



Good Neighbors

San Diego
Housing Commission

REPORT

DATE: For the Agenda of July 20, 2001

ITEM 107

REPORT NO.: HCR01-049

SUBJECT: Loan to Housing Development Partners for the Mason Hotel
(Council District 3)

SUMMARY

Issue No 1: Should the Housing Commission recommend Housing Authority approval to facilitate acquisition of the Mason Hotel, by Housing Development Partners of San Diego, to operate as special purpose housing for extremely low income individuals?

Recommendation No. 1: That the Housing Commission recommend Housing Authority approval to facilitate acquisition of the Mason Hotel, located at 1345 Fifth Avenue, by Housing Development Partners of San Diego (HDP) from the owner, Housing Opportunities, Inc.(HOI), and authorize the Chief Executive Officer to execute necessary documents, subject to General Counsel's approval, including those to;

- Allow HDP to assume an existing \$420,500 Commission loan, that will become the first position loan, and borrow an additional \$226,000 of Commission funds, to be secured by a Third Trust Deed, and receive a revocable grant from the Commission of \$230,000, to pay off a bank loan to the project, fund reserves, and pay for rehabilitation work to make the site ready for lease to a nonprofit operator; and,
- Allow HDP to assume two Centre City Development Corporation (CCDC) loans and merge them into one Second Trust Deed loan on the condition that HDP pay CCDC 50 percent of the residual receipts of the development.

Issue No 2: Should the Housing Commission approve and recommend Housing Authority approval to amend the Commission's Fiscal Year 2002 budget, adding \$470,000 of Community Development Block Grant funds for special purpose housing, \$230,000 of which would be committed to the Mason Hotel?

Recommendation No. 2: It is so recommended.

Fiscal Impact: The Commission loaned Housing Opportunities, Inc. (HOI) \$420,500 in 1994 for rehabilitation of the Mason Hotel. Acquisition by HDP would increase the amount of Housing Commission investment in the property to an estimated \$876,500 because it would cost HDP approximately \$456,000 to pay off an existing First Trust Deed bank loan HOI has on the property, relocate the residents, fund an operating reserve, and prepare the building for lease to a nonprofit operator.

Certificate of Funding Availability:

Certificate No:	FY01-156	FY02-044
Amount:	\$226,000	\$230,000
Funding Source:	Housing Trust Fund	CDBG
Department:	HF&D	HF&D
Line Item:	Loans	Grants

Affordable Housing Impact: This development would preserve the affordability of 27 single-room occupancy units for residents with incomes of up to 50 percent of Area Median Income and extend the affordability period 55 years. The minimum tenant-paid rent would be \$50 per month; rents would be limited to 30 percent of resident gross income.

Previous Related Actions: In 1994, the Housing Commission and Housing Authority authorized a loan for acquisition and rehabilitation by HOI. At its meeting on July 10, 2001, the Loan Committee voted to approve the transaction outlined in this report.

Future Related Actions: If approved, the recommendations related to these issues will be submitted to the Housing Authority for consideration.

HOME Program Compliance: Acquisition by HDP is allowable under HOME rules. All 27 units are subject to HOME-restricted rents.

Environmental Review: Acquisition of housing for housing assistance programs is categorically exempt under the California Environmental Quality Act (CEQA), pursuant to Section 15326 of the CEQA Guidelines, and rehabilitation is categorically exempt from CEQA, pursuant to Section 15301 of the CEQA Guidelines. Rehabilitation of the Mason Hotel, using federal funds, has been determined to be in compliance with the National Environmental Policy Act (NEPA) by meeting the requirements of 24 CFR Parts 58.70 through 58.76.

BACKGROUND

The Mason Hotel is an 88 year old, three-story, 27-unit, single-room occupancy hotel located in Centre City, three blocks north of Broadway on Fifth Avenue. The ground floor of the building contains approximately 3000 square feet of unoccupied commercial lease space; a laundry room and 500 square foot community room are for the residential tenants. All 27 residential units are located on the second and third floors. Six of the housing units have their own bathrooms. A full basement contains mechanical equipment for the building and storage space for commercial tenants.

In 1994, HOI, a Section 501(c)3 nonprofit corporation, purchased the Mason Hotel and relocated the residents. HOI financed the development with two loans from CCDC: a \$685,000 30-year, 5 percent interest, residual receipts loan, and a \$29,509 30-year amortized loan. A \$140,000 First Trust Deed loan from San Diego National Bank and a 30-year, 3 percent interest, residual receipts loan of HOME Program funds in the amount of \$420,500 from the San Diego Housing Commission were used to renovate the building. Substantial upgrades to the building were performed, including a community room, a new heating system boiler, and a structural retrofit for earthquake safety. Agency funds were not used for improvements to the commercial lease space. A declaration requiring rents affordable at 50 percent or less of Area Median Income for 30 years was recorded against the property by the Commission. The CCDC loans are in third and fourth position behind the second position Housing Commission loan and the first position bank loan. In compliance with affordability restrictions, the building has been rented as very low income housing since completion of the initial rehabilitation in 1995. However, HOI was unsuccessful in implementing plans to lease the building to an operator of transitional housing for mentally ill residents.

On December 6, 2000, City Council approved a five-part program to assist Downtown's special needs homeless population. The program is a collaborative effort of the City, the County, CCDC, and the San Diego Housing Commission, in partnership with organizations specializing in services for homeless residents. The program includes:

- Creation of a centralized intake and referral system and facility;
- Construction or rehabilitation of 100 beds of transitional housing for severely mentally ill residents;
- Construction or rehabilitation of 100 units of permanent supportive housing for severely mentally ill residents;
- Expansion by 80 beds of residential alcohol and drug treatment programs for chronic inebriates, the drug-addicted, and those dually-diagnosed with mental illness and substance abuse problems; and,

- Evaluation and expansion of the Serial Inebriate Program (for chronic inebriates).

On March 20, 2001, the Commission received written notification from HOI of the nonprofit's desire to sell the Mason Hotel. In business since 1974, the Board of Commissioners of HOI feels the organization has realized its goal of fostering development of affordable housing. HDP proposes acquisition of the Mason Hotel to help fulfill the City's commitment to develop housing for residents with special needs.

DISCUSSION

The Developer

On March 19, 1990, the Housing Commission authorized the establishment of a nonprofit housing corporation, which led to the creation of the San Diego Development Corporation. On June 3, 1998, the Housing Commission amended the Articles of Incorporation of the California public benefit corporation to change its name to Housing Development Partners of San Diego. As expressed by its Articles of Incorporation, the goals of HDP are:

- To provide low and moderate income persons, elderly persons, and disabled persons with affordable housing by acquiring or developing publicly-financed low and moderate income housing and renting that housing to these persons;
- To provide facilities and services related to housing; and,
- To take other actions, in cooperation with private persons and public agencies, to promote the creation and preservation of low and moderate income housing.

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 San Diego Housing Commission, and four at-large directors designated by the San Diego Housing Commission. HDP's officers are the President, Vice-President, Secretary, and Chief Financial Officer.

The Mason Hotel would be HDP's second affordable housing development.

HDP developed and owns Knox Glen, a 54-unit affordable housing development for families, located at 4720 Logan Avenue in the San Diego community of Lincoln Park.

With 32 units affordable at 60% of AMI and 22 units affordable at 50% of AMI, the approximately \$7,000,000 development was completed in 1996.

The Proposal

In purchasing the Mason Hotel, HDP would pay off HOI's First Trust Deed loan from San Diego National Bank and assume the Commission loan and the combined CCDC loans. (CCDC would roll the remaining principal of its amortized loan into its residual receipts loan so HDP would not have to pay debt service.) The existing Commission loan, made in 1994, would be in first position; a three percent interest residual receipts Commission loan of \$226,000 would be recorded in third position behind the second position CCDC loan. The Commission's revocable grant, of \$230,000 in CDBG funds, would be in fourth position. The HOME Program contribution and restrictions would remain in place.

Following acquisition, HDP would operate the Mason Hotel as rental housing with occupancy restricted to residents with incomes at or below 50 percent of Area Median Income. Actual resident income is expected to be less than 30 percent of Area Median Income. A declaration making the affordability period 55 years would be recorded against the property.

HDP would be responsible for locating a nonprofit operator of special purpose housing, to lease and operate the Mason Hotel, and entering into an agreement with that organization. A desirable outcome would be marketing of the units as rental housing for residents recovering from substance abuse and/or mental illness who are capable of living independently.

It is estimated that it would take up to a year for HDP to acquire the Mason Hotel, perform rehabilitation work, select a qualified nonprofit operator, and negotiate a lease of the site to the selected nonprofit operator. Current occupants of the residential units would be relocated to other single-room occupancy housing if a special purpose housing program can be initiated. Because special purpose resident populations are characteristically extremely low income, with incomes of \$800 per month or less, the Housing Commission could provide Project-based Section 8 vouchers to subsidize the units. The Project-based Section 8 Program provides 10-year rent subsidies that are renewable at the discretion of participating agencies.

The current property manager of the Mason Hotel is Barone Galasso & Associates, Inc., a for-profit organization specializing in the development and management of affordable rental housing. Barone Galasso does not want to continue managing the facility, but it has indicated it would agree to stay on until HDP can enter into an agreement with another provider. The costs of a contract with a property manager,

and any other costs of operation, would be paid with development income and funds from an operating reserve.

The estimated \$346,000 cost of preparing the Mason Hotel for lease would include physical improvements to the residential portion of the building, a capitalized replacement reserve, and a developer fee to the nonprofit lessee. Most of the developer fee would be used to pay administrative and legal costs related to lease negotiations. The building is fundamentally sound; \$108,000 is budgeted to pay the costs of deferred maintenance, plumbing system renovation, and the addition of a kitchen for the residential tenants. (See Attachment 7 - Preliminary Inspection Report.)

Of the residual income from any sublease of the commercial space and the rental housing activity, 50 percent would go to CCDC to pay down its loan. The remaining 50 percent would be negotiated to an equitable split between HDP and the nonprofit operator. (No residual receipts would go to the Commission.) The nonprofit operator would use its portion first to maintain an operating reserve account and second to fund an account for rent subsidy (if the rent subsidy program would expire prior to the end of the lease). The Commission would have the right to approve the form and content of HDP's lease agreement with the nonprofit operator.

Affordability

There would be an affordability restriction on all 27 units requiring rents at 50 percent or less of Area Median Income for 55 years. Because it is estimated that the target tenant population can afford to pay a monthly rent of \$230, or less, project-based Section 8 vouchers could be used to subsidize rents. It is estimated that total annual rent savings would be \$74,520 below market.

The following is an outline of projected rents following lease to a nonprofit operator:

Occupancy	27 Units	Restricted Rents @ 50% MAI	Tenant-Paid Portion (average) With Sec. 8	Estimated Monthly Market Rate Rents	Proposed Annual Rent Savings
maximum 50% of AMI	6 units with bath	\$450	\$230	\$495	\$19,080
maximum 50% of AMI	21units without bath	\$405	\$230	\$450	\$55,440

The Financial Plan

Total Development Cost:	The estimated total development cost, including assumption of the CCDC loan, is \$1,516,000. The Commission's new contribution to the development is \$456,000 including paying off the bank loan and the costs of improvements. HDP would assume previous loans from the Housing Commission and CCDC.
Funding Amount:	Funds in the amount of \$456,000 would be used to pay off the bank loan, pay for relocation, fund an operating reserve, pay for improvements, and pay a developer fee to a nonprofit operator.
Cost per Unit:	Total cost of the development would be \$56,148 per unit. The estimated "new" cost per unit to the Commission is \$16,889 which includes rehabilitation, improvements, and reserves. The Housing Commission's total cost per unit including the prior loan is \$32,463/unit.
Appraised Value:	An "as-is" appraisal of \$1,015,000 is dated June 15, 2001.
Loan-to-Value Ratio:	The loan-to-value ratio is 127 percent.
Security:	The new Commission loan would be in third position behind the first position Commission loan and the second position CCDC loan. The Commission grant would be in fourth position. The Commission loans and grant would be secured by the value of the property.
Rent Restrictions:	A 55-year rent restriction at 50 percent or less of Area Median Income would be recorded against the property.

Occupancy Restrictions:	A 55-year restriction limiting occupancy of 27 units to households earning 50 percent or less of Area Median Income would be recorded against the property.
Management Plan:	Barone Galasso & Associates, Inc. would continue managing the property until HDP could contract with an interim property management firm. Following lease of the building, the nonprofit operator would manage the property in-house or contract with a property manager.
Operating Expense:	Monthly operating expense is projected at \$310 per unit.
Replacement Reserves:	\$200 per unit per year and a \$50,000 capitalized reserve.
Residual Receipts:	CCDC would receive 50 percent; the remaining 50 percent would be split between HDP and a nonprofit operator.
Pro Forma Assumptions:	Income increase projected at 2.5 percent per year; expense increase projected at 3.5 percent per year; and vacancy projected at 5 percent per year. (For the residential space only.)

Risks and Mitigation

HDP would own the property, controlling the operation until it could enter into a lease agreement with a qualified nonprofit operator. The risk of difficulties in locating a nonprofit to lease the facility and rent the units to a special purpose target population would be mitigated by HDP continuing to rent the units as very low income housing.

While the loan-to-value on the property would be 127%, rent values in the downtown area are quickly appreciating. The project will also generate commercial income which is not shown in the proforma but which will add to cash flow.

Disclosure

Commissioners Arthur and Steinke and Chief Executive Officer of the 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 Arthur, Commissioner Steinke, 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 Arthur, Commissioner Steinke, 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 Commission, that none of the board members of Housing Development Partners have 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.

ALTERNATIVES

The Commission could deny the proposed loan to HDP. Without the Commission loan, HDP would not acquire the Mason Hotel and HOI could sell the property to another entity. The City could lose an opportunity to have 27 units of very low income rental housing converted to rental housing affordable to extremely low income homeless residents with special needs.

The Housing Commission could acquire the Mason Hotel, selling the development to HDP following lease to a nonprofit operator and stabilization with the target tenant population of homeless residents.

Submitted by,

Pat Duplechan
Director, Housing Programs

**Signature on File
With Original Document** Approved by,

Elizabeth C. Morris
Chief Executive Officer

- Attachments:
1. Location Map
 2. Project Development Summary
 3. Development Timeline
 4. HC Development Form
 5. Preliminary Inspection Report

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ATTACHMENT 2

DEVELOPMENT SUMMARY JULY 20, 2001

Name: Mason Hotel
Location: 1345 Fifth Avenue
Description: Rental housing for very low income households
Sponsor: Housing Development Partners

Unit Affordability

Total # of units: 27 single-room occupancy
Assisted units: 27 single-room occupancy
Subsidized rents: 6 units with baths @ \$495
21 units without baths @ 450

Market rent: units with baths @ \$550
units without baths @ \$500

Percent of AMI: 27 units would be restricted to households earning 50 percent or less of AMI

Affordability: 55 years

Development Cost

Total development cost: \$1,516,500
HC development cost: \$ 876,500
Total development cost per unit: \$ 56,167
HC cost per unit (27 units): \$ 32,463
HC subsidy per room @ 27 r's: \$ 32,463

Sources of Funds

SDHC 1st T.D. Loan (HOME funds) \$420,500
Redevelopment Agency 2nd T.D. Loan \$640,000
SDHC 3rd T.D. Loan (Trust Fund funds) \$226,000
Commission Grant (CDBG funds) \$230,000

Pro Forma Summary

Estimated effective gross income: \$ 129,295 (year 1)
Estimated annual expense: \$ 100,280 (year 1)
Annual debt service: \$ not applicable
Estimated residual receipts: \$ 29,015 (year 1)
Est. cumulative residual: \$ 383,538 (year 15)

ATTACHMENT 3

**MASON HOTEL
DEVELOPMENT TIMELINE**

July 31, 2001	Proposal to the Housing Authority for approval
September 14, 2001	Estimated recording of sale to HDP
September 24, 2001	Start of Rehabilitation
November 2, 2001	Completion of Rehabilitation