



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: March 7, 2017

Approved

D. D. Syl

Date

3/15/17

COUNCIL DISTRICT: 3

SUBJECT: AUTHORITY FOR DIRECTOR OF HOUSING TO NEGOTIATE AND EXECUTE AMENDMENTS OF THE CITY GROUND LEASE AND LOAN DOCUMENTS FOR DONNER LOFTS APARTMENTS

RECOMMENDATION

Adopt a resolution authorizing the Director of Housing to negotiate and execute amendments to the City’s ground lease and loan documents for the restricted-affordable Donner Lofts property, located at 156 E. St. John Street (“Site”), to accommodate permanent-period financing from the State Department of Housing and Community Development’s (“HCD”) Transit Oriented Development program (“TOD”).

OUTCOME

Approval of the recommended actions will enable the final commitment of \$3,500,000 from HCD for Donner Lofts. This development is MidPen Housing’s newly-constructed rental property in the Downtown that offers 101 affordable apartments, including 20 studios for formerly-homeless residents.

BACKGROUND

In June 2013, the City Council took several actions to support the application of Donner Lofts’ sponsor, MidPen Housing (“MidPen”), for competitive 9% Low Income Housing Tax Credits (“tax credits”) from the State Tax Credit Allocation Committee. This action included the negotiation and execution of a purchase and sale agreement, an option to ground lease the Site to the development’s limited partner owner, a right of entry to the Site and other documents, and the assignment of certain affordability restrictions to the Site.

The City Council approval on June 18, 2013, followed several years of staff work on the Development and two previous City Council actions. In August 2012, the City Council approved

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a predevelopment loan of up to \$300,000 to MidPen Housing or its affiliate for the development of Donner Lofts. On February 26, 2013, the City Council approved a \$4,900,000 construction/permanent loan for the Development.

In the 2013-14 period, MidPen sought several other sources of financing to make Donner Lofts possible. In 2013, MidPen obtained \$1,000,000 in Affordable Housing Program funding from the Federal Home Loan Bank for Donner Lofts. In February 2014, MidPen also received two awards from HCD: an Infill Infrastructure Grant ("IIG") award of \$2,100,000 and a TOD loan of \$3,500,000. The Development's TOD award was the first for San José. On its second attempt, MidPen successfully competed for a 9% tax credit allocation, which was awarded in May 2014. MidPen then finalized tax credit investor and commercial bank commitments sufficient to support Donner Lofts' total development cost of \$49.8 million.

Shortly before Donner Lofts closed its construction financing in November 2014, the Director of Housing increased the City's total commitment by \$500,000, to a total of \$5,400,000, to support five additional apartments designated for residents who were formerly homeless. These five apartments augmented the 15 apartments required to be set aside for formerly homeless residents under County of Santa Clara's Mental Health Services Act ("MHSA") funding.

After having successfully assembled eight sources of financing, MidPen and its development team started construction on Donner Lofts in November 2014. The Development was completed on time in June 2016. It is now fully occupied, including the 20 apartments that house formerly homeless residents. Pending approval of this action, the Development is expected to convert to its permanent financing at the end of March 2017.

ANALYSIS

Authority to Amend

The 2013 City Council approvals of its loan and ground-lease related actions were prior to MidPen's application to HCD for IIG and TOD awards. Therefore, these sources were not listed in the 2013 City Council actions, nor did staff know their business terms at that time, and the need to provide additional documentation was not anticipated.

While the 2013 City Council approvals permitted the Director of Housing to negotiate and execute documents related to the City's ground lease, the language in the approval request did not allow the Director to later amend business terms and documents for the ground lease after they were finalized at construction closing. This distinction between setting business terms and later amending them is consistent with the Municipal Code's Delegation of Authority to the Director of Housing regarding loans. Although Chapter 5.06 of the San José Municipal Code permits the Director of Housing to set business terms for loans and grants, and to amend them if certain findings are made, the Director has no delegated authority to amend business terms for ground leases. Therefore, the City Council's approval is required to amend the existing City ground lease.

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HCD Documentation

Unfortunately, HCD documents for the TOD permanent-period financing are prepared shortly prior to conversion to permanent period, and are not meaningfully negotiated nor finalized prior to construction closing as are other lenders' documents. Had TOD documents been prepared and negotiated prior to the close of construction, this City Council action would not have been necessary as the Director would have set the ground lease's business terms from the start to accommodate the TOD documents' specifics. However, given that the ground lease was finalized prior to HCD's TOD documentation preparation, this action now is necessary to amend the existing ground lease at conversion.

As part of its TOD documentation, HCD requires that a Rider be placed on all ground leases for developments receiving TOD awards. The HCD Rider and subordination, in their current draft form, could limit the City's ability to enforce the provisions in its loan documents and ground lease and requires unsupportable representations from the City. Among these provisions, the Rider also attempts to assert control over the ground lease term to ensure HCD's repayment prior to the Lease's expiration.

Housing Department staff and the City Attorney's office are working actively with HCD and MidPen to negotiate acceptable final versions of HCD's documents and to finalize edits to the City's documents in time for conversion at the end of March 2017. To wait until the final terms are agreed and to return to City Council for approval of the final version is unadvisable, as this would delay conversion an additional month, and would add \$30,000 of additional construction interest to development costs. HCD's \$3,500,000 loan is essential for Donner Lofts feasibility, so an agreement must be reached prior to conversion.

For these reasons, staff requests that the City Council grant the Director of Housing the authority to negotiate and execute amendments to the City's ground lease for Donner Lofts by the attachment of a HCD TOD Rider. Staff also requests the authority for the Director to approve related amendments to other City loan or ground lease documents, including the Memorandum of Lease, to the extent required by a senior lender, by the tax credit investor, or to improve the clarity of the City's documents.

EVALUATION AND FOLLOW-UP

There will be no follow-up report or request to the City Council for Donner Lofts' successful conversion to permanent period financing, as its construction is complete and all necessary approvals will have already been obtained.

POLICY ALTERNATIVES

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

Alternative: *Deny the requested actions.*

Pros: Denying the Director of Housing the ability to negotiate and execute amendments to City documents would result in staff bringing back the final amended City ground lease to City Council, improving transparency and more fully informing the City Council on business terms. Alternatively, rejecting HCD's edits to the City's documents would best maintain the City's current set of rights.

Cons: Waiting to bring the final negotiated ground lease to City Council for approval would add an additional month to the conversion timeframe at an approximate cost of \$30,000. This cost would be additive to the approximate \$20,000 that obtaining approval of this action has already added to costs. This delay would unnecessarily increase development costs that are subsidized by the City as gap lender. Rejecting HCD's Rider outright would cause HCD to not close its financing, creating a new funding gap of \$3.5 million and delaying conversion indefinitely, seriously imperiling the Development's financial feasibility.

Reason for not recommending: The recommended actions will enable Donner Lofts to convert to its permanent period financing, to contain its development costs, and to continue to house San José's extremely low- and very low-income residents, including 20 formerly-homeless households.

PUBLIC OUTREACH

This memorandum will be posted on the City Council's website for the March 28, 2017 meeting.

COORDINATION

This memorandum has been coordinated with the Office of the City Attorney and the City Manager's Budget Office.

COMMISSION RECOMMENDATION/INPUT

The Housing and Community Development Commission did not hear this item, as approvals related to financial commitments to developments do not fall under the functions, powers and duties of the Commission as delineated in Section 2.08.2840 of the San José Municipal Code.

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FISCAL/POLICY ALIGNMENT

These actions support the provision of 20 housing opportunities for formerly homeless households. Further, these actions are consistent with the City's *Envision 2040 General Plan*, the City's *2014-23 Adopted Housing Element*, and the City's *2015-20 HUD Consolidated Plan* in that they help to create existing affordable housing opportunities for very low- and extremely low-income households.

COST SUMMARY/IMPLICATIONS

There is no cost implication of these requested actions.

CEQA

Resolution No.72767.

/s/

JACKY MORALES-FERRAND
Director, Housing Department

For questions, please contact Kristen Clements, Division Manager at (408) 535-8236.

Attachment

ATTACHMENT

Donner Lofts Location Map
156 E. St. John Street, San José

