

# Agenda Report

March 14, 2016

TO: Honorable Mayor and City Council

THROUGH: Economic Development and Technology Committee (March 7, 2016)

FROM: Housing and Career Services Department

SUBJECT: **KEY BUSINESS TERMS OF A DEVELOPMENT AND LOAN AGREEMENT WITH HHP-SUMMIT, LLC FOR THE DEVELOPMENT OF A 21-UNIT AFFORDABLE HOMEOWNERSHIP PROJECT AT 104-124 E. ORANGE GROVE BOULEVARD AND 677 N. SUMMIT AVEUNE**

## **RECOMMENDATION:**

It is recommended that the City Council take the following actions:

1. Amend the Fiscal Year 2016 adopted operating budget of the Housing and Career Services Department by appropriating a total of \$1,300,000 in City affordable housing funds consisting of: a) \$420,276 from HOME Investment Partnerships ("HOME") Program Year 2014 funds (Fund 221); b) \$693,991 from HOME Program Income funds (Fund 221); and c) \$185,733 from Inclusionary Housing Trust Funds (Fund 239) to assist the development of a 21-unit affordable homeownership project located at 104-124 E. Orange Grove Boulevard and 677 N. Summit Avenue (the "Summit Grove project" or "Project") to be developed by HHP-Summit, LLC ("HHP");
2. Approve the proposed key business terms of the Development and Loan Agreement (the "DLA") between the City and HHP for the development of the Summit Grove project; and
3. Authorize the City Manager to execute, and the City Clerk to attest, the DLA and all other related documents, agreements, or amendments that may be required to implement the DLA and effectuate the development of the Summit Grove project.

## **BACKGROUND:**

HHP-Summit, LLC ("HHP") proposes to construct a 21-unit affordable condominium development (the "Summit Grove project" or "Project") at the southwest corner of

Summit Avenue and Orange Grove Boulevard, at 104–124 E. Orange Grove Boulevard and 677 N. Summit Avenue. The Project site has a net lot area of 19,376 sq. ft. (see Site Map, Attachment A). HHP purchased a portion of the site in February, 2014, and the remainder of the site in April, 2014. Improvements currently on the site consist of two vacant single-family houses and a vacant one-story commercial building (see Site Photos, Attachment B). The commercial building was formerly occupied by a liquor store and other month-to-month retail tenants. The site has been completely vacant as of October 16, 2015. The Project has received all required land use entitlements and is currently in the City plan check process.

The existing improvements will be demolished and replaced with a new 35,150 sq. ft., three-story building over a 14,600 sq. ft. semi-subterranean parking garage. The building will include 21 condominium units in a U-shaped configuration wrapping around a 5,300 sq. ft. interior courtyard. The unit mix includes 20 three-bedroom units and one (1) two-bedroom unit. Project plans and renderings are shown in Attachments C and D.

All units will be restricted by the City and sold to income-eligible, first-time homebuyers at affordable housing cost. Fourteen (14) units will be designated for Low-Income households, and seven (7) units for Moderate-Income households. Twelve (12) of the Low Income units will fulfill “off-site” inclusionary housing obligations from the market rate housing developed by City Ventures, Inc. at the former Ambassador College site. The homeownership costs for income-eligible buyers of these units will equate to affordable sales prices ranging from \$242,500 to \$342,700 for typical two-bedroom Low- and Moderate-Income units, respectively.

Non-profit housing developer Heritage Housing Partners, as the sole and managing member of HHP-Summit LLC, will take the lead role in managing the development of the Project. Heritage Housing Partners is a non-profit, Pasadena-based developer which promotes affordable homeownership through the preservation of historic homes and the construction of new, single-family residences. They have built and sold over 130 homes to low- and moderate-income first-time homebuyers since its inception in 1998, of which 110 units were developed and sold within the last seven years. Projects in Pasadena include Fair Oaks Court, Haskett Court, and Herkimer Gardens. In addition to the 21 units in the Summit Grove project, Heritage Housing Partners has another 32 units in its development pipeline. The developer also maintains an interest list of over 3,000 households; most of which are seeking to purchase an affordable homeownership unit in Pasadena.

In January 2016, HHP submitted a funding request to the Housing and Career Services Department for the City for gap financing in the amount of \$1.3 million. The City loan funds would be used to leverage New Market Tax Credit (“NMTC”) equity and make it financially feasible for the project to provide a greater number of affordable units than the 12 Low-Income/9 market rate unit mix in HHP’s original project.

Project development costs (not including costs paid from sales proceeds) are estimated to be \$11.3 million. Major cost components include: (1) site acquisition costs of \$1.7 million; (2) construction costs of \$6.74 million; (3) soft costs of \$2.22 million; and (4) financing costs of \$568,200 (see Project Budget, Attachment E). The funding sources used to cover development costs are summarized in the table below and detailed in

Uses and Sources of Funds, Attachment F. Forty percent (40%) of the funding for the development of the Project is from private, non-debt sources consisting of HHP and HHP-Summit LLC equity and New Markets Tax Credit ("NMTC") equity. The HHP and HHP-Summit LLC equity includes \$2,765,000 received from City Ventures, Inc. as part of the transaction between the two developers which resulted in the transfer of the Inclusionary housing obligation from the market rate development of the former Ambassador College site to "off-site" Inclusionary units at the Summit Grove project.

<b>Funding Source (development phase)</b>	<b>Status</b>	<b>Amount</b>	<b>Percentage</b>
HHP equity	Committed	\$2,115,000	19%
HHP-Summit LLC equity	Committed	\$675,000	6%
City housing loan	Requested	\$1,300,000	12%
New Markets Tax Credit equity	Committed	\$1,745,800	15%
Construction loans	Committed	\$5,468,047	48%
<b>Total</b>		<b>\$11,303,847</b>	<b>100%</b>

The City's funding to assist in the development of the Project would be provided as a loan to HHP Capital, Inc. ("HHP Capital"), a nonprofit supporting organization of Heritage Housing Partners. The proceeds of the City Loan will be used as one of the sources of a leverage loan to an Investment Fund of approximately \$5,822,250. The leverage loan will be combined with NMTC equity from the tax credit investor to make an equity investment in the entity providing the NMTC allocation, the Community Development Entity (the "CDE"). The CDE will, in turn, make a loan to HHP to develop the Project. The term of the City Loan will be approximately seven years (equal to the length of the compliance period of the NMTC program) with a possible one-year extension. At maturity, after the compliance period, the NMTC structure will unwind and the City Loan will be repaid using subordinate mortgages in the amount of the City Loan distributed from HHP to HHP Capital.

Direct funding assistance will also be provided to the homebuyers of the fourteen (14) Low-Income units from State "Calhome" program funds totaling \$840,000 which were awarded to HHP in 2014. The assistance would be in the form of second trust deed loans in the amount of \$60,000 per loan. Finally, additional subordinate purchase financing will be attached to each Project unit in the form of a junior trust deed lien in the average amount of \$131,666 per unit (the "Inclusionary Lien"). The aggregate amount of Inclusionary Liens total \$2,765,000, securing the full amount of the Ambassador Inclusionary Off-Site Funding. Examples of homebuyer purchase financing structures for typical Low- and Moderate-Income units are provided in Attachment G.

The City's \$1.3M leveraged loan, plus HHP equity consisting of \$2.115M from the Ambassador transaction, will generate additional equity through the NMTC structure in the amount of \$1.745M for the project. The proposed 3% cost of funds on the City loan is consistent with the City's underwriting practice on affordable homeownership projects over the past five years. Upon HHP's successful completion of the project, the accrued interest on the City's loan would be forgiven -- which is also consistent with the City's practice with loans for such projects -- and the \$1.3M principal would be recast as homebuyer purchase financing for the 11 Low-Income units under the City's Homeownership Opportunities Program ("HOP") guidelines. The HOP loans would bear

no interest but have an equity share provision. Fannie Mae will not underwrite mortgages for home purchase transactions in which "community soft second" loans (such as the City's HOP loans) charge both interest and an equity share. Furthermore, the State Calhome program requires that the City's HOP loans be in a junior lien position to the Calhome second mortgages.

In evaluating HHP's funding request, staff also considered the availability of affordable housing funds from other sources. Local housing agencies are typically called on to fill financing gaps to make affordable housing development projects feasible. This is especially the case for homeownership projects in which there exists a scarcity of development funding at the state and county levels. Without City loan funding to leverage NMTC equity, the project would be financially unfeasible at the proposed affordability levels, and HHP would be required to obtain conventional construction financing for the original project consisting of 12 Low-income and 9 market rate units. However, with the project's location the market rate units would be risky (in terms of market value at a level sufficient to make the project financially feasible), and with lenders' tighter underwriting standards, securing conventional financing is not necessarily a given. If the recommended City funding is approved, the proposed project will remove a neighborhood blight and provide a greater number of affordable homeownership units.

#### **INTERNAL HOUSING LOAN COMMITTEE REVIEW:**

The key business terms of the proposed Development and Loan Agreement ("DLA") were presented to and approved by the City's Internal Housing Loan Committee at its regular meeting of February 18, 2016.

#### **ADVISORY BODY RECOMMENDATION:**

The key business terms of the proposed DLA were presented to the Northwest Commission at its regular meeting of February 9, 2016 for consideration of a recommendation to the City Council. The Northwest Commission recommended to City Council that it approve the staff recommendation.

#### **KEY TERMS OF DEVELOPMENT AND LOAN AGREEMENT:**

The proposed Development and Loan Agreement ("DLA") between the City and HHP includes the following key business terms:

- a) City funding assistance for the project will total \$1,300,000 consisting of \$1,144,267 in federal HOME funds and \$185,733 in City Inclusionary Housing Trust Funds. The City funding shall be provided in the form of a loan to HHP Capital (the "City Loan"). The City Loan, along with other funding sources will be used by HHP Capital to make a loan to an Investment Fund. The Investment Fund will use the loan proceeds and tax credit investor equity to make an equity

investment in the CDE, which will loan the proceeds of that equity investment to HHP Summit to complete the Project.

- b) The DLA shall contain a scope of work and uses of funds that are substantially in the form as submitted to the City by HHP in its funding proposal. Eligible expenses shall include predevelopment, construction, soft costs, financing, and other project development related costs.
- c) The City Loan shall: 1) be evidenced by a promissory note and secured by a pledge of a junior interest in the Investment Fund's interest in the CDE (subject to a seven-year standstill provision required by the NMTC structure); 2) have a term of seven (7) years; and 3) bear 3.00% simple, fixed interest; and 3) provide provisions for subordination to conventional construction financing.
- d) HHP shall develop the Project in accordance with a schedule of performance which includes commencement of construction in May 2016; completion of construction in May 2017; and Project unit sales from June-September 2017.
- e) At maturity (after the seven-year NMTC compliance period) purchase financing for eleven (11) Low-Income units in the form of subordinate loans averaging \$118,181 per loan under the City's Homeownership Opportunities Program (the "HOP Loans") will be distributed by HHP through unwind of the NMTC structure to HHP Capital. These HOP Loans will be assigned to the City as repayment of the City Loan. Buyers must provide a minimum 5% down payment of the affordable sales price, and complete a qualified homebuyer education course.
- f) The HOP Loans shall: 1) be secured by a recorded third trust deed, in a junior lien position to the conventional mortgage and the Calhome second trust deed loan; 2) have a term of 45 years; 3) bear no interest, but require a City equity share; 4) be deferred for the period that the Calhome loan is outstanding; and 5) comply with HOME regulations.
- g) A regulatory agreement in favor of the City shall be recorded against the Project, binding HHP during the development and unit sales phases of the Project, and binding homebuyers of the 11 HOP-assisted Low-Income units, to federal HOME and City Inclusionary program regulations, and owner-occupancy, resale, and other restrictions. The term of the regulatory agreement shall be 45 years.
- h) HHP will commit \$840,000 in State "Calhome" funds to assist homebuyers of the fourteen (14) Low-Income units in the Project. In accordance with State guidelines, the Calhome loans shall be in the principal amount of \$60,000 per loan, be secured by a second lien deed of trust, bear simple interest at the rate of 3.00% for a term of 30 years, with payments deferred for the full term.
- i) Additional subordinate purchase financing shall be secured by each Project unit in the form of a fourth trust deed lien (for Low-Income units) and a second trust deed lien (for Moderate-Income units) in the average amount of \$131,666 per trust deed lien (collectively, the "Inclusionary Liens"). The aggregate amount of Inclusionary Liens shall total \$2,765,000 which is equivalent to the amount of

Project funding that HHP received from City Ventures, Inc. as part of the transaction between the two developers which resulted in the transfer of the Inclusionary housing obligation from the market rate development of the former Ambassador College site to "off-site" Inclusionary units at the Summit Grove project. Inclusionary Liens shall have a term of 45 years, bear no (0%) interest, with payments deferred for the full term, and include an equity share provision. Inclusionary Liens shall be held by HHP during the seven-year New Markets Tax Credit compliance period. Upon expiration of the compliance period, all such liens shall revert to the City. Inclusionary housing deed restrictions shall also be recorded against each Project unit.

- j) HHP shall submit to City an agreement between HHP Capital, HHP-Summit, LLC and Heritage Housing Partners evidencing: i) the interest and role of each entity in the NMTC structure; and ii) Heritage Housing Partner's lead responsibility in managing the development of the Project in accordance with the DLA.
- k) HHP shall comply with all applicable City ordinances, policies and regulations including the City's First Source Hiring ordinance.

**PROJECT SCHEDULE:**

<b>Activity</b>	<b>Schedule</b>
Demolition of existing improvements	Work to commence on March 19
Building permit issuance	May 2016
Construction start - Excavation	May 2016
Construction – Underground garage	June – October 2016
Construction - Housing	November 2016 – May 2017
Sales period	June - September 2017

**ENVIRONMENTAL ANALYSIS:**

On July 1, 2015 the City Hearing Officer approved a staff recommendation to adopt the Environmental Determination and approve Affordable Housing Concession Permit #11817 for the Project. Under the Environmental Determination, the Project was determined to be exempt from environmental review pursuant to the guidelines of the California Environmental Quality Act (Public Resources Code §21080(b)(9); Administrative Code, Title 14, Chapter 3, §15332, Class 32, In-Fill Development Projects. Section 15332 specifically exempts from environmental review in-fill development where: 1) the project is consistent with the applicable general plan designation and all applicable general plan policies as well as with applicable zoning designation and regulations; 2) the proposed development occurs within city limits on a project site of no more than five acres substantially surrounded by urban uses; 3) the project site has no value as habitat for endangered, rare or threatened species; 4) approval of the project would not result in any significant effects relating to traffic, noise, air quality, or water quality; and 5) the site can be adequately served by all required utilities and public services.

**COUNCIL POLICY CONSIDERATION:**

The proposed action supports and promotes the quality of life and the local economy -- a goal of the City Council's Strategic Objectives.

**FISCAL IMPACT:**

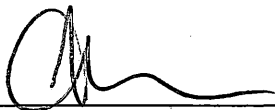
The proposed action will increase the FY 2016 operating budget of the Housing and Career Services Department in the amount of \$1,300,000. The budget increase will come from the Department's HOME and Inclusionary Housing Trust Fund balances, which will result in fund balances of approximately \$458,868 and \$1,769,627, respectively, in available, unreserved monies.

Respectfully submitted,



WILLIAM K. HUANG  
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Approved by:



STEVE MERMELL  
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Attachments:

- Attachment A – Site Map
- Attachment B – Site Photos
- Attachment C – Project Plans
- Attachment D – Project Renderings
- Attachment E – Project Budget
- Attachment F – Uses and Sources of Funds
- Attachment G – Homebuyer Purchase Financing Structure