CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Jacky Morales-Ferrand
Jim Shannon

SUBJECT: **SEE BELOW**

DATE: April 21, 2021

Approved D. DSyL

Date **4/22/2021**

COUNCIL DISTRICT: 3

SUBJECT: APPROVAL OF A LOAN COMMITMENT TO THE KELSEY AYER STATION, L.P., FOR THE DEVELOPMENT OF THE KELSEY AYER STATION APARTMENTS, A NEW AFFORDABLE APARTMENT COMMUNITY

RECOMMENDATION

(a) Adopt a resolution:

(1) Approving a total commitment of up to $15,925,000 with $10,875,000 in Low and Moderate Income Housing Asset Funds and $5,100,000 in Inclusionary Fee Funds for an Acquisition & Construction-Permanent Loan to The Kelsey Ayer Station, L P. or an affiliated entity (“The Kelsey” or “Developer”), for The Kelsey Ayer Station Apartments, a new affordable development to be located at 447 North First Street (“Site”), which is being developed to offer 113 rent--and income--restricted apartments for extremely low-income, very low-income and low-income households and two unrestricted manager’s unit (“Development”).

(2) Authorizing the Director of Housing to acquire the Site from the Developer for a price not to exceed the Acquisition Loan balance at the time of transfer, and to negotiate and execute loan documents, the documents related acquisition and ground leasing of the Site and all other documents, including any amendments thereto, related to the City financing for the Development;

(3) Approving a loan-to-value ratio of greater than 100% for this loan; and

(4) Making a determination that, consistent with Government Code Section 37364, after acquisition, the Site can be leased to the Developer without first offering the Site to the public for any other use, since the Site will be restricted so as to provide housing affordable to persons and families of low or moderate income, as defined by Section 50093 of the Health and Safety Code or as defined by the United States Department of Housing and Urban Development or its successors, and that this use is in the City’s best interests.

(b) Adopt a resolution allowing an exception to the City's Policy for the issuance of Multifamily Housing Revenue Bonds for the Kelsey Ayer Station Apartments, to permit the California Housing Finance Agency (CalHFA) to issue Bonds.
(c) Adopt the following 2020-2021 Appropriation Ordinance Amendments in the Low and Moderate Income Housing Asset Fund:
    (1) Decrease the Housing Project Reserve appropriation by $10,875,000; and
    (2) Increase the Housing Loans and Grants appropriation to the Housing Department by $10,875,000.
(d) Adopt the following 2020-2021 Appropriation Ordinance Amendments in the Inclusionary Fee Fund:
    (1) Decrease the Housing Project Reserve appropriation by $5,100,000; and
    (2) Establish a Housing Loans and Grants appropriation to the Housing Department in the amount of $5,100,000.

OUTCOME

Approval of the recommended actions will enable the Developer to assemble financing to build a new affordable development at 447 North First Street in San José. This development will provide affordable housing for 113 households in San José. The City will acquire the land, restrict it for affordable housing, and ground lease it back to the Developer. As funding sources are secured, the expected start date for construction to begin is January 2022. **Attachment A** provides an overview and site map for the Development.

EXECUTIVE SUMMARY

In response to the $100 million Notice of Funding Availability, The Kelsey submitted a Development proposal in October 2018 with a request for a commitment of funding to provide a total of 113 affordable apartments. The County of Santa County funding agreement requires that 34 of these apartments be reserved for intellectually and developmentally disabled individuals. The City will be using Low and Moderate Income Housing Asset funds & Inclusionary Fee funds for the project. The developer also plans to use County of Santa Clara funding for Intellectual and Developmental Disability (I/DD) Housing, California Housing and Community Development (HCD) Transit-Oriented Development (TOD) Program, and the Tax-Exempt Multi-Family Housing Revenue Bonds. Approval of this funding commitment and allowing CalHFA to be the Bond Issuer allow the developer to move forward with an application to the Mixed-Income Set Aside Pool for the California Debt Limit Allocation Committee.

BACKGROUND

On August 31, 2018, following the City Council's direction, the Housing Department issued a $100,000,000 Notice of Funding Availability ("NOFA") for the development of affordable housing for extremely-low income, very low-income, and low-income individuals and families. The NOFA prioritized projects that provided housing for homeless households that achieved cost effectiveness and that leveraged additional non-City sources of financing.

In response to the NOFA, the Developer submitted a project proposal with a request for a commitment of funding in the amount of up to $11,125,000 to provide 113 affordable units, of which 34 are intended to be included for Intellectually and Developmentally Disabled (I/DD) individuals. The I/DD units will be restricted to 20% area median income (AMI) and will include supportive living services. There will also be 31 units affordable to households at 50% AMI, 22 units affordable to households at 60% AMI, and 26 units affordable to households with rents at up to 80% AMI. Finally, there will be one studio manager's unit and one two-bedroom manager's unit, for a total of 115 units. The Development will also provide on-site service coordination.

The NOFA guidelines stated that the City would allocate funding at $125,000 per unit and The Kelsey Ayer Station Apartments was originally awarded $11,125,000. However the project has taken approximately two years to secure all additional funding and to accommodate lower rents for the tenants, therefore the Kelsey has requested an additional $1,700,000 from the City to cover this gap, providing a total commitment of $12,825,000 in Construction and Permanent Financing, at a cost of approximately $113,500 per-unit ***(See Attachment B - Construction/Permanent Sources for the Development)***.

Additionally, if approved, consistent with the Ground Lease Policy in the City of San José Housing Department Underwriting Guidelines, the City will provide additional funding of up to $3,100,000 in Inclusionary Fee funds to acquire the land ("Acquisition Loan") prior to the close of construction funding and will negotiate and execute a ground lease or option to the Developer for 70 years, and if required by HCD or CalHFA regulations, an option to extend for up to an additional 29 years, for a total term not to exceed 99 years.

The Developer is also pursuing supplemental construction/permanent funding sources for the Development, including:

- **CalHFA Tax-Exempt Multi-Family Housing Revenue Bonds ("CalHFA Bonds")**
  The Developer is requesting that the City allow CalHFA to be the issuer of approximately $32,000,000 in tax-exempt multifamily housing revenue bonds to, in part, finance the Development and thereby enable The Kelsey to apply under the Mixed-Income Set-Aside of the May 2021 State Tax credit and California Debt Limit Allocation Committee joint application funding Round. Awards are anticipated to be announced by CDLAC in August 2021.

- **Santa Clara County Program for Intellectual Developmental Disability Housing**
  On August 21, 2020, the County of Santa Clara Board of Supervisors approved $9,000,000 in one-time funding, the second tranche of funding, towards the $40,000,000 goal for the development of affordable housing for extremely low-income and very-low income persons with intellectual or developmental disabilities ("I/DD"). The County approved the capital investment of up to $4,000,000 for this project in December 2020.

- **California Housing and Community Development (HCD) Transit-Oriented Development (TOD) Program**
  On April 30, 2020, California Department of Housing and Community Development (HCD) Transit-Oriented Development (TOD) Program issued a NOFA to increase public transit ridership by funding higher density affordable housing developments within one-quarter mile of transit stations and infrastructure improvements necessary for the development of specified housing developments. The Kelsey was awarded $10,000,000 in funding in January 2021.

ANALYSIS

The Development will provide 113 fully inclusive mixed ability, mixed income housing for I/DD individuals as well as mixed-income residents in the Japantown/Ayer Station area of Downtown San José. The Development provides a mix of 2-bedrooms and studios as well as 15,251 sq. ft. of community, commercial, and outdoor space. Under the Developer's proposal the communal spaces include a lobby lounge with on-site concierge services, terraces and rooftop gardens, and a community room on each residential floor. The Kelsey Ayer Station is located approximately 500 feet from the VTA Japantown/Ayer station – the Santa Clara Valley Transportation Authority light rail. Downtown San Jose is a short 15- minute walk, and Diridon Station is a 1.3-mile stroll along the Guadalupe River Trail. The Development is in a transit-oriented location that will use both on-site support services and community programming as well as leverage nearby urban amenities.

The Developer secured funding approvals from Santa Clara County in December 2020 and HCD in January 2021. The City's Construction-Permanent Loan commitment to the Developer of up to $12,825,000 and $3,100,000 in acquisition funding from Inclusionary Fee funds is necessary at this time because it will enable The Kelsey to leverage their public financing to be competitive for Tax Credit and other public and private funding sources.

Construction-Permanent Loan

The Housing Department recommends that City Council approve a Construction-Permanent Loan amount for up to $12,825,000 from Low and Moderate Income Housing Asset funds and Inclusionary Fee funds, which equates to approximately $125,000 per financed unit up to 60% AMI. The City will contribute Inclusionary Fee funds for 26 units with rents in excess of 30% of 60% AMI, which equates to approximately $77,000 per financed unit at 80% AMI.

Capitalized interest from the construction phase is included in the total amount of financing for this Development because a portion of the City funds will be used during the construction phase and the accrued interest will be capitalized into the permanent financing up to the approved amount. The City's Construction-Permanent Loan commitment will represent approximately 19% of the total financing for the Development. The City's loan will be structured consistent with its underwriting guidelines and policies and will be repaid through a share of the Development's net cash flow. It is anticipated that the final loan terms will be underwritten, negotiated, and determined as the Development approaches construction loan closing. The final loan terms will be documented through the Director's Delegation of Authority.

If approved, the City will also fund the purchase of the land from the Developer. The City will own the land and lease it to the Developer for up to 99 years, subject to the required findings under the Surplus Lands Act. Upon acquisition, the City will record an affordability restriction on the fee interest. See Attachment B for a summary of the construction/permanent sources for the Development.

By the authority delegated under section 5.06.335 of the Municipal Code, the Director of Housing will negotiate additional terms and execute documents for these loans in accordance with the City Council's approval, if granted, for this Development.

Loan-to-Value Ratio
An appraisal that will be prepared for the senior lender before construction closing is expected to result in a combined loan-to-value ratio ("LTV") that significantly exceeds 100%, which is the City's LTV policy threshold for the Delegation of Authority in Municipal Code Chapter 5.06. The 100% LTV policy was intended to reduce the City's risk of loss associated with its loans; however, the deep affordability of the development increases the need for public subsidies, while decreasing the Development's market value, leading to an increased LTV. An elevated LTV is not uncommon for public lenders in the affordable housing industry. Developments that have a high LTV are considered acceptable by City staff if the Development's projected operating income is expected to be at least 1.15 times the permanent mortgage debt service payments, as is the case in this Development. This is a common standard for assessing the financial feasibility of affordable housing developments.

The security for a City loan with a high LTV is that the development receives loan repayments once fully constructed. Therefore, a site cannot be easily liquidated should a proposed development not proceed. Additionally, the City of San Jose will own the land and will ground lease the property to the Developer. This approval will enable the Development to move forward with obtaining tax credits, financing from a senior lender, and an investor, thereby enhancing the City's repayment potential. For these reasons, a LTV over 100% is warranted.

Affordability Unit Mix/Area Median Income Levels
The Developer proposes to build a unit mix as follows: 34 apartments restricted to ELI households at 20% AMI (a household of one earning approximately $22,120 annually), 31 apartments restricted to VLI households at 50% AMI (a household of one earning approximately

$55,300 annually), 22 restricted to Low-Income households at 60% AMI (a household of one earning approximately $66,360 annually), and 26 restricted to Low-Income households at 80% AMI (a household of one earning $78,550 annually). The Housing Department finds that this unit mix will help meet priorities expressed by City Council and it will position the Development to be competitive for alternative funding sources. It will further serve the goal of inclusivity by providing affordable and supportive housing for disabled individuals as well as providing 26 80% AMI units. Figure 1 below demonstrates the breakdown of affordability restrictions for the 115 units.

Fig. 1 – Unit Mix: The Kelsey Ayer Station Apartments

Unit Type **	20% AMI	Monthly Rent	50% AMI	Monthly Rent	60% AMI	Monthly Rent	80% AMI	Monthly Rent	Manager	Total
Studio	27	$ 495	26	$ 1,238	18	$ 1,486	18	$ 1,982	1	**90**
2-BR	7	$ 637	5	$ 1,592	4	$ 1,911	8	$ 2,548	1	**25**
Total	**34**		**31**		**22**		**26**		**2**	**115**

***Maximum incomes limits are based upon HCD occupancy guidelines of 1 person per bedroom, plus 1.*

Surplus Lands Act Findings for Leasing

Under the recent amendments to the Surplus Lands Act, the City must follow certain procedures in selling or ground leasing of City-owned property which require the offering of that property to the public, unless the sale or lease falls under an exemption. Once the Site is acquired by the City it will become City property. The Site to be leased after acquisition will be restricted for the term of the lease to provide housing affordable to persons and families of low or moderate income, as defined by Section 50093 of the Health and Safety Code or as defined by the United States Department of Housing and Urban Development or its successors. Based on the description of the Development provided in this memo, staff recommends that the Council make a determination as part of these actions that this use will be in the City's best interest.

Basis for Multifamily Housing Revenue Bonds Policy Exemption

The City's Policy for the Issuance of Multifamily Housing Revenue Bonds (City Policy 1-16) states that the City shall be the issuer of all bonds financing multifamily housing rental projects within the City, with specified exceptions. One of these exceptions, Section I.C allows the City Council to authorize an outside issuer to issue bonds for affordable housing within the City when there are "special circumstances" merited by the project and its financing. In the case that the City is not the issuer of bonds for the project, it is the City's policy to require the issuer to assume full responsibility for issuance and ongoing compliance of the bond issuance with federal tax and state laws.

The Kelsey Ayer Station was selected by California Housing Finance Agency Mixed- Income Program (MIP) to apply under the Mixed-Income funding Pool of the CDLAC Qualified Residential Rental Project Program (QRRP) for the upcoming May 2021 CDLAC Round. As a condition of applying with CalHFA under the MIP, the development must be paired with CalHFA's Conduit Bond Issuance Program and a CalHFA Mixed-Income Qualified

Construction Lender. Additionally, the program must be paired with CalHFA's Permanent Loan product. The MIP resources will take the form of a subordinate loan to incentivize newly developed multifamily housing projects that serve a range of extremely low to moderate income renters.

Allowing the Developer to use the special circumstances exemption to the City of San José Multifamily Housing Revenue Bonds Policy enables them to be more competitive to secure construction funding for the development and ensures that the Kelsey Ayer Station Apartments will not compete against other City-funded developments which may be (re)applying in the May 2021 round. This is extremely important given the recent challenges of obtaining 4% tax credits. It is likely this project will receive funding as a result of this set-aside.

CONCLUSION

Once The Kelsey has obtained all necessary funding commitments for the Development, they will apply for Low Income Housing Tax Credits and a Tax-exempt Bond Allocation in May 2021. Construction would initiate in February 2022 and conclude in August 2024. **Attachment C** provides an anticipated development timeline for the Development.

EVALUATION AND FOLLOW-UP

The Housing Department produces quarterly Information Memoranda regarding the use of the Director of Housing's Delegation of Authority under the Municipal Code; therefore, final loan business terms would be summarized in those Memos. In addition, the Housing Department posts periodic reports on the status of its affordable properties undergoing rehabilitation or construction to its website, www.sjhousing.org. If the recommended actions are approved and Development successfully closes construction financing, it would be included in these Quarterly Production Reports.

CLIMATE SMART SAN JOSE

The recommendation in this memo aligns with one or more Climate Smart San José energy, water, or mobility goals.

POLICY ALTERNATIVES

To arrive at this proposal, Housing Department staff considered the following options:

Recommendation #1

Alternative:	***The City Council could deny the request for funding to the Developer for the Development.***
Pros:	The funds being requested could be used for other affordable housing developments.
Cons:	The City will lose an opportunity to provide this affordable, inclusive, transit-oriented housing
Reason for not recommending:	The proposed Development is a viable opportunity to meet the demand for deeply affordable housing for vulnerable individuals in an inclusive setting. The Development will help the City fulfill its affordable housing goals and will provide additional employment opportunities for 15 or more property management, supportive services and case management jobs.

PUBLIC OUTREACH

Prior to obtaining SB 35 approvals of the Development's entitlements in February 2020, The Kelsey implemented a comprehensive outreach plan to engage with the community to provide information, answer questions, and better understand the concerns and character of the neighborhood, residents and businesses. From January to July 2019, the Developer hosted a total of four neighborhood or community meetings, attended by various advocacy groups and community members, addressing a wide array of topics regarding the Development. Many of the community's comments and suggestions were incorporated into the development.

This memorandum will be posted on the City's Council Agenda website for the May 4, 2021 Council Meeting.

COORDINATION

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

COMMISSION RECOMMENDATION/INPUT

This item was not heard by the Housing and Community Development Commission, as approvals of affordable development financing do not fall under the functions, powers, and duties of the Commission delineated in Section 2.08.2840 of the San José Municipal Code.

FISCAL/POLICY ALIGNMENT

This expenditure is consistent with the following policy documents: *The City's Envision 2040 General Plan* and the *2014-23 adopted Housing Element* in that it will help the City meets its Regional Housing Needs Allocation; the City's current *Housing Investment Plan* in that it increases San José's supply of affordable housing; and the *City's 2015-20 HUD Consolidated Plan* in that it will provide rental apartments affordable to low, very low- and extremely low-income households.

COST SUMMARY/IMPLICATIONS

1. Estimated Costs:

Uses	Amount
Acquisition Loan	$ 3,100,000
Total Acquisition Loan Amount	**$ 3,100,000**
Construction Loan	$12,347,250
Interest	$ 477,750
Total "Up To" Permanent Loan Amount	**$12,825,000**
Total Funding Package	**$15,925,000**

2. SOURCE OF FUNDING: $10,825,000 from the Low and Moderate Income Housing Asset Fund and $5,100,000 from the Inclusionary Fee Fund

3. FISCAL IMPACT: Funding has been reserved in the amount of $10,825,000 in the Low and Moderate Income Housing Asset Fund and $5,100,000 in the Inclusionary Fee Fund and is recommended as part of this memorandum to be appropriated to the Housing Loans and Grants appropriations in the respective funds to encumber and draw upon when construction is initiated in winter 2021/2022. There is no ongoing fiscal impact to the General Fund as a result of this action.

4. Approving this recommendation to allow CalHFA to be the Bond Issuer will result in forgoing the City's $5,000 fee for holding a TEFRA for bond issuance and bond administration fees for the transaction. The fee resolution outlines the parameters for the Issuance Fee, an amount equal to the sum of (a) 0.50% of the first $10,000,000 issued and (b) 0.25% of the remaining par issued. The annual fee applicable to developers is an amount equal to 0.125% of the permanent loan amount at conversion, subject to a minimum fee of $7,500, for the 55-year term of the regulatory period. Based on these parameters, the City will forgo approximately $450,000 in issuance fees and $7,500 annually. These fees would only be collected, however, if the developer was able to secure an allocation from CDLAC in the regular funding pool which is incredibly competitive.

BUDGET REFERENCE

The table below identifies the funds and appropriations recommended to fund the actions included in this memorandum.

Fund #	Appn #	Appn. Name	Total Appn	Recom. Budget Action	2020-2021 Adopted Operating Budget Pg.	Last Budget Action (Date, Ord. No.)
346	8437	Housing Project Reserve	$25,791,653	($10,825,000)	X-61	02/23/2021, 30537
346	0070	Housing Loans and Grants	$87,548,307	$10,825,000	X-60	02/23/2021, 30537
451	8437	Housing Project Reserve	$15,000,000	($5,100,000)	X-56	06/23/2020, 30437
451	New	Housing Loans and Grants	N/A	$5,100,000	N/A	N/A

CEQA

Exempt per Public Resources Code Section 21080(b)(1) and CEQA Guidelines Section 15369, Ministerial Project pursuant to Government Code Section 65913.4, File No. ER20-109.

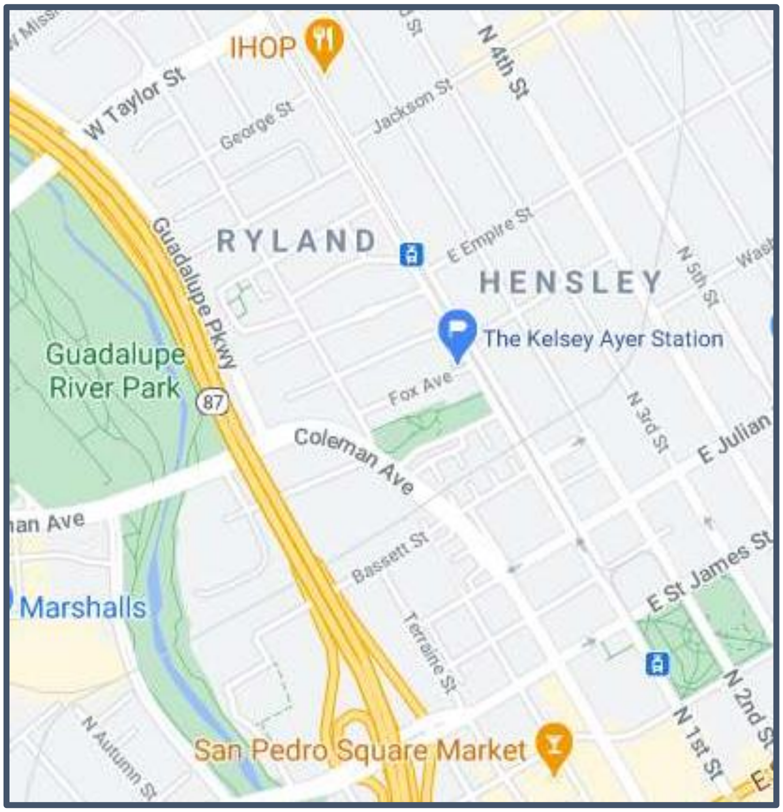
/s/
JACKY MORALES-FERRAND
Director, Housing Department

Jim Shannon
JIM SHANNON
Budget Director

For questions, please contact Division Manager, Kemit Mawakana at (408) 535-3851.

Attachment A: Developer's Overview and Site Map
Attachment B: Construction/Permanent Sources for the Development
Attachment C: Anticipated Development Timeline

Attachment A: Developer's Overview and Site Map



The Kelsey Ayer Station will be a fully inclusive mixed ability, mixed income housing community located at 447 North 1st Street in downtown San Jose. The 115 apartment homes include a mix of 2-bedrooms and studios. The Project includes 15,251 sf of community, commercial, and outdoor space. Communal space include a lobby lounge with on-site Inclusion Concierges™, terraces and rooftop gardens, and a community room on each residential floor.

On First Street, a community café serves neighbors and passerby during the day and operates as a communal dining area by night.

The Project is located approximately 500 feet from the VTA Japantown /Ayer Light Rail station. Downtown San Jose is a short 15-minute walk, and Diridon Station is a 1.3-mile stroll along the Guadalupe River Trail. The Project is a dense transit-oriented location that will both utilize on-site support services and community programming as well as leverage nearby urban amenities.

As a transit-oriented project, residents will be encouraged to utilize public transit, bikes, and rideshare. The Kelsey Ayer Station will provide active ground level commercial space, including a community café. Whether to stop by for a morning coffee, join for an evening community event, or sign up for a community service project with residents led by our Inclusion Concierge™, neighbors will be welcomed into the inclusive community.

A rendering of the Kelsey Ayer Station Apartments and a typical unit interior.

Attachment B: Construction/Permanent Sources & Acquisition Budget

Sources of Funds - Permanent

Loan	Amount
Tax Exempt Perm Loan	**$ 8,689,000**
HCD TOD Loan	**$ 10,000,000**
City of San Jose	**$ 12,825,000**
County of Santa Clara HOME I/DD Funds	**$ 4,000,000**
Owner Loan - Philanthropic Sources	**$ 2,469,589**
CDLAC Performance Deposit Refund	**$ 100,000**
Deferred Developer Fee	**$ 466,363**
AHP	**$ 500,000**
GP Capital	**$ 100**
State Tax Credit Equity	**$ 2,666,800**
Federal Tax Credit Equity	**$ 23,164,119**
TOTAL	**$ 64,880,971**

Sources of Funds - Construction

Loan	Amount
Tax Exempt Construction Loan	**$ 32,000,000**
Taxable Construction Loan	**$ 8,864,396**
City of San Jose	**$ 12,347,250**
County of Santa Clara HOME I/DD	**$ 4,000,000**
Owner Loan - Philanthropic Sources	**$ 2,000,000**
CDLAC Performance Deposit Refund	**$ 100,000**
Deferred Developer Fee	**$ 466,363**
GP Capital	**$ 100**
Deferred Costs	**$ 3,333,567**
Tax Credit Equity (Through Construction)	**$ 1,291,546**
TOTAL	**$ 64,403,222**

Sources of Funds - Acquisition

Loan	Amount
City of San Jose	**$ 3,100,000**
TOTAL	**$ 3,100,000**

Attachment B: Acquisition Budget

Acquisition Budget

Expenses	Cost
Land	$ 3,032,070.00
Closing Costs	$ 10,000.00
Legal Costs for Closing	$ 10,000.00
Estimated Real Estate Taxes	$ 23,000.00
Other Carrying and Property Management Costs	$ 18,000.00
Estimated Fencing	$ 5,000.00
Alarm System (1 year)	$ 1,930.00
TOTAL	**$ 3,100,000.00**

Attachment C: Anticipated Development Timeline

Submitted Construction Drawings for Building Permits	May 2021
Apply for CDLAC/TCAC	May 2021
Bond Allocation Award	August 2021
Close Financing	February 2022
Start Construction	February 2022
Complete Construction	August 2024