



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Jacky Morales-Ferrand

**SUBJECT:** SEE BELOW

**DATE:** May 17, 2023

Approved

Date

5/25/23

**COUNCIL DISTRICT: #3**

**SUBJECT: TRANSFER AFFORDABILITY RESTRICTIONS FOR THE PACIFIC  
MOTOR INN LOCATED AT 455 SOUTH SECOND STREET**

## RECOMMENDATION

Adopt a resolution authorizing the Director of Housing to:

- 1) Negotiate and execute a Standard Grant Agreement with the California Department of Housing and Community Development and all other related documents to include a provision that allows the transfer affordability restrictions placed on the property located at 455 South Second Street through the HomeKey program to a new site in San José in the circumstance that an affordable housing development is unable to secure financing;
- 2) Make minor modifications to the terms of the deal if necessary; and
- 3) Increase the previously approved agreement amount by up to \$100,000 for the expected increase in acquisition costs.

## SUMMARY AND OUTCOME

The proposed development at the Pacific Motor Inn site, located 455 South Second Street, allows for the creation of a mixed-income community near the transit and amenities of downtown. It is a unique collaboration between the City, PATH Ventures, and Westbank. In the near term, the existing hotel will be operated as interim housing with wrap-around services targeting

individuals experiencing homelessness. PATH Ventures will redevelop a portion of the site into a mid-rise affordable housing development, including 72 units of permanent supportive housing and up to 48 additional affordable apartments. A high-rise building with approximately 350 units of market-rate housing will be constructed by Westbank.

PATH Ventures will redevelop the hotel into a 120-unit affordable development. PATH Ventures will need to assemble all the needed financing including tax credits for the project. In the unlikely event that PATH Ventures is not able to secure financing for the affordable housing development, or a new nonprofit is unable to replace PATH Ventures, PATH Ventures will exit PMI Partners LLC (PMI Partners). The City is in discussion with the California Department of Housing and Community Development (HCD) whereby PMI Partners would repay the HomeKey funds to the City of San José and PMI Partners would proceed with the design and construction of both the mid-rise affordable building and the high-rise market-rate building. If approved by HCD, the recommended action authorizes the Director of Housing to transfer the affordability restrictions placed on the property through the HomeKey program to a new site located within the City.

## **BACKGROUND**

HomeKey is a State grant program administered by HCD. The program's objective is to provide interim or permanent housing options for persons experiencing homelessness and who are also at risk of COVID-19. It aims to achieve this by providing grant funding to eligible applicants to quickly acquire, rehabilitate, or master lease a variety of housing types.

On October 5, 2021, the City Council approved actions authorizing the City Manager to apply for three HomeKey grants. The three HomeKey grant application sites were the Pacific Motor Inn, Arena Hotel, and the City-owned property located at the intersection of Branham Lane and Monterey Road. HCD announced a grant award for the Pacific Motor Inn in December 2022.

On December 13, 2022, the City Council approved actions authorizing staff to: accept a HomeKey grant award of \$19,868,250 from HCD; enter into a Standard Agreement with HCD; and provide a funding commitment of \$25,026,939 of Measure E funds and up to \$19,868,250 in state HomeKey funds directly to PMI Partners to fund the acquisition, rehabilitation, operations, and services for the Pacific Motor Inn.

On March 14, 2023, the City Council approved actions authorizing the Housing Director to execute a master prelease, with an option to purchase apartments built by PMI Partners (a joint venture of PATH Ventures, a California nonprofit public benefit corporation, and Westbank, a private developer) located at 455 South Second Street in the circumstance that an affordable housing development is unable to secure financing.

## **ANALYSIS**

The Pacific Motor Inn development (Project) includes multiple phases and options based on the success of the anticipated phases moving forward. The purpose of this section is to describe the proposed development phases and alternative development strategies for the site.

## **Proposed Development Phases**

### ***Acquisition Phase***

The acquisition phase will commence as PMI Partners purchases the Pacific Motor Inn site for a total of \$18,165,500 funded through \$16,556,250 in HomeKey funds from HCD and \$1,609,250 in Measure E funds from the City.<sup>1</sup> This amount is likely to increase by \$100,000 due to the extended period on the purchase and sale agreement. The amount of funds budgeted in Fiscal Year 2022-2023 in Measure E funds for this acquisition is \$5,756,250 and is recommended to increase to \$5,856,250. PMI Partners and the City will enter into a Standard Agreement with HCD to ensure 72 units are made available to homeless individuals for 15 years. Additionally, the City will place an affordability restriction restricting rents affordable to residents earning to 30% of the Area Median Income on the site for 15 years.

### ***Interim Housing Phase***

During the interim housing phase of the Project, PMI Partners will contract with PATH Ventures to operate the Project as an interim housing site with robust supportive services, targeting individuals who are experiencing homelessness or who are at risk of homelessness. The existing 72 rooms will all be reserved for HomeKey-eligible residents and one room will be the on-site property manager's unit. The City will enter into an operations grant contract with PMI Partners, with PATH Ventures as the sub-consultant to PMI Partners, to fund operations during the interim housing phase.

During this same period, Westbank will seek entitlements for the two buildings on the site. One building will be designed as a high-rise, market-rate residential building. The second building will be designed as a mid-rise, affordable residential building. After entitlements are approved for the site, PATH Ventures will seek financing for the affordable housing development. PATH Ventures may apply for funding to the California Debt Limit Allocation Committee and/or Tax Credit Allocation Committee multiple times.

### ***Redevelopment Phase***

In the redevelopment phase, Westbank will purchase the market rate portion of the site from PMI Partners. Once this payment is made, the affordability restriction will be lifted from the market-rate portion of the site. Westbank will move forward with the construction of the market-rate residential building. PATH Ventures will move forward with the development of the affordable, mid-rise development. During the construction period, the City will provide 72 units in an alternate location to meet the requirements of the HomeKey program.

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<sup>1</sup> City Council authorization on December 13, 2022:

<https://sanjose.legistar.com/LegislationDetail.aspx?ID=5949590&GUID=811C2514-DC44-4D4E-A20A-FF058C49CE72&Options=&Search=>

### **Worst Case Scenario Development Strategies**

In the unlikely event that PATH Ventures is not able to secure financing for the affordable, mid-rise development, and another entity is not able to move into the partnership, then PATH Ventures will withdraw from PMI Partners. Following the exit, Housing staff is discussing with HCD the scenario when PMI Partners will pay the City a total of \$18,165,500 for the site.

#### ***Transfer of Affordability Restrictions***

The City will then transfer the existing affordability restriction for interim housing for the remaining term of 15 years to a new interim site. Concurrently, the City will identify a new site to develop 72 new permanent supportive housing units and will transfer the permanent affordability restriction to the new site for a 55-year term. The City will assume the responsibility of identifying a suitable site to fulfill the obligations under the original HomeKey affordability restrictions. This obligation will likely require the investment of operating costs for the interim phase and acquisition and construction costs for the permanent phase of development. The \$18 million that will be paid back from PMI Partners will be utilized to offset these costs. The City was intending on financing the development of new permanent supportive housing on the Pacific Motor Inn site and will instead finance the development of this housing on a new site. This is a highly unlikely scenario, and the staff recommends moving forward with this agreement to allow the development plan to move forward.

#### ***Master Prelease for the Mid-Rise Building***

As approved by City Council in March 2023, if PATH Ventures is unable to secure funding for the affordable development, one strategy to allow development to move forward is that PMI Partners, with Westbank as its sole remaining member, will begin the construction of both the market-rate, high-rise building and the affordable mid-rise building. The City will enter into a master prelease with Westbank that will take effect once the construction of the mid-rise building is complete.

#### ***Option to Purchase the Mid-Rise Building***

In addition to the master prelease alternative, the City has an option to purchase the mid-rise residential building from PMI Partners. The option to purchase will provide the City an alternative to the master prelease. The City will evaluate available funding and target populations to determine the best alternative at that time.

#### ***Remaining Discussion Items***

City staff, HCD staff, and Westbank are continuing to flesh out final deal terms. If the discussion exceeds the current time allotted for the deal to close on the purchase of the property, the City will need to allocate an additional \$100,000 to extend the timing of the Project. The purchase price is likely to increase by \$100,000 due to the extended period of the purchase and sale

agreement. As the proposed development moves forward there may be minor changes to terms required, staff requests that the Director of Housing be authorized to make minor changes to successfully conclude the negotiations.

### ***Climate Smart San José Analysis***

The recommendation in this memorandum aligns with one or more Climate Smart San José energy, water, or mobility goals. The recommendation furthers the goals of Climate Smart San José by facilitating the creation of low-income housing close to jobs and transit, which would reduce vehicle miles traveled and greenhouse gas emissions.

### **EVALUATION AND FOLLOW-UP**

If the development is able to obtain financing and moves forward, its progress will be reported in the Housing Department's information memoranda regarding the use of the Director of Housing's Delegation of Authority under the San José Municipal Code. During the life of the Project, while it operates as an interim housing facility, performance metrics will be included in the City's annual homelessness report. If the Project is unable to move forward, the Housing Department will issue an information memorandum informing the City Council. If the Housing Department moves forward with a funding request to fund interim or permanent housing on a new site, the Housing Department would return to the City Council with a funding request.

### **COST SUMMARY/IMPLICATIONS**

1. ESTIMATED COSTS: On December 13, 2022 (Item 8.4) City Council approved the acceptance of a \$19.9 million HomeKey 2.0 grant to be received directly by PMI Partners. This action also approved the commitment of \$25.0 million of Measure E funds,

subject to appropriation over a seven-year period, as the City's matching requirement to the HomeKey 2.0 grant award. Of this amount, \$5.8 million has been appropriated in 2022-2023 to serve as a capital match (\$1.6 million) and for the rehabilitation of the Pacific Motor Inn property (\$4.1 million). Allocation of the remaining \$19.2 million in Measure E funding for operating and maintenance costs will be brought forward as part of future budget processes. The recommended action increases the agreement amount by \$100,000 from \$5,756,250 to \$5,856,250. The existing appropriation of \$38,613,686 is expected to have the capacity to absorb this increase.

2. FISCAL IMPACT: The actions recommended in this memorandum will allow staff to negotiate with PMI Partners. Staff will return to City Council following the conclusion of negotiations, if needed, for budget appropriations as part of the budget process.

**BUDGET REFERENCE**

The table below identifies the funds and appropriations funding the actions described in this memorandum.

| Fund # | Appn. # | Appn. Name                                | Total Appn.  | Amt. for Agreement | 2022-2023 Adopted Operating Budget Page | Last Budget Action (Date, Ord. No.) |
|--------|---------|---|--------------|--------------------|---|-------------------------------------|
| 001    | 224R    | Measure E – Project HomeKey 2.0 (40% ELI) | \$38,613,686 | \$5,856,250        | N/A                                     | 2/28/2023 Ord. No. 30885            |

**COORDINATION**

The memorandum has been coordinated with the City Attorney’s Office, the City Manager’s Budget Office, and the Office of Economic Development and Cultural Affairs.

**PUBLIC OUTREACH**

This memorandum will be posted on the City’s Council Agenda website for the June 6, 2023 City Council meeting.

The Housing Department hosted a series of virtual public meetings to share details and answer questions about the City’s HomeKey applications and solicit input. The first public meeting was held on October 1, 2021, and focused on the City’s overall HomeKey strategy. The meeting

included a presentation from the County of Santa Clara Office of Supportive Housing regarding the regional approach to the HomeKey program. On October 25, 2021, another public meeting was held to discuss this specific interim housing project proposal. The meeting included staff from the Housing Department and PATH Ventures. Each agency provided a presentation followed by a project-specific question and answer session.

**COMMISSION RECOMMENDATION/INPUT**

No commission recommendation or input is associated with this action.

HONORABLE MAYOR AND CITY COUNCIL

May 17, 2023

**Subject: Transfer Affordability Restrictions for the Pacific Motor Inn Located at 455 South Second Street**

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**CEQA**

Exempt from CEQA Review, File No. ER21-159, Public Health and Safety Code Section 50675.1.4.

**PUBLIC SUBSIDY REPORTING**

The item does not include a public subsidy as defined in government code section 53083 or 5308.1 or in the City's Open Government Resolution.

/s/

JACKY MORALES-FERRAND

Director of Housing

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