



CITY OF SAN JOSE HOUSING DEPARTMENT

PROJECT DEVELOPMENT PROGRAM POLICIES AND PROCEDURES MANUAL

SUBSIDIZED LOAN PROGRAM

OCTOBER 2006

Note: Sections amended from the 11/05 version of this document are in blue italic type.

SECTION ONE: INFORMATION AND GENERAL
REQUIREMENTS

I. OVERVIEW

The City is considered a “gap lender,” which means that the City’s funds are utilized to “fill the gap” between the total amount of project funds needed and the amount of project funds that can be raised through outside sources. Applicants are required to aggressively pursue these outside funding sources as the primary source of development funds. City subsidy funds are underwritten to a project by City staff with the expectation that the applicant will identify and utilize these outside sources to the fullest extent feasible in sufficient amounts to both minimize the City’s subsidy contribution and also to ensure the long-term feasibility of the project.

II. APPLICATION PROCESS

The types of City loans available and types of projects eligible for financing at a given time are defined periodically through the Department of Housing’s issuance of its Notices of Funding Availability (NOFAs), which can be found at www.sjhousing.org. The NOFA will include the types of projects that will be considered for funding, selection criteria and weights, as well as the expected amount of funds to be made available.

Posted NOFAs will incorporate these policies and procedures by reference. Please refer to the following documents regarding NOFA procedures:

- Announcement Letter
- Notice of Funding Availability
- Detailed Scoring Criteria
- Form of Application

In addition, refer to documents relevant to the Preliminary Commitment Letter process, if that option applies to a particular project:

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- Criteria and Process for Preliminary Commitment Letters (Section Four of this document).
- Request for Preliminary Commitment Letter for a Multifamily Housing Project

III. GENERAL PROGRAM REQUIREMENTS

A. ACCEPTABLE PROJECT TYPES AND FEASIBILITY

Project types to be funded will be defined by the NOFA as will be released from time to time. Generally, the City is committed to provide affordable housing opportunities to the populations that have the greatest needs. The City also strives to provide affordable housing opportunities to specific segments of the population that are underserved or are at risk of homelessness. The City will not provide funds for applicants proposing housing types that are in violation of Federal or State fair housing laws.

The sponsor shall propose projects with individual units and amenities that meet the needs of the intended resident population. For example, multifamily project units shall be of size and functionality to accommodate more than one individual occupant with project amenities to provide for recreational activities for both adult and children . Senior project units shall have sufficient accessibility for the elderly and recreational and service amenities to accommodate a senior population.

All units, regardless of income restrictions, shall have access to the same amenities, be comparable in size, *interior finishes*, design, and function, and be dispersed evenly throughout the project.

Project Feasibility

- **Market Studies**

A project sponsor must show market feasibility by providing a market study to the City along with their funding request. In the event a market study is not available at the time of application for funding, a project sponsor will provide to the City a rental survey of similar properties in the immediate vicinity or other alternate information acceptable to the City. If the City determines that the project is feasible based on the information presented by the sponsor, the City will accept the application for funding. However, as a condition to proceed with a

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funding commitment, the sponsor must provide a market feasibility study that must be approved by the City.

The market study must be prepared by an individual or company with the necessary certification and skill level to provide meaningful data and analysis sufficient for the City to reach a conclusion about the feasibility of the proposed project. The market study must be prepared at the expense of the applicant, by an independent third party having no identity of interest with the proposed project's development partners, intended partner or general contractor. The study must provide up-to-date demographic information from a clearly identified source. Additionally, the market study must include an analysis of such data, identifying assumptions, estimates, and projections used in the analysis. Recommendations should be based on market conditions, and not simply build a case for the applicant's proposal. A resume describing the author's qualifications, experience and background must be provided with each market study.

The *National Council of Affordable Housing Market Analysts* (NCAHMA) have provided recommended guidelines for the content of market studies for affordable housing, which are attached for reference and should be used to guide the preparation of the market study.

See NCAHMA Website at www.housingonline.com.

- ***Tenant Services Plan***

For projects with targeted populations that include special needs residents, a service plan must be submitted with the application. The plan should include:

- ***Descriptions of services that are needed for the target population***
- ***How and where the services will be provided***
- ***Information on transportation links to services***
- ***Information regarding the service provision agencies***
- ***Details regarding existing commitments with the service agencies***
- ***Other relevant information.***

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B. FORMS OF CITY SUBSIDIES AVAILABLE AND ELIGIBLE USES

- **Loans**

In the event the proposed project is deemed to generate sufficient cash flow from operations in the future to support debt payments, the City will provide subsidy funding in the form of a low-interest rate loan. The City will evidence the project loan with a promissory note detailing the repayment requirements of the borrower. The note will be secured by a deed of trust recorded against the project.

- **Conditional Grants**

Grant funds may occasionally be available to assist projects that target Extremely Low Income residents.

In the event the proposed project is deemed to generate insufficient cash flow from operations to support debt payments, the City may provide subsidy funding in the form of a conditional grant. The City will evidence the grant with a Grant Agreement detailing the terms and conditions for maintaining the grant, and a Deed of Trust to secure the Grant Agreement.

In certain cases, the City may elect to provide a combination of both loans and grants to a single project.

- **Eligible Uses of City Subsidies**

City funds may be used solely for reasonable costs directly related to the acquisition, construction, rehabilitation or preservation of affordable housing in San José. The City will determine, at its sole and absolute discretion, costs deemed excessive or unreasonable or uses deemed ineligible.

The general categories of eligible costs are those for:

- Predevelopment
- Land acquisition (see “Approval of Land Transaction and Site Control”) and predevelopment
- Hard and soft construction uses
- Permanent financing / commitments
- Acquisition and rehabilitation of existing properties
- Relocation

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- Preservation and extension of affordability

Although these costs are allowable uses of City funding, general funding availability for different types of projects (such as new construction, acquisition/rehabilitation, etc.) varies according to the City's current Notices of Funding Availability. Check the City's website, www.sjhousing.org, for current NOFA definitions of eligible project types.

City funds will be permitted to pay for development expenses only after all other sources of permanent financing have been committed, and development costs have been incurred.

C. PROJECT CHARACTERISTICS AND DETERMINATION OF LOAN / GRANT AMOUNTS

The amount of funding the City may provide for a project is dependent on several factors. The amount of City funding available for a proposed project will depend upon the proposed project's type, potential financing structure, affordability mix, and availability of outside funding sources, as well as the City's funding capacity, established funding limits, and other factors. Some of the major factors that determine the loan or grant amount are further described below:

- **Type of Project and Population Served**

The City is interested in supporting projects that propose to serve the City's greatest needs for affordable housing. In this regard, the funding amount available for a particular project may, in part, be based on the population served by the project.

A project sponsor must demonstrate in its financing application that the proposed project is needed and that sufficient demand exists for the targeted population in the neighborhood or the market area in which the project is being proposed. A project sponsor must demonstrate such demand by providing independently prepared documentation, including a market study, rental survey or other alternate information to the City along with their funding request. See Section One regarding Project Feasibility.

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- **Income Limits and Affordability Mix**

In determining the funding amount for projects, staff will consider the type of project, population served and the rent restriction levels proposed for the tenant population. Generally, the lower the income levels and rents for the population served by the project, the higher the per unit subsidy for that project that staff may evaluate.

- **Financing Structure**

One of the goals of the Project Development Program is to minimize the amount of City subsidy funding provided to a particular project. In order to accomplish this goal, a project sponsor will be required to seek other outside sources of funding in order to fund their project with as much as possible with non-City funding sources. These outside funding sources must be flexible in their requirements and in sufficient amounts to both minimize the City's subsidy contribution and also ensure the long-term feasibility of the project.

- **Funding Availability and Restrictions**

Due to the scarcity of resources available to fund City subsidy loans and grants, the City may, from time to time, place restrictions on the total amount of City funding allocated for a particular project. Furthermore, the City may only fund projects up to a certain number of units (e.g. 50 units or less), to ensure a high number of projects are funded and that these funds are evenly disbursed throughout the City. It is anticipated that such funding restrictions will be established periodically through the City's Notice of Funding Availability cycles.

- **Loan or Grant Amounts and Limits**

Loan or Grant amounts and limits are negotiated on a project-by-project basis. The City may publish limits for projects at the time when the City issues a Notice of Funding Availability.

D. GENERAL TERMS, CONDITIONS, AND RESTRICTIONS

The City may require specific terms, conditions and restrictions through the issuance of a NOFA that differ from and/or may be in addition to these General Terms, Conditions, and Restrictions. Those specific NOFA

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provisions will supercede and/or be in addition to the provisions described herein for the duration of the NOFA.

- **Term of the Loan**

The City may provide Construction financing for a period of up to three years for construction and lease-up of the project.

The City may provide Permanent financing, in conjunction with Construction financing or alone. The typical term is 30 years, but should be no greater than the term of the senior permanent loan.

For projects using Multifamily Housing Program funds from HCD, the City's Permanent loan term will correspond to that defined in the MHP regulations, typically 55 years.

The term of City loans will be based on the type of the loan and may be negotiated based upon the project's ability to repay.

If the entire principal balance of the City's loan cannot be retired through cash flow payments during the identified term of the loan, the project sponsor must demonstrate the ability for the City's loan to be retired within 12 months of the end of the loan term through a loan refinancing. Assumptions regarding the new loan—including underwriting DCR, interest rate, and term—must be clearly articulated and acceptable to the City. The pro forma must demonstrate the ability for the loan to be taken out in its entirety given the underwriting assumptions defined within this Manual.

- **Repayment Terms**

Loan repayment can be fully amortizing, deferred payment, residual receipts or any form suitable for a particular project. Generally, permanent loans are generally simple interest, residual receipt loans with all interest and principal paid yearly and due in full at maturity. In the case where the City provides subordinate loans, repayments may be deferred in priority to primary mortgage lender's payments. In the case where the City has approved the deferral of developer fees, City loan repayment may be subordinated to repayment of these deferred fees until the allowed maximum developer fee is attained (see Section III Part IV(B)).

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- ***Interest Rates***

Interest rates on loans are generally 4% simple, but should never go below the City's cost of funds. Interest rates can range from zero percent to amounts as set forth by the Director of Housing's the Delegation of Authority or as approved by the City Council. All construction period interest on City loans is due and payable at conversion to the permanent period.

- **Affordability Restriction**

The City shall record a deed restriction on the property describing the affordability levels the project shall maintain. For rental projects, this restriction shall be no less than 55 years. For ownership housing, this restriction shall be no less than 45 years. As allowed by California Law, the deed restriction may be subordinated to another secured debt instrument in the event the project would be otherwise infeasible.

- **Deed of Trust**

The City shall record a deed of trust against the property as security for the loan evidenced by a promissory note. The deed of trust will be subordinate to the Affordability Restriction. The deed of trust shall have priority over any other secured debt instrument filed against the property. As allowed by California Law, the deed of trust may be subordinated to another secured debt instrument in the event the project is deemed to be infeasible otherwise.

- **Ten percent of units with Section 8 preference**

The City requires that a minimum of 10% of the units in the proposed project maintain priority occupancy for tenants holding HUD Section 8 vouchers. In the event the sponsor has provided notice to the Section 8 voucher program administrator for the City (currently the Housing Authority of the County of Santa Clara) of available vacant units at the project and there are no qualified Section 8 voucher holders seeking occupancy at the project, the sponsor may lease any such units to a non-voucher holding qualified household. In the event the occupancy in the project of Section 8 voucher holders falls below 10% of the total units of the project, the next vacant unit must be made available on a priority basis to Section 8 voucher holders.

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- **Assignment of Personal Property and Rents, UCC filing**

The City shall take an interest in any and all personal property associated with the project as well as a security interest in rents and income. This security interest may be evidenced by a UCC filing with the State of California. As allowed by California Law, the security interest in personal property and rents may be subordinated to another secured debt instrument in the event the project is deemed to be otherwise infeasible.

- **Consideration**

Any concession on terms by the City that would otherwise be to the City's detriment -- such as reducing an interest rate -- requires that the sponsor compensate the City by providing consideration that will benefit the public good. Examples of consideration may include, but are not limited to, deeper affordability targeting, an increase in the City's residual receipts split, or lengthening of the project's affordability restrictions.

IV. DEVELOPMENT TEAM EXPERIENCE AND CAPACITY

The City may specify developer team experience and capacity requirements through the issuance of a NOFA that differ from and/or may be in addition to the Developer Team Experience and Capacity requirements below. Those specific NOFA requirements will supercede and/or be in addition to the requirements described herein for the duration of the NOFA.

A. Project Sponsor

A sponsor may be an individual, joint venture, general partnership, limited partnership, trust, corporation, limited equity housing cooperative, local public entity, limited liability company, or other legal entity, or a combination thereof. A sponsor may be organized as a for-profit, including limited-profit, or as a nonprofit. A sponsor must provide supporting documentation to demonstrate its ability and experience relevant to owning, developing, constructing, and operating affordable rental housing. Experience in projects with similar funding source types, such as Federal, state or local assistance is mandatory. The sponsor must submit the following information:

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- Information showing substantial participation by the project sponsor in completing at least three similar development projects. The information must include types of projects, locations, dates completed, list of staff members involved, income levels served, number of units, sources of funding, and, for developers new to San José, contact information for references from other municipalities or jurisdictions.
- Most recent three years of audited financial statements for the company and/or its principals.
- In addition, the City may require consent from the company and principals to obtain a third-party credit report and UCC information report.
- Project Manager experience in completing at least two projects of the same general type and at least the same complexity as the proposed project.
- Resumés of key staff members involved in the project.

In the event the project sponsor or applicant has existing project financing transactions with the City that are being administered by the City, the Loan Compliance and Collection Division will provide details of the applicant's financial condition and performance related to existing City affordable housing transactions. If the project sponsor or applicant is deemed to be in substantial noncompliance of existing agreements with the City, the project sponsor or applicant will not be eligible for consideration for project funding and their application will be declined.

If a nonprofit organization is part of the project's ownership structure and intends to obtain the Welfare Tax Exemption, the nonprofit must meet the qualifications set forth by the State Board of Equalization.

B. Architect

The project architect must have design experience with at least three recent and similar projects as the proposed project. The architect must show experience in similar construction types and similar project complexities as the proposed project. Experience in projects with similar funding source types, such as federal Section 202, State MHP or local assistance is desirable, but not mandatory. The architect should submit the following information for review:

- Information showing project architect experience in completing at least three development projects with similar design types and project

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complexities as the proposed project. Information must include types of projects, locations, dates completed, list of staff members involved, income levels served, number of units, and sources of funding.

- Lead architect experience in completing at least two projects of the same general design type and at least the same complexity as the proposed project.
- Resumés of key staff members involved in the project.

C. General Contractor

Although it is not necessary to select the project General Contractor (GC) at the application stage, it is recommended that the sponsor involve the proposed GC as early as possible during the project design stage. The City's expectation is that the selected GC has relevant experience working on housing of a similar design to the project being proposed, and it is highly desirable that the developer have previous experience working with the proposed GC. Experience in projects with similar funding source types, such as Federal, state or local assistance is desirable, but not mandatory. Following the City's approval of funds, the developer shall submit the following information for review:

- Information showing experience by the project GC in completing at least three development projects with similar construction types and project complexities as the proposed project. The information must include types of projects, locations, dates completed, list of staff members involved, income levels served, number of units, and sources of funding.
- Provide evidence of the GC's ability to either obtain performance and payment bonds for the full amount of the proposed contract or provide guaranties for the same.
- A copy of the GC's State of California business license, including the State license number.
- Information specifically related to the GC's experience in successfully completing projects with prevailing wage or Davis-Bacon wage requirements. It is highly desirable that the contractor has experience in this area, but it is not mandatory.
- Lead Project Manager experience in completing at least two projects of the same general type and at least the same complexity as the proposed project.

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- Resumés of key staff members involved in the project, including the on-site Construction Supervisor.
- The Department of Housing reserves the right to approve in writing the project's GC pursuant to the City's Construction Budget Review and Project Monitoring policies and procedures.

It is the City's policy that any construction projects funded by the City will require prevailing wage payments or in the case of Federal funds, Davis-Bacon wage payments. (See Section VI, Citywide Policies and Initiatives.) Any previous unsettled violation of the prevailing wage requirements of the City may disqualify the contractor or any subcontractors from participating in the Project Development Program.

D. Financial Advisor / Consultant

Due to the complexity of many affordable housing financial structures, which involve many layers of funding and strict regulations on the use of those funds, affordable housing developers often hire financial advisors or consultants to assist them in the structuring of their project's financing proposal. Financial advisors or financial consultants also assist developers in understanding how to best utilize the various available resources for affordable housing and provide links to various private funding sources, such as credit enhancement providers, construction lenders, and tax credit syndicators.

As a policy, the City will allow payment for work of financial advisors or financial consultants only from the developer fee. Generally, the work of financial advisors or financial consultants to prepare basic budgets and pro formas does not qualify as an eligible expense for payments or reimbursements with project funds. Project sponsors are expected to have qualified staff who possess these basic skills and to pay this cost as part of the sponsor's corporate overhead.

The cost of an external financial advisor or consultant may be paid for from project funds up to a limit of \$50,000 for for-profit developers, or \$100,000 for nonprofit developers, with any exception made at solely at the City's discretion. The cost of in-house financial advisors or consultants is considered to be part of the organization's cost of doing business, and therefore will be reimbursable only from the project's developer fee.

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E. Property Management Company

Although it is not necessary to select the property management company at the application stage (unless the applicant is proposing to acquire an existing residential rental development), it is recommended that the sponsor involve the proposed property management company as early as possible during the project design phase. In the event the proposed property management company is known at the time of application or prior to the project's permanent financing, the following information should be included in the application:

- Sponsor to complete a City-provided Management Plan checklist prior to submission for approval as property manager.
- Prospective property management company to submit current professional credentials to Department of Housing for review.
- Prospective property management company to submit sample rent roll, monthly income statement and as requested, other sample reports generated by its software system.
- Information showing property management duties in at least three development projects with similar construction types and project complexities as the proposed project. Information must include types of projects, locations, dates managed, list of staff members involved, income levels served, number of units, and sources of funding.
- Information showing Lead Project Manager's experience in managing at least two projects of the same general type and at least the same complexity as the proposed project.
- Resumés of key staff persons involved in the project, including on-site property manager, leasing agent, and maintenance personnel.
- For property management companies new to San José, references from at least three property owners.
- The Department of Housing must approve, in writing, the property management company as property manager of the project. Prior to closing of construction financing, the property manager must prepare and submit for approval a project management plan including sample rental agreements. The Loan Compliance Division of the Housing Department shall review and approve, in writing, the management plan prior to final project business terms and approval of permanent City financing.

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V. APPROVAL OF LAND TRANSACTION AND SITE CONTROL

Generally, the applicant must meet the following conditions to qualify for City financing of new construction or acquisition/rehabilitation projects under the Department's Project Development program and NOFA criteria. For transactions involving acquisition and rehabilitation of an existing property, donated land or a non-market priced transaction, the establishment of a transfer price will be determined on a case-by-case basis.

A. Option or Purchase Contract between unrelated third parties

The purchase price will be established by a written contract or agreement between unrelated buyer and seller and must be an "at-arms-length" transaction. Any transactions contemplated between parties related to the buyer that increase the price stated in the underlying contract or agreement between unrelated buyer and seller, shall not be considered as a valid contract or agreement for the purpose of establishing the purchase price of the land, nor the amount of City funding available for such purchase. Prior to or at the closing of the land transaction, Borrower will be required to confirm by way of a written affidavit that they have no interests in the seller or land being proposed for sale other than the interest contained in the at-arms-length written contact or agreement to purchase. (See the NOFA for an example of the affidavit language.)

B. Appraisal to Validate Purchase Price and/or Loan/Grant Amounts

The value of land proposed for purchase by a sponsor will be established based on an appraisal commissioned by the lender, or may be commissioned by the City, and acceptable to the Department of Housing at its sole discretion.

In no event will the City provide funding for a proposed project where the cost to acquire the land is greater than its appraised value.

The amount of City funds used to pay for the land shall be established by the lesser of (1) the appraised value, or (2) the purchase or option price for the land as established by a contract or agreement between unrelated buyer and seller. In the event there are costs associated with maintaining site control for an extended period of time, such as reasonable financing costs or non-attributable deposits, the City may approve these costs as inclusive

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in establishing the total cost of the land if the sponsor explicitly identified such costs in their funding application budget.

C. Required Deposits and Time Deadlines in Purchase Contracts

In the event the sponsor proposes use of City funds for deposits related to purchase or option agreements, those deposits must be refundable and attributable to the purchase price of the land. In no event will City funds be used for deposits that are nonrefundable or not attributable to the purchase price of the land.

Generally, time deadlines related to option or purchase agreements must allow sufficient time for the sponsor to obtain the necessary environmental and zoning approvals and conduct the necessary public outreach efforts sufficient to ensure that the project can proceed as proposed as well as meet any requirements for use of City funds for the acquisition of the land, including outside funding commitments. These required approvals may include, but not be limited to general plan amendments, environmental (CEQA or NEPA) clearance and PD zoning.

D. Allowable Broker Fees and Closing Costs

As a general policy, fees paid to real estate brokers, agents, their affiliates or related parties shall not be paid or reimbursed with City funds or any other project funds. Any exceptions to this policy may be made on a case-by-case basis and the applicant would need to provide sufficient information to justify a payment or reimbursement of these fees with City funds. Such exceptions may include payment of fees to a real estate broker or agent representing the buyer if there exists a material benefit to the City in doing so. This benefit may include the preservation of an “at-risk” rental development or the acquisition of land that would substantially improve the quality of a development project where the City requires the sponsor to pursue its acquisition.

City loan or grant funds may be used to pay reasonable and customary closing costs, including the cost of title insurance policies and escrow fees.

E. Ownership of Land

In the event that the applicant already has fee ownership of the land anticipated to be developed with affordable housing by an entity related to

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the applicant, the land shall be deemed as the equity contribution of the applicant to the project unless otherwise agreed to by the City.

In the event the applicant anticipates either selling or leasing the land for use in the project and has maintained fee ownership of the land for less than two years prior to applying for funding, the price or net present value will be determined by the lesser of the current appraised value or the last at-arms-length transfer price unless otherwise agreed to by the City.

F. Suitability for Development

Land proposed for an affordable housing project must be suitable for development. Some characteristics of suitability include close proximity to transportation, services, schools, recreational amenities and compatibility with adjacent land uses. In negotiating the cost to acquire land, the developer should keep in mind that the development site should not have extraordinary costs associated with the proposed project, such as higher than typical grading costs due to unusually steep sloping or unstable soil characteristics or extraordinary costs to bring roads or utilities to the site, unless there exists some offsetting characteristic of the land, such as a lower price or there exists a City policy encouraging development at that particular location, that would provide equal or greater public benefit for allowing development as affordable housing.

The City also encourages infill development and the redevelopment of properties that have outlived their useful lives, where economically feasible. This aligns with the City's land use and development policies to accommodate growth without outward expansion of the urban area.

G. Public Outreach

As a matter of City policy, sponsors are required to notify the public and hold public meetings regarding their proposed project. This public outreach gives community residents an opportunity to meet and discuss the proposal and voice their opinion as to the affects of the project on their neighborhood and the surrounding vicinity. Public outreach is a vital part of the affordable housing development process in San José and is coordinated through the Department of Planning, Building and Code Enforcement and the Council Office representing the district where the project is to be located.

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Sponsors are also required to reach out to the neighborhood when their City-funded projects undergo a material change, such as change of sponsor, project concept, rehabilitation, or income targeting. Sponsors should use Planning Department guidelines for public outreach (refer to www.sanjoseca.gov/planning) and work with the appropriate City Council office to keep the community informed and updated.

H. Zoning or Ability to Obtain Zoning

It is the policy of the City to provide funding to acquire land for affordable housing development purposes only if the land purchase being funded by the City has received the necessary Planned Development Zoning approvals (or equivalent land use entitlements) from the Department of Planning, Building and Code Enforcement and a majority vote of the City Council.

The City will not provide funding for land being acquired for “land banking” purposes (i.e. where the City or sponsor does not anticipate immediately proceeding with land development).

I. Relocation Assessment

It is the policy of the Department that any applicant proposing to acquire land using City funds that may result in the displacement of tenants or businesses will be required to fully comply with both State and federal relocation laws, and to provide the following information for the City’s review and approval:

1. At the time of application, an assessment of the potential of displacement of tenants or businesses, including a detailed summary of the number of tenants or businesses and the estimated costs and timing of relocation, along with the name, resume and contact information of the proposed relocation consultant.
2. Prior to acquisition funding, a relocation plan as prepared by a qualified consultant specializing in relocation, who has completed at least three municipally-approved relocation plans, acceptable to the City. In the event State or federal laws require the approval of the governing body, the relocation plan must be approved by the City Council.

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J. Hazardous Materials Assessments and Environmental Indemnity

It is the policy of the Department of Housing that any land acquired with City funds shall require the following assessments and indemnities:

1. All property transactions covered by this administrative policy shall receive a Phase I Environmental Site Assessment, which will be reviewed by the City's Environmental Services Department.
2. All Property Transactions covered by this administrative policy shall receive a Phase II Environmental Site Assessment if the Phase I Environmental Site Assessment recommends the subject property receive further investigation.
3. Any borrower of Department of Housing funds will be required to sign an environmental indemnity in acceptable form and for the benefit of the City. In the event the borrower is not deemed by the City to have sufficient financial resources to honor the indemnity, the City may request that sponsors, principals or other parties affiliated with the borrower provide an indemnity.

VI. CITYWIDE POLICIES AND INITIATIVES

A. PREVAILING WAGE REQUIREMENTS

The policy of the City that was adopted on February 7, 1989 by Resolution No. 61144 requires the payment of prevailing wages to all City housing projects administered by the City's Department of Housing with the exception of the following:

- City housing projects, both new construction and rehabilitation, involving less than eight (8) dwelling units;
- The construction work portion of City self-help housing projects that are not contracted out by the developer.

On January 27, 2004, the City adopted a policy related to certain agreements administered by the Department of Housing regarding implementation and enforcement mechanisms for Prevailing Wage Law requirements. The policy requires the project developer to secure initial compliance documentation and the certified monthly payroll from the contractor prior to disbursement of construction funds. Under these

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agreements, the developer will be required to pay to the City daily liquidated damages in the event the documentation is not provided within the time established in the agreement or in the event that the developer has been deemed to be in non-compliance with the prevailing wage requirements. In no event can liquidated damages be paid by the developer using any project funds, including loan or grant proceeds provided by the City.

In the event the applicant uses other funding sources with wage payment standards, such as state tax-exempt bond allocation (prevailing wage) or federal funding (Davis Bacon) programs, they must comply with the wage payment requirements for those programs.

On February 1, 2005, the City Council adopted Resolution No. 72518 which amended Resolution No. 61716 to extend the City's existing affordable housing prevailing wage requirements also to include projects receiving City funding in the permanent period.

For information on wage rates to be used in City-subsidized projects, please contact the City's Office of Equality Assurance at 408-535-8430.

B. ISSUANCE OF TAX-EXEMPT BONDS

In accordance with the policy adopted by the City Council on June 4, 2002, the City of San José requires that the City be the issuer of tax-exempt bonds for all tax-exempt bond financed affordable housing projects to be located within the City's boundaries. Only certain exceptions may be made, which include:

- The Redevelopment Agency may issue bonds for any project located within a Redevelopment Area;
- If the City is not making a loan or grant to the project and if the project is part of a multiple bond issuance that produces economies of scale, the City may agree to the issuance of bonds by a regional issuing conduit (such as ABAG or CSCDA).
- Special circumstances apply, only at the approval of the City. The other issuer must assume full responsibility for issuance and on-going bond compliance, but the City shall seek to hold the TEFRA hearing.

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This policy does not pertain to projects using CalHFA tax-exempt loans that do not involve the issuance of bonds for the specific project. Such CalHFA loans are simply considered mortgage loans and are closed without need for project-specific issuance or TEFRA.

In addition, developers should be careful to use the City's current bond issuance fee in the calculation of senior permanent loan amounts. *For current fees, please contact the Housing Department's Project Development team at 408-535-8236.*

C. SUSTAINABLE DEVELOPMENT AND GREEN BUILDING

The City of San José encourages building owners, architects, developers, and contractors to incorporate meaningful sustainable building goals early in building design process. By using the United States Green Building Council's Leadership in Energy and Environmental Design (LEED™) Rating System to document sustainable building features, project teams can publicize their progress.

Green Building practices promote the construction of buildings that are healthier for the occupants and healthier for the environment. The City of San José's Green Building Policy establishes sustainability as a City priority and demonstrates the City's commitment to the environment. Sustainable or "green" building practices can reduce the impact that building design, construction and maintenance have on both people and nature. Sustainable building practices go beyond energy and water conservation to incorporate environmentally sensitive site planning, resource-efficient building materials, and superior indoor environmental quality.

Increased project costs associated with Green Building systems, materials, or design, must be reviewed and approved by the City. The basis for such approval includes a cost/benefit analysis. The present value of energy savings and operating and maintenance expenses will be evaluated against increased costs related to installation of Green Building systems.

For more information on the City's Green Building program, contact the City's Environmental Services Department at 408-535-8550. For more information on the Housing Department's involvement in Green Building, please contact the Project Development team at 408-535-8236.

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VII. EVENT PLANNING

In order to make planning for groundbreakings and grand openings go as smoothly as possible and involve leadership throughout the City, project sponsors should follow the following guidelines:

1. Developers should start planning groundbreakings or grand openings at least 3 to 4 months ahead of time.
2. Developers should contact the Department's Marketing and Communications Manager about potential dates to schedule with the Mayor's and Department Director's schedules no less than 2.5 months ahead of time. Developers can also discuss what resources they might need for the event, such as sound systems, podiums, and visuals.
3. Developers should stay in touch with their Councilmember's office to discuss the project generally, but also to schedule with them for events 2.5 months ahead.
4. Once invitations are done, no less than 1 month ahead, they need to send 30 hard copies *and* the PDF file to the Department's Marketing and Communications Director. She will ensure that the invitations are sent to the appropriate parties in the City.

For more information and assistance, please contact the Housing Department's Marketing and Communications Director at 408-535-8234.

SECTION TWO: PROJECT UNDERWRITING

I. OVERVIEW

This section contains the guidelines used by the City staff in reviewing and underwriting proposals for developing affordable rental housing.

II. STAGES OF UNDERWRITING APPROVAL

The City recognizes that a project as initially proposed in an applicant's funding request may not exactly reflect the final project financing structure once the project has been reviewed and approved by all financing participants. In order to account for the movement in these external factors, the City has a procedure to ensure that the project underwriting process can accommodate changes and adapt to the needs of both the applicant and the City in its affordable housing goals. The following are the stages in that process:

STAGE 1 – Preliminary Commitment Application and Reservation

The City is introducing an option for developers—the issuance of a Preliminary Commitment letter before all site entitlements are obtained. This Preliminary Commitment is designed to give developers greater certainty that their projects will meet the City's requirements for funding and that funding will be available once project entitlements are obtained.

Applicants fill out the Preliminary Commitment Application. The City will evaluate the project given current NOFA rules and determine if the minimum score is obtained and if the project meets all other requirements. If so, the City issues a Preliminary Commitment Letter that commits the Department staff to recommend to City Council that the project receive funding at the time it reapplies for a full Commitment once all site entitlements are obtained, so long as no material change in the project occurs and all other conditions in the Letter are met.

STAGE 2 – Application, Initial Underwriting and Fund Reservation

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Whether or not a Preliminary Commitment is obtained from the City, the developer must apply for a full commitment through the City's NOFA process once the project has received its entitlements.

Assuming the project qualifies for a full Commitment and is approved by the City Council, the City will provide to the applicant a Fund Reservation as evidence of the City's conditional commitment to the project. This will allow the project to apply for State and federal programs that allocate grants, tax-exempt bond authority, tax-credits, low interest loans or other outside funding sources.

If the application varies in any way from the policies stated herein, the applicant must disclose as such in the application and request the City's approval for variances from stated policy, which will be considered and approved at the sole discretion of the City.

STAGE 3 – Letter of Intent for Business Terms and Conditions

After the project has received its allocation of financing from State or federal programs, and all of the funding sources and uses have been identified for the project, the applicant will be required to promptly submit an updated Sources and Uses budget and an Operating Pro forma for review and approval by the City.

The City will verify whether the budget and pro forma are consistent with the proposal submitted by the sponsor at the time of application. *Once a project has secured a funding commitment from the City Council, no changes can be made to the project design or affordability mix that will affect the scoring without the consent of the Director of Housing. Such changes made without the consent of the Director will automatically cancel the City's funding commitment.* No changes will be approved which result in an overall score of less than the greater of 70 points or the score of the applicant(s) that had the highest number of points during the funding round who did not receive an allocation. No material increase in the City's funding commitment will be accepted.

If, after review by the City, the project is deemed to require less than the original fund reservation amount, the City will reduce the fund reservation amount accordingly. Upon completion of the review and confirmation of the business terms, the City will issue a Commitment Letter with business terms and conditions.

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STAGE 4 – Final Business Terms and Conditions

Once the applicant, all of the project's lenders, investors, and the City have agreed to final business terms and conditions, and so long as the City's financing amount has not increased and there have not been material changes to the terms of the commitment letter, the City can release draft loan documents. As stated previously, any material changes would require administrative or City Council review and approval.

STAGE 5 – Loan Closing

The City will close its Construction financing concurrent with the closing of the senior debt, investments, and other loans or grants.

The City will close its Permanent financing in a Construction/Permanent loan when all conversion conditions are met. In the case of a Permanent loan only, the City will close its financing concurrent with the senior permanent lender, when all the City funding terms and conditions are met.

III. APPROVAL OF FUNDING SOURCES AND LEVERAGING OF OTHER FUNDS

It is expected that the applicant will leverage outside funding sources to the greatest extent possible to minimize the City's gap funding. During the earliest stages of the project development, the applicant is strongly encouraged to explore as many outside funding sources as possible. The applicant should provide to the City evidence of their activities in soliciting proposals from the various funding sources and/or detailed information supporting their funding assumptions.

Prior to completion of each Stage of the underwriting process, the applicant will provide to the City for review and approval, evidence of funding commitments for the outside funding sources proposed for the project. This section identifies sources of funds and the minimum level of evidence required.

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Funding Source	Stage 2	Stage 3	Stage 4
Construction Lender	Letter of Interest or Letter of Intent	*Conditional Commitment	Final Form Loan Documents
Tax-Credit Investor or Equity Provider	Letter of Interest or Letter of Intent	*Conditional Commitment	Final Form Partnership Agreement
Credit Enhancement Provider	Letter of Interest or Letter of Intent	*Conditional Commitment	Final Form Credit Documents
Permanent Lender	Letter of Interest or Letter of Intent	*Conditional Commitment	Final Form Loan Documents or Take-out Commitment
Others – Private	Letter of Interest or Letter of Intent	*Conditional Commitment	Final Form Documents
Others – Public	Evidence of funding availability and evidence of project competitiveness for fund allocation	Governing body approval and an allocation letter reserving funds	Final Form Documents or Take-out Commitment

**Conditional Commitment—Conditioned upon final formal committee approval of outside funding sources and final City Funding Commitment only.*

- **Construction Loan**

Applicants are required to actively solicit bids from prospective construction lenders in order to best leverage the use of construction funds while also working to minimize interest expense, credit enhancement costs, and lender fees incurred by the project. Applicants shall contact at least three different construction lenders to compare the various terms and conditions to see which loan program may work best with the proposed project.

- **Permanent Loan (Conventional mortgage loan or tax-exempt bond proceeds)**

Applicants are required to actively solicit bids from prospective permanent lenders in order to best leverage the use of bond proceeds or private mortgage loans for their proposed project. Although applicants are not encouraged to use bank loans or tax-exempt bond proceeds for debt leveraging that would jeopardize the long-term viability of the project, they are encouraged to seek out the most competitive terms and conditions that allow for the maximum leveraging of project cash flow, while ensuring the long-term viability of the project operations.

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A project must have sufficient value to provide security to the primary hard debt lenders. A sponsor must be able to show evidence that the project as proposed meets this requirement. The sponsor can show this by providing preliminary commitment letters from lenders and/or an appraisal by a qualified appraiser showing that sufficient due diligence has been conducted to qualify the project for the proposed hard debt amount.

The City will allow leveraging of these hard debt funds to the extent that the cash flow projected from the operations of the project will result in a Debt Service Coverage Ratio of at least 1.10, but no greater than 1.20~~30~~.

In the event the sponsor chooses a permanent lender that provides a loan in amounts lower than the highest lender bid or at an interest rate, debt coverage ratio, or cost that is higher, the sponsor must provide information to the City, in sufficient detail, explaining the greater benefit to the project of that lender's proposal.

- **Loan-to-Value**

The permissible Loan-to-Value ratio for construction loans shall not exceed 100% of value, including both hard-pay and all soft-pay debt.

For purposes of underwriting the construction loan on a LIHTC project, value used shall be As-improved with Restricted Rents incorporating value for Below-market Financing, or should follow the methodology employed by the senior construction lender.

The permissible Loan-to-Value ratio for permanent loans shall not exceed 90% of value, including both hard-pay and all soft-pay debt.

For purposes of underwriting the permanent loan on a LIHTC project, value used shall be As-improved with Restricted Rents, or should follow the methodology employed by the senior permanent lender.

- **Appraisals**

Sponsors must provide a current appraisal prior to the closing of the City's construction loan. The appraisal must be commissioned by the senior lender or by the City, funded through project costs, and performed by a reputable agency that is acceptable to the City. The appraisal must address unit type demand at the submarket level (or other geographic area if deemed more appropriate), and must provide unit comparables of other

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restricted affordable apartments. The valuation methodology should assess:

- Value of unimproved land
- Value as-improved without rent restrictions
- Value as-improved with restricted rents
- Value of below-market financing
- Value of tax credits
- Value of commercial space, if any.

The City should be consulted in determining the scope of appraisal to ensure it meets the City's underwriting needs.

For purposes of the appraisal, "current" means that is no older than 6 months old. As San José's real estate market can change rapidly, an update for appraisals less than six months old may be appropriate for purposes of accurate valuation.

For leasehold properties, appraisals should define market value and estimate the property's below-market value.

The appraisal valuation, whether for fee simple or leasehold properties, should support the amount of the first-priority loans as well as the City's loan amount. (See the Section on Loan to Value.)

- **Tax Credit Equity Commitment**

Applicants are required to actively solicit bids from prospective tax credit equity investors. As with construction lenders, the applicant shall contact at least three different tax credit equity investors or syndicators to compare the various terms and conditions, such as tax-credit factors and pay-in schedules, to see which investor or syndicator may be able to provide the most beneficial tax credit equity contributions for the proposed project.

In the event the sponsor chooses the tax credit investor that provides equity in amounts lower than the highest equity bid, the sponsor must provide information to the City, in sufficient detail, explaining the greater benefit to the project of that investor's proposal.

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- **Deferred Developer Fees**

If, due to unforeseen circumstances, prior to the closing of the construction loan or during the course of construction, the project budget becomes out of balance, the City may allow deferral of developer fees as a source of funds to rebalance the project budget. In the event development fee is deferred, the priority of payment of these fees will only be allowed under the following situation.

Priority Repayment of Deferred Developer Fee

The City will allow the deferred portion of developer fees to receive a priority repayment from net cash flow ahead of repayment of the City Loan in the case that:

1. The total developer fee amount adheres to the City's limits (see Section IV(B)).
2. The deferred portion of the developer fee was used to calculate eligible basis to determine tax credits, received tax-credit equity, and can be paid out within sufficient time to preserve the tax credits.

In this case, the deferred and unpaid developer fee shall be allowed to earn interest calculated at a rate up to the amount necessary to satisfy federal tax requirements, such as the Applicable Federal Rate ("AFR").

- **Lease-up Income**

Lease-up income is defined as cash flow from the project operations prior to the conversion of the primary construction loan to a permanent loan. Lease-up income need not be shown as a source of funds for budgeting purposes; however, borrower must submit details of lease-up income amounts prior to conversion to permanent loan. Lease-up income can only be used to pay construction loan interest or reduce the City's permanent loan.

- **Equity Contributions**

Any contributions of equity to the project must be thoroughly documented. In the case of cash equity contributions, the sponsor must show evidence of available funds, such as the most recent bank account statement where the funds are being held. In the case of equity contributed

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in the form of real property, the equity amount will be based on the net difference between the appraised value of the real property and the amount of City funds proposed to be used to acquire the real property pursuant to the Section on Approval of Land Acquisition and Site Control.

- **Reimbursables and Deposits**

Reimbursements to the project, such as CDLAC deposits and utility deposits, may be used to pay other costs in the project budget. In order to use these funds to pay project budget items, the reimbursement must be identified as both a source and use of funds in the project budget; otherwise, the refunded amounts can only be used to reduce the amount of the City's subsidy.

- **Fee Reimbursements or Exemptions**

The City provides for certain exemptions from Parkland Impact Ordinance and Parkland Dedication Ordinance. The City also provides waivers of construction taxes for very low-income units developed. These fees may be included as a source of funds if they are also classified as a use of funds. The sponsor should consult with their tax advisor on the proper accounting and income tax treatment for these various items.

Housing staff must obtain the Director of Housing's approval for inter-departmental correspondence authorizing fee reimbursements or exemptions.

IV. APPROVAL OF PROJECT BUDGETS, PRO FORMAS AND DRAW SCHEDULE

Prior to completion of each Stage of the underwriting process, the applicant will provide to the City for review and approval, detailed budget information for the project. The budget information provided during Stage 3 will be certified by the borrower as being true and correct and will be incorporated into the funding documentation. This section identifies budget information and the minimum level of supporting documentation required:

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Budget Information	Stage 2	Stage 3	Stage 4
Total Uses Budget	Initial Budget	Updated Budget with Supporting Information	Certified Final Budget
Construction Budget (see Section Three for detailed requirements)	Initial Budget and Plans	Proposed Construction Contract, Plans and Updated Budget for City Review	Executed Contract and Budget Approved by City
Schedule of Rents	Initial Schedule, Current Rent and Income Limit Schedule, Current Utility Allowance Schedule	Updated Schedule, Current Rent and Income Limit Schedule, Current Utility Allowance Sched.	Certified Final Schedule of Rents
Operating Budget	Initial Budget with Market Information or Market Study	Updated Budget with Market Study	Certified Final Budget
Operating Pro forma	Initial Pro forma	Updated Pro forma	Certified Pro forma
Lease-Up Budget	Initial Budget	Updated Budget	Certified Budget
Fund Draw Schedule	Not Needed	Not Needed	Certified Fund Draw Schedule

A. AFFORDABILITY, RENT, AND INCOME LIMITS – APPROVAL OF SCHEDULE OF RENTS

It is expected that the applicant will provide the deepest levels of affordability practical for the proposed project. This can be accomplished by maximizing outside funding sources geared towards achieving deeper affordability, such as HCD – MHP program funds, HUD funds, or TCAC 9% tax credits. Deeper affordability targeting can also be achieved by capping annual rent increases during the operating period for the project to the extent feasible, yet prudently, so as to not negatively impact the physical condition or long-term viability of the project. Efficient design during the pre-construction process, quality materials and workmanship during construction, along with careful property management during operations, will also assist in minimizing operating costs allowing the sponsor to minimize annual rental increases and keep rents below annual HUD limits.

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- **Rental Affordability Targets**

Generally, the City encourages deeper affordability levels to meet the most critical housing needs and to ensure that units are marketable. The City recognizes, however, that leveraging of outside funds is dependent on cash flow generated from rents, which allows the City to minimize the subsidy amounts. Generally, the minimum affordability levels for rental developments is 20% at 50% of Area Median Income and 80% at 60% of AMI. One unit in the project will be allowed to remain unrestricted and used as a manager's unit. If additional unrestricted units are proposed, based on a high number of units at the project or the need for on site service providers, the City may approve an increase in the number of unrestricted units on a case-by-case basis.

- **Rents as Compared to Market Rents**

Pro formas should include a comparison of proposed rents to market rents for each type of unit at the submarket level, and a calculation of the percentage above or below market rate. Regardless of maximum rents allowable according to HUD or LIHTC rules, rents should be no less than 10% below market rents for a given type and size of unit unless expressly permitted by the City.

Market rent levels should be derived from the appraisal for units of like amenities and similar location, and should note current vacancy rates.

- **Utility Allowance Schedule**

In determining the utility allowance for the proposed units, the applicant should use the most current published schedule from the Housing Authority of the County of Santa Clara.

- **Miscellaneous Income**

The applicant should show the details of any miscellaneous income expected to be generated from the project. This income could include laundry machine income, storage, or other non-housing related income sources.

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- **HUD and State Published Current Income (Rent) Limits**

In determining the rental rates and affordability for the proposed units, the applicant should use the most current published schedule from HUD and the state.

B. PROJECT OPERATING CHARACTERISTICS–APPROVAL OF OPERATING BUDGET AND PRO FORMA

The operating budget and pro forma provide information about the anticipated operating characteristics of a proposed development project. The operating budget is required to show the details of the project's operating characteristics for the first full year of operations and should include gross revenues, vacancy loss, other revenues, detailed operating expenses, replacement reserves and net operating income.

For long-term projections of cash flow, the operating pro forma is required. The operating pro forma shows the anticipated revenues, operating expenses, capital expenses, other expenses, debt service and cash flow of the proposed project. The operating pro forma must be prepared prior to the finalization of business terms and conditions and must show annual operating projections of the project for no less than the length of time it takes to repay the City loan. Some general operating assumptions used by the City in reviewing operating budgets and pro formas are described below.

Note that all pro formas should be provided to the City in Excel versions with visible formulas. Sponsors may opt to lock the spreadsheets prior to sending.

- **Vacancy Rate Assumptions**

Projects shall be underwritten with a vacancy rate assumption appropriate for projected market conditions and unit mix, but shall be no less than 5% of Gross Potential Rents for all projects. The exception is for Single Room Occupancy projects, which shall have a vacancy rate assumption of 10% unless otherwise determined by the City at its sole discretion.

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- **Total Operating Expenses (Minimum and Maximum)**

Total operating expenses shall be no less than the current minimum amounts allowed by California Tax Credit Allocation Committee, California Debt Limit Allocation Committee, California Housing Finance Agency, or MHP. Total operating expenses shall be no greater than \$5,000 per unit per year unless there exists operating characteristics or other factors that warrant a higher expense budget per unit. Some factors warranting a higher expense budgets include a greater number of large family units (3+ bedrooms) or changes in non-controllable expenses, such as increased property and liability insurance premiums, property taxes or utilities charges which affect the property management industry as a whole. Some factors not warranting a higher expense budget include incentive management fees, tenant services costs, or higher than industry standard property management fees or staff salary expenses.

- **Revenue and Operating Expense Inflaters**

The pro forma revenues should not be inflated by more than 2.5% per annum. The pro forma operating expenses should not be inflated by less than one percent (1%) higher than the pro forma revenues. For example, in the case operating revenues are inflated by 2.5% annually in the pro forma, the operating expense inflator cannot be less than 3.5%.

- **Replacement Reserves**

Total replacement reserves shall be no less than \$250 per unit or the current minimum amounts allowed by California Tax Credit Allocation Committee or California Debt Limit Allocation Committee, whichever is greater. The maximum shall be no greater than \$350 per unit per year unless property characteristics or market conditions that warrant a higher reserve budget per unit, or the requirements of the most competitive outside financing sources identified for the project have higher reserve requirements. A higher reserve budget may be warranted if there is a high proportion of large-family units (3+ bedrooms) in the project, which may result in accelerated replacement requirements for the building or its systems. A higher reserve budget may also be warranted if the City determines, at its sole discretion, that the total financing structure as proposed requires less City subsidy funding on a per unit basis than the next-best financing structure available for the project.

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- **Property and Incentive Property Management Fees**

Property management fees above and beyond industry standard are not allowed as an operating expense in the project budget, and are typically 5% of effective gross income. The City may consider increased property management fees if the project serves extremely low-income residents, resulting in lower gross revenues than a very low or low-income project. Other conditions that may warrant higher property management fees include intense service-related components such as special needs housing. The City will consider these exceptions on a case-by-case basis. No other property management fees budgeted, such as incentive property management fees, shall be permitted as an eligible operating expense. Such fees shall only be deducted from the developer's share of residual receipts.

- **Debt Service, Debt Coverage Ratio, and Interest Rate**

In the event the project sponsor proposes hard debt for the project, the budget must show sufficient cash flow to pay debt service on the proposed hard debt. The debt coverage ratio for the hard debt shall be in the range 1.10 to 1.30 after deducting operating expenses and replacement reserves. The interest rate on the hard debt must be competitive with the prevailing market interest rate for similar financing structures with similar risk characteristics.

- **Partnership or Asset Management Fees Allowed**

The developer is allowed a deduction of Partnership or Asset Management Fees during the period of managing the tax-credit partnership, which is typically 15 years for federal tax credits. To pay this expense, the developer will be allowed to either budget an expense of up to \$30,000 per annum with no inflation adjustments for the tax-credit period or \$25,000 per annum adjusted for inflation at a rate not to exceed 3.5% annually. This amount should also cover any LP Asset Management Fees, if assessed.

Any additional Partnership, or Asset Management Fees can only be deducted from the developer's portion of residual receipts.

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- **Deferred Developer Fee**

In the event the developer fee is deferred due to unanticipated funding shortfalls, the City may allow the deferred fee to receive priority repayment from project residual cash flow prior to the repayment of the City loan if necessary to preserve fee amounts used in the eligible basis computation for tax purposes. Interest can only be charged at the Applicable Federal Rate (AFR) for any deferred developer fee note. Any other priority repayment of deferred developer fee is subject to City review and approval at its sole discretion.

- **Commercial Income**

So as to protect the financial condition of affordable housing units in mixed-use properties, projected income from commercial spaces should be clearly excluded from underwriting assumptions of housing units. Commercial space should be condo-ized and underwritten separately from housing.

An exception may be made for daycare spaces that are available only to the residents of the project. Project income projections may include that from the daycare space, and other City underwriting exceptions may be sought depending upon provisions of the daycare financing.

- **Ground Lease Expense**

In the event the project is to be developed on leased land and the lease transaction is, in part or in full, a hard-pay obligation for the project, the lease payment shall be subject to the same loan-to-value requirements as hard debt obligations.

Terms of the leasehold are subject to City approval, so developers should keep the City fully informed during negotiations with lessor, particularly regarding any payment structures that may adversely affect the City's residual receipts payments.

- **Tenant Services Expense**

Any expenses for tenant services will be paid from the developer's split of residual receipts. An exception will be allowed for projects targeting special-needs populations where tenant services are a necessary

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requirement for the special-needs population or required under the City’s zoning requirements. If required by another subordinate funder or City entity, these services are allowed to be paid as a permitted expense, but should be excluded in lenders’ calculation of Debt Service Coverage Ratio.

- **Residual Receipts and Repayment of City Loan**

The previously described expenses are the only expenses the City will allow to be included in the operating budget or pro forma prior to the distribution of cash flow to repay the City loan. The standard residual receipt split for repayment of the City loan is 50% to the City and 50% to the sponsor. In the case repayment of non-City subsidy soft funding (e.g., HCD-MHP or the Santa Clara County Office of Affordable Housing), the City will share, as may be required, the 50% of residual receipts not going to the sponsor in proportion to relative sizes of all the soft funding loans to the project. In order for sponsors to be appropriately incentivized to maintain properties for the long-term, sponsors should get 50% of residual receipts without prior City approval, except a lesser split to the borrower is necessary to ensure the project’s financial feasibility.

C. PROJECT COST BUDGETING – APPROVAL OF USES OF FUNDS AND DRAW SCHEDULE

The applicant is required to provide a detailed breakdown of the anticipated uses budgets for the proposed development project. At the time of application submittal to the City, to the extent possible, the applicant should include the details of each of the budgeted line items in the proposed uses budget. Two weeks prior to the finalization of business terms and conditions, the applicant will be required to submit a detailed uses budget, including all supporting documentation required by the City for review and approval (“Closing Budget”).

For a project that has affordable units on one portion of a larger site, all costs that are reflected in the affordable project’s budget should be only those relevant to the affordable project. The City will approve the developer’s methodology of separating costs. In addition, any project that incorporates non-housing uses, such as space for commercial businesses or service providers, must split out costs for each type of space on the Sources and Uses.

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USES OF FUNDS

- **Land**

Land costs should include a detailed breakdown of land, title and recording costs and any reasonable carrying costs associated with land financing. Land cost does not include title and recording costs for loans made to construct improvements.

- **Hard Costs**

- Offsite Costs, Demolition and Remediation

Offsite costs, demolition and remediation should include detailed costs to remove existing structures from the site, remediation of hazardous materials and provide for improvements that are not directly on the project site, such as bringing utilities to the site and traffic mitigation measures Such as traffic signals, crosswalks, etc.

- Site Improvements and Construction

Site improvements and construction costs should include site preparation, irrigation and landscaping, parking, and residential structures. Costs for any commercial portion of the project must be itemized separately in the budget, as the Department’s usual funding sources are prohibited from paying for commercial costs.

- Contractor Profit, Overhead and General Conditions

Applicant must submit a budget of contractor overhead, profit and general conditions. The contractor profit cannot exceed 6% of the total contract for site improvements, offsite improvements and building construction, and is further limited in the table below.

	Portion of Contract & Corresponding Profit Allowed on that Portion		
	\$0 to \$10MM	>\$10 to \$15MM	Over \$15MM
Total Contract			
Up to \$10MM	6%	N/A	N/A
Up to \$15MM	\$600K +	5%	N/A
Over \$15MM	\$600K +	\$250K +	4%

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For example, the profit cap on a \$25 million contract would be calculated as follows:

$$\begin{aligned} &\text{Profit on } \$25\text{MM} \\ &= \$600,000 + \$250,000 + (4\%)(\$25\text{MM}-\$15\text{MM}) \\ &= \$850,000 + \$400,000 \\ &= \$1,250,000 \text{ maximum contractor profit} \end{aligned}$$

Combined contractor overhead and general conditions cannot exceed 8% of the total contract for site improvements, offsite improvements and building construction. Overhead and general conditions are not typically to include purchase of capital items with an expected life of over 12 months. Overhead and general requirements must be broken out into specific line items. If actual costs needed to support the builder's presence on the site total less than 8%, the project budget must reflect only actual costs. Sponsor should provide details of any proposed capital expenditures for equipment and proposed budgeted project staffing allocations onsite and offsite. Budgets are subject to the City's review and approval.

- Payment and Performance Bond

Payment and performance bond is required in coverage amounts and from a surety approved by the City. The sponsor may substitute a payment and completion guarantee from a credit-worthy project participant(s) for the payment and performance bond requirements. Approval of such substitution is at the sole discretion of the City. Payment and performance bond costs must be excluded from the General Contractor's contract.

- Furniture, Fixtures and Equipment

Detailed list of all furnishing, fixtures and equipment must be submitted to the City for review and approval and must be excluded from the General Contractor's contract.

- Construction Contingency Reserve

Construction contingency fund cannot exceed 5% of the direct construction costs and must be under the sole control of the borrowing entity. The City will reserve the right to approve any

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funding request from the contingency reserve. Hard cost contingency must be excluded from the General Contractor's contract.

- **Soft Costs**

Soft costs are costs not directly related to the acquisition of land, site improvements or construction of buildings. These costs are related to professional work, such as architectural & engineering, financing, governmental fees and permits, developer fees, reserves, etc. Limitations are placed on certain costs as described below.

- Legal Fees

In most cases, legal fees paid by the borrower from project funds for real estate, partnership creation and tax credit syndication cannot exceed \$75,000 unless agreed to by the City in advance. The City may agree to legal fees up to \$100,000 as a project expense if the financial structure proposed for the project is of greater legal complexity than a typical project, and is deemed to be more cost effective for the purpose of leveraging City funds. Legal fees in excess of \$100,000 shall be allowable only with prior City authorization and shall be supported by the provision of invoices for past and projected work by the relevant law firms.

Legal fees cannot be paid or reimbursed with City funds for legal services provided to sponsor regarding disputes, litigation, or litigation preparation, either direct or indirect, of any terms or conditions of existing project loans or grants provided by the City.

- Financing and Issuance Costs

Detailed financing and issuance cost budgets must be provided to the City for review and approval. The total financing and issuance costs must be reasonable and subject to approval by the City

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- Reserves

Reserve accounts, such as lease-up, marketing or operating reserves are allowable to the extent they are necessary to meet the reasonable underwriting requirements of senior lenders and tax credit equity providers based on a lease-up and operating pro forma supported by a market study or appraisal performed to the standards required by the City.

- Soft Cost Contingencies

The soft cost contingency reserve cannot exceed 3% of the total project soft costs, and the City will reserve the right to approve any funding requests from the contingency reserve.

- *City Construction Interest*

Adequate funds must be budgeted in the construction budget for the full payment of City construction loan interest at the conversion to permanent period financing. If City funds are designated as the source of payment of City construction interest, the City will hold back the estimated interest charges from disbursement of approved City loan funds. If another source of funding will pay for City construction interest, the City will not hold back funds for City loan interest—however, the developer should continue to plan for the City to hold retention on certain hard cost line items as discussed in Section Three of this Manual.

- Developer Fee

The developer is the central member of the development team who is responsible for coordinating all aspects of the transaction, and generally is responsible for budget preparation, funding application preparation, compliance with funding requirements, overseeing timely and completed construction of the project and other technical details during development. If qualified, the developer may assume other roles, such as general contractor, property manager, and general partner of the partnership that owns the property.

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Developer fees include developer overhead, profit and fees for the services normally performed by a developer, such as obtaining land entitlements, project budgeting, arranging project financing and other technical project duties. Developer fees also compensate for fees paid to parties hired by the project sponsor to fulfill part or all of the roles of the developer. An exception for Financial Advisor / Financial Consultant fees is allowed up to the limits as previously described.

As an incentive, an applicant should receive a reasonable developer fee for completing and leasing the proposed project. Because this incentive is vital to encourage applicants to take on the project risks, the City does not encourage deferral of developer fees as an initially defined source of funding for a proposed project.

The developer fee shall be paid only upon closing of all permanent financing and upon the City's review and approval of final cost certifications. Exceptions will be allowed for earlier payment of a portion of developer fees if agreed to by all funding sources as follows: up to \$100,000 for for-profit primary sponsors, or up to \$200,000 for non-profit primary sponsors, at the closing of construction funding.

The total developer fee allowed by the City shall not exceed the amount allowable in tax credit basis by TCAC (see TCAC Regulations Section 10327).

The developer's contribution of equity reflected in the project's Sources and Uses may include the dollar value of any capital or real property contributed by the sponsor or an affiliate for project development costs, and supported by appraisal or other appropriate documentation as requested and approved by the City.

If the developer defers part of the project developer fee allowable under the City's guidelines, the deferred amount may be taken in a priority position above the City's loan repayment until the full allowable developer fee is taken. For example, if the allowable developer fee as defined by the City is \$1.4 million, but the development budget can support only a developer fee of \$900,000, the difference of \$500,000 may be taken out of the developer's, the

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City's, and other lenders' share of cash flow until that amount is recaptured.

However, if the developer fee reflected on the development budget exceeds the allowable amount calculated based on the established limits cited in Sections 1 through 3 above, and is not offset by the provision of additional developer equity, the overage shall be deferred and payable over time only from the developer's share of operating cash flow, as defined in these policies and procedures.

Alternatively, if the developer shows a developer fee in the budget that is higher than the City allows, but which adheres to that limit for another project funder, it is allowable as long as the developer contributes the difference between the two limits as equity to the project, and indicates this in the project's list of Sources. For example, if the developer fee allowable to the City is \$1.4 million but the development budget shows a \$2.5 million developer fee, the sponsor must put \$1.1 million in equity into the project's Sources.

Further, the amount of the City's gap loan must therefore be reduced commensurately so as to balance Sources and Uses, given the increase in Sources from the developer's contribution.

For purposes of defining allowable developer fee, for projects incorporating two distinct properties, the definition of what constitutes one project versus two will be determined on a case-by-case basis, and will consider the following criteria:

- Timing of construction
- Location of relevant parcels
- Differences in financing structures
- Number of loans and investments being underwritten
- Numbers of sets of documents being produced.

○ Relocation Costs

Relocation costs must be supportable by relocation assessment provided by a qualified consultant specializing in California

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relocation under UCC law and a relocation plan as approved by the City.

- Reimbursement of Previous Expenditures

Funds from the City subsidy funding can be used to reimburse the applicant's previously expended funds specifically related to the proposed project, such as land acquisition and carrying costs, architectural and engineering costs, legal fees, and consultant fees up to the limits allowed by the City. City subsidy funds cannot be used to reimburse an applicant for corporate expenses, such as salaries, overhead or operating expenses or for contract expenses for services that are typically provided by the sponsor.

- **Examples of Ineligible Uses are Described Below:**

- Nonrefundable deposits and deposits not attributable to the purchase price
- Developer overhead and administrative expenses
- Consultant fees, with the exception of reasonable fees paid for architectural and engineering, appraisals, environmental, hazardous materials costs which directly related to the planning and execution of the project and are incurred through a third-party contract and financial advisor / consultant fees on a limited basis as described further in this chapter.
- Offsite improvements not required under the Plan Development zoning or Plan Development permit
- Nonresidential uses or land allocated for nonresidential uses.
- Excessive attorney fees or attorney fees not specifically related to the review of legal documents necessary for completion of the financing of the project.

MASTER DRAW SCHEDULE

The master draw schedule shows the anticipated funding amount, timing and sources for the proposed project. The applicant need not provide a detailed draw schedule at the time of funding application; however, a draw

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schedule should be submitted at least two weeks prior to the close of project funding.

Construction loan draws anticipated to occur shortly after construction loan closing must be submitted according to rules established in Section III, Part IV of this Manual.

SECTION THREE: CONSTRUCTION BUDGET REVIEW
AND PROJECT MONITORING

I. OVERVIEW

The purpose of this chapter is to describe the policies and procedures employed by the Department of Housing to facilitate the review and approval of project budgets, plans and specifications; provide the applicant and their contractor a clear understanding and defined time deadlines for the delivery of the complete set of documents that are required for construction budget review and approval; allow for analysis of possible value engineering and cost savings opportunities; ensure that the project progresses through construction and to completion efficiently with minimal deviation from the approved budget, plans and specifications; and the compliance requirements for the City's prevailing wage ordinance.

There are four stages of project review and monitoring.

- Initial Application Submittal
- Pre-Closing Document Review
- Monitoring During Project Construction
- Project Close-out

Please note that the last three stages of review and monitoring may be performed by a consultant assigned by the Department of Housing. The cost of the consultant is the responsibility of the applicant. For budgeting purposes, the applicant should use \$3,000 for the Pre-Closing Document Review and \$1,000 per month for monitoring during the period of project construction through project close-out as an approximation of the cost of the consultant; however, for more complex projects, the cost may be higher. The contract information and actual costs will be provided to the applicant prior to the consultant beginning their work. Costs may be increased further if the applicant fails to provide complete submittal information in a timely manner.

II. INITIAL APPLICATION SUBMITTAL REVIEW

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Project sponsors are generally required to submit the following information upon initial application.

- a. Narrative describing the proposed project that includes planned number of units, unit sizes, unit layouts, unit features, building finishes and project amenities
- b. Most recent and complete set of building plans, site plans and specification
- c. Location map, parcel map and legal description of the site
- d. Phase I hazardous materials evaluation. If further testing (including a Phase II environmental assessment) or estimates of remediation costs are available, this information must be provided as well.
- e. Environmental Impact Study (CEQA/NEPA Initial Study) (if available)
- f. Detailed list of any proposed “green building” features to be incorporated into the project, including a preliminary cost / benefit analysis
- g. Description and cost analysis of any unusual site conditions that may entail extraordinary costs
- h. Contact names and phone numbers of architects, engineers, contractors, consultants and other parties involved in the project planning, design and construction
- i. Detailed construction budget in a format to be prescribed.

The initial review of the construction budget, plans and specifications allow the Department of Housing staff to comment on the basic design of the project and to circulate the project design information to the Housing Action Team (“HAT”), a select Citywide group of staff members from Planning, Building & Code Enforcement, Public Works, Transportation, Redevelopment, Parks Recreation & Neighborhood Services, Fire Department, and the City Attorneys Office. This initial review allows for preliminary discussion and planning for expediting the project through the development approval process of the City.

The City will review plans and specifications to identify value engineering recommendations. In the event the City review concludes that there are

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specific areas within the budget that can be reduced through value engineering the City may elect to approve the budget subject to the applicant revisiting those specific items in question with the applicant agreeing to work towards reducing the budgeted amounts for those specific areas.

Because of City is a gap lender and must ensure efficient use of City funds, it is important that the developer not finalize contractors' contracts before the City has reviewed them and given feedback. If for some reason the contracts are finalized prior to City review, the City may require that terms be renegotiated and Addenda appended to individual contracts.

III. PRE-CLOSING DOCUMENT REVIEW

The Applicant should submit two (2) sets of construction documentation materials listed below as soon as they become available in order to facilitate the review and address issues as early as possible. In order to ensure adequate time for review and approval of construction documentation, the Applicant must submit all required information at least 30 days prior to the targeted closing date of the construction financing. It is anticipated that upon receipt of completed information that meets the requirements as set forth in these procedures, the City will complete its review within 20 days. If Applicant fails to provide complete information that meets the requirements as set forth within the timeframe described above, the City may not have sufficient time to review the information, which may cause a delay in the closing of the construction financing.

The City will require assignments of various agreements related to the project construction as additional security for its project funding.

The following construction documentation materials are to be provided:

1. Plans and Specifications

The sponsor shall provide a duplicate copy of the complete set of plans and specifications, that have been reviewed by the City's Building Department and have received initial comments, including architectural, structural, civil, landscaping, plumbing, mechanical and electrical. The specifications should be complete and provide details of the entire interior and exterior finishes.

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2. ALTA Survey and Title Report

Including complete listing of easements and exceptions.

3. Soils Report and Engineer’s Review

Soils Engineer’s review of plans and specifications must show conformance with recommendations made in the soils report.

4. Environmental Reports

Provide Phase I environmental assessment or if further investigation or remediation is required, all follow-up reports (including a Phase II environmental assessment) and the plans for any recommended remediation, including budgets and identified funding sources.

5. Proposed Construction Contract and all Exhibits and Attachments

- Form of Construction Contract

The contract type used should be Cost Plus a Fee with a Guaranteed Maximum Price. This contract type is required if Applicant has a direct or indirect interest in both the developer and contractor.

For projects where the Applicant does *not* have a direct or indirect ownership interest in both the developer and the contractor, a Stipulated Sum form of contract may be used if, based on the City’s review of the contract and budget, it is determined that there exists a substantial benefit to the project, such as a substantial price reduction in the construction period. In the case a stipulated sum contract is acceptable, the developer will be required to provide copies of all subcontracts executed for performance of the work.

Contracts must be in the most recent form provided by the American Institute of Architects (“AIA”).

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- Cost Savings

Under a Cost Plus a Fee with a Guaranteed Maximum Price contract in which the owner and builder are unrelated entities, the savings clause in the contract must indicate that at least 50% of the cost savings will be returned to the developer, which then must be used to reduce the City's permanent loan amount. Builders are limited to cost savings of 1% of the hard cost contract amount or \$150,000, whichever is less. The contract must also not allow any exceptions to the clause that returns cost savings to the owner unless expressly approved by the City. For projects owned and built by related entities, the contract's savings clause must allow 100% of cost savings to be returned to the owner.

6. Construction Budget and Cost Breakdown

The detailed construction budget and cost information must be provided in the most recent version of the Construction Specification Institute's (CSI) 16-division Master Format specifications system format.

Contractor's profit, overhead and general requirements are limited to amounts as described below:

Contractor Profit

The contractor profit cannot exceed 6% of the total hard cost contract amount for site improvements, offsite improvements and building construction and is further limited according to Section II, Part IV(C).

Contractor Overhead and General Requirements

Contractor Overhead means project allocable costs of continuing operations of a building construction firm. This category generally includes office salaries, equipment, licenses and taxes, warranty services, and estimating allocable to the project. Contractors' liability insurance may be a separate construction budget line and not included in Overhead.

General Requirements consist of items that will vary due to project type, location and site conditions. This category generally includes, but is not limited to supervision, job site engineering, job office expense

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including clerical wages, whether on-site or offsite, if for the Project, temporary buildings, tool sheds, shops and toilets, temporary heat, water, light and power for construction, temporary walkways, fences, roads, siding and docking facilities, sidewalk and street rental, construction equipment rental not in individual trade item costs, clean-up and disposal of construction debris, medical and first aid supplies and temporary facilities, watchman's wages, security cost and theft and vandalism insurance signage or other barriers.

General Requirements and Overhead costs must be itemized in the construction budget. All budgets are subject to the City's review and approval.

7. Subcontractor Bid Lists

Prior to acceptance of any bids, the list must be submitted to the City's Department of Housing and Office of Equality Assurance for debarment and prevailing wage review.

8. Detailed Soft Cost Budget

Including breakdown of fees for architectural and engineering services

9. Construction Schedule

To be presented in the form of a California Bar Chart detailed by line item.

10. Architect's and Engineer's Agreements

Include confirmed copies of agreements and evidence of professional liability insurance coverage in reasonable amounts based on the scope and size of the project.

11. Planned Development Permit

12. Evidence of Insurance

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13. Evidence of Performance and Payment Bond or Completion Guaranty

A completion guaranty from a financially responsible member of the development team may be substituted for this requirement at the sole discretion of the City. At a minimum, the guarantor must have financial capacity to honor payment demands made against the guaranty evidenced by a liquid net worth of the guarantor equal to or greater than (10% or determined by City) of the construction contract amount, not be an obligor under the proposed transaction documentation, AND the guarantor must be acceptable as a guarantor to all other lenders to the project.

14. Utility “Will-Serve” Letters and Service Agreements

Including, but not limited to, estimated costs for water, sewer, and electricity.

15. All Building Permits as they become available

16. Contractor’s Information

Contractor’s resumé, including detailed description of past projects of similar type, size and scope. Project construction superintendent and project manager resumé.

17. Copies of all consulting contracts

Provide copies of all consultant contracts related to the construction work. Generally, no project funds may be used for “non-arms length” contracts, and the sponsor must identify any and all financial interests that the sponsor may have with entities with which it enters into contracts in relation to the project.

Unless expressly permitted by the City, no project funds may be used for construction management in addition to those spent for General Contracting services.

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IV. BIDDING OF SUBCONTRACTS & REQUIREMENTS

Bidding Process

In order to ensure competitive bidding for the subcontracts, bids from unrelated third-party subcontractors should be the basis for estimated costs included in the construction budget for pre-closing document review. At least three bids must be obtained for each trade and all bids must state that they are based on the approved set of plans that have received plan check comments from the City.

A Department of Housing representative must be notified in advance of the bid opening. If the lowest bid is not the accepted bid, the contractor and developer must provide sufficient information regarding the financial benefit to the project for the selection, which must be approved by the Department of Housing.

In the case time constraints prevent a negotiated bid process to take place for all trades prior to the close of the construction financing, the basis for determining the estimated costs prior to close will be subject to the Department of Housing review and approval. All subsequent bidding activities will determine the budget and any savings from previous estimates will be used to reduce the City loan. A detailed breakdown of overhead and general requirements is also required.

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Affirmative Marketing

If programmatic regulations of specific funding sources require the contractor to affirmatively market contracting opportunities, Contractor will affirmatively market subcontracting opportunities to Minority Business Enterprises and Women Business Enterprises as required by these requirements.

Prevailing Wage Requirement

The contract must contain requirements for payment of prevailing wages and compliance with City's documentation requirements, including, but not limited to initial compliance documentation, weekly payroll reports, and delivery of monthly certified payrolls. For Federally funded projects, contract language addressing compliance with Davis Bacon wage rate laws must be included in the contract. See Section I, Part VI.

Performance and Payment Bonds

Bond amounts must be based on the industry standard for similar projects and bonds and must be acceptable to all other lenders to the project. The surety must be licensed in California and have an AM Best rating that is acceptable to City Department of Finance, Risk Management Division (which is hereafter referred to as the "Risk Management Division") and must be acceptable as a surety to all other lenders to the project. The City and the Redevelopment Agency of the City of San Jose must be named as co-obligees on the bonds.

Insurance Requirements

Insurance amounts and coverage must be based on the industry standard for similar projects and requires Risk Management Division review and approval. The insurer must be licensed in California and have an AM Best rating that is acceptable to the Risk Management Division.

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V. **MONITORING AND PROGRESS PAYMENTS DURING PROJECT CONSTRUCTION**

The Department of Housing will be monitoring the project during the construction phase to ensure the project is constructed based on the approved plans and specifications, on schedule, within budget, and that the proper procedures are used for disbursement of funds. A pre-construction meeting will take place to go over the monitoring, progress payments, lien release requirements and documentation process for the project.

1. Notice to Proceed

Notice to Proceed that includes all necessary information must be delivered prior to commencing construction.

2. Pre-construction Meeting

This meeting is required to be attended by all construction participants and is held prior to construction start. The purpose of the meeting is to go over the procedures that will be used to monitor construction, comply with the City's prevailing wage ordinance, and disburse funds in accordance with the City's construction loan agreements.

3. Scheduled Draw Meetings

During the pre-construction meeting, the construction participants will develop a schedule for draw request meetings. These meetings will be attended by authorized and qualified representatives of the developer, contractor, architectural firm, City representatives and any other construction participants needed to respond to any inquiries and review and approve draw requests. It is anticipated that draw meetings will occur on a monthly basis. A schedule of interim site meetings will also be established and a City representative may attend these interim meetings from time to time.

4. Meeting Minutes and Logs

Two sets of the following information will need to be provided by the developer and contractor at each Draw Meeting:

- RFI Log
- Change Order Log

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- Fully Executed Change Orders
- Potential Change Orders
- Previous Meeting Minutes
- Updated Construction Schedule
- Any Other Pertinent Information

5. Submittal of Draw Requests

The draw request must be submitted to the City representative no less than five business days prior to the meeting day. The request must include:

- The AIA G702 form
- Copies of all invoices with details of materials and work completed
- Conditional lien releases from all subcontractors and suppliers
- Unconditional lien releases from the prior meeting's request
- Reports on Undisbursed Loan Proceeds from other lenders, as available.

No items can be submitted for payment or paid unless the City has received copies of executed purchase orders and subcontracts. It is anticipated that draw requests will be funded within 14 days of complete submittal.

6. Review of Draw Requests

The City's construction manager or its consultant will receive draw packages no less than one week in advance of scheduled draw meetings, review all draw packages, attend all draw meetings, and approve all draws, regardless of the source of funds for each draw. If this process is not followed, the City reserves the right to disallow draws; therefore, it is important that the project team initially establish a process that is workable for all parties. See Section IV.

7. Inspections and Monitoring by the Department of Housing

Department of Housing construction inspector or its designee to be allowed on site to inspect the project no less than monthly or as frequently as necessary to assure project construction within the approved plans and specifications.

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8. Change Order Approvals

Any material changes to the project or any change orders aggregating above \$5,000.00 will require prior City approval as a budget adjustment or as a submittal for payment.

General contractor markups on change orders are limited to the percentage of profit allowed in the contract. Subcontractors are limited to 15% maximum markup on change orders.

9. Prevailing Wage Information, Violations, Audits

The City's Office of Equality Assurance will establish the requirements for compliance at the pre-construction meeting.

10. Payments for Stored Materials

With the exception of lumber/framing materials, sheetrock, doors, windows or other items legally transferred to the owner, adequately insured, suitably stored on site and customarily paid for prior to installation, no payment for stored materials will be allowed unless previously approved by the City.

11. Mechanics Liens

The City will not fund requests for payment on work when a dispute exists as may be evidenced by a mechanics lien unless the contractor or developer have provided a bond from an acceptable surety in an amount equal to at least 150% of the disputed amount.

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12. 10% Retention of City's Funds Required

Retention of City funds in the amount of 10% will be held back from each City loan draw request on all construction line items, including general contractor fee, general conditions, and insurance. An exception may be allowed, if agreed upon by the City in writing prior to closing of construction funding, for materials and labor for structural concrete and for materials, but not labor, on items such as installed lumber, drywall, and appliances prior to project close-out. Requirements for the early release of this retention would include the work being accepted by the general contractor, design professionals and developer, along with the appropriate final lien releases and submittal of any as-built drawings for the closed-out items.

V. PROJECT CLOSEOUT

1. Final Walkthrough and Punch List Items

City or its representative will meet with the developer and contractor for the “punch list” walkthrough. Developer will deliver to City a copy of the final punch list prior to the final walk through of the project. City or its representative will meet with developer and contractor for the final walkthrough to ensure that all remaining construction issues are resolved and the project has been completed based on the terms of the construction contract and has been deemed as accepted by the developer.

2. Release of Retention

Retention will be released within 30 days after all the following information has been provided to the City Housing staff and its representative:

- Contractor's letter request for release
- Consent of contractor's surety
- Architect's Certificate of Final Payment
- Confirmation of Title Company Readiness to Issue Proper Title Endorsements to the Original Title Policy
- Recorded or Correct filing of the Notice of Completion
- Certificate of Occupancy

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- Notice of Substantial Completion
- Final and Unconditional Lien Releases
- Confirmed Compliance with Other Lenders Conditions
- Owner’s Manual including As Built Set of Plans
- Final Signed off Permit Cards
- Foundation Certification
- Confirmed Compliance with City’s Prevailing Wage Ordinance

Early release of retention for specific trades is allowed only if identified explicitly in the City’s loan documents before construction begins.

3. Warranty Period

All materials and workmanship must have at least a one-year warranty. The roof must be covered by a manufacturers’ NDL 20-year roof guarantee.

SECTION FOUR: CRITERIA AND PROCESS FOR
PRELIMINARY COMMITMENT LETTERS

For those projects that do not yet have land use entitlements, the Housing Department offers a Preliminary Commitment option in order to give developers greater certainty regarding the likelihood of future City project funding while the project is in its early development phases.

Eligible Projects

- *New Construction of (or Adaptive Re-Use to create): Family Rental Apartments; Rental Housing for Special Needs Populations; Rental SROs/Studio Apartments.*

Threshold Criteria

- The project sponsor must have evidence of site control.
- The proposed project must be able to conform to the City of San Jose’s General Plan.
- The project sponsor or affiliates must have no negative financial and project management history with the City (i.e., sponsor has never been in monetary default on a loan from the City and is current on all financial and compliance documentation).
- The proposed project and its financing structure must be competitive for other funding sources being proposed.
- The project sponsor must have completed initial research and show efforts to communicate with stakeholders about the proposed project.

Additional Requirements for a Funding Commitment

- The project must score an estimated minimum of 70 points under the Project Scoring System under the Housing Department’s Notice of Funding Availability in effect at the time that a “Request for Preliminary Commitment Letter for a Multifamily Housing Project” is submitted.

Application Requirements

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- One paper copy each of the Housing Department’s “Request for Preliminary Commitment Letter for a Multifamily Housing Project” (hereinafter, “Request”) and the proposed development budget together with all attachments and documentation required in conjunction with the application form. One electronic copy each, on diskette, of: (1) the “Request for Preliminary Commitment Letter for a Multifamily Housing Project” in Microsoft Word; and (2) the development and operating pro formas in Microsoft Excel.
- Self-score to document how the project will meet the scoring criteria of the NOFA.
- Self-score to document how the project will be competitive for the non-City funding sources being proposed.

Process

- After the Housing Department receives a complete Request application, Housing Department staff will:
 - Perform a preliminary underwriting of the proposal, including an evaluation of estimated project costs, financing structure and other relevant issues.
 - Assess the potential risk associated with such issues as relocation or contamination.
 - Issue a Preliminary Commitment Letter upon the determination that the proposed project is feasible.
- The Housing Department will endeavor to issue a Preliminary Commitment Letter (or to notify the project sponsor why the Department is unable to issue such a Letter) within 10 working days of receiving a Request application.
- A Preliminary Commitment Letter will expire 18 months after issuance, meaning that the PD rezoning (or equivalent land use entitlement) must be approved and a NOFA application for a City Council commitment of funding must be received within that 18-month timeframe.
- If anything changes during the land use entitlement process that would materially change any aspect of the project (as determined solely by the City) including but not limited to an increase the amount of City funding needed for the proposed project or the amount needed on a Per-Unit basis (e.g., number of units allowed, project design, changes in the regulations governing outside funding sources, the cost of cement), the project sponsor should submit a revised Request so that the Housing Department can assess whether the larger amount will be available when a formal NOFA application is filed. If the Sponsor fails to inform the Housing Department of material increases in the proposed City loan amount that will

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ultimately be requested, there is no guarantee that that the larger amount will be available. The revised Request will need to also score an estimated minimum of 70 points according to the rules in effect at the time the Preliminary Commitment Letter was issued.. Issuance of a revised Preliminary Commitment Letter based on a revised request will not, however, alter the original expiration date of the Preliminary Commitment Letter.

Other/General Requirements

- Any change in the proposed project type (e.g., families vs. SRO vs. special needs) or a material change in the unit mix (as determined by the City) after the issuance of a Preliminary Commitment Letter will automatically void that Preliminary Commitment Letter.
- The 18-month duration of a Preliminary Commitment Letter may be extended by up to six months by the Housing Department, at its sole discretion, if in its judgement, extraordinary circumstances so warrant.
- Should the City ultimately fund the proposed project, the issuance of a Preliminary Commitment Letter may trigger a relocation obligation for any residential or commercial tenants occupying the project site at the time that the Preliminary Commitment Letter is issued.
- Funding available for senior housing projects is limited by State law, which may affect the Housing Department’s ability to preliminarily commit funding for such projects.
- Depending upon the availability of City funding from difference sources, a Preliminary Commitment Letter may require that the land use entitlement process include NEPA as well as CEQA review. In such a case, any extra costs incurred as a result need not be counted as a project cost when scoring the project under the NOFA Project Selection System for Per-Unit Subsidy and Leveraging, although the extra costs will be eligible for City funding.
- A project that has received a Preliminary Commitment Letter will be scored for a formal City Council commitment of funds under the rules of the NOFA in effect at the time the Preliminary Commitment application was submitted.
- All Preliminary Commitment Letters will require that the following conditions, at a minimum, be satisfied in order convert the preliminary commitment to a formal commitment for City funding approved by the City Council:
 - That a formal application using the forms posted on the City’s website (www.sjhousing.org) is filed with the Housing Department.

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- That a PD rezoning (or equivalent land-use entitlement) is agendaized for approval prior to the date when the Housing Department's funding recommendation will be presented to the City Council.
- That the project, in its final design and financial structure, complies with the Housing Department's Project Development Policies and Procedures Manual and scores at least 70 points under the Housing Department's NOFA scoring system at the time that the Preliminary Commitment Letter was issued.
- The Preliminary Commitment Letter should not be relied on by any party as a commitment of the City Council to the proposed project until the City Council has approved the project funding.