



Good Neighbors

San Diego
Housing Commission

REPORT

DATE: For the Agenda of June 22, 2001

ITEM 106

REPORT NO: HCR01-081

SUBJECT: Loan to San Diego/Fox Hollow, L.P. for the Construction of Hollywood Palms (Council District 3)

SUMMARY

Issue #1: Should the Housing Commission approve a loan in the total amount of up to two million two hundred thousand dollars (\$2,200,000) to Affirmed Housing Group and City Heights Community Development Corporation in the name of San Diego/Fox Hollow, L.P., (the Developer) for the construction of 94 apartment units located at 4366 Home Avenue?

Recommendation#1: That the Housing Commission approve a loan in the amount of up to two million two hundred thousand dollars (\$2,200,000) upon the terms and conditions as further outlined in this report.

Issue #2: Should the Housing Commission recommend that the Housing Authority take the *final steps* to issue tax-exempt housing revenue bonds for a project which the Housing Authority previously approved a Bond Inducement resolution?

Recommendation #2: That the Housing Commission recommend that the Housing Authority authorize:

- (a) Issuance of tax-exempt revenue bonds in an amount not to exceed \$7,000,000 to finance the construction of Hollywood Palms Apartments, located at 4366 Home Avenue (Council District 3); and
- (b) The Executive Director of the Housing Authority or the Chief of Staff of the Housing Commission, or their designee, to execute all documents necessary to facilitate the financing.

Issue #3: Should the Housing Commission recommend that the Executive Director of the Housing Authority be empowered to enter into project-based Section 8 contracts?



Recommendation #3: That the Housing Commission recommend that the Chief Executive Officer or designee be authorized to enter into project-based Section 8 contracts in accordance with the applicable annual contributions contract with HUD.

Fiscal Impact: Funding for the Housing Commission loan would be allocated as follows:

| | | |
|------------------|---------------------------------|-----------|
| Certificate No.: | 01-178 | 02-043 |
| Amount: | \$1,488,809; | \$711,191 |
| Revenue Source: | HOME/Housing Trust Fund | |
| Division: | Housing Finance and Development | |
| Line Item: | Loans | |

The issuance and sale of the bonds will not financially obligate the City, the Housing Authority or the Housing Commission because security for the repayment of the bonds will be limited to specific private revenue sources. All costs of the financing, including compensation for staff efforts in preparing the bonds will be borne by the developer. The Housing Commission's origination fee as well as the annual administrative fee under the financing will be up to \$14,720 (0.23 percent of the bond amount). Any project-based Section 8 would be funded from existing contracts with HUD.

Housing Affordability Impact: Development of this project will create 94 new rental units: 44 two-bedroom, 28 three-bedroom, 20 four-bedroom and 2 five-bedroom units. A total of 93 units will be affordable, with rents ranging from 50% to 60% of median area income; one unit will serve as a manager's unit. Occupancy of the 93 affordable units will be restricted to households earning a range of 50% to 60% of median area income. The restricted units will be affordable for a term of 55-years.

Community Planning Group: On April 2, 2001, the City Heights Area Planning Committee held a community information seminar to discuss community issues. While the project did not receive community support at this meeting, a Project Oversight Committee was established to continue negotiations with the Developer to ensure community concerns were addressed in the project. Project Oversight Committee meetings are ongoing, and it is anticipated that a list of project requirements, as agreed to by the Committee and the Developer, will be incorporated into the development and also that the list will be included in the Housing Commission regulatory agreement recorded against the property.

HOME Program Compliance: A loan for construction of new units is an eligible activity under the HOME Program. The proposed rents are in conformance with HOME guidelines. Eleven units will be designated as HOME-restricted units, with the balance of units restricted as Trust Fund units. The Housing Commission's HOME funds will only be used to pay HOME-eligible costs yet to be expended.

Equal Opportunity Statement: The Developer has certified that it will comply with the Housing Commission's Equal Opportunity Programs.

Environmental Review: The proposed acquisition received a Negative Declaration under the California Environmental Quality Act (CEQA). Although the development is already under construction, a review under the National Environmental Policy Act (NEPA), pursuant to 24 CFR Part 58, Section 58.34(a)(12) is currently being performed due to the proposed expenditure of HOME funds.

Previous Related Actions: On March 2, 2001, the Housing Commission approved the initial steps for a bond issuance, recommended the City Council hold a TEFRA hearing, and that the members and roles of the final development team be brought back for approval prior to consideration of a bond issuance (HCR01-032 *Revised*); on March 20, 2001 the City Council approved the TEFRA resolution and financing team, but reserved the right to terminate the application for bonds if community issues were not resolved, and directed that the matter return to the next City Council meeting for a report on community issues; on April 17, 2001, the City Council voted 7 to 1 to support the application for bond financing, and Councilmember Atkins stated she would be personally involved in the progress of this project with the community.

BACKGROUND

Fox Hollow Apartments is a 94-unit new construction project located at 4366 Home Avenue. The project was approved by the City Council in 1987, and development entitlements were vested with City Council approval of the Final Map in 1992. The project received 9% tax credit financing in 1998. Development permits were obtained and construction began in late summer 2000. Because the project could not be placed in service by the December 31, 2000 deadline established for the tax credit financing, the tax credits were forfeited and financing was withdrawn. Construction of the project is approximately 50% complete.

The owner/developer determined that in order to complete the project and preserve the affordability, the clearest course was to restructure the project and finance the project with tax-exempt debt and 4% tax credits. Staff reviewed the request and, in order to preserve options for financing the development, took the item to the Housing Commission meeting of March 2, 2001, to initiate the initial steps for a bond issuance. The Housing Commission approved the item, recommending that the City Council hold the TEFRA hearing, and that the members and roles of the final development team be brought back for approval prior to consideration of a request for bond issuance.

At the March 20, 2001, TEFRA hearing before the City Council, community representatives from the neighborhoods surrounding the Fox Hollow development voiced opposition to the development, citing issues with the developer, the construction, and the development approval process. In response to these concerns, the City Council directed that the developer and Housing Commission meet with the community

to resolve the issues. The City Council approved the TEFRA resolution and financing team to preserve the option of bond financing, but it also reserved the right to terminate the application for bonds if the issues with the community were not resolved. The matter was scheduled to return to City Council April 17, 2001.

In the interim, the City Heights Area Planning Committee held a community information seminar on April 2, 2001. Housing Commission staff was in attendance, along with the investor limited partner, Boston Capital, Affirmed Housing Group and City Heights CDC. City staff from the Redevelopment Division and the Planning and Development Services Departments were also present.

Mr. Joel Levitz of Boston Capital explained that the current partnership was being restructured, and that the original development team was going to be replaced with a new development team. While no documents had yet been signed, it was hoped that Mr. Jim Silverwood of Affirmed Housing Group and Mr. Jay Powell of City Heights CDC would agree to be the new development team (the for-profit and nonprofit general partners) along with Boston Capital, the investor limited partner. (This development team is now in place.)

The Committee was concerned that there had been no opportunity for the community to review the project prior to the start of construction and that the developer had been non-responsive to community issues and unwilling to meet and work with them. A major concern raised by the Committee was the loss of tax revenue that would result from the tax-exempt status of the limited partnership or other nonprofit ownership. Other concerns related to the adequacy of the original environmental analysis, lack of a traffic impact report, access to the development, erosion and other construction problems, as well as impacts to park and school facilities. The community also wanted to be assured there would be local management for the property and adequate security and crime management.

Following an extensive question and answer session, the Committee voted unanimously to recommend that the City Council pull the application for bond financing.

The project returned to the City Council meeting of April 17, 2001, and the results of the meeting were reported. While there was still negative testimony from the community, Mr. Levitz of Boston Capital reported substantial progress in meetings with community leaders. At the meeting, it was also reported that the California Debt Limit Allocation Committee (CDLAC) had just issued a recommendation for bond allocation for the project. The City Council voted 7 to 1 to support the application for bond financing with CDLAC, and Councilmember Atkins advised community leaders that she would personally be involved in the progress of this project.

As a result of the ongoing discussions between the new development team and community leaders, a number of changes to the project have been made, and include enhancements to the project design, site work and landscaping. In addition, the developer has agreed to the payment of an "in-lieu" fee that will compensate for lost tax increment revenue that would otherwise go to the community redevelopment area. The

agreed upon items are to be formalized in a list that will be included in the Commission's regulatory agreement recorded against the property. Please refer to Attachment 2 for the list of community concerns.

DISCUSSION

The Borrower

Affirmed Housing Group is the replacement General Partner responsible for completion of the development of the project. Affirmed is a for-profit real estate development firm located in Escondido, California. The firm specializes in the development of affordable, multifamily rental housing. Its President, James Silverwood, has over twenty years of experience in the development and construction industry, and has extensive experience acting as general partner in various partnerships with over \$100,000,000 of real estate development activity in the past 10 years. Recent developments include new construction as well as acquisition and substantial rehabilitation projects in San Diego County, Riverside County and Ventura County. The company also develops in the mid-Atlantic states of West Virginia, Virginia and North Carolina. Affirmed's financing experience includes low-income housing tax credits, multi-family tax exempt bonds, HOME funds, and Redevelopment Agency set-aside funds as well as conventional construction and permanent loans.

Over the last two years, Affirmed's local projects have included the 76-unit Mission Village Apartments, a combination new construction and acquisition/rehabilitation in response to a Request For Qualifications issued by the City of Temecula; Laurel Village, a 41-unit acquisition/rehabilitation for large families in the City of El Cajon; the Mariposa Apartments in San Marcos, a 70-unit acquisition/rehabilitation, and Sonoma Court, a 61-unit garden-style acquisition/rehabilitation in Escondido. The Terraces, a 190-unit new construction development was completed in 1996 in Escondido. On January 30, 2001, Affirmed received a loan commitment from the Housing Commission, contingent upon the receipt of tax credits and disbursed over two fiscal years, in the total amount of \$2.6 million for the construction of the 112-unit Nestor Family Housing development. The Nestor development is competing in the present round of 9% tax credit applications.

Staff has reviewed Affirmed's credit report and it is satisfactory. It is on file at the Housing Commission offices.

City Heights Community Development Corporation, the nonprofit partner of Affirmed, is a community-based nonprofit and a federally designated Community Housing Development Organization (CHDO). Established in 1981, the mission of City Heights CDC is to "enhance the quality of life in City Heights by working with our community to create quality affordable housing and livable neighborhoods, foster economic self-sufficiency and stimulate investment." The Executive Director, Jay Powell, oversees the operation of over 132 units of multifamily housing at 10 locations throughout City Heights and coordinates resident services to over 400 units at 50 locations through their Bridgeport Properties Partnership.

City Heights CDC has 6 multifamily housing development loans with the Housing Commission, totaling \$2,231,000. All loans are current, and in compliance with Housing Commission regulatory requirements.

City Heights CDC will be the managing General Partner and will oversee the management of Hollywood Palms, which will be performed by a local management company selected by the partnership.

Site Location/Description

The 14.5-acre site will have 12 residential buildings consisting of two, three, four and five bedroom units. Unit sizes are 820 sq. ft., 1,000 sq. ft., 1,200 sq. ft., and 1,620 sq. ft., respectively. The buildings are wood frame construction with stucco exterior finish and concrete tile roofs. Kitchens will include garbage disposals, frost-free refrigerators and all appliances. Each apartment will include an individual gas-fired water heater.

All appliances, windows, glass doors, insulation and certain design specifications will be state-of-the-art in energy efficiency, in excess of Title 24 energy requirements. These features will minimize the cost of utilities to the tenants as well as the owner. While the installation of the more efficient appliances and higher quality glass and insulation adds to the cost of development initially, the developer intends to recapture this investment quickly with energy savings that will start immediately, along with the utilization of SDG&E rebate programs. In exchange for a commitment to this program, the developer is being allowed to use an estimated utility allowance which is lower than the standard utility allowance, and is based upon the energy rating of the appliances, doors, windows and insulation used. At the end of the first year of stabilized occupancy, an audit will be performed to ensure the accuracy of the utility allowance used.

Other site amenities include a recreation/community building, passive recreational space, barbecue areas, swimming pool, tot lots and multiple laundry facilities.

City bus and trolley service is provided along Home Avenue and Fairmount Avenue. The property is served by bus Route 13. The development is in close proximity to Hamilton Elementary, at 2807 Fairmount Avenue. Hollywood Park and Azalea Park are both located just northwest and are in ½ mile. A grocery store is within walking distance from the property.

The project timeline is shown in Attachment 4, and estimates completion of construction by February 2002, with full occupancy by May 2002.

Relocation

No relocation was needed as the project site was vacant initially, and is currently under construction.

The Funding Request – Housing Commission Loan

Total development costs for the project are \$14,309,186 (\$152,253/unit). The proposed permanent financing sources include tax-exempt bond proceeds estimated at \$6,590,000, equity from the sale of four percent tax credits in the amount of \$4,198,186, a partnership contribution of \$1,321,000, and a Housing Commission loan of up to \$2,200,000.

The addition of project-based Section 8 vouchers to 23 units in the development is also proposed. This will benefit the project in several ways. To the extent possible, the resulting increase in cash flow to the project allows an increase in bond indebtedness and a decrease in the amount of gap financing required from the Housing Commission.

For the 10-year term of the project-based Section 8 contract, the owner would be allowed to collect the lesser of the HUD published fair market rent, or the market rent in the area for a unit of comparable size and amenities, for the 23 units. When the contract expires, the rents for those units will revert to the Housing Commission restricted rent levels (50% and 60% of median area income).

The addition of project-based Section 8 results in approximately \$41,154 in additional cash flow annually, which equates to approximately \$240,000 in additional debt that the project can sustain.

The approval requested in this report would allow the Executive Director of the Housing Authority to further leverage the public funds invested in affordable housing developments such as this one and minimize the amount of gap financing needed from the Housing Commission.

Attachment 5 shows rental income and proforma projections with Section 8 in the project. Attachment 6 shows rental income and proforma projections without Section 8.

The Commission loan will be amortized over 55 years, due one year following the payoff of the first position loan (a 30-year loan). Until year 2016, the payment of the Housing Commission's debt will be the lesser of the amortized payment or 50 percent of the cash flow following payment of the first position note debt payments, operating expenses of the properties, Partnership Management Fees and the Community Trust Fund. The Community Trust Fund payment is equal to the first 20% of residual receipts. This payment is being made as the result of the community's concern over losing tax increment payments that would otherwise be made to the redevelopment area if the project were not in a tax-exempt ownership structure necessitated by the affordable housing financing.

Beginning in 2016, in the event there have been any shortfalls in payments not made up in the preceding years, the Housing Commission loan would be re-amortized over the remaining term of the loan.

The Housing Commission's loan proceeds shall be used to fund the financing gap and the physical improvements added to the development above and beyond the original plan.

The appraised value of the land is \$864,000, which supports the purchase price of \$850,000. An estimate of value after completion of construction is \$7,250,000 based on prospective market value at stabilized occupancy. This results in an estimated loan-to-completion value, including the Housing Commission's loan, of 121%. An as-built appraisal will be obtained prior to the Commission's loan funding. A loan-to-completion value in excess of 100% is typical for new construction developments, and particularly those without the large equity contribution generated by the 9% tax credit financing.

The Funding Request – Tax-exempt Bonds

On February 21, 2001, the Housing Authority, on behalf of the developer, submitted an application to the California Debt Limit Allocation Committee (CDLAC) for a bond allocation in the amount of \$7,000,000. On May 8, 2001, CDLAC awarded the requested bond allocation to the project. The project's bond allocation will automatically revert to CDLAC unless the bonds are issued by August 6, 2001.

While this approval is for a total bond issue of up to \$7,000,000, the CDLAC bond allocation amount, it is anticipated that the bonds will be issued in two parts, a Series A and a Series B, to make up the total of \$6,590,000 in bond financing estimated for the project. The Series A issuance will be approximately \$6,090,000, with debt service secured by project income. The Series B bond will be approximately \$500,000, with debt service collateralized by tax credit payments the project will receive.

Staff has been working with Dain Rauscher, Inc., the Housing Commission's financial advisor, to perform due diligence under the proposed financing and in formulating the resulting recommendation for the Housing Authority. After evaluating the projects' financial circumstances, the terms of the proposed financing and public benefits to be achieved, it is the financial advisor's recommendation that the bond issuance for the project be authorized. The Financial Advisor's analysis and recommendation to proceed is included as Attachment 7.

If the bond issuance is authorized, the following primary documents will be executed on behalf of the Housing Authority: Indenture of Trust, Loan Agreement, Regulatory Agreement and Bond Purchase Agreement. All bond documents in a substantially final form will be on file in the Housing Commission and City Clerk offices at the time of docketing for consideration by the Housing Authority.

A general description of the Housing Commission's Multifamily bond Program and actions that must be taken by the Housing Authority and by the City Council to initiate and finalize the proposed financing are described in Attachment 8.

The Financial Plan

| | |
|---|---|
| Total Development Cost: | The total development cost is \$14,309,186 |
| Appraised Value: | The appraised land value is \$864,000. An estimated value at completion of construction is \$7,250,000. This results in an estimated loan-to-completion value including the Housing Commission's loan of 121%. An as-built appraisal will be obtained prior to funding. |
| Security: | During construction, the Commission will be subordinate to a construction loan. Upon permanent financing, the Commission's total loan amount will be secured by a second trust deed against the property. |
| Debt Service Ratio: | Debt service on the first position loan is estimated at 1.15 at year one. |
| Interest: | 3% simple interest. |
| Payments on the Housing Commission Loan | Until year 2016, the payment of the Housing Commission's debt will be the lesser of the amortized payment or 50 percent of the cash flow following payment of the first position note debt payments, operating expenses of the properties, Partnership Management Fees and the Community Trust Fund. Beginning in the year 2016, in the event there have been any shortfalls in payments not made up in the preceding years, the Housing Commission loan would be re-amortized over the remaining term of the loan. |
| Rent Restrictions: | A Declaration of Covenants and Restrictions with a 55-year term will be recorded against the property. Ten percent of the units will be restricted at 50% area median income, with the balance at 60% area median income. For the term of the project-based Section 8 contract, 23 units, will have project-based Section 8 rents, which at the end of the contract will revert to the Housing Commission restricted rent levels. |
| Occupancy Restrictions: | Occupancy of the assisted units will be restricted to households earning no more than |

50% to 60% of area median income. One unit will be set aside as a manager's unit.

Recourse: The loan will be recourse during construction but become non-recourse at the completion of construction, as provided for in the Housing Commission lending policy for tax credit projects.

Term: 55-years

Management Plan: A Management Plan is currently under review.

Operating Expense: Operating expense is projected at \$283 per unit per month.

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 5.0 percent per year.

Risks and Mitigation

While new construction projects carry inherent cost overrun and completion delay risks, Hollywood Palms is already under construction and is approximately 50% complete. Compared with other Housing Commission loans, these new units will come on-line quickly, with completion expected in February 2002.

The uncertainties of the new construction process are further mitigated by the fact that this development has all of its financing commitments, and therefore the risk of not obtaining financing is eliminated.

Another risk is that the total indebtedness of the project exceeds the value of the property. Most of the Commission's recent loans for new construction have been in conjunction with 9% tax credit financing which provides a large equity contribution to the development. A bond financed, 4% tax credit scenario provides about half of the equity contribution, which is why the resulting loan-to-value is high. On the other hand, new construction of market rate multifamily housing requires a similar large initial investment that is more than recouped over the useful life of the buildings. The value in affordable housing is that these are newly created affordable units that will remain affordable for 55 years, at a cost to the Housing Commission of \$23,656 per unit.

Loans to tax credit projects become non-recourse upon the creation of the limited partnership for tax credit syndication. 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 and not the assets of the developer.

This risk is typically taken by the Commission in tax credit projects, and is deemed mitigated by conservative underwriting assumptions.

The new construction of 94 units will add to the housing stock, and will include the addition of 50 large family (three-, four- and five-bedroom) units.

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

ALTERNATIVE

Do not recommend funding the project. This would most likely result in the loss of the bonds and 4% tax credits in addition to adding more holding costs on to the development, making this project infeasible for affordable housing development

Respectfully submitted,

Approved by,

Pat Duplechan
Director, Housing Programs

Elizabeth C. Morris
Chief Executive Officer

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- Attachments:
1. Project Location Map
 2. List of Community Concerns
 3. Project Development Summary
 4. Development Timeline
 5. HC Development Form with Section 8
 6. Rental Income and Proforma Without Section 8
 7. Financial Advisor's Analysis
 8. Housing Commission's Multifamily Bond Program
 9. Developer's Disclosure Statement*
 10. Audited Financial Statements*
 11. Appraisal *

*Distribution of these attachments is limited. Copies are available for review at the Housing Commission and the Office of the City Clerk, 2nd Floor, 200 C Street.

ATTACHMENT 3

Project Development Summary June 15, 2001

Name: Hollywood Palms Apartments
Location: 4366 Home Avenue
Description: Rental housing for very low and low income residents
Sponsor: San Diego/Fox Hollow, L.P.

Unit Affordability

Total # of units: 94
Assisted units: 93
Restricted rents:

| Type | Sq. Ft. | Number of Units | Restricted Rent (net of utility allowance) | Market Rate | Savings |
|-------------------------|---------|-----------------|--|-------------|---------|
| 2br@ 50% | 820 | 2 | \$591 | \$943 | \$352 |
| 2br@60% | 820 | 39 | \$719 | \$943 | \$224 |
| 3br@50% | 1,050 | 3 | \$651 | \$1,138 | \$487 |
| 3br@60% | 1,050 | 25 | \$794 | \$1,138 | \$344 |
| 4br@50% | 1,200 | 3 | \$693 | \$1,415 | \$722 |
| 4br@60% | 1,200 | 17 | \$847 | \$1,415 | \$568 |
| 5br@60% | 1,640 | 2 | \$902 | \$1,600 | \$698 |
| TOTAL | | 93 | | | |

Market rent: None. One unit will be reserved as a manager's unit.
Percent of MAI: Restricted Rents will be affordable to persons earning between 50% and 60% percent of median area income.

Affordability: 55 years

Development Cost

| | | |
|--|--------------|-----------|
| Total development cost: | \$14,309,186 | |
| HC development cost: | \$ 2,200,000 | (maximum) |
| Total development cost per unit: | \$ 149,034 | |
| HC cost per (restricted) unit: | \$ 23,656 | |
| Subsidy per (restricted) bedroom @ 262 BR's: | \$ 8,397 | |

Sources of Funds

| | | |
|--|-------------|------------------------|
| Tax-exempt bonds – 1 st TD: | \$6,590,000 | |
| 4% Tax Credits: | \$4,198,186 | |
| Partnership Contribution: | \$1,321,000 | |
| Housing Commission Loan: | \$2,200,000 | (55-year amortization) |
| Estimated Value At Completion: | \$7,250,000 | |

Pro Forma Summary

| | | |
|--|-----------|----------------------|
| Estimated annual income: | \$874,369 | (Year 1) |
| Estimated annual expense: | \$319,630 | (Year 1) |
| Net Operating Income: | \$554,739 | |
| Annual debt service, 1 st TD: | \$482,732 | (1.15 debt coverage) |
| Estimated residual receipts: | \$ 72,007 | |
| Min. debt service, HC Loan: | \$ 66,869 | (amortized payment) |

ATTACHMENT 4

DEVELOPMENT TIMELINE

- Loan Committee June 13, 2001
- Housing Commission June 22, 2001
- Housing Authority July 17, 2001
- Estimated Loan & Bond Closing July 31, 2001
- Estimated Completion of Construction February, 2002
- Estimated Full Occupancy May, 2002