



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Jacky Morales-Ferrand
Jennifer A. Maguire

SUBJECT: SEE BELOW

DATE: February 18, 2016

Approved

D. D. SyL

Date

2/19/16

COUNCIL DISTRICT: 8

**SUBJECT: APPROVAL OF NEW LOAN COMMITMENTS AND OTHER ACTIONS
FOR THE METROPOLITAN SOUTH APARTMENTS**

RECOMMENDATION

(a) Adopt a resolution:

- (1) Approving a new construction/permanent loan commitment of up to \$3,112,500 ("New Loan") to 2112 Monterey Road South, L.P., a legal entity related to Charities Housing Development Corporation ("Charities"), for the development of The Metropolitan South Apartments ("Development" or "The Met South") located at 2128 Monterey Road ("Site");
- (2) Approving a new predevelopment loan of \$500,000 to be repaid from the New Loan proceeds at the closing of construction financing ("Predevelopment Loan");
- (3) Extending the maturity of the Development's existing HOME-funded loan of \$3,043,290 ("Existing Loan") to be coterminous with the term of the New Loan;
- (4) Forgiving of \$753,402 in accrued interest on the Existing Loan through March 1, 2016;
- (5) Authorizing the Director of Housing to negotiate other changes to the Existing Loan if required by lenders and investors, and to execute all documents as may be needed to effectuate such changes and to facilitate the combination of the City loans for streamlining purposes; and
- (6) Authorizing an aggregate Loan to Value amount in excess of 100%.

- (b) Adopt the following 2015-2016 Appropriation Ordinance amendments in the Low and Moderate Income Housing Asset Fund to:
- (1) Increase the Housing Loans and Grants appropriation to the Housing Department in the amount of \$3,112,500; and
 - (2) Decrease the Housing Project Reserve appropriation in the amount of \$3,112,500.

OUTCOME

The recommended actions will enable Charities to apply on March 2, 2016, for 9% Low Income Housing Tax Credits to develop a restricted affordable 31-unit apartment development called The Metropolitan Apartments South. This development will include nine apartments that will receive referrals of individuals holding homeless rental subsidy coupons who are participating in the City's Transition in Place ("TIP") program. Once constructed, 30 of the 31 apartments will be affordable to Extremely Low-Income ("ELI") and Very Low-Income ("VLI") individuals and families earning up to approximately \$22,350 and \$47,835 per year, respectively.

EXECUTIVE SUMMARY

This memorandum seeks approval for a new construction/permanent loan commitment of up to \$3,112,500 to enable construction of a new 31-apartment affordable apartment building called The Metropolitan Apartments South. This action also approves a \$500,000 predevelopment loan which will be repaid from construction loan proceeds at the closing of construction. Further, this action enables a restructuring of the City's existing \$3.0 million HOME-funded loan (which originally funded the prior affordable development at this site) and forgives accrued interest on this loan. Forgiving the interest allow lenders and investors to underwrite the new Development - including the existing debt. This memorandum also appropriates funds for the City's loans. These actions will enable Charities Housing to apply for competitive Low Income Housing Tax Credits from the State, ultimately creating new housing opportunities for nine homeless rental coupon holders, 10 households eligible for Section 8, and 11 other households with incomes up to approximately \$47,835.

BACKGROUND

Charities Housing Development Corporation ("Charities"), a nonprofit affordable housing developer based in San José, has worked since early 2008 to advance development of The Metropolitan Apartments ("The Met"). The development was originally designed as one 101-unit affordable apartment complex, but was later redesigned into two phases for purposes of financial feasibility. The two phases—"The Met North" and "The Met South," respectively—are located at 2112 and 2128 Monterey Road. The actions herein pertain only to The Met South.

At the City's request, Charities agreed to purchase the entire site in 2008 as part of the structured financial workout with Emergency Housing Consortium ("EHC"). Since that time, Charities has been working to move forward on construction of this family rental apartment complex. When Charities purchased the site, it agreed to assume the existing debt for the former affordable development on the site known as Markham Terrace. The City's loan of \$3,043,290 from HOME funding remains secured on the Met South lot, while a grant of \$220,000 in federal Community Development Block Grant ("CDBG") funding was satisfied and the obligation was cancelled. Charities demolished Markham Terrace in 2010, which by that time had become an attractive nuisance and a safety hazard. Charities subsequently subdivided the site into two lots.

On March 10, 2015, the City Council approved a final funding commitment for development of The Met North and an allocation plan reconveying each of the former Markham Terrace existing outstanding loans onto either the north or south lot. In late March 2015, the Met North successfully closed on its financing and started construction. It is now approximately 50% completed, and is on schedule to be completed in late Summer 2016. Charities plans to accept applications for The Met North apartments in Spring 2016; interested parties may sign up for notifications at <http://charitieshousing.org/2112-monterey/>.

On June 16, 2013, the City Council approved a performance-based loan commitment of up to \$240,000 (\$80,000 per year for 3 years) in Low and Moderate Income Housing Asset funds to pay for operating costs incurred by Charities for holding and maintaining the vacant property while waiting for the City to commit construction/ permanent financing for both projects ("Operating Loan"). The Operating Loan closed in August 2013, and Charities drew down the loan proceeds to pay for site fencing, security, and weed abatement. Both this Operating Loan and the Existing Loan of \$3,043,290 in federal HOME funds that supported Markham Terrace at this location, are allocated to The Met South, as noted in the City Council's March 2015 approval.

Development Description

Once constructed, The Met South will house 30 affordable apartments—nine studios, 8 one-bedrooms, 4 two-bedrooms, 9 three-bedrooms—and one unrestricted two-bedroom manager's apartment. The nine studios will be restricted to ELI households earning up to 30% of Area Median Income ("AMI") with annual incomes of approximately up to \$22,350. The other 21 apartments will be restricted to VLI households earning a maximum of 45% AMI with incomes of approximately \$47,835 per year.

The 31 apartments will be located just south of The Met North, separated physically and located on its own parcel for which a final parcel map has been recorded. Charities has all site entitlements in place to build The Met South. The Development is conveniently located along the Monterey and Tully bus lines, which provide ample connections to Light Rail and Caltrain. Employment opportunities and amenities such as retail, grocery stores and restaurants are all easily accessible from the Site, given its close proximity to the GE Plant shopping center. Both phases together offer a range of amenities, including a community kitchen and multi-purpose room, staff and service provider offices, fitness center, laundry facilities, and an outdoor area of

approximately 1/3 of an acre for children and adults to play and relax. A separate 2-story parking garage will provide ample car, motorcycle, and secure bicycle storage for residents, with 48 parking spaces being constructed by The Met North to serve The Met South.

ANALYSIS

Homeless Apartments

Charities has agreed to accommodate the City's priority of creating housing opportunities for homeless households for nine of the 30 income-restricted apartments. Nine studios will be restricted at 30% AMI and designated for non-chronic homeless residents holding the City's rental coupons through its "Transition In Place (TIP)" program. The Development will make these studios available to TIP coupon-holders who are centrally referred by the City at initial lease-up. Later, if the initial residents in the TIP apartments leave, the property management company will agree to hold the units for up to 60 days for newly-referred TIP coupon-holders. The General Fund subsidized TIP coupons will help an individual renter for two years, after which time it is expected that the individual will be employed and able to afford a normal 30% AMI rent without a rental subsidy. If and when the former coupon-holder vacates that apartment, Charities will make the studio (or a comparable apartment) available ongoing to future coupon-holders so as to maintain a total of nine TIP units at any given time, subject to availability.

New Loan Commitment

In order to proceed with construction of The Met South, a new City construction/permanent loan commitment is needed to support construction costs, and is required to obtain competitive tax credits from the State – which will generate debt and equity financing from the private sector. The amount requested for commitment of the New Loan is up to \$3,112,500. The loan will pay for hard and soft construction costs, including the City's estimated construction interest costs. This amount also encompasses the previously awarded \$240,000 Operating Loan, for a new net cash amount needed of \$2,872,500.

The current estimated construction budget for the Met South is \$19.5 million. While this is relatively high for 31 units, \$3.4 million (17%) of that amount is City and County debt carried over from the previous project that do not contribute to constructing this building. The gap in cash that is needed to complete construction and delivery of the units, assuming 9% tax credits are obtained, is only approximately \$3.1 million, or \$100,000 per unit—a very reasonable subsidy per unit.

To further support the development's financial viability, Charities successfully sought an award of 10 project-based Section 8 vouchers from the Housing Authority of the County of Santa Clara. The vouchered apartments, supported by a 15-year Section 8 HAP contract, will house typical Section 8 residents and will range in size and income levels. The rental income derived from Section 8 units will add significantly to the property's feasibility, as the payment standard is

expected to be in excess of a typical 60% AMI rent. Financing of the South Phase is recommended at this time for several reasons.

First, the Development has been in the City's queue for several years as part of a negotiated workout for EHC Lifebuilders (now known as HomeFirst). This action will enable the second half of the proposed development to proceed, once it wins a highly-competitive tax credit allocation.

Second, it allows Charities—a San José-based nonprofit affordable housing developer—to complete a transaction that it has worked on trying to advance since 2008. As Charities owns and operates seven other affordable rental properties with 565 apartments in San José, supported by loans from the City, it is in the City's interest to support the organization's ongoing financial viability. Charities' financial position will be enhanced when it is allowed to finally take a partial developer fee at construction closing of The Met South.

Third, final development of this empty parcel is positive for the neighborhood as it will remove the attractive nuisance of the now vacant lot and, once completed, will house tenants who will support local businesses in the Monterey Corridor.

Predevelopment Loan

The requested \$500,000 Predevelopment Loan is considered necessary to enable Charities to fund costs for architectural, engineering, and other studies and work needed in preparation of the start of construction. The Predevelopment Loan will be repaid from New Loan proceeds at such time as a tax credit award and all necessary financing is obtained, and all construction financing closes. Given that Charities is a nonprofit, and given the extremely long timeframe of completing funding of this development, the City's short-term support through this Predevelopment Loan is warranted.

Maturity Extension of Existing Loan

Staff expects that lenders and/or investors will require that the maturity of the City's Existing Loan be extended in order to be co-terminus with the New Loan, which is expected to have an 18 to 24 month construction term and a permanent term between 30 and 55 years. The current Promissory Note, as amended, matures in December 2039. The Existing Loan will be repaid from annual residual receipts of the new operating Development, and will be due in full at its new maturity. Staff expects that the extension will result in a new term from construction closing that is between 32 and 57 years, depending on investor analysis—an extension of between 9 and 34 years. Final business terms will be determined closer to construction closing, pursuant to the Director of Housing's limited delegation of authority to negotiate and execute Council-approved loans under Section 5.06.335 of the Municipal Code.

Interest Forgiveness on Existing Loan

It is recommended that the City forgive \$753,402 of interest accrued to March 1, 2016 on the Existing Loan of \$3,043,290. This forgiveness amount is recommended for several reasons.

Staff intended to bring forward construction/permanent commitments to enable the full development to proceed shortly after Charities purchased the land in 2009. However, the City's anticipated commitments were delayed due to funding shortfalls caused by the financial market problems at that time, and, subsequently, the elimination of redevelopment in 2012. None of these delays were due to Charities' lack of action. Further, repayments of the loan were impossible during this time because the previous building was unoccupied and then demolished.

In addition, it is in the City's financial interest to forgive this accrual. When the total amount of public debt that a tax credit development carries grows too large in proportion to its projected net cash flows, the business terms of the new public loans can be undermined due to the need for lenders and investors to evidence that the loans are indeed fully repayable, and not grants. The City's term is often lengthened and/or its interest rate is reduced in order to make this finding. Staff considers the amount of the Development's total public debt, exclusive of the accrued interest on this Existing Loan, to be as much as it can carry and not unduly impact the New Loan's final interest rate and term. Final business terms will be determined pursuant to the Director of Housing's delegation of authority to negotiate and execute Council-approved loans under Section 5.06.335 of the Municipal Code.

Therefore, the amount of interest that staff requests to be forgiven is calculated to March 1, 2016, covering the time during delays not caused by Charities until the City was able to give its complete construction/permanent commitment so the Met South project could proceed.

Loan-to-Value

There will be two parts to the City's commitment at the time of construction closing, totaling approximately \$6,155,790: the City's New Loan of up to up to \$3,112,500; and, the City's Existing Loan of \$3,043,290. The Existing Loan will continue to be documented separately from the New Loan.

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 required to obtain the 9% tax credit allocation increases needed public subsidy and decreases the project's market value, thereby resulting in an increased LTV. Thus, an elevated LTV is not uncommon for public lenders in the affordable housing industry. Further, LTV—a concept useful in foreclosure situations—is not very germane to affordable housing multifamily developments, as foreclosures are very rare. However, a high LTV is considered acceptable by City staff as operating income is expected to be at least 1.15 times permanent mortgage debt service payments—a common standard of financial feasibility.

Ultimately, the security for a City loan is that the development gets built and moves into permanent operations, during which time the City starts to receive its loan repayments as a portion of net cash flow. This is particularly true for affordable housing developments, as the

use of public funds creates requirements for affordably-restricted apartments to be created on a particular location. Therefore, a site cannot be easily liquidated if the project does not proceed. As this approval will enable Met South to move forward to obtain tax credits and financing from a senior lender and an investor, the City's repayment potential will be considerably enhanced.

For these reasons, a Loan-to-Value over 100% is warranted.

Economic Development Benefits

Taking actions to further this project will benefit San José economically in four ways. First, the project's proximity to the GE Plant shopping center makes this an ideal location for housing affordable to retail workers. Second, according to a 2009 study by the National Association of Homebuilders (NAHB) on the economic benefits to local areas for multifamily low-income housing tax credit-funded construction, 31 units of family housing are estimated to generate over \$2.5 million of local spending and economic benefits in the first year and approximately \$805,000 each year thereafter. Third, according to the NAHB metrics, it is also anticipated that proceeding with the development of Met South will create 47 local jobs in San José in the first year, directly and indirectly, and 12 local jobs each year thereafter. Fourth, Charities expects to pay City development fees of approximately \$958,000 in order to proceed with construction.

EVALUATION AND FOLLOW-UP

The Housing Department posts quarterly reports on the status of its subsidized construction developments to its website, www.sjhousing.org. If approved, The Met South would be included in these reports. The Director's determination of final business terms under her Delegation of Authority also will be reflected in a future Information Memorandum regarding these types of actions.

PUBLIC OUTREACH/INTEREST

Charities' four separate site entitlement requests between 2010 and 2015 were conducted through public meetings and due process. The Housing Department has also taken four earlier actions to City Council between 2008 and 2015 in order to move this entire development (the Met North and the Met South) forward. As this action requires Council action on the use of public funds equal to \$1 million or greater, a copy of this Memorandum will be posted to the City Council's website for the March 1, 2016, meeting.

POLICY ALTERNATIVES

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

- Alternative:** *Direct staff to use these funds for another affordable housing development.*
- Pros:** The new loan commitments recommended for this project could be used to fund another affordable housing development.
- Cons:** There are no other proposed affordable housing developments in San José that are seeking 9% tax credits in this category during this round. The tax credit funding award would go to a development in another city. Furthermore, the City already has funding in this project. It would also prevent construction from being completed in the near-term, which is the City's source of repayment for most of the funds already disbursed. This greatly increases the City's risk for repayment. Finally, as the City has already spent Low and Moderate Income Housing Funds on this Site, affordable housing must go forward due to use restrictions for this funding source.
- Reason for not recommending:** The proposed project will help to meet the local demand for deeply affordable housing for ELI and VLI households, including apartments for homeless households, helping the City to fulfill its affordable housing goals. Timely approval of this project's financing will assist this housing Development to start construction after several years of delays.

COORDINATION

This Memorandum was coordinated with the City Attorney's Office.

FISCAL/POLICY ALIGNMENT

This expenditure is consistent with: the City's *Envision 2040 General Plan*, *The 2014-23 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 the supply of affordable housing; the City's *2015-20 HUD Consolidated Plan* in that it will provide apartments that will be affordable for 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 housing for homeless residents. This development was also included in the *Affordable Housing Investment Plan* which was approved by City Council in December 2015.

COST SUMMARY/IMPLICATIONS

1. ESTIMATED COSTS OF COMMITMENT:

<u>USES</u>	<u>AMOUNT</u>
Previously disbursed funds for hard and soft costs (on previous development)	\$3,043,290
New Operating Loan for land carrying costs	\$240,000
New cash needed for hard and soft construction costs (to be disbursed)	\$2,872,500
TOTAL 'UP TO' LOANS' AMOUNT	\$6,155,790
TOTAL NEW LOAN AMOUNT REQUESTED	\$3,112,500

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 the appropriation proposed to fund the commitment recommended as part of this Memorandum.

Fund #	Appn #	Appn. Name	Total Appn	Amt. for Contract	2015-2016 Proposed Operating Budget*	Last Budget Action (Date, Ord. No.)
346	8437	Housing Project Reserve	\$55,853,509	\$3,112,500	XI-53	10/20/15, Ord. No. 29636
346	0070	Housing Loans & Grants	\$17,075,000	(\$3,112,500)	XI-52	10/20/15, Ord. No. 29636

HONORABLE MAYOR AND CITY COUNCIL

February 18, 2016

Loan Commitments and Other Actions for The Metropolitan South Apartments

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CEQA

Mitigated Negative Declaration File Nos. GP08-07-04 and PDC09-015.

/s/

JACKY MORALES-FERRAND

Director of Housing



JENNIFER A. MAGUIRE

Senior Deputy City Manager/
Budget Director

Budget Director

For questions, please contact Jacky Morales-Ferrand, Director of Housing, at 408-535-3855.

Attachment A: Anticipated Development Timeline - The Metropolitan Apartments – Met South

Attachment B: Site Map - Metropolitan South Apartments

ATTACHMENT A

Anticipated Development Timeline The Metropolitan Apartments – Met South

Submit Construction Drawings for Building Permits	October 2015
City Council Approval of Construction/Perm Funding Commitment	March 2016
Low Income Housing Tax Credit Award	May 2016
Select Lender and Equity Investor	August 2016
Close of Financing and Start of Construction	December 2016
Construction Completion	December 2017

ATTACHMENT B

**Site Map
Metropolitan South Apartments**

