



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Jacky Morales-Ferrand

**SUBJECT:** SEE BELOW

**DATE:** October 28, 2020

Approved

Date

10/29/2020

**COUNCIL DISTRICT: 6**

**SUBJECT: APPROVE REFINANCING CONDITIONS REQUIRED BY THE U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT FOR HUFF AVENUE APARTMENTS**

## RECOMMENDATION

Adopt a resolution authorizing:

- a. The refinancing of the Huff Avenue Apartments (“Property”), a 72-unit affordable apartment development located at 3021 Huff Avenue in San José, owned by Huff Avenue LLC, a California limited liability company (“Borrower”), an affiliate of the Santa Clara County Housing Authority, a public body, corporate and politic that is also the Project sponsor, by the U.S. Department of Housing and Urban Development (“HUD”);
- b. The Director of Housing to negotiate and execute a HUD required amendment to the City’s existing affordability restriction that includes an override of any City terms that conflict with any HUD document and limit the City’s right to make claims including claims for excess rents, damages and City fees as provided in the existing Affordability Restriction to surplus cash only and other amendments to the City’s loan documents in order to enable refinancing of the Property’s senior loan and payoff of the City Loan; and
- c. The Director of Housing to negotiate and execute a Payment Guaranty from the Santa Clara County Housing Authority guaranteeing the ability of the City to exercise its right to claim and receive payment for excess rents, fees, and other monetary penalties in the event that the Borrower violates the Affordability Restriction.

## **OUTCOME**

Approval of this action will authorize the Borrower to refinance the Property's existing senior loan and payoff the City loan with HUD loan proceeds. The request will also authorize significant HUD required limits on the City Affordability Restriction, which are recommended by staff since the City will receive a substantial benefit that it could not otherwise obtain due to the Borrower's agreement to extending the City's 55-Year Affordability Restriction for an additional 25 years.

## **EXECUTIVE SUMMARY**

This action allows the City to preserve the longevity of the Affordability Restrictions by adding 25 more years to an existing restricted affordable rental property, Huff Avenue Apartments, while allowing the Borrower to reduce the Property's debt service payments and generate stronger cash flows.

## **BACKGROUND**

### **Property Description**

Built in 1997, Huff Avenue Apartments ("Project") located at 3021 Huff Avenue consists of 72 apartments with a mix of 40 two-bedroom, 28 three-bedroom and four four-bedroom apartments affordable to 36 very-low and 36 low-income households and families. A map of the site can be viewed on **Attachment A**. Santa Clara County Housing Authority ("SCCHA" or "Sponsor") is the developer and Sponsor of Huff Avenue LLC, a California limited liability company ("Borrower"). Given these income restrictions and unit sizes, maximum resident incomes for each type of apartment range from approximately \$71,100 to \$102,360, with monthly rents ranging from \$1,592 to \$2,293.

The Property was originally financed with (1) equity derived from the sale of low-income housing federal and state tax credits of \$10,320,000; (2) a City loan of \$989,181; and (3) a senior loan of \$3,969,000 from ARCS Commercial Mortgage.

The City's loan has a current balance of \$36,000 and is paid by 75% of annual net cash flow after payment of expenses, bears 2.5% interest compounding annually, and is due in full at maturity on March 12, 2027. The City loan was funded with 20% Redevelopment Funds, and the City's Affordability Restriction expires on March 20, 2052.

### Refinancing Request

In September 2020, the Borrower submitted a proposal to City to refinance the Property to take advantage of the current low interest rates to reduce financing costs, rehabilitate the Property and augment the cash flow. The proposal is to obtain a new senior loan from a HUD-insured 223 loan in the amount of \$9,000,000 (“HUD Loan”), which would be used to pay off the existing senior loan and City loan of approximately \$3,302,439; to pay fees and closing costs of \$294,871; rehabilitate the Property at an estimated cost of \$4,677,194 and increase replacement reserves as required by HUD in the amount of \$725,496.

The proposed HUD Loan of \$9 million will bear an interest rate of approximately 2.65% with a maturity of 35 years, with required monthly payments of principal and interest in the amount of \$32,903 based on a 35-year amortization. The existing ARCS Commercial Mortgage loan, with monthly payments of \$25,572, at 6.685% interest rate will mature on August 1, 2036. The City would need to allow the HUD Loan documents to limit the City’s right to exercise its claim to excess rents, City fees and other monetary penalties in the case of noncompliance under the existing Affordability Restriction. The City Affordability Restriction however, will not be subordinate to the HUD Loan and will survive in the event that HUD forecloses.

### ANALYSIS

The City’s current Underwriting Guidelines regarding subordination of the City Affordability Restriction do not specifically allow carve-outs of certain provisions from the Affordability Restriction as part of a refinance without City Council approval. Therefore, staff elected to bring this action before the City Council to approve the proposed refinance transaction which will allow the HUD refinancing to proceed.

### Value of Santa Clara County Housing Authority to San José

The Santa Clara County Housing Authority is a public agency that shares the City’s mission of creating, maintaining, and preserving housing affordable to low-income residents in San José, and has demonstrated consistency with the City’s policy priorities. SCCHA has been a development partner of the City for many years and has built hundreds of affordable apartments which means they are committed to preserving the existing units built in the City. SCCHA is in good standing, has no unresolved issues of material non-compliance on any of its existing deals with the City; it has submitted its financial documents for review by the City; and, its affiliate Borrower plans to retain the sole ownership stake in the Property for the foreseeable future.

### Physical Assessment of the Property

The Property is in fair to good physical condition and currently structurally sound. The Borrower will spend approximately \$4,677,200 for substantial critical and non-critical repairs, replacements and upgrades including exterior building facade improvements, replacement of exterior cladding, roof (incl. gutters and downspouts), windows, exterior doors, building exterior

lighting, signage, ADA parking and site improvements, landscape in central court area, conversion of four units to be ADA accessible and two units to have visual and hearing impairment alarms. The \$4,677,000 will be funded from the refinancing proceeds.

#### Financial Review of the Proposed Structure

The refinance proposal results in a net positive financial benefit to the Property. The HUD Loan LTV is 38%, with a debt coverage ratio of not less than 1.15, meeting the City's parameters. However, because the HUD Loan is conservatively underwritten, the size of the loan does not present additional risk to the City or the Project. Although monthly payments of the new senior loan will increase by \$7,331, the increased loan size will provide funds for much needed rehabilitation of the Property. Additionally, the increased replacement reserve amount will ensure that the Property will preserve and extend its economic life.

The City's Affordability Restriction will not be subordinated to the HUD Loan. However, the City will agree to give HUD rights to excess rents, fees, and other monetary penalties which will be mitigated to some degree by having SCCHA, a public entity, provide a payment guaranty to the City in the case of noncompliance of the Affordability Restrictions.

#### HUD Required Amendments

The HUD required amendment is a significant limitation on the City's ability to enforce its restrictions. It requires the City to agree that any terms of the HUD documents will override the City restriction terms and includes within those overriding documents items that HUD has not provided to the City, so it is not possible to fully assess the scope of the changes to the City restriction. The HUD required amendment also requires the City to limit any claims it may make under the restriction to surplus cash, potentially limiting the City's remedies.

Normally such a request would be rejected. However, staff has recommended that in this instance the City Council authorize this significant departure from the City guidelines because (a) this project offers unique benefits to the City in the form of an offer to significantly extend the years of affordability and (b) the risks of the potential detriment to the project as an override of the City's terms is reduced because the Developer's sponsor is the SCCHA, which has the same affordable housing mission that City. The risks to the City of nonpayment of its claims is less than it might be under a private party guarantor, because the SCCHA budget and finances are matter of public record, and have been reviewed by staff.

### Consideration

This action gives Borrower the City's consent to refinance the Huff Avenue Apartments with new limits on City's existing Affordability Restriction. As consideration for making the requested changes, Borrower has agreed to give the City the following:

1. An extension of the Property's term of affordability by at least 25 years.
2. A Payment Guaranty to be executed by SCCHA, guaranteeing the City's claim to excess rents, fees, and other monetary penalties against the Borrower. The Payment Guaranty shall terminate on the earlier of the maturity date of the HUD Loan or the HUD Loan payoff.
3. Payoff of the existing City loan.

### EVALUATION AND FOLLOW-UP

The Housing Department produces a quarterly Information Memorandum regarding the use of the Director of Housing's Delegation of Authority under the Municipal Code; therefore, final amended City business terms would be summarized in those Memos.

### CLIMATE SMART SAN JOSE

The recommendation in this memo has no effect on Climate Smart San José energy, water, or mobility goals.

### POLICY ALTERNATIVES

In developing the recommendations set forth in this memorandum, the following alternative was considered:

**Alternative #1:** *Deny the Borrower's request to refinance the Huff Avenue Apartments with a HUD Loan*

**Pros:** Allowing the HUD Loan documents to amend the Affordability Restriction provisions is not consistent with the City Underwriting Policies because the action limits the City's right to exercise its remedies under the Affordability Restriction.

**Cons:** Failure to allow the refinancing would preclude or delay performance of much-needed substantial rehabilitation to the Property, may decrease Project reserves for the physical maintenance of the Property and may preclude the Borrower from taking advantage of current low interest rates.

**Reason for not recommending:** It is warranted to permit the refinancing of the Property by HUD because it would resolve several issues without additional risk to the City. Denial of this request would leave issues of Property repairs and financial weakness unresolved without any other readily available solutions.

## **PUBLIC OUTREACH**

This memorandum will be posted on the City Council Agenda website for the November 10, 2020 meeting.

## **COORDINATION**

Preparation of this report was coordinated with the City Attorney's Office.

## **FISCAL/POLICY ALIGNMENT**

These actions are consistent with the City's *Envision 2040 General Plan, the 2014-23 Adopted Housing Element* and with the City's *2015-20 HUD Consolidated Plan* in that they will help to preserve existing affordable housing opportunities for very low- and extremely low-income households through lengthened and strengthened affordability restrictions.

## **COST SUMMARY/IMPLICATIONS**

Approval of the recommended actions would allow the City to receive a payoff of its loan on the property in the approximate amount of \$36,000. No additional City funds are being disbursed for this transaction.

The anticipated revenue will be deposited in the Low and Moderate Income Housing Asset Fund and will be used to fund affordable housing developments.

## **CEQA**

Categorically Exempt, File No. ER20-201, CEQA Guidelines Section 15301, Existing Facilities.

/s/  
JACKY MORALES-FERRAND  
Director, Housing Department

For questions, please contact Rachel Vander Veen, Housing Deputy Director at (408) 535-8231.

Attachment A

# ATTACHMENT A

## Property Location

