



Good Neighbors

San Diego  
Housing Commission

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# REPORT

**DATE ISSUED:** April 29, 2005

**ITEM 106**

**REPORT NO.:** HCR05-35  
For the Agenda of May 6, 2005

**SUBJECT:** Loan Increase and Subordination for Island Village Apartments (Council District 8)

## SUMMARY

**Issue:** Should the Housing Commission recommend that the Housing Authority approve adjustments to its current funding commitment to Barone Galasso & Associates for Island Village Apartments?

**Recommendation No. 1:** That the Housing Commission recommend increasing its second position loan by \$800,000, from \$3,600,000 to \$4,400,000, to pay for construction cost increases and increases in project reserves for construction of 280 rent-restricted units located at 1245 Market Street. The terms of the Housing Commission loan would remain the same with the exception of an extension of the loan period by four years.

**Recommendation No. 2:** Revise the FY2005 Rental Housing Production budget by adding \$100,000 of Inclusionary Funds as presented in Attachment 4.

**Recommendation No. 3:** That the Housing Commission recommend subordination of the Housing Commission's Deed of Trust and Declaration of Covenants, Conditions, and Restrictions to senior encumbrances increased by up to \$1,150,000.

**Fiscal Impact:** Approval of these recommendations would result in an increase in the Housing Commission's FY2005 Rental Housing Budget from \$28,924,012 to \$29,024,012, the expenditure of up to \$800,000 in Housing Commission funds, and subordination of the Housing Commission loan to senior financing increased from \$11,000,000 to \$12,150,000.



**Certificate of Funding Availability:**

Certificate No.: FY05-104  
 Amount: \$800,000  
 Revenue Source: Inclusionary  
 Division: Housing Finance and Development  
 Line Item: Loans

**Affordable Housing Impact:** Housing Commission affordability restrictions would be extended from 2056 to 2060 with this action. Of the 281 units, 84 are affordable and restricted to households with incomes at or below 50 percent of Area Median Income (\$24,150 for a one-person household), and 196 are affordable and restricted to households with incomes at or below 60 percent of Area Median Income (\$29,000 for a one-person household). Of the units restricted at 60 percent of AMI, 40 have their rents frozen, with no increases, until the rents for those units are equivalent to the 50 percent of AMI rent level. Following conversion to permanent financing, and as the initial tenants move out, the 40 units will become restricted at the 50 percent level and rented to tenants qualifying at that income limit. One unit is set aside for occupancy by the resident manager. The following table shows a breakdown of the restricted rents by unit size and affordability level. Maximum occupancy for all units is two persons; the owner pays for the utilities.

| Unit Type    | Unit Size (sq. ft.) | No. of Units | Rent Levels @ Percent of AMI | Monthly Rent | Average Monthly Market Rent | Annual Rent Savings Over Market Rate |
|--------------|---------------------|--------------|------------------------------|--------------|-----------------------------|--------------------------------------|
| studio       | 275                 | 84           | 50%                          | \$600        | \$900                       | \$ 302,400                           |
| studio       | 275                 | 196          | 60%                          | \$695        | \$900                       | \$ 482,160                           |
| studio       | 450                 | 1            | manager's                    |              |                             |                                      |
| <b>Total</b> |                     | 281          |                              |              |                             | <b>\$784,560</b>                     |

**Environmental Review:** The City completed an environmental review of the project under the California Environmental Quality Act (CEQA), which resulted in a Mitigated Negative Declaration, and under the National Environmental Policy Act (NEPA), which resulted in a Finding Of No Significant Impact (FONSI) which was certified by HUD. This additional funding of a previously approved project is not a “project” within the meaning of CEQA and no additional environmental review is required. No additional federal funding is contemplated by this action and further NEPA processing is not required.

**Previous Related Actions:** On November 9, 2001, the Housing Authority approved recommendations from the Housing Commission to make a \$3,600,000 third position loan to

Island Palms, LP and take the final steps to issue up to \$11,000,000 in Multifamily Housing Revenue Bonds for the development (see Attachment 5 – Housing Commission Report No. HCR01-126). On April 12, 2005, the Loan Committee voted to recommended this loan increase and subordination to the Housing Commission.

**Future Related Action:** An \$800,000 loan increase, budget amendment, and subordination to increased senior debt requires Housing Authority approval.

## **BACKGROUND**

Construction of the mixed-use project was completed in September of 2003 and the residential portion of the complex is 95 percent leased. Housing Commission loan proceeds of \$3,600,000 were fully expended to pay costs of constructing the housing units.

Housing Development Partners (HDP) is a co-general partner in the project. HDP is operated by a Board of Directors consisting of two members of the Board of Commissioners of the San Diego Housing Commission, the Chief Executive Officer of the Housing Commission, and four at-large directors designated by the Housing Commission.

## **DISCUSSION**

Island Palms Apartments, LP (IPA) is the owner and borrower. IPA is a partnership consisting of the for-profit Barone Galasso & Associates (BGA) as general partner, the nonprofit Housing Development Partners (HDP) as co-general partner, and Alliant Capital as the limited partner and tax credit investor.

Island Village was developed to house low-income residents working Downtown. The initial general partner in this project, JMI Realty, was inexperienced in development of affordable housing and stepped aside in favor of Barone Galasso & Associates after the budget and design were formulated. Because JMI benefited from redevelopment of the Ballpark District, as a limited partner it contributed \$496,500 in cash for Island Village development costs. JMI will not be repaid or receive any monetary compensation for its participation in the financing.

The partnership experienced a development budget shortfall of approximately \$1,950,000 caused by an increase in water and sewer hookup costs, increased reserves required by Freddie Mac and the tax credit investor, and increases in labor and materials charges during construction. The reserve requirements were imposed prior to closing of the bond funding because of investor concerns regarding the type of housing proposed and the physical location of the development. Construction loan interest costs increased because of delays in completion and leaseup due in large part to installation of a new sewer main by the City. Because the developer was late in

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completing the project, tax credit rules negated the developer's ability to obtain additional tax credit investment to fund the cost increases.

Housing Commission approval of this proposed loan and subordination would facilitate the scheduled June 1, 2005, closing of conversion to permanent financing. The proposed Housing Commission loan increase, and an additional \$1,150,000 loan from Freddie Mac (Freddie Mac holds the first trust deed on the property as a credit enhancement for the \$11,000,000 bond issuance) would be used to pay off construction debt, legal fees and loan fees, and fund \$400,000 of operating and debt service reserves. The operating and debt services reserves are to remain in effect for the 20-year term of the Freddie Mac second loan. To the extent funds remain in those accounts upon repayment of the Freddie Mac second position loan, the developer will use those reserves to capitalize a replacement reserve account for the affordable housing units.

The Housing Commission debt will be in third position upon conversion to permanent financing. The potential amount of residual receipts available to the Housing Commission will be reduced until repayment of the 20-year Freddie Mac second loan. Terms of the original Housing Commission loan require IPA to make the lesser of amortized Housing Commission loan payments (amortized over fifty-five years) or an annual payment of seventy-five percent of the residual receipts beginning in September of 2002. Due to delayed occupancy and start-up costs, IPA has not made a payment to date.

Security for the Housing Commission loan is improved due to increased value of the property since 2001. An appraisal by Steven L. Bowen & Associates, dated April 26, 2004, estimates the value at \$17,360,000, which is \$2,860,000 more than the \$14,500,000 as-built value estimated in an appraisal obtained prior to the start of construction. With a total debt amount at conversion of approximately \$16,550,000, the loan to value ratio improves from 99 percent to 95 percent. Housing Commission approval of this loan increase and subordination would be contingent upon receipt of a satisfactory updated appraisal, which is expected to show a further increase in value.

The following table compares financial conditions projected in 2001 to the estimated costs at conversion to permanent financing in 2005. The borrower's budget for the project includes the additional \$1,150,000 Freddie Mac loan and an \$800,000 increase in the Housing Commission loan:

|  | 2001         | 2005         |
|--|--------------|--------------|
| Total Development Cost                       | \$21,500,000 | \$23,896,144 |
| Total Loans                                  | \$14,600,000 | \$16,550,000 |
| Housing Commission Loan Amount               | \$3,600,000  | \$4,400,000  |
| Housing Commission Cost Per Unit (280 units) | \$12,857     | \$15,714     |
| Senior Loans                                 | \$11,000,000 | \$12,150,000 |
| Total Loan-To-Value                          | 99%          | 95%          |
| Estimated 2010 Residual Receipts Payment     | \$290,773    | \$80,970     |
| Debt Service Coverage Ratio                  | 1.31         | 1.28         |

IPA deferred 100 percent of its developer fee to pay development costs. Allowing for payment of the developer's fee, it is estimated that in the first year the development will produce residual receipts will be 2010. Payments of the lesser of 75 percent of residual receipts or payments of amortized principal and interest of \$169,549 will be due to the Housing Commission starting in April of 2006. In April of 2016, any shortfalls in payments to the Housing Commission will be re-amortized into the Housing Commission loan and the minimum annual payment due will be that amount until one year after the first position loan is paid in full or until the Housing Commission loan is paid in full through residual receipts. Notwithstanding payoff of the Housing Commission loan, affordability restrictions would remain in effect through December 21, 2060.

### The Financial Plan

|                                   |  |
|-----------------------------------|--|
| Total Development Cost:           | The estimated total development cost increases to \$23,896,144, which includes construction costs, construction interest costs, loan fees, and reserves.                   |
| Appraised Value:                  | A Housing Commission recommendation of approval would be contingent upon receipt of an acceptable as-built appraisal, which is expected to be delivered on April 25, 2005. |
| Loan-to-Value:                    | Loan-to-value based on the 2004 appraisal is 95 percent.   |
| Housing Commission Loan Amount:   | The increased loan principal would leverage \$4,400,000 against \$19,496,144 from other sources.   |
| Housing Commission Loan Terms:    | A 55-year, three percent simple interest amortized loan with provisions for residual receipts payments.  |
| Housing Commission Cost Per Unit: | Estimated total per-unit cost increases to \$15,714 for 280 affordable units.  |
| Security:                         | The Housing Commission loan would be in third lien position secured by the value of the property.  |
| Recourse:                         | The loan is a non-recourse loan because Internal Revenue Service regulations make the tax credit investment undesirable if structured otherwise.                           |

|                                      |   |
|--------------------------------------|---|
| Housing Commission Loan Payments:    | A payment equal to the lesser of principal and interest over a 55-year amortization period or 75 percent of residual receipts. It is estimated that the project will not generate residual receipts until the developer fee is paid in 2010. Until 2016, payments to the Housing Commission would be the lesser of the amortized payment (\$169,549 per year) or 75 percent of residual receipts following payments for debt service on the senior loans, the deferred developer fee, and project expenses. Beginning in 2016, in the event of shortfalls in payments during preceding years, the Housing Commission loan would be re-amortized over the remaining loan term. All principal and interest of the Housing Commission loan is due in full one year after payoff of the first trust deed. |
| Debt Service Ratio for Senior Loans: | 1.28 (year 2005)  |
| Affordability Restrictions:          | A Housing Commission Declaration of Covenants, Conditions, and Restrictions with a 55-year term of affordability was recorded against the property on December 21, 2001. An amended Declaration would be recorded to extend Housing Commission affordability restrictions to December 21, 2060.   |
| First Deed of Trust:                 | A 30-year tax-exempt bond loan of \$11,000,000 would be in first position at the estimated bond market interest rate at closing of 5.65 percent.  |
| Second Deed of Trust:                | A fully-amortized \$1,150,000, 20-year loan from Freddie Mac at the estimated interest rate at closing of 6.26 percent.   |
| Management Plan:                     | A management plan was reviewed and approved by Housing Commission staff. The Management Plan is subject to periodic review and approval by the Housing Commission in its reasonable discretion.   |

|                        |   |
|------------------------|---|
| Operating Expense:     | Operating expenses are estimated at \$89,162 per month (\$317 per unit).  |
| Pro Forma Assumptions: | Income increases are projected at 2.5 percent per year; operating expenses at 3.5 percent per year; vacancy rate at 5 percent per year.   |
| Reserves:              | An annual replacement reserve of \$63,225 is included in the pro forma. Use of this reserve would be subject to the reasonable approval of the Chief Executive Officer of the San Diego Housing Commission. |

### Risks and Mitigations

Loans to tax credit developments become non-recourse upon completion because Internal Revenue Service regulations make the investments undesirable if structured otherwise. This limits the Housing Commission's ability to recover funds because the encumbrance is on the property and not the other assets of the developer. This risk is typically taken by the Housing Commission for tax credit-financed developments and is deemed mitigated by conservative underwriting assumptions and the equity contribution provided by tax credit financing.

There is no further construction period risk to the Housing Commission because the project is complete and occupied. Because the value of the property has increased since funding of the Housing Commission loan in 2001, subordination to increased senior debt would not significantly reduce the quality of security for the Housing Commission loan.

### Disclosure

Commissioners Salas and Yipp and Chief Executive Officer of the Housing Commission, Elizabeth C. Morris, are each directors and officers of Housing Development Partners, a California nonprofit public benefit corporation qualified as an Internal Revenue Code Section 501(c)(3) corporation. Neither Commissioner Salas, Commissioner Yipp, nor Ms. Morris receive compensation for their service on the Board of Directors of Housing Development Partners. Pursuant to the provisions of Government Code Section 1091.5(a)(7) and (8), Commissioner Salas, Commissioner Yipp, and Ms. Morris each have a "non-interest" as described in Government Code Section 1091.5 and are therefore legally entitled to vote and be counted for quorum purposes.

It is the opinion of Charles B. Christensen, General Counsel for the Housing Commission, that none of the board members of Housing Development Partners has a financial interest in the development that would legally preclude their participation under the provisions of

Government Code Sections 1090 and/or 87100, et.seq., and/or the San Diego Housing Commission's Conflict of Interest Code. This disclosure shall be and is hereby documented in the official records of the San Diego Housing Commission.

**ALTERNATIVE**

The Housing Commission could deny approval of the recommendation to increase the Housing Commission loan and approve subordination of the Housing Commission loan to increased senior debt. Without Housing Commission financing of the gap in funding of increased project costs, the developer would experience increased costs of financing from paying debt service on the construction loan while looking for alternative funding sources. The developer asserts it has maximized the private debt available to the project, which is somewhat restricted because it is a mixed-use development with an atypical housing component.

Submitted by,

Cissy Fisher  
Director of Housing Finance & Development

**Signature on File  
With Original Document**

Approved by,

Elizabeth C. Morris  
President & Chief Executive Officer

- Attachments:
1. Development Summary
  2. Development Timeline
  3. HC Development Form
  4. FY2005 Rental Housing Production Budget
  5. Previous Report (HCR01-126)\*

\*Distribution of this attachment is limited. A copy is available for review at the Housing Commission office at 1625 Newton Avenue and the office of the City Clerk, 2<sup>nd</sup> floor, 202 "C" Street.

Information: Mr. Dan Cady (619) 578-7594

## ATTACHMENT 1

### DEVELOPMENT SUMMARY April 29, 2005

Name: Island Village  
Location: 1245 Market Street  
Description: Rental housing for very low-income households  
Sponsor: Island Palms Apartments, Limited Partnership

#### Unit Affordability

Total # of units: 281  
Assisted units: 280  
Restricted rents: 280 studios @ rents from \$600 to \$695  
  
Market rent: studios rent for approximately \$900 per month  
  
Percent of AMI: 280 units at 60 percent or less of Area Median Income  
Affordability: to be extended to December 21, 2060

#### Development Cost

Total development cost: \$23,896,144  
HC development cost: \$ 4,400,000  
Total development cost per unit: \$ 85,040  
HC cost per unit (281 units): \$ 15,658

#### Sources of Funds

Tax-exempt Bonds \$11,000,000  
Freddie Mac Loan \$ 1,150,000  
Housing Commission \$ 4,400,000  
4% Tax Credits \$ 5,705,544  
Deferred Developer Fee \$ 1,144,100  
Developer Equity \$ 496,500

#### Pro Forma Summary

Estimated annual income: \$2,310,068 (2005)  
Estimated annual expense: \$1,069,939 (2005)  
Annual debt service: \$ 965,880  
Estimated residual receipts \$ 80,970 (2010)

ATTACHMENT 2

**ISLAND VILLAGE  
ESTIMATED DEVELOPMENT TIMELINE**

May 10, 2005

Loan to the Housing Authority for approval

June 1, 2005

Loan closing

