



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Leslye Corsiglia

SUBJECT: SEE BELOW

DATE: June 5, 2013

Approved

Date

6/7/13

COUNCIL DISTRICT: 3

**SUBJECT: ACTIONS RELATED TO THE DEVELOPMENT OF THE DONNER
LOFTS APARTMENTS PROJECT LOCATED AT 156 E. ST. JOHN
STREET**

RECOMMENDATION

Adopt a resolution:

- a) Authorizing the Director of Housing to:
 - 1) Execute a Purchase and Sale Agreement with MidPen Housing Corporation or its affiliated development entity ("MidPen") for the Donner Lofts Property located at 156 E. St. John Street in an amount of up to \$2,300,000 from proceeds of the County Children's Shelter settlement agreement; execute a right of access for MidPen; and accept a grant deed for the property;
 - 2) Negotiate and execute an Option Agreement granting MidPen an option to obtain a long-term ground lease of the property for the Project;
 - 3) Reserve the 31 currently unrestricted units as destination units for transferring Community Redevelopment Law affordability restrictions on certain vacant units located at the following sites — 96 South 10th Street, 1072 & 1082 Vermont Street, and 1759 Hester Street—and record equivalent restrictions on the Property at or after the after closing of construction financing; and
- b) Authorizing use of predevelopment funds approved by the City Council in August 2012, for site security costs during the option period and demolition of the existing fire-damaged building on the Property and other existing improvements.

OUTCOME

Approval of the recommended actions will maximize MidPen's likelihood of success in applying for a 9% low-income housing tax credit ("LIHTC") allocation by the State Tax Credit Allocation

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Committee's ("TCAC") July 3, 2013 deadline. If its application is successful, MidPen could obtain private debt and equity financing and start construction in late 2013 on the 102-unit development. Consideration of these actions at the June 18, 2013, City Council meeting is necessary to meet TCAC's July 3, 2013 deadline.

BACKGROUND

In July 2011, MidPen purchased the 4.3-acre Property located on the southeast corner of East St. John Street and North Fourth Street ("Property"). The Property currently has a fire-damaged multifamily residential building that will be demolished in order to construct the new rental development.

On February 11, 2009, a previous owner of the Property obtained a Planned Development Permit, File No. H09-004. Subsequently, MidPen obtained a Permit Adjustment, File No. AD11-088 on February 11, 2011. The City determined that the Project will have no significant impact on the environment and that therefore an Environmental Impact Report under the California Environmental Quality Act ("CEQA") is not required.

On August 28, 2012, the City Council approved a predevelopment loan of up to \$300,000 for the Project.

On February 26, 2013, the City Council approved a \$4,900,000 construction/permanent loan for the Project. The \$4,900,000 is the amount of City subsidy needed for the total development cost of the residential portion of the Project, including the property acquisition cost. These funds will be used only to support the Project's housing units; the approximate 2,684 square feet of commercial space will be provided through separate non-City funding. This approval also noted that affordability restrictions from a Settlement Agreement with the County of Santa Clara regarding the Children's Shelter would be recorded at the closing of the Project's predevelopment and acquisition financing. At the time of the City's construction/permanent approval in February 2013, staff had anticipated transferring Community Redevelopment Law restrictions on housing units located on various sites onto this Property, but had not yet finalized the plan.

In March 2013, MidPen's application for 9% low-income housing tax credits ("LIHTCs") was unsuccessful due to competition from other developments in the region and the scarcity of available credits.

ANALYSIS

Property Purchase

The funding commitment for the \$4,900,000 City construction/permanent loan already includes the cost of land. Therefore, the cost for purchasing the Property does not require an additional commitment of City funds.

The Property purchase price will be up to \$2,300,000, which reflects the original price paid by MidPen plus selected land holding costs. The price is supported by an appraisal by CBRE from May 2013, which concludes that the value of the Property is \$4,590,000—well above the City's purchase price. The purchase price will be subtracted from the City's total construction/permanent loan amount of \$4,900,000, leaving approximately \$2,600,000 to support construction costs.

At the time the City purchases the Property, it will record 55-year affordability restrictions reflecting the transferred obligations associated with the Children's Shelter Settlement—70 units affordable to VLI individuals and families at 50% of Area Median Income ("AMI"). The City Council approval on February 26, 2013, had anticipated the recordation of these restrictions at the closing of predevelopment and acquisition financing. Instead, the City's purchase of the Property will take the place of an anticipated acquisition loan; thus, the restrictions will be recorded at the time the Property transfers to the City.

Ground Lease

The City will take ownership of the Property and enter into a long-term ground lease of \$1 per year. In addition to having more control over the long-term provision of affordable units in key locations, ground leases enhance the competitiveness of LIHTC applications and will enable MidPen to obtain a better tax credit application score and improve their chance of success.

The ground lease term for Donner will be at least 55 years, and may be extended at the Director of Housing's discretion to be up to 99 years, depending upon financial feasibility calculations of senior lenders and equity investors. In addition to the nominal \$1 per year payment, there is also the potential for a payment stream to be collected based on a percentage of the appraised value after the repayment of the City's loan, subject to approval of other Project funders. At the end of the lease term, the land and new building will be owned by the City. MidPen will have up to 24 months to exercise the Option to the ground lease, with up to three one-year extensions at the City's discretion for a total of 60 months.

MidPen has agreed to demolish the fire damaged building on the Property after the City's purchase to remove public safety hazards. This may involve the use of the predevelopment funds approved by the City Council in August 2012. If used for demolition, the City's predevelopment loan would be documented to include construction provisions appropriate for demolition work and would include a right of entry to be used if the lease option has not been executed.

A draft Purchase and Sale Agreement in substantially final form and a draft Option to Ground Lease have been posted in conjunction with this item.

Movement of Recorded Affordability Restrictions

The use of former Redevelopment housing set-aside (“20%”) funds requires the recordation of affordability restrictions, which define household income and rent limits per Community Redevelopment Law. Once restrictions are recorded and residents inhabit those housing units, an obligation to move the restrictions exists if the affordability covenants cannot be honored long-term at the original location. The new location for the moved restrictions must offer comparable units and cannot have been funded with 20% funds.

As Donner Lofts is not funded with 20% funds and has comparable units to those in four subsidized projects for which the City would like to transfer affordability restrictions, it is eligible to receive these restrictions. The following restrictions on units that are currently vacant and are unsuitable for restrictions will be moved to this property consistent with the requirements of Health and Safety Code 33334.3(f) and any applicable relocation law provisions:

- Casa Camino, 96 South 10th Street—four 1-bedroom vacant/rescinded units at 50% AMI, transferring to equivalent units (either 4 – bedroom or 8 efficiency units) so that this property could be sold unrestricted to help the small nonprofit owner, InnVision Shelter Network.
- Vermont House, 1072 & 1082 Vermont Street –The bed-based restrictions will be amended to provide for the restriction of a seven-bedroom and an eight-bedroom unit and the vacant seven-bedroom unit restriction at 50% AMI would be rescinded, transferring to 14 efficiency units with an assumed household occupancy of one each, to assist the City (owner) in financial restructuring and conveyance to a new nonprofit owner.
- 1759 Hester Street—three one-bedroom units at 30% AMI, transferring to one-bedroom and efficiency units at 30% AMI for a total of six people assisted, recommended to assist the small nonprofit owner, InnVision Shelter Network, because some of the units on this property were subdivided without permits to create more apartments. If any of the restricted units to be transferred are occupied at the time of the transfer, the occupants will be offered the opportunity to rent the new units with the transferred restrictions.

In addition, the transferred affordability restrictions from the Children’s Shelter settlement—70 units at 50% AMI—will be recorded at the time of the City’s purchase of the Property, in accordance with the terms of the negotiations with MidPen. As recorded affordability restrictions can suppress land value, the transferred restrictions will be recorded at the time of the construction loan closing in order to protect the value of the City’s asset until such time as the project’s financing is finalized and closed. If the units are occupied, the rescission of the existing restriction will not occur until after the destination units are constructed and available.

Use of Predevelopment Funds

Predevelopment funds typically pay for work completed on project design, engineering, and environmental studies, and to pay for costs including appraisals, market studies, and land use entitlement applications. For this Project, the City Council already has approved \$300,000 for predevelopment costs from inclusionary in-lieu funds. If needed, these predevelopment funds can also be used to cover costs associated with demolition of the existing structures.

EVALUATION AND FOLLOW-UP

The Housing Department posts periodic reports on the status of its subsidized construction projects to its website, www.sjhousing.org. Staff would include the status of the Donner Lofts Apartments in these reports.

POLICY ALTERNATIVES

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

Alternative: Deny the requested actions.

Pros: The transaction would be simplified were MidPen to retain ownership of the land. Recorded affordability restrictions should be honored on their original sites, not transferred to other locations.

Cons: The City will benefit from owning the property under a purchase and ground lease as it will enhance the Project's feasibility, will support the City's ability to control affordability over the long-term, and will enable the City to receive the ground plus improvements at the end of the lease term. Finally, State redevelopment law allows the movement of affordability restrictions given that certain conditions are met. Donner Lofts is a suitable recipient of the restrictions, and they will work well with the project-specific restrictions already identified for the Project.

Reason for not recommending: The recommended actions will facilitate the development of the Donner Lofts Project, which will help to meet the demand for rental homes for San José's extremely low- and very low-income residents.

PUBLIC OUTREACH/INTEREST

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**

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- Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

This item does not meet any of the above criteria but will be posted on the City's website for the June 18, 2013 Council Agenda.

COORDINATION

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

FISCAL/POLICY ALIGNMENT

This action is consistent with the Housing Department's *Five-Year Investment Plan for Fiscal Years 2007/08-2011/12* in increasing the supply of affordable housing, and with the City's *Consolidated Plan for 2010-15* in providing reasonably-priced apartments for very low- and extremely low-income households.

COST SUMMARY/IMPLICATIONS

There are no cost implications for these requested actions as they address funds already approved by the City Council for use in this Project.

CEQA

Resolution No. 68839.

/s/
LESLYE CORSIGLIA
Director of Housing

For questions, please contact Leslye Corsiglia at 408-535-3851.

Attachment

ATTACHMENT
Donner Lofts Property Aerial Map

