



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Kim Welsh
Jacky Morales-Ferrand

SUBJECT: ACQUISITION OF 71 VISTA
MONTANA DRIVE

DATE: June 9, 2020

Approved

Date

6/11/2020

COUNCIL DISTRICT: 4

REPLACEMENT

REASON FOR REPLACEMENT

The reason for this replacement memorandum is to correct the legal names of the Seller, which will have changed by close of escrow of this transaction, and to provide the full legal name of the previous buyer. Through the course of the negotiations, the original seller, San Jose Vista Montana, LLC, has decided to split its various owners' interests into separately held entities prior to the close of escrow. The updates to the names of the respective entities is reflected below in both the Recommendation and Outcome sections of this memorandum.

RECOMMENDATION

Adopt a resolution authorizing the City Manager to negotiate and execute:

- (a) An Agreement with Delaware Retail Control, LLC, et al., for the purchase by the City of San José of approximately 4.21 acres located at the western corner of Vista Montana and Renaissance Drive in San Jose, identified as Assessor's Parcel Number 097-52-027, for a price of \$22,875,000, and all other documents necessary to effectuate the property transfer to the City of San Jose; and
- (b) A Two-Year Exclusive Negotiating Agreement with Charities Housing Development Corporation of Santa Clara County to prepare a proposal to City of San Jose for the future development of an affordable housing project on the 71 Vista Montana property.

OUTCOME

Approval will authorize the City of San José (“City”) to negotiate and execute a purchase and sale agreement to acquire the property known as 71 Vista Montana (“Property”) from Delaware Retail Control, a Delaware limited liability company, Vista Glik LLC, a California limited liability company, Vista IFT, LLC, a California limited liability company, Vista KBRT, LLC, a California limited liability company, SMF Vista LLC, a California limited liability company, GTP Vista, LLC, a California limited liability company, and RAF Vista, LLC, a California limited liability company (collectively “Delaware Retail Control, LLC, et al.”) securing a key site for future affordable housing development. The City would subsequently enter into a Two-Year Exclusive Negotiating Agreement for Charities Housing Development Corporation of Santa Clara County (“Charities Housing”) to propose development of an affordable housing project on the Property in partnership with the City. The development of this site will support the City in meeting several affordable housing goals including providing affordable housing in North San José and to acquire scarce sites for affordable housing in an area currently under-served by affordable housing opportunities.

BACKGROUND

The City of San José has been a national leader in the development of affordable housing. Since 1988, the Housing Department has leveraged over a billion in City resources to attract an additional \$5 billion in public and private capital to create approximately 20,000 new and newly-affordable apartments and homes.

There is a Significant Need for Affordable Housing

Despite this success, the need for affordable housing in San José continues to outpace the construction of subsidized housing. A 2020 survey of 309 urban markets around the world ranked San José as the 8th most unaffordable housing market overall, ahead of cities such as San Francisco, London, and New York City.¹ In San José, 49% of renters pay more than 30% of their gross income on rent and nearly 24% of households are “severely cost-burdened,” meaning that residents are paying more than half of their gross income on housing. This leaves the household with insufficient income to pay for their other needs such as food, clothing, medical care and transportation.² For a household to afford a one-bedroom apartment in the San José metro area requires an annual income of \$91,902 a year, roughly equivalent to three full-time minimum wage jobs.³ Consequently, 10% of all homes are overcrowded, living with more than one person per room.⁴ The high rents place tremendous pressure on individuals and families to crowd into smaller apartments, to endure longer commutes to less expensive housing markets, and to accept

¹ 16th Annual Demographia International Housing Affordability Survey: 2020

² HUD Comprehensive Housing Affordability Strategy (CHAS) for San José City, 2012-2016

³ EDD - Occupational Employment (May 2018) & Wage (2019 - 1st Quarter) Data

⁴ ACS 2018 5 Year - Universe is Occupied Housing Units or in other words Households

substandard housing. If the current housing trends continue, the regional economy may suffer if local businesses cannot attract and retain employees.

Aggressive 10,000 Unit Goal

On September 28, 2017, the Mayor issued a memorandum entitled “Responding to the Housing Crisis” that outlined a 15-point strategy leading to the development of 25,000 homes in five years, of which 10,000 would be affordable. Since the 10,000-unit goal was unveiled, 1,640 affordable homes have been completed, started construction or entitled. In an effort to respond to this goal, the Housing Department, Office of Economic Development and the Planning and the Building and Code Enforcement Department have worked together to develop the Housing Crisis Workplan and the Housing Catalyst team. This group has worked together to review potential sites and identify opportunities for development of affordable housing.

Make it Easier to Acquire Land for Affordable Housing

Finding a suitable site for an affordable housing development is a challenge in San José’s real estate market. High land prices and competition for sites make it difficult for an affordable developer to acquire land. The lack of viable sites is often identified as a primary obstacle to affordable housing developments. The Affordable Housing Investment Plan adopted by the City Council in June 2018 included a strategy to identify underutilized, small or surplus lands. The strategy built on the Mayor’s recommendation to better identifying housing sites.

Unmet Affordable Housing Goals in North San José

The North San José Area Development Policy supports the implementation of a unique vision for the North San José Area. The Policy establishes a specific procedure for the allocation and timing of development capacity within the policy area. The Policy has been amended several times since its initial adoption in 2005. The policy was most recently amended by the City Council on December 15, 2015 under Resolution No. 77631.

The North San José Policy includes an affordable housing goal stating 20% of new residential units are expected to be affordable. This policy is consistent with the long-standing redevelopment area requirement that 20% of all new housing be affordable, and the area generally has the same boundaries as the former Rincon de Los Esteros Redevelopment Area.

The four phases of housing development were broken into 8,000 unit groups, with 1,600 of each phase being affordable. Phase one has been developed, with only 432 affordable housing units. Given the challenges of building affordable housing, including the challenge of competing with market rate housing developers to acquire land, the goal for affordable housing in North San José remains unmet. Additionally, during Phase one of development, the Palmer Case (Palmer Sixth Street Properties vs. City of Las Angeles) prevailed not allowing the Inclusionary Housing Ordinance to apply to rental housing development. The majority of development during this period of time was rental, therefore not including an affordable housing set-aside.

Property Details

The current owner of the property, Delaware Retail Control, LLC, et al., purchased the property in 2013. The site has frontage on Vista Montana and Renaissance Drive in San José. The property contains a roughly 62,000 square foot vacant industrial building.

The property is being purchased as-is. There is soil contamination on the property due to past agricultural activities, characterized by Golder Associates in a Phase II Environmental Site Assessment report obtained by the City. Testing of the soil confirmed that arsenic is present above levels safe for residential use in the shallow soil in 7 out of 10 sampling locations. The ultimate developer of housing on the site would be required to mitigate the arsenic by either removing and disposing contaminated soil off site or capping it beneath either hardscape or two feet of clean soil. Mitigation would be done under regulatory oversight to ensure the property is safe for any proposed housing project.

The City conducted or obtained a cost estimate for clean-up of the contamination on site based on likely development scenarios. The estimates range from \$770,000 for a scenario with no subsurface parking to \$4,915,000 for a scenario that includes parking across the site at a half a grade (7 feet) down. The higher end costs are driven by the landfill disposal fees and trucking costs for off-site disposal of contaminated soil to construct subsurface parking. By designing a project that limits subsurface parking, the project can remove the most significant potential expense in environmental cleanup. Charities Housing has indicated that they plan to develop project alternatives that limit costs in this manner. Neighboring parcels that were developed with residential projects have generally similar arsenic contamination and these projects limited costs by constructing above ground parking.

ANALYSIS

The 71 Vista Montana property is strategically located in North San José and presents a unique opportunity to develop affordable housing in this area. Phase I of residential development in North San José fell short in the target for the number of affordable housing units. Securing over four acres of land for future affordable housing development will create the potential to make progress toward affordable housing goals in this area.

While the property was never publicly listed for sale, the landowner is currently under contract with Charities Housing to sell the property for \$27,000,000. Due to Charities Housing's difficulty in securing financing for site acquisition they approached the City with the opportunity for the City to acquire the property in lieu of Charities Housing. Delaware Retail Control, LLC, et al. has since agreed to sell the property to the City for \$22,875,000 and Delaware Retail Control, LLC, et al. and Charities Housing have agreed to terminate their purchase contract to allow the City to acquire the property. Additionally, the City will provide a letter which could be used by the seller to attempt to obtain the benefits afforded by I.R.S. Code §1033.

The City obtained an appraisal calculates the best-use value as high density residential valuing the property at \$24,570,000 based on a housing highest and best use. The appraisal does not account for the presence of soil contamination, which is estimated by staff to range from \$770,000 to \$4,915,000, depending largely on the depth of the future project, as described above under Property Details. The purchase price of \$22,875,000 reflects a discount of \$1,695,000 for potential environmental remediation costs and the benefit of providing the I.R.S. §1033 letter to the sellers. The \$1,695,000 discount was negotiated as a reasonable remediation offset given the size of the property and the corresponding potential to design a project with minimal underground parking leading to reduced remediation costs. While the price is discounted due to the soil contamination, property is being purchased as-is – any remediation costs will be the responsibility of the City and/or the developers of any future projects on the property.

At the time that the City acquires the property, the City will enter into an Exclusive Negotiating Agreement (ENA) with Charities Housing that will continue the strong spirit of partnership between the two organizations on this project. There are no current plans for development and any such project would be subject to full CEQA review at the time of proposal. Charities Housing will provide a proposal for an affordable housing development within two years of execution of the ENA for an affordable housing project on the Property at the City Manager's sole discretion. The term is necessary to allow time to address the outstanding CEQA and VMT challenges to the North San José Area Development Plan. The term will also allow time for the selected developer initiate development of affordable housing within five years of City's acquisition of the Property pursuant to Health & Safety Code §33334.16. Should Charities Housing not advance a project and the ENA expires, the City can proceed with a different affordable housing developer to develop affordable housing on the Property.

Summary of Key Terms

The purchase price is \$22,875,000 and the City is to provide a §1033 letter. Other key requirements of the deal include an as-is sale, closing no later than June 30, and the seller's termination of a \$7,000,000 deed of trust secured against the property. Closing costs are to be split according to Santa Clara County custom.

Investment of Low and Moderate Income Housing Asset Funds

The City's Low & Moderate Income Housing Asset Funds (LMIHAF) will be used to finance this acquisition. This fund has certain expenditure requirements, which require that certain LMIHAF funds must be spent before July 1, 2020 or the City risks losing those dollars to the State under Community Redevelopment Law LMIHAF recapture rules. Staff's analysis suggests that the City must expend funds by the end of the fiscal year, or risk losing scarce affordable housing funds. The purchase of 71 Vista Montana will ensure the LMIHAF expenditure deadline is met.

CONCLUSION

The City's purchase of the 71 Vista Montana property is a strategic opportunity that would allow the provision of critical affordable housing in North San José. The opportunity for acquisition of an off-market property through partnership with Charities Housing will allow the City to strategically leverage LMIHAF reserves and address a key affordable housing imbalance in North San José.

Approval of the recommendation in this memo will direct staff to complete negotiations on City's acquisition of the 4.21-acre 71 Vista Montana property for development of future affordable housing and an exclusive negotiating agreement with Charities Housing. Closing of the sale would occur no later than June 30, 2020.

CLIMATE SMART SAN JOSE

The recommendation in this memo furthers the goals of Climate Smart by facilitating the creation of low-income housing close to jobs and transit in North San Jose, which would reduce vehicle miles traveled and greenhouse gas emissions.

COORDINATION

The memorandum has been coordinated with the City Attorney's Office, the City Manager's Budget Office, and the Department of Planning, Building and Code Enforcement.

COMMISSION RECOMMENDATION/INPUT

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

COST SUMMARY/IMPLICATIONS

1. AMOUNT OF RECOMMENDATION: \$22,875,000
2. SOURCE OF FUNDING: Low and Moderate Income Housing Asset Fund (Fund 346).
3. FISCAL IMPACT: Funding in the amount of \$22,875,000 is available in the Low and Moderate Income Housing Asset Fund to acquire the 71 Vista Montana property. There is no on-going fiscal impact to the General Fund as a result of this action.

BUDGET REFERENCE

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

Fund #	Appn #	Appn. Name	Current Total Appn	Rec. Budget Action	2019-2020 Adopted Operating Budget Page	Last Budget Action (Date, Ord. No.)
346	0070	Housing Loans and Grants	\$63,839,960	\$22,875,000	X-56	1/14/2020, 30356

CEQA

Statutorily Exempt, File No. ER20-112, CEQA Guidelines Section 15262, Feasibility and Planning Studies.

/s/
JACKY MORALES-FERRAND
Director, Housing Department

/s/
KIM WALESH
Director, Office of Economic Development

For questions, please contact Nanci Klein, Assistant Director of Economic Development at 408-535-8184, or Rachel VanderVeen, Deputy Director, Housing Department, at 408-535-8231.