



# REPORT

**DATE ISSUED:** May 7, 2004

**ITEM 101**

**REPORT NO.:** HCR04-39  
For the Housing Commission Agenda of May 14, 2004

**SUBJECT:** Proposed Loan To Affirmed Housing Group For New Construction Of  
“Creekside Trails” (Council District 8)

## SUMMARY

**Issue:** Should the Housing Commission recommend Housing Authority approval of a \$1,830,000 loan to facilitate Affirmed Housing Group’s (Affirmed) acquisition of a vacant parcel and new construction of 50 apartment homes at Creekside Trails (2100 Block of Coronado Avenue)?

**Recommendation:** That a loan up to \$1,830,000 be approved as described in this report and summarized below:

- Housing Commission funding of a \$1,400,000 loan to Affirmed for land purchase prior to the June 23, 2004 land purchase-option expiration;
- Contingent upon the California Tax Credit Allocation Committee (TCAC) award of 9% tax credits, the Housing Commission loan to Affirmed of up to an additional \$430,000 for the construction of the proposed units; and

Documentation of terms and conditions of this loan would be contingent upon satisfaction of the General Counsel. The Chief Executive Officer would be authorized to take all actions necessary to effectuate this transaction.

### Certificate of Funding Availability:

Certificate No.:	AC# 04-129
Amount:	\$1,830,000
Revenue Source:	HOME/Other
Division:	Housing Finance and Development
Line Item:	Loans and Grants

**Affordable Housing Impact:** Development of this project will create 50 new rental units: 22 one-bedroom, 12 two-bedroom and 16 three-bedroom units. A total of 49 units will have affordability restrictions, with rents ranging from estimated 30% to 60% of area median income (AMI) (a range of \$20,550 to \$41,100 for a family of four). The Creekside Trails



restricted units will be affordable for a term of 55 years, with initial rents (net of utility allowance) ranging from \$353 to \$739 for one bedroom units; \$422 to \$885 for two bedroom units, and \$484 to \$950 for three bedroom units.

**Community Planning Group:** On February 11, 2004 the Otay Mesa-Nestor Community Planning Committee heard a project presentation and voted 12-1 to: “recommend to initiate a re-designation to the plan amendment to change the property from a park designation to a residential designation with a stipulation to conserve the lineal park along the creek within the implemented guidelines for the Nestor Town Center.” City Long Range Planning later indicated that a Community Plan Amendment is no longer required.

**HOME Program Compliance:** The proposed loan is an eligible activity under the HOME Investment Partnerships Program (HOME). Proposed rents are below HOME guidelines; eleven units will be designated as HOME units.

**Equal Opportunity:** Affirmed is in compliance with the San Diego Housing Commission Equal Opportunity Program. Affirmed is not certified as a Disadvantaged Business Enterprise (DBE) and its “Report of San Diego County Workforce” is on file.

**Environmental Review:** The development is currently under review by the City under the California Environmental Quality Act (CEQA) guidelines and the National Environmental Protection Act (NEPA). CEQA approval will occur prior to Commission review, and NEPA approval is expected prior to Housing Authority review.

**Previous Related Action:** The Loan Committee will consider this housing loan proposal on May 11, 2004. Action taken by the Loan Committee will be reported at the May 14 Board meeting.

**Future Related Action:** Housing Authority consideration on May 25, 2004 should the Housing Commission approve this loan proposal.

## **DISCUSSION**

### Summary

Affirmed proposes to construct 50 apartment units on an unimproved parcel located at 2100 Coronado Avenue, west of Hollister Street, in the Nestor Community (Attachment 1 – Site Map, Attachment 2 – Estimated Timeline). Affirmed submitted a loan application under the Housing Commission’s current NOFA. Affirmed has a land-purchase option that expires on June 23, 2004 and was unable to obtain a time extension on the land option. Consequently, Affirmed is requesting that the Housing Commission provide a \$1,400,000 loan to acquire the property by June 23.

### New Concepts

This report raises policy questions regarding predevelopment assistance to affordable housing developments; the Board may wish to discuss these separately from the specifics of this transaction. (The proposed permanent financing is consistent with Housing Commission underwriting standards.)

Affirmed's request for an acquisition loan prior to attaining a commitment of tax credits distinguishes this proposal from the standard loan package. The proposal is reflective of the heated real estate market and the attendant problem that affordable housing developers have in finding sellers who will wait for all project funding sources to become available before closing escrow on the land.

At recent meetings, the Housing Commission Board has expressed willingness to consider land banking or land acquisition for future new construction deals. This proposal includes funding of the entire cost of the site (100 percent of appraised value) with the Housing Commission loan.

By funding a land purchase, this proposal could be characterized as providing predevelopment funds to a for-profit developer. To date, predevelopment assistance has been offered only to nonprofit developers.

### The Proposed Development

The proposed new construction development will be 50 units of two-story rental housing, including: 22 one-bedroom units, 12 two-bedroom units, and 16 three-bedroom units. There will be a centrally located community building containing a management office, recreational room, and resident computer learning center. The project will include: laundry, tot lot, barbecue and picnic areas. The entire first floor will be handicap accessible, and the project will incorporate a number of accessibility/Universal Design features. There will be 75 onsite parking spaces. The project includes construction of a walking trail/park along Nestor Creek, requested by the community, that runs along the property's southern border. The project will utilize materials that increase energy efficiency by at least 15% - 20% above State Title 24 energy standards. The project architectural style would be similar to Tesoro Grove, which Affirmed recently completed and which has won awards from the San Diego Chapter of the American Institute of Architects and from Residential Architect Magazine, and was nominated for the prestigious National Association of Homebuilders' "Best Affordable Housing" award.

### Housing Commission Loan Financial Structure:

**Proposed Site Acquisition Loan** - Prior to the June 23, 2004 land purchase-option expiration, it is proposed that the Housing Commission fund a \$1,400,000 recourse land acquisition loan to Affirmed. Affirmed would pay the title, escrow, closing costs, carrying costs, and legal costs. This recourse acquisition loan would be at the Applicable Federal Rate of interest (estimated at 4.6% and compounded). The principal and interest would be due and payable upon the earlier of either Affirmed obtaining the tax credits, or at the end of eighteen months. The Housing Commission's \$1,400,000 loan would be secured by a first position deed of trust on the land (appraised at \$1,400,000 as of January 30, 2004) and would be a recourse loan against

Affirmed's assets. After the anticipated approval of the tax credits, the \$1,400,000 acquisition loan and interest would roll into the permanent loan.

**Proposed Permanent Loan** - After the project receives tax credits, the Housing Commission's permanent loan will increase to \$1,830,000 (which includes the \$1,400,000 acquisition and an additional \$430,000 for the construction). The permanent loan would become non-recourse (as required by the tax credit program) and secured by a second trust deed recorded against the property. Interest would be at the Applicable Federal Rate (estimated at 4.6% compounded). The Housing Commission note shall be due and payable upon the earlier of the pay off of the permanent financing or 31 years from the inception of the Housing Commission loan. The Housing Commission would subordinate to other lenders as necessary and prudent. Cost savings and/or additional tax credit and/or additional senior debt shall be used to reduce the principal of the public subsidy. The developer will obtain the largest possible private first mortgage.

#### Property Description

This 2.78 acre vacant property (121,097 square feet), is located west of the I-5 Freeway/Coronado Avenue interchange, just west of Hollister Street. The site is flat, triangular, bounded on the east by a religious facility, and a single-family subdivision on the west and south. To the North are Coronado Avenue and the South Bay Drive-in theatre. Mendoza Elementary School is located a short distance to the northeast on Coronado Avenue with residential uses beyond. Further east is a trailer park, gas stations, a pharmacy, Days Inn, and the I-5 Freeway. All necessary community facilities and services are located within a reasonable distance of the proposed development.

Recent affordable housing new construction in the area includes 112-unit Tesoro Grove (by the same developer) and 42-unit Mesa Family Villas. Both projects have waiting lists for vacancies.

#### Zoning

The site is zoned RM-1-1 for multifamily residential development with a density of one unit per 3,000 square feet of land area (40 units maximum). The developer proposes to use the 25% Density Bonus Program to increase the maximum allowed units to 50. The Housing Commission's Density Bonus staff has tentatively determined that a Density Bonus for this project is approvable and a Density Bonus Agreement would be required, to achieve the needed density, as a condition precedent to the funding of the Housing Commission's loan.

#### Project Costs

The estimated total development cost of the project is \$10,261,720. Proposed financing sources include: \$7,196,580 equity from the sale of nine percent tax credits; \$1,235,140 conventional bank loan; and a Housing Commission loan up to \$1,830,000 (\$37,347/assisted-unit). The developer will pay State Prevailing Wage rates. The developer's fee is within TCAC's parameters, as allowed by the NOFA, and would be released incrementally as required by the limited partner and approved by the Housing Commission.

#### The Borrower

Affirmed is a for-profit real estate development firm located in Escondido, California specializing in the development of affordable, multifamily rental housing. Affirmed's President,

James Silverwood, has twenty-two years of experience in the development and construction industry, and has extensive experience acting as general partner in various partnerships. Since 1994, Affirmed has developed over 1,100 units in Southern California and the mid-Atlantic states of West Virginia, Virginia and North Carolina. Since 1994, Affirmed has secured over \$200 million of tax credit, conventional and other financing for affordable housing. Recent developments include new construction as well as acquisition and substantial rehabilitation projects in San Diego County, Riverside County and Ventura County. Affirmed's financing experience includes use of low-income housing tax credits, multi-family tax exempt bonds, HOME funds, Redevelopment Agency set-aside funds, and private loans for construction and permanent financing. Affirmed's recent local projects included the 106-unit Tesoro Grove Apartments (new construction 9% tax credits in San Diego, with a \$2,630,000 Housing Commission loan), and the 94-unit Hollywood Palms Apartments, (new construction 4% tax credits in San Diego, with a \$2,200,000 Housing Commission loan). Staff has reviewed Affirmed's credit report and finds it is satisfactory and on file at the Housing Commission offices.

A tax credit limited partnership will be formed and will be the ownership entity, with Affirmed acting as General Partner; the terms of the limited partnership agreement are subject to the prior approval of the Housing Commission. The developer will provide a copy of the partnership agreement once a partnership is formed. The project architect will be Eric Nasland, Studio E Architects. A contractor will be selected for the construction. Solari Enterprises, a professional management company, will provide property management services for the development.

The Permanent Financial Plan:

Total Development Cost (TDC):	TDC is \$10,261,720 including land value; construction; interest costs; builder overhead and profit; consultants; permits/fees.
Loan Amount:	The proposed Housing Commission loan is up to \$1,830,000 (\$37,347 per assisted unit and \$20,110 per assisted bedroom) and would leverage \$8,431,720 expected from other sources. Commission funds provide 18% of TDC and other sources provide 82%.
Equity Investment:	Tax credit investment is estimated at \$7,196,580.
First Trust Deed:	The limited partnership will obtain conventional construction and permanent loans from private sector lenders. A permanent loan is estimated to be \$1,235,140 at 8%, from Bank of America, amortized over 30 years but due in 16 years.
Second Trust Deed: (Housing Commission Loan)	A residual receipts Housing Commission loan up to \$1,830,000, junior and subordinate only to a

construction loan estimated at \$5,660,767, and the take-out loan estimated at \$1,235,140.

Payments on the Housing Commission's Loan:

Annual Debt Service Payments:

- Starting at the end of year one through year three, annual debt service payments of 50 percent of residual receipts.
- Starting in year four, annual debt service payments will equal the greater of: 50% of residual receipts or \$11,117 (derived from half the estimated residual receipts at the end of year one). In the event that the \$11,117 amount exceeds the available Residual Receipts, the Housing Commission would waive the right to receive an amount in excess of the available Receipts and instead agree that the Annual Payment Amount shall be satisfied by the payment to the Housing Commission of 100% of the available Residual Receipts.

Interest:

To preserve the full amount of the tax credit award, the Housing Commission typically charges the Applicable Federal Rate on HOME funds provided to the project, currently estimated at 4.6% (compounded annually, as required by federal regulations).

Permanent Loan Term:

The Housing Commission note shall be due and payable upon the earlier of the pay off of the permanent financing or 31 years from the inception of the Housing Commission Loan, provided however, that a refinancing of the permanent financing with no cash out, shall not require a payoff of the Housing Commission loan within the first 31 years of the Housing Commission loan, only. Upon any refinancing, at any time, Affirmed will pay to the Housing Commission all accrued and unpaid interest on the Housing Commission loan.

A Declaration restricting occupancy and rents for 55-years would be recorded against the property.

Appraised Value:

Based on a January 30, 2004 appraisal by Anderson & Brabant Inc. (Gilbert Kunkel, MAI), the "as-is"

land value is \$1,400,000, which supports the \$1,400,000 purchase price.

Security:

- Initially, the short-term land acquisition loan (\$1,400,000) will be secured by a first trust deed against the property and recourse to the developer. If the tax credits are not obtained within eighteen months, then the Housing Commission can call the loan due and foreclose or exercise the option to acquire the property for \$1,400,000.
- During construction, the Housing Commission's loan (up to \$1,830,000) will be secured by a second trust deed and subordinate to a construction loan estimated at \$5,660,767.
- Upon permanent financing, the Housing Commission's loan will be secured by a second trust deed junior to a permanent conventional loan estimated at \$1,235,140.
- After timely completion of project construction, the permanent loan will be non-recourse as provided in the Housing Commission lending policy for tax credit projects.

Loan to Value:

Loan to value is to be determined upon receipt of an as-built appraisal. It is very likely that significant developer equity from the tax credits would result in a favorable loan-to-value ratio.

Debt Service Ratio:

Debt service ratio is estimated at 1.20 at year one.

Rent Restrictions:

A Declaration of Covenants and Restrictions with a 55-year term will be recorded against the property to restrict rents on 49 units at levels affordable to 30% to 60% of AMI, which is more favorable than the HOME requirement.

Occupancy Restrictions:

Occupancy of 49 assisted units will be restricted to households earning no more than 30% to 60% of area median income. One unit will be set aside as the manager's unit.

Management Plan:

A Management Plan has been reviewed and approved by Housing Commission staff.

Operating Expense:	Operating expenses are estimated at \$410 per unit per month (excluding limited partnership fees and replacement reserves). The estimated operating costs include \$35,000/year property taxes and \$10,000/year for service amenities necessary to maximize tax credit points.
Pro Forma Assumptions:	Income increase is projected at 2.5 percent per year; expense increase is projected at 3.5 percent per year, and vacancy is projected at 5 percent per year.
Reserves:	As required by TCAC, an annual \$15,000 minimum replacement reserve (\$300/unit) is included in the pro forma. Reserve expenditures would be subject to Housing Commission approval.
First Right of Refusal:	The Housing Commission will have a first right of refusal to purchase the property on the same terms and conditions of any offer made to Affirmed or to the partnership to be formed.

#### Risks and Mitigation

1. The \$1,400,000 land purchase loan would fund prior to Affirmed's application to TCAC for low income housing tax credits. Should Affirmed be unable to obtain the necessary tax credits, the Commission's \$1,400,000 loan would be secured by a first position deed of trust on the land (appraised at \$1,400,000 as of January 30, 2004) and would be a recourse loan against Affirmed's assets. The risk is somewhat mitigated by Affirmed's prior success in applying for and obtaining tax credits and their general development experience. If 9 percent tax credits are not obtained, alternate financing such as bonds and 4 percent tax credits could be considered or the land could be sold. An alternate financing plan that included restricted rents would most likely require additional gap financing.

2. After the award of tax credits, loans to tax credit projects become non-recourse upon the timely completion of the construction of the project. This is due to IRS regulations that make the investment undesirable if structured otherwise. The conventional first position loan is also non-recourse for the same reason. This limits the Housing Commission's ability to recover funds to the property itself. This risk is typically taken by the Housing Commission in tax credit financed developments, and is deemed mitigated by conservative underwriting assumptions and the equity contribution provided by the tax credit financing, the favorable loan-to-value provided by tax credit equity, and the Housing Commission's right of first refusal.

CONCLUSION - The new construction of 50 units will add to the housing stock for low income families. The Housing Commission's \$1,830,000 loan would restrict 49 units for 55 years at a reasonable cost of \$37,347 per assisted unit. The developer is experienced with tax credit financed developments and construction may start as soon as February 2005. For the reasons

stated above, staff recommends project funding upon the terms and conditions outlined in this report.

**ALTERNATIVES**

1. Require the developer to seek land acquisition financing elsewhere. This alternate short term financing would increase project development costs by at least an estimated \$75,000 for the first year in origination fees and higher interest costs and would necessitate a greater gap permanent loan from the Housing Commission.

2. Have the developer assign the current purchase agreement to the Housing Commission (allowing the Housing Commission to purchase the land outright) and lease the land to the developer. The disadvantage to this alternative is that in order to maximize tax credit scoring process points, the land lease payment would likely be limited to only \$1 per year. Also, this alternative may subject the Housing Commission to carrying costs and potential liability as owner. This alternative does not provide any periodic income to the Housing Commission.

3. Do not recommend funding the project. This would most likely result in the loss of the contract to purchase the land and the ability to apply for tax credits, which would make this project infeasible for affordable housing development.

Submitted by,

Cissy Fisher  
Manager Housing Finance & Development

**Signature on File  
With Original Document**

Approved by,

Elizabeth C. Morris  
Chief Executive Director

- Attachments:
1. Site Location Map
  2. Development Timeline
  3. Development Summary
  4. SDHC Application Form
  5. Disclosure Statement \*
  6. Financial Statement \*
  7. Appraisal \*

\* - 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.

**ATTACHMENT 2  
DEVELOPMENT TIMELINE**

Summary of Estimated Timeline

- Loan Committee Review . . . . . May 11, 2004
- Housing Commission Review . . . . . May 14, 2004
- Estimated Housing Authority Review . . . . . May 25, 2004
- Estimated HC Loan Closing/Land Acquisition . . . . . June 22, 2004
- Purchase-Option Expiration Date. . . . . June 23, 2004
- Tax Credit Application . . . . . July 22, 2004
- Estimated Tax Credit Award/Reservation . . . . . Sept 22, 2004
- Estimated Start of Construction. . . . . Feb 19, 2005
- Estimated Construction Completion & Occupancy . . . . . Feb 28, 2006

### ATTACHMENT 3 Development Summary

Name: Creekside Trails Apartments  
 Location: 2170 Coronado Avenue (Near Hollister Street)  
 Description: Rental housing for very low and low income residents  
 Sponsor: Affirmed Housing Group

Unit Affordability:  
 Total # of units: 50  
 Assisted units: 49  
 Restricted rents: 49

Unit Type and Estd % of Area Median Income *	Unit Size (sq. ft.)	No. of Units	Restricted Monthly Rent (Net of Utility Allowance)	Monthly Market Rent ** (Net of Utility Allowance)	Annual Rent Savings Over Market Rate
1br/1ba @30%	621	2	\$353	\$893	\$12,960
1br/1ba @40%	621	2	\$482	\$893	\$9,864
1br/1ba @50%	621	11	\$610	\$893	\$37,356
1br/1ba @60%	621	7	\$739	\$893	\$12,936
	subtotal	22			
2br/1ba @30%	835	1	\$422	\$1,010	\$7,056
2br/1ba @40%	835	1	\$576	\$1,010	\$5,208
2br/1ba @50%	835	6	\$731	\$1,010	\$20,088
2br/1ba @60%	835	4	\$885	\$1,010	\$6,000
	subtotal	12			
3br/2ba @35%	1,086	2	\$484	\$1,175	\$16,584
3br/2ba @45%	1,086	2	\$662	\$1,175	\$12,312
3br/2ba @50%	1,086	8	\$800	\$1,175	\$36,800
3br/2ba @60%	1,086	3	\$950	\$1,175	\$8,100
	subtotal	15			
3br/2ba	1,086	1			
<b>Total</b>		50			<b>\$184,464</b>

\* - Estimated percent of Area Median Income (rounded).

\*\* - Based on the Anderson & Brabant Inc. appraisal, January 30, 2004.

Manager's Unit: One unit will be reserved as managers' units.

Percent of MAI: Restricted Rents will be affordable to persons earning between an estimated 30% and 60% percent of median area income.

Affordability: 55 years

**Development Cost**

Total development cost: . . . . .	\$10,261,720	
HC development cost: . . . . .	\$1,830,000 (maximum)	
HC cost per (restricted) unit: . . . . .	\$37,347 (49 restricted units)	
HC Subsidy per (restricted) bedroom @ 91 Bdrm's: . . .	\$20,110 (91 Bdrms)	

**Sources of Funds**

Conventional Loan – 1 <sup>st</sup> TD. . . . .	\$ 1,235,140	
SDHC – 2 <sup>nd</sup> TD . . . . .	<u>\$ 1,830,000</u>	(Residual Receipts)
Subtotal . . . . .	\$ 3,065,140	
Low Income Housing Tax Credits: . . .	<u>\$ 7,196,580</u>	
Total Sources. . . . .	\$10,261,720	

**Uses of Funds**

Total Uses. . . . .	\$10,261,720	
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**Pro Forma Summary**

Estimated Annual Effective Gross Income: . . . . .	\$392,092	(Year 1)
Estimated Annual Expense (with Replacement Reserves): .	<u>-.261,100</u>	(Year 1)
Estimated Net Operating Income . . . . .	\$130,992	
Estimated Annual debt service, 1 <sup>st</sup> TD . . . . .	<u>- 108,756</u>	(1.20 debt coverage)
Subtotal (Estimated Cash Flow) . . . . .	\$ 22,235	
Estimated HC Residual Receipts * . . . . .	\$ 11,117 *	(Year 1)

\* - Estimated Residual Receipts does not include an estimated \$3,000 Limited Partner Asset Management Fee which is intended to come from the developer's portion of the Residual Receipts.