Housing Department
Affordable Housing Gap Financing Guidelines

Catalog of Developer Comments on October 26, 2017 Draft
and City of San Jose Response

| Background |
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| On October 26, 2017, the City of San Jose (City) Housing Department released draft guidelines for its Affordable Housing Gap Financing loan program. The intention of the revision was to bring the City's guidelines up to current market practice and revise policies in response to a shrinking loan pool. The City solicited feedback from partners and this document is a catalog of partners' input. This document also provides a response to each comment and, where appropriate, a rationale for whether or not the requested change was made to the next draft of the Guidelines and Term Sheet (dated December 8, 2017). |

## BASIC ELIGIBILITY

| Policy | Developer Comment / Question / Recommendation | Change? | Response / Rationale |
|---|---|---|---|
| In Good Standing with the City | Specify 100% compliance. | Y | 100% compliance refers to compliance with all standing loan documents. |
| | Will older projects be required to follow new policies? | n/a | Older projects will be subject to their loan documents. |

## FINANCING OPTIONS AND FEES

| Policy | Developer Comment / Question / Recommendation | Change? | Response / Rationale |
|---|---|---|---|
| Predevelopment Loan | Allow extensions. | Y | Two six-month extensions now included in policy. |
| | Should be non-recourse. | Y | Recommendation partially accepted: up to $200,000 may be unsecured with an assignment of plans & specs. |
| | Defer interest until permanent loan conversion. | Y | Policy was silent, but consistent with prior practice, interest may be capitalized. |
| | Please consider a higher amount. | N | No change made due to limited loan pool and availability of other predevelopment financing options in the marketplace (i.e. CDFIs). |
| | Agrees with loan limit of $1MM. | n/a | |
| Acquisition Loan | Allow extensions. | Y | Two six-month extensions now included in policy. |
| | Should be non-recourse. | N | Consistent with the Housing Trust of Silicon Valley's loan terms, the City will require full recourse to the borrower including repayment guaranties from project sponsor and parent organizations, as applicable |
| | Increase LTV from 95% to 100%. | Y | Policy changed to 100% LTV of the City loan plus all senior debt. |
| Construction Loan | Does the $100k/unit cap exclude the acquisition piece on ground lease deals? | n/a | No, but please note the changes to the ground lease policy. |
| | $100k/unit not sufficient, especially for supportive housing deals. | Y | Policy has been increased to $125k/unit. |

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|---|---|---|---|
| | Recourse should be consistent with historical practice. | Y | Recourse will stay the same as current loan documents (Completion Guaranty). |
| | Are early conditional loan commitments still available during the predevelopment phase? | n/a | This will be addressed in the upcoming NOFA. |
| | Set loan limits at inclusionary baseline of $158,343. | N | Policy has been increased to $125k/unit. |
| Permanent Loan | $100k/unit not sufficient. | Y | Policy has been increased to $125k/unit. |
| | Recommend mirroring the HCD 4% subsidy per unit by targeting and the minimum not to be lower than the City's inclusionary housing program ($158,343). | N | Policy has been increased to $125k/unit. |
| | Blind rate reset won't work for underwriting. | Y | Rate reset has been eliminated. |
| | Should not be full-recourse.<br>No repayment guaranty. | Y | Policy changed to non-recourse as originally intended. |
| | $100k inclusive or exclusive of land? | n/a | The new policy of $125k/unit is inclusive of land. |
| | 100% LTV is problematic. | Y | Policy changed to 100% LTV of the City loan plus all senior debt |
| | AFR should only be used for resyndications; propose 1-3% simple for new loans. AFR may create a true debt issue and AFR will accrue interest too quickly to be repaid. | N | The City is keeping the AFR policy to encourage repayment; this policy is expected to highly impact the replenishment of the loan pool. |
| | | | |
| Fees | Fees appear high.<br>Bond counsel said SJ is only one of two cities in the country to charge a conversion fee and it is high; very few charge recap fees. | N | It is a City-wide practice to set fees to cover departmental and interdepartmental costs incurred; the current fee schedule is based on the estimated costs to fully reimburse all City departments for work performed. |
| | Recommend tying fees to loan size with a cap. | N | The housing department is going to start exploring this option in 2018. |
| | Construction monitoring fee: City should share construction inspector with lender and investor (only happens sometimes) with no upfront fee and $500/month. | n/a | For both efficiency and costs savings, the City uses the same construction inspector as the lender whenever possible. However, some conventional lenders do not allow this practice, in which case the City would need to hire its own inspector. |

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|---|---|---|---|
| | Is the work being done efficiently? | n/a | These revised guidelines are expected to bring efficiency to deal negotiations and closings. In 2018, the housing department is hoping to further explore how it might be able to increase efficiency. |
| | If you keep the flat fee, please consider recaps with multiple sites as one project. | n/a | This will be addressed in the recapitalization policy expected to be released in 2018. |
| | Timing and capitalization of fees are unclear. | Y | The timing of fees is addressed in the Loan Commitment letter and only interest may be capitalized. |

LOAN TERMS AND CONDITIONS

| Policy | Developer Comment / Question / Recommendation | Change? | Response / Rationale |
|---|---|---|---|
| Affordability Restrictions | Is there a way to manage the City's ARs to be as or less restrictive than TCAC? | N | The City's ARs follow TCAC unless further dictated by a funding source or NOFA. |
| | Last sentence not clear. Could the City provide feasibility language like HCD does? | N | The last sentence is intended to indicate that the City is flexible and is open to a float-up or other alternatives if conditions warrant. |
| Subordination | Not subordinating ARs eliminates debt sources that can get to higher proceeds (i.e. HUD FHA loans). | n/a | The City is working with HUD to negotiate a solution. |
| | Can we include flexibility to float to 80% if can demonstrate it's needed for underwriting? | N | The City is amenable to a float-up under two to circumstances (foreclosure and transition) up to 60% AMI. |
| | Allow partners (including large volume affordable lenders) to review draft language when ready. | Y | The City is amenable to a float up provision and will work on standardizing language and sharing with partners for feedback. |
| | The Term Sheet mentions that the City will consider use restriction subordination to the deed of trust securing such loans, presumably when the City benefits through a reduction in the principal amount it loans, is intriguing. | n/a | There may have been some confusion about subordination. The City's Deed may be subordinated to a senior lender. The City will not, however, subordinate its Affordability Restriction. |
| Design and Construction Costs | Agree with premise; concerned it will add time and cost to project without any substantial change or benefit. | Y | This provision has been removed. The original intent was to allow the City to influence construction efficiencies where possible, while still allowing for sufficient amenities and an aesthetically pleasing design. Most projects were approaching the City for construction financing after the design was set in stone, and too late in the development cycle to allow the City to have input on design |
| | Please clarify rationale; seems excessive. | | |
| | We would not want this to be akin to the early review that HUD used to provide, which eliminated important design elements and amenities. | | |

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| | How would this dovetail with planning reviews and entitlements, and who would be responsible for coordinating among City departments? | | elements that could potentially lower the size of the gap loan. |
| | Process and scope needs to be more clearly defined. | | |
| Green Building Costs | Recommend eliminating policy. | N | The City wants to ensure that other funding sources are covering the cost of green elements above and beyond City building code. |

UNDERWRITING GUIDELINES – DEVELOPMENT

| Policy | Developer Comment / Question / Recommendation | Change? | Response / Rationale |
|---|---|---|---|
| Moderate Rehabilitation | What about extensive rehab? | n/a | The policy sets a minimum cost per unit but not a maximum. |
| | Do not place minimums or limits in excess of TCAC or other sources. | N | The City wants to ensure that the cost of a tax credit syndication is justified by the scope of rehabilitation needed. Market rate projects converting to affordable properties will be exempt from this policy. |
| Project Cost Savings and GC Contract | How is savings defined? Recommend "the aggregate improvement is sources and uses of funds from construction loan closing through the final cost certification". | n/a | This City's Loan Agreement already includes this concept of aggregate development budget savings as determined by an account's report and cost certification. |
| | Cannot be enforceable prior to permanent conversion, which is the earliest development milestone when there would be a source (limited partner equity) for such a payment. | n/a | Agreed; the language in the City's standard loan agreement details the process for determining the savings after cost certification. |
| | Sharing of some project cost savings is essential (and industry standard) in a tight construction market. | N | At this time, the City feels that GC fees are adequate compensation for work performed. |
| | Recommend diving cost savings between developer and the City to create incentive to create savings. | N | Cost savings have significantly contributed to replenishing the loan pool. |
| | Any project cost savings should go to pay back deferred developer fee. | N | Cost savings have significantly contributed to replenishing the loan pool. |
| | Other residual receipts lenders might expect equal treatment. | n/a | The City will address this on a case by case basis. |
| | This reduces the tax credit basis, which results in lower equity; it reduces the basis available for the developer fee calculation, which further decreases the amount of equity available. | N | If the project has more public sources (i.e. tax credit and gap financing) than needed, it should return such sources to agencies so that other projects in need pay received these valuable resources. |
| | City should allow modified forms A102 and A201. | n/a | The City is looking into this. |
| Contractor Profit, Overhead and General Conditions | Add "of the cost of construction" to the last bullet point. | Y | Thank you for the suggestion. |
| | Capping GC fee is in contrast with incenting larger projects and limits the GC pool for smaller rehab projects; the cap of $1.25MM won't be acceptable to a GC for a project over $30MM. | Y | The cap has been removed. |
| | Rationale not clear. | n/a | The rationale for limiting contractor profit is to limit excessive development costs so that the gap financing loan program can fund as many projects as possible. |

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|---|---|---|---|
| | This policy disallows increased general conditions or overhead increases for change orders, but frequently change orders increase scope or time, which does trigger increased general conditions and overhead and a GC should be paid for this. | n/a | The standard GC contract required by the City includes a provision to allow for a reasonable increase in applicable general conditions if there is an increase in time. |
| GC Performance and Payment Bonds | Why does the City have a stricter policy than construction lenders? | Y | This City may rely on the construction lender's policy. A bond will be required if there is no construction lender. |
| Change Orders | Why not rely on the construction lender's CO policy? | N | The City is working on a new CO policy with internal and external partners. |
| | Recommend $50k individual or $300k aggregate or a % of contract cost, or at least $25k / $250k. | N | |
| | Policy should include a max number of days (5 bus days) for City response or deemed approved. | N | |
| Soft Cost Contingency | Add offsite improvements to the list of items excluded from calculation. | Y | Thank you for the suggestion. |
| Reasonable Development Costs | Admirable objective but guideline unclear. | n/a | The housing department is currently working on collecting development cost data on recent project and in addition has hired a consultant to provide recent construction cost data. More clarity around this with be forthcoming. |
| | How would this policy work with projects that need special bids or the current environment of cost escalation? | n/a | The developer would need to provide evidence to substantiate the need to request an exception to policy. |
| Costs Excluded from Development Budget | Bid or design contingency is an important tool for executing GC contracts where additional costs cannot be resolved prior to execution. | Y | Design contingencies and allowances are subject to the City's approval. |
| | Recommend mirroring TCAC, not more restrictive. | Y | The City will follow TCAC's exclusions unless otherwise noted. |
| | Need to be able to store materials. | n/a | Certain stored materials are allowed, but must get City's approval prior to construction loan closing. |
| | Appropriately priced construction consultant costs should be eligible costs included in a construction budget and not require that they be paid out of developer fee, *except when there is an identity of interest between the developer and general construction contractor*. | n/a | A third-party construction manager is not an excluded cost. The policy reference was to developers paying themselves a fee to construction manage a related-party GC firm. |
| Section 8 or Subsidy Transition Reserve | Please add if required by investor. | Y | This has been added. |

**Catalog of Developer Comments and City Responses**
**Draft Gap Financing Guidelines**

| Policy | Developer Comment / Question / Recommendation | Change? | Response / Rationale |
|---|---|---|---|
| Capitalized Operating Reserve | Not sure if this provision is meant to prohibit other sources from funding the portion the City will not fund. | n/a | No, it is not. |
| | Owner should not be responsible for replenishing; should come from cash flow before distributions to developer or City. | N | This policy has the potential to greatly impact loan pool replenishment. |
| Lease-up Income | Rewrite to "Net lease-up income prior to conversion to permanent loan to be included in source of construction funds and included in calculation of Project Cost Savings. | Y | Thank you for the clarifying language. |
| Prevailing Wage | Work to exclude prevailing wage on all up to 50% of AMI affordable units. | N | This would not be in line with the City's overall prevailing wage policy. |
| | Which types of financing trigger prevailing wage? Does a recap with no new money trigger PW? | n/a | A recapitalization with no new money does not trigger prevailing wage. This will be included in the forthcoming recapitalization guidelines. |

UNDERWRITING GUIDELINES – OPERATIONS

| Policy | Developer Comment / Question / Recommendation | Change? | Response / Rationale |
|---|---|---|---|
| Commercial Income | Entitlement has increased the likelihood of commercial use and in most cases, it is not feasible. This policy is too restrictive. | Y | Revised to mirror TCAC policy. |
| | A subdivision is not always feasible or ideal; recommend eliminating condo requirement and using a master lease to guaranty payment instead. | Y | Revised to mirror TCAC policy. |
| | Commercial income needs to be able to support first mortgage debt. | Y | Revised to mirror TCAC policy. |
| Total Operating Expenses | The approval of maximum operating expenses should be in City's reasonable, not sole, discretion and based on other factors including the project requirements, population served, size, etc. | N | Exceptions to this policy may be granted if the developer partner is able to provide comparable data (including due to project requirements, tenant population, etc.) to support early proformas in the absence of an appraisal. |
| Replacement Reserves | Recommend deferring to lender or investor on this. | N | The City has a direct interest in cost savings and the lender and investor do not. |
| | These maximums are low and assume that in a rehab no work will be deferred to the operating period. | N | Exceptions may be granted if warranted by a 20-year replacement schedule. |
| | Some projects (not required by funding source) will warrant higher reserves (more expensive high-density projects or smaller projects). | N | Exceptions may be granted if warranted. |

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| | Recommend no cap; any cap should be for 100+ unit that are not large family projects. | N | Exceptions may be granted if warranted. |
| | Cost of replacing items is increasing. | n/a | Thank you for the information. The City is very interested in collecting comparable data to support exceptions if warranted. |
| Partnership and Asset Management Fees | Clarify this statement: "unpaid fees shall accrue but not be paid until after the City's full share of RR has been paid". | Y | Statement clarified. |
| | Should be based on project size. | N | Policy not changed as it impacts loan pool replenishment. |
| | Scattered site projects should have a higher cap. | N | |
| | Should be higher if there is no deferred developer fee. | N | |
| | Be consistent with Uniform Multifamily Regulations, HCD allows $30,000 (2006) increasing 3.5% per annum. | N | |
| | Recommend matching county's $27k cap. | N | |
| Resident Services Coordination | Limits seem low; insufficient to allow the projects to comply with the CDLAC, TCAC and AHP required level of services. | Y | Limits have been increased. |
| | Combination of AMIs & services levels should be individualized by project. | N | |
| | Projects with ELI residents should have 1 FTE = $36k. | N | |
| | Recommend double: Based on a 60-unit property at 30% AMI the maximum expense would be $2,500 (salary only w/ no benefits or payroll taxes) and at a 60% AMI the expense would be $1,250 (salary only w/ no benefits or payroll taxes). | N | |
| | HCD in its recent Uniform Multifamily Regulations (UMRs) determined funding levels should be between $1051-$4,182 PUPY. | n/a | The UMRs also reference $250 PUPY for service coordination. |
| Homeless Case Management | If the costs aren't covered by a program they will need to be covered by a capitalized reserve, which would increase the development costs/gap loan. | n/a | The County currently has a program that supports these costs. |
| Property and Incentive Property Management Fees | Recommend $65 plus compliance fees and other cost-recovery fees, which are included in administrative costs. | Y | Policy increased to $70 per unit per month |

| Policy | Developer Comment / Question / Recommendation | Change? | Response / Rationale |
|---|---|---|---|
| | Mirror TCAC. | N | Management fees in the City's loan portfolio span a very wide range. Setting a per unit limit is a standard practice for lenders and investors and the City feels the maximum in the guideline is fair. |
| | Management fee should be a min/max not an absolute number. | | |
| | Recommend no limit for difficult to manage buildings. | | |
| | Recommend $65 plus compliance fees and other cost-recovery fees, which are included in administrative costs. | | |
| | Recommend management fee be based on the higher of 5%-7% or the maximum HUD would allow – fairer for small and large projects; allow an additional reasonable fee for accounting services provided by the property management agent ($7.50 to $10.00 PUPM); allow a property management agent to charge compliance fees like HUD (typically $30-$40 per file review); allow a fee for oversight and supervision of capital improvements (HUD typically allows 10% for capital improvement over $10k). | | |
| | Rationale for tying escalation to AMI is unclear. | n/a | The City is focusing on having the increase in property management fees tie to an increase in EGI (and the AMI escalation drives EGI escalation). |
| | The statement that management fees will cover services is unclear and inconsistent with the description of services fees in other parts of the underwriting guidelines. We disagree with the concept that services would not be its own line item within the operating budget. | n/a | The City is not sure what this comment is referencing. The City allows for social services to be its own line item, subject to the per unit limitations in the policy. |
| Operating Reserve Withdrawals and Replenishment | Replenishment should be ahead of residual receipts in the waterfall. | N | The City views operating deficits as the obligation of the general partner. |
| | Inconsistent with industry standards. | n/a | |
| Debt Service Coverage Ratio | Recommend 1.00x at exit, which means early year DSCR could be higher than 1.20x. | N | The guideline includes a minimum of 1.00x at exit. |

PROPERTY MANAGEMENT

| Policy | Developer Comment / Question / Recommendation | Change? | Response / Rationale |
|---|---|---|---|
| On-Site Property Management | Please clarify the requirement for on-site management staff during normal business hours. Smaller properties frequently use part-time managers to make the operations feasible. | n/a | Part-time staff for smaller projects may be appropriate and a developer can recommend an exception to policy. |
| Management Plan | Typo in last bullet; change to "without City approval". | Y | Thank you. |
| Security Plan | Is this new? | n/a | The City has been negotiating this on an ad hoc basis. |
| Ongoing Compliance | In the third bullet point, the requirement needs to state what the City's monthly lease-up requirements are. | N | These requirements are outlined in the City's loan documents. |
| | Recommend CSJ evaluate its process and reduce duplication – can CSJ piggyback on reporting for other funding sources? | n/a | The housing department will be considering potential efficiencies in 2018, including the creation of its own proforma. |

OTHER SPECIFIC POLICIES

| Policy | Developer Comment / Question / Recommendation | Change? | Response / Rationale |
|---|---|---|---|
| Developer Fee | Mirror TCAC. | Y | This change has been made. |
| | Deferred fee should be funded 100% before residual receipts – there could be significant unintended consequences of this dramatic shift in policy. Most LPs require the payment of deferred developer fee prior to payment of City loans. | N | This policy is essential to the replenishment of the loan pool. |
| | Defer to developer fee payment schedule of investor or lender; it affects pricing. | Y | This change has been made. |
| | Can there be a priority deferred developer fee up to the maximum capitalized developer fee? That's how most other public agencies work. | N | This policy is essential to the replenishment of the loan pool. |
| | We do recognize that some of the fee in basis can be reinvested in the project as a General Partner equity contribution or loan, if the investor allows. With our recent recapitalization with the City, we ran into several structuring issues with this requirement and these nuances should be built into the requirements for the treatment of deferred developer fee. At a minimum, this policy should reflect those structural limitations, such as a General Partner equity investment from developer fee to the project cannot exceed the Limited Partner's initial pay-in amount. | N | The policy may be waived or amended if justified by project dynamics. |

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|---|---|---|---|
| Ground Lease Policy | Does the ground lease payment (in addition to the loan payment create a true debt test problem? | n/a | The City will consider this, but not likely an issue since we changed the lease payment to $1.00. |
| | A ground lease makes sense if the City has a lot of $ in deal. Consider waiving policy if City is a small part in financing. | n/a | In the event of a small loan, it would make sense for the developer to request a waiver. |
| | Makes sense; I think most new construction deals will require a large loan from the City to get done. | n/a | The City agrees; the loan would be sized to include the acquisition plus gap financing, thus is expected to be sizeable. |
| | Most lenders require an 85-year term. | N | This term falls within the policy's range. |
| | The underwriting guidelines are silent on what happens when the ground lease matures. This must be clarified. | Y | When the lease term expires or, when the lease is otherwise terminated under the terms of the lease, title to the improvements shall revert to and vest in lessor without cost to lessor. |
| | Complicates tax credit financing. | n/a | Ground leases are commonplace in today's market. |
| | We would only be supportive of this policy if the City is putting in a sufficiently large amount of gap financing that the City is essentially purchasing the land. | n/a | The City's loan would be sized to include the acquisition plus gap financing, thus is expected to be large. |
| | Sometimes good sites become available from private parties who desire to retain ownership of the land and lease to us (churches). Is the city open to this structure? In an era when good sites are so expensive and so hard to come by, we would hate to have to pass on opportunities like these from long term owners. | n/a | Yes, the City is open to third party leases. |
| | Confirm which projects the policy applies to. | Y | The policy applies to projects new construction projects. |
| | TCAC requires a ground lease addendum that should be accounted for. | n/a | Thank you for the information and we will have legal review the addendum. |
| | FMV should be the restricted FMV, not unrestricted. | Y | This portion of the policy was deleted. |
| | Recommend only requiring for projects where the land is being acquired from the City. | N | The policy applies to all new construction projects. |
| | Recommend annual rent of $1.00. | Y | This was incorporated into the policy. |
| Operating Expense and Residual Receipts Policy | Definitions should be consistent with TCAC or is confusing for annual reporting. | N | As a residual receipts lender, the City has an interest is being detailed and transparent about operating expense terms and limitations. |
| | Under other permitted expenses: confused by must-pay portion of ground lease. | Y | A third-party lease's hard payments would be an allowable expense. |

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|---|---|---|---|
| | Under other operating expenses please add pre-approval for expenses related to other lenders' and TCAC requirements, i.e. resident transit passes if required as a condition of funding. | N | City approval of other expenses will be made on a case-by-case basis. |
| | Other permitted expenses please add LP loans or fees, GP loans or fees, ODG and reserve deficit restoration. | N | The City may GP and LP loans have been added, but reserve deficit restoration has not. |
| | 50% going to the City might limit the amount of eligible basis if it cannot be paid in 15 years. | N | The City is expecting a reduction in eligible basis due to a reduction in deferred fee to be the exception, not the norm. |