Council Meeting.

### **COORDINATION**

Preparation of this report has been coordinated with the Office of the City Attorney and the City Manager's Budget Office.

### **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.

### **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.



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**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.

/s/

JACKY MORALES-FERRAND  
Director, Housing Department

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

Attachments

A – Location Map

B – Summary Report

**Attachment A – Location Map**



**SUMMARY REPORT PURSUANT TO  
SECTION 33433  
OF THE  
CALIFORNIA HEALTH AND SAFETY CODE  
ON  
THE GROUND LEASE OF 226 BALBACH STREET BY AND BETWEEN  
THE CITY OF SAN JOSE  
AND  
SATELLITE AFFORDABLE HOUSING ASSOCIATES (SAHA)**

**I. INTRODUCTION**

The California Health and Safety Code, Section 33433, requires that if a Housing Successor of a former redevelopment agency wishes to sell or lease property to which it holds title and if that property was acquired in whole or in part with property tax increment funds, the Housing Successor must first secure approval of the proposed sale or lease agreement from its local legislative body after a public hearing. Section 33433 also requires a copy of the proposed sale or lease agreement and a summary report that describes and contains specific financing elements of the proposed transaction to be available for public inspection prior to the public hearing. As contained in the Code, the following information shall be included in the summary report:

1. The cost of the agreement to the Housing Successor that is to be funded from property tax increment, including land acquisition costs, clearance costs, relocation costs, the costs of any improvements to be provided by the Housing Successor, plus the expected interest on any loans or bonds to finance the agreement;
2. The estimated value of the interest to be conveyed or leased, determined at the highest and best use permitted under the redevelopment plan;
3. The estimated value of the interest to be conveyed in accordance with the uses, covenants, and development costs required under the proposed agreement with the Housing Successor, i.e., the reuse value of the site;
4. An explanation of how the sale or lease of the property will assist in the elimination of blight; and
5. The purchase price or sum of the lease payments that the lessor will be required to make during the term of the lease. If the sale price or total rental amount is less than the fair market value of the interest to be conveyed or leased, determined at the highest and best use consistent with the redevelopment plan, then the Housing Successor shall provide as part of the summary an explanation of the reasons for the difference.

This report outlines the salient parts of the lease agreement (the "Agreement") to be entered into by and between the City of San José (City) and Satellite Affordable Housing Associates (Developer / SAHA) for the lease of the subject property. This report is being prepared due to the fact that property tax increment funds from the former Redevelopment Agency of the City of San Jose (RDA) were used to acquire the subject property in 2007 and Low and Moderate Income Housing Asset Funds were used by the City of San Jose to acquire the property from the Successor Agency to the Redevelopment Agency of the City of San Jose on August 11, 2016.

This report is based upon information in the proposed Agreement and is organized into the following five sections:

1. **Summary of the Proposed Agreement** – This section includes a description of the property, the proposed development and the major responsibilities of the City and the Developer.
2. **Cost of the Agreement to the City** – This section outlines the cost of the Agreement to the City for costs that have been funded with property tax increment funds. It presents the terms of the property's lease and sets forth the net cost of the Agreement to the City.
3. **Estimated Value of the Interest to be Conveyed** – This section summarizes the value of the property to be leased to the Developer.
4. **Consideration Received and Reasons Therefore** – This section describes the value of the payments to be made by the Developer to the City. It also contains a comparison of the purchase price and the fair market value at the highest and best use consistent with the redevelopment plan for the interests conveyed.
5. **Provision of Very Low, Low, or Moderate-Income Housing** – This section demonstrates how the lease/sale of the property will provide housing for Very Low-, Low-, or Moderate-Income persons.
6. **Elimination of Blight** – This section demonstrates how the Project satisfies the blight elimination criteria imposed by Section 33433 through the provisions of housing for Very Low- to Moderate-Income persons.

## **II. SUMMARY OF THE PROPOSED AGREEMENT**

### **A. Description of the Property, Project, and Lease**

#### ***Property***

The subject property is located at the Southeast corner of Balbach Street and South Almaden Boulevard, in downtown San Jose. The property is identified as Assessor's Parcel Number 264-31-109 and address 226 Balbach Street, San Jose, CA 95110. The property is 16,014 square feet and is improved as a surface parking lot.

The property was acquired by the Redevelopment Agency of the City of San Jose in 2007 at an unknown price using Redevelopment Agency property tax increment revenue and the Successor Agency to the Redevelopment Agency was required to sell the property, as required by the redevelopment dissolution process. The City of San Jose acquired the property from the Successor Agency to the Redevelopment Agency on August 11, 2016. The site was purchased at its appraised value of \$2.41 million using Low and Moderate-Income Housing Asset Funds.

The City acquired the site with the intention for it to be developed with affordable housing and in 2015 the City issued an RFP to solicit development proposals from affordable housing developers. On September 27, 2017 the Director of Housing executed an Exclusive Negotiation Agreement "ENA" with Satellite Affordable Housing Associates (SAHA) and provided a predevelopment loan in the amount of \$200,000. An amendment to the predevelopment loan to add an additional \$40,000 to the predevelopment loan was requested in November 2019, which brings the total predevelopment loan to \$600,000.

#### ***Project Description***

As proposed, SAHA will develop the subject site with 87 rental apartments. The building will be an 8-story concrete building, with parking on the first floor and residential units starting on the second floor. The gross building area is 92,000. Forty-four (44) on-site parking spaces will be provided. The project will offer 19 studios, 54 one-bedroom units, and 14 two-bedroom units, with units ranging from 300 to 920 square feet and averaging 639 square feet.

All units excluding one unit for a property manager will be restricted affordable units. Eighteen (18) units will be restricted to Extremely Low-Income Households earning no more than 30% of the Area Median Income (AMI), thirty-eight (38) units will be restricted to Very Low-Income households earning no more than 50% of the AMI, and thirty (30) units will be restricted to Low-Income households with rents set to be affordable to households earning 60% of the AMI.

Housing at the project will be open to families and smaller households that are income qualified and that meet the Developer's leasing criteria.

### ***City Loan***

The City will be providing the project with a Permanent Loan amount of up to \$12,023,320. The City's permanent loan will represent approximately 18% of the total cost of the project. The permanent loan amount includes:

- the previously approved predevelopment loan amount of \$200,000 in June 2017;
- the request to increase the predevelopment loan by \$400,000;
- accrued interest on the predevelopment loan, which accrues at the rate of 4% and is estimated to total \$15,000;
- a construction loan totaling \$11,655,920 (which includes the predevelopment loan and accrued interest on the predevelopment loan); and
- and \$367,400 of projected accrued interest on the construction loan, which accrues at the rate of 2%.

The term of the City loan is 55 years and it will carry a 2% interest rate.

### ***The Lease***

The Lease term will be 65 years, with an option to extend an additional 20 years, if the affordability restrictions are extended for an additional 20 years. The lease will be prepaid for a sum of \$1.00 per year at the close of the construction financing. The base prepaid lease payment will be \$65.00.

### **B. Income Restrictions**

Eighty-six (86) of the units will be subject to long-term affordable housing deed restrictions that limit the income of eligible households and the maximum rent that can be charged on the units for a minimum term of 65 years. The restrictions that will be in effect during the 65-year base term of the lease, by unit type, are as follows:

	<b>Extremely Low- Income Units (30% of AMI)</b>	<b>Very Low- Income Units (50% of AMI)</b>	<b>Low Income Units (60% of AMI)</b>	<b>Total Units</b>
0-Bed	11	5	3	19
1-Bed	5	29	20	54
2-Bed	2	4	7	13
Unrestricted Manager 2- bed unit				1
<b>Total Units</b>	<b>18</b>	<b>38</b>	<b>30</b>	<b>87</b>

### **C. City Responsibilities**

The City (Lessor) is responsible for:

1. Leasing the property and improvements to the Developer (SAHA) for a base term of 65 years with an option to extend the term by an additional 20 years. The lease rate will be \$1.00 per year, to be prepaid at the close of construction financing. At the end of the least term, the property and improvements will revert to ownership by the City.
2. Providing a predevelopment financing, totaling \$600,000, which includes the previously approved \$200,000 predevelopment loan and the November 2019 request for an additional \$400,000 of predevelopment financing. The predevelopment loan will carry an interest rate of 4% and will be converted into the construction loan upon the completion of the predevelopment period.
3. Providing a construction loan totaling \$11,655,920, which includes the predevelopment loan and accrued interest on the predevelopment loan. The construction loan will carry an interest rate of 2% and will be converted into the permanent loan upon the completion of the construction period.
4. Providing a permanent loan totaling \$12,023,320, which includes the construction loan and \$367,400 of accrued interest on the construction loan. The permanent loan will carry an interest rate of 2% and a term of 55 years. Annual payments will be made from 48.48% of the project's annual residual net cash flow<sup>1</sup> and net refinance or sales proceeds. The balance will be due and payable at the end of 55-year loan term.
5. Reviewing the annual occupancy compliance reports to be submitted by the Developer (SAHA).

### **D. Lessee Responsibilities**

SAHA (Lessee) is responsible for:

1. Obtaining approximately \$49.3million of equity and financing commitments in addition to the \$12.02 million permanent loan to fund the Project's development.
2. Developing the project.
3. Managing the project and maintaining the property and improvements.

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<sup>1</sup> After preferred distributions for an asset management fee, general partner management fee, and a 50% cash flow distribution to the General Partner to fund the deferred developer fee

4. Ensuring compliance with the affordability covenants described in Section IIB.
5. Annually submitting an annual report to the City detailing the property's compliance with the rent and occupancy restrictions.
6. Submitting annual residual receipts loan payments in accordance with the terms of the permanent loan.
7. Meeting all terms, responsibilities and conditions identified in the lease agreement with the City.
8. Repaying the City's permanent loan in its entirety, including accrued interest, no later than 55 years after conversion to the permanent loan. The loan is anticipated to become due and payable in year 2079.



### III. COST OF THE AGREEMENT TO THE CITY

This section presents the total cost of the Agreement to the City that will be funded with Low and Moderate-Income Housing Asset Funds.

The "net cost" of the Project after consideration of the revenues that will accrue to the Low/Mod Fund, if any, is also evaluated. The net cost can be either an actual cost, when expenditures exceed receipts, or a net gain, when revenues created by implementation of the Agreement exceed expenditures.

#### A. Estimated Cost to the City (Low/Mod Fund)

The cost to the City associated with this specific transaction includes the price that the City paid to acquire the site from the Successor Agency and the additional "out of pocket" funding to be provided by the Low-and Moderate-Income Housing Asset Fund. While the original \$200,000 predevelopment loan funding was previously funded, for purposes of this report it has been included as a cost of this transaction because the principal and accrued interest are to be rolled into the construction and permanent financing to be executed as part of the subject transaction. However, accrued interest on the predevelopment and construction loans reflect the structure of repayment provisions rather than an additional outlay of funds and are not considered as a cost of the transaction.

As shown below, the total cost of this transaction to the City to be funded with Low/Mod.-Income Housing Asset Funds is \$14,041,000 ,000 in nominal dollars and \$14,312,000 in \$2019/20 dollars.

	<i>Nominal Dollars</i>	<i>\$2019/20 Dollars</i>
Site Acquisition Cost	\$2,400,000	\$2,657,000
Predevelopment Loan	\$600,000	\$614,000
Additional Construction Funding	\$11,041,000,000	\$11,041,000
<b>Total Cost to be Funded with Low/Mod Funds</b>	<b>\$14,041,000</b>	<b>\$14,312,000</b>

#### B. Revenues to the City (Low/Mod Fund)

Given that the City acquired the property with Low/Mod Income Housing Asset Funds, the City is required to deposit any ground lease revenues derived by the Property into the Low/Mod Income Housing Asset Fund. Under the terms of the Agreement, the City will receive prepaid lease payments of \$1.00 per year, 48.48%<sup>2</sup> the project's annual net cash flow (residual

<sup>2</sup> Ibid.

receipts), and the outstanding balance of unpaid principal and interest upon the end of the 55-year loan term.

Based on the project's cash flow projection, it is estimated that the City will receive \$65.00 of lease payments (assuming a base 65-year lease term) and \$25.25 million of loan principal and interest payments through the end of the loan term.

In addition to lease and loan payments from SAHA, the City will also retain full ownership of the site and improvements upon the termination of the lease. For purposes of this analysis, it is assumed that the improvements have no value upon the termination of the 65-year lease and that the site retains its current estimated fair market value of \$2,657,000.

	Nominal Dollars (inflated at 3% per year)	\$2019/20 Dollars
Prepayment for 65-year lease	\$65.00	\$65.00
Annual Residual Receipts + balloon payment at end of 55-year term	\$25,249,000	\$5,534,000
Property Value at End of 65 - year Lease Term	\$18,147,000	\$2,657,000
Total Revenues	\$43,396,000	\$8,191,000

### C. Net Cost to the City (Low/Mod Fund)

The net cost to the City resulting from this transaction is the difference between the City's costs funded with Low/Mod Funds and revenues to be received by the City.

	<b>Maximum 99-Year Lease Term</b>	
	<b>Nominal Dollars</b>	<b>2019/20 Dollars</b>
Costs to the City	\$14,041,000	\$14,312,000
Revenues to the City	\$43,396,000	\$8,191,000
<b>Net Surplus to the City</b>	<b>\$29,355,000</b>	<b>(\$6,121,000)</b>

#### **IV. VALUE OF THE INTEREST TO BE CONVEYED**

##### **A. Reuse Value**

The reuse value of the development site is directly a function of the economics of the property under the specific terms of the transaction. In this case, the Developer will be responsible for developing the property with the proposed project and leasing 86 of the units to income eligible households at restricted rent levels. The average monthly rental rate approximates \$1,190 per month, which is far below an average market rate rent of \$2,900 per month for a one-bedroom unit in downtown San Jose.

The project is anticipated to generate sufficient cash flow to fund annual operating expenses, annual debt service on a \$5.6 million loan funded by a tax-exempt bond, annual asset management payments, and the \$354,100 deferred developer fee over a 15-year period. The project's anticipated cash flow is insufficient to fund annual amortization payments on the City's loan or the \$12.78 million AHSC loan that have been provided to fund capital construction costs.

Because the project's cash flow is insufficient to cover 100% of capital construction costs, there is not available cash flow to fund a market-rate ground lease payment. Therefore, the near-term reuse value of the property is negligible.

Upon the expiration of the lease, the City will hold title and all rights to the property.

##### **B. Estimated Value at Highest and Best Use**

The most recent appraisal of the property was prepared in March of 2015 to determine the purchase price to be paid by the City. The appraisal determined that the property's highest and best use would be for development of high density multifamily or mixed use with a small commercial component and established the property's fee simple value at \$2.40 million. For purposes of this analysis, it is assumed that the fair market value of the site has increased at the rate of inflation, which yields an estimated current fair market value of \$2,657,000.

## V. CONSIDERATION RECEIVED AND REASONS THEREFORE

Under the terms of the Agreement, the ground lease rate will be \$1 per year, with the annual ground lease payments to be prepaid at the close of construction financing. Assuming a 65-year ground lease, the prepaid ground rent will total \$65.00. As presented in Section IV.A, this lease payment is consistent with the property's economics and nominal reuse value.

A market rate project would typically make an annual ground lease payment equal to 4% to 7% of the fair market value of the property. Based on the subject site's fair market value of \$2,657,000, a fair market annual ground lease payment would typically range from \$106,000 to \$186,000. As discussed in Section IV.A, the subject project is an affordable housing project with long term restrictions that limit the rents that can be charged to levels that are significantly below market. As a result, the project's economics cannot support 100% of the project's construction costs, much less paying a market rate ground lease payment. The project's economics and ability to support a ground lease payment will be constrained for the duration of the affordability restrictions.

Once the lease term expires, the City will have the option to sell the site at it's then highest and best use, which will enable the City to receive a price equal to the site's fair market value.

## VI. PROVISION OF VERY LOW, LOW, AND MODERATE-INCOME HOUSING

The project will provide eighty-six (86) units of affordable housing. The units will be subject to long-term affordable housing deed restrictions that limit the income of eligible households and the maximum rent that can be charged on the units throughout the term of the lease. During the initial 65-year term, the restrictions, by unit type are as follows:

	<b>Extremely Low- Income Units (30% of AMI)</b>	<b>Very Low - Income Units (50% of AMI)</b>	<b>Low Income Units (60% of AMI)</b>	<b>Total Units</b>
0-Bed	11	5	3	19
1-Bed	5	29	20	54
2-Bed	2	4	7	13
Unrestricted Manager 2- bed unit				1
Total Units	18	38	30	87

If the lease extends beyond 65 years, then for the remaining term of the lease the units shall be restricted to be affordable to households earning no more than 60% of the Area Median Income, adjusted for household size.

## **VII. BLIGHT ELIMINATION**

The property's units are subject to rent and income restrictions for a minimum of 65 years. In accordance with California Redevelopment Law, as stated in the California Health and Safety Code Section 33433, the conveyance of property that results in the provision of housing for Low- or Moderate-Income persons satisfies the blight elimination criteria imposed by Section 33433. Thus, the subject transaction fulfills the blight elimination requirement.