

# Agenda Report

December 11, 2017

TO: Honorable Mayor and City Council

THROUGH: Economic Development and Technology Committee (December 5, 2017)

FROM: Housing and Career Services Department

SUBJECT: APPROVAL OF KEY BUSINESS TERMS OF RESTATED DEVELOPMENT AND LOAN AGREEMENTS WITH HERITAGE HOUSING PARTNERS FOR AFFORDABLE HOMEOWNERSHIP PROJECTS AT 1661 N. FAIR OAKS AVENUE AND 1669 N. FAIR OAKS AVENUE, INCLUDING ADDITIONAL CITY HOUSING FUNDS ASSISTANCE IN THE AMOUNT OF \$3,007,982

## **RECOMMENDATION:**

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

1. Amend the FY 2018 adopted operating budget of the Housing and Career Services Department by appropriating a total of \$3,007,982 in City affordable housing funds consisting of \$2,782,982 from HOME Investment Partnerships funds ("HOME"), and \$225,000 from Inclusionary Housing Trust Funds to assist the development of two (2) affordable homeownership projects located at 1661 N. Fair Oaks Avenue ("Decker Court") and 1669 N. Fair Oaks Avenue ("Gil Court"), both to be developed by Heritage Housing Partners ("HHP");
2. Find that the recommended action to approve the key business terms, as described in this agenda report, of the respective Restated Development and Loan Agreements (the "Restated DLAs") with HHP in connection with the proposed development of the Decker Court and Gill Court projects are consistent with the In-Fill Development Projects exemption under Section 15332 of the California Environmental Quality Act;
3. Approve the key business terms of Restated DLA for the Decker Court project, including an additional \$1,177,254 in City housing funds consisting of \$952,254 in federal HOME and \$225,000 in Inclusionary funds; and
4. Approve the key business terms of Restated DLA for the Gill Court project, including an additional \$1,830,728 in federal HOME funds; and

5. Authorize the City Manager to execute, and the City Clerk to attest, the Restated DLAs and all other related documents, agreements, or amendments that may be required to implement the Restated DLAs and effectuate the development of the Decker Court and Gill Court projects.

### **ADVISORY BODY RECOMMENDATION**

The key business terms of the proposed Restated Development and Loan Agreements for the Decker Court and Gill Court projects were presented to the Northwest Commission at its regular meeting of November 14, 2017 for consideration of a recommendation to the City Council. The Northwest Commission unanimously recommended to the City Council approval of key business terms of restated development and loan agreements with Heritage Housing Partners for affordable homeownership projects at 1661 North Fair Oaks Avenue and 1669 North Fair Oaks Avenue and approval of additional funds totaling \$3 million. The Commission further recommended that the Northwest Commission collaborate and participate in the review of the outreach process and criteria for selection of the residents for the projects.

### **BACKGROUND**

In August 26, 2014 the City of Pasadena ("City") entered into a Development and Loan Agreement No. 21947 (the "DLA") with local nonprofit housing developer Heritage Housing Partners ("HHP") for the construction of an 8-unit affordable homeownership project located at 1661 N. Fair Oaks Avenue. Pursuant to the DLA, the City provided loan assistance in the amount of \$1.1 million utilizing federal Home Investment Partnership Act ("HOME") program monies.

On October 22, 2015 the City entered into that certain Amendment to Development and Loan Agreement No. 30171 (the "Amended DLA") with HHP for the development of an expanded 15-unit project on the combined parcels of 1661 and 1669 N. Fair Oaks Avenue. The project would entail the new construction of 13 units and the relocation of the historic Decker House for renovation as two (2) units. Eight (8) units would be sold to low income families and seven (7) units to moderate income families. Under the Amended DLA the City provided HHP with additional loan assistance in the amount of \$1.25 million from the Inclusionary Housing Trust Fund. Other proposed funding for the 15-unit project included an allocation of New Market Tax Credits ("NMTC") of approximately \$4.49 million and State Calhome monies in the amount of \$480,000 secured by HHP.

HHP had received a verbal commitment from Bank of America for a NMTC allocation of \$4.49 million. Unfortunately, Bank of America did not receive an allocation in the 2016 NMTC Allocation Round (the first time in five years that the lender did not receive an allocation). HHP did reach out to several other financing institutions for a NMTC allocation but they all chose not to provide an allocation to the project. The primary reason was that these institutions were prioritizing their NMTC investments in manufacturing and job creation projects. At this time, NMTC is no longer a viable source of funding for this project as the census tract in which the development sites are

located no longer qualify for NMTC. Furthermore, the NMTC program may be in jeopardy as the current administration has proposed eliminating NMTC as part of the proposed tax reform package.

Another challenge arose in September 2016, when the U.S. Department of Housing and Urban Development (“HUD”) determined that in order for the City to commit and utilize additional HOME funds to fill the financing gap caused by the non-availability of NMTC, the 15-unit development would have to be entitled and built as two separate projects. HUD’s position was that a federal environmental review was not done for the expanded 15-unit project (despite the fact that no additional HOME funds were contemplated at the time the Amended DLA was approved for the expanded project). Staff appealed this decision, arguing that an environmental review was completed for the original site at 1661 N. Fair Oaks Ave, and offered to immediately perform the environmental review for the 15-unit project on the combined sites. Unfortunately, HUD declined and required the City to perform new environmental reviews for each project. These reviews were completed on July 25, 2017 and approved by HUD on August 28, 2017. Consequently, the 15-unit development was required to be re-designed as two separate projects on adjacent sites: the 9-unit Decker Court on 1661 N. Fair Oaks Avenue and the 7-unit Gill Court on 1669 N. Fair Oaks Avenue.

HHP had already taken the 15-unit project into an advanced design stage when the HUD imposed the new requirements, causing HHP to redesign the project. The extended predevelopment, re-design, environmental review, and entitlement activities associated with moving from a single 15-unit project to two separate projects added costs to the funding shortfall which totaled approximately \$3.0 million. On June 9, 2017 HHP submitted a funding request to the Housing and Career Services Department for City gap financing. The request included certain modifications to the original 15-unit project, including separation of the single-site development into two projects with a greater number of total units (16), all of which would be at Low Income affordability.

The table below summarizes the circumstances resulting in the \$3.0 million funding gap:

<b>Circumstance Resulting in \$3.0M Funding Gap</b>	<b>Shortfall amount</b>
HHP inability to obtain NMTC allocation	\$1,486,500
Development cost increase due to project separation (HUD requirement) and addition of 1 unit	\$ 767,600
HHP redeployed Calhome funds to Summit Grove project to meet State expenditure deadline	\$ 480,000
Sales proceeds decrease due to conversion of moderate income units to low income affordability	\$ 273,900
<b>Total</b>	<b>\$3,008,000</b>

In evaluating HHP’s funding request, staff considered not only the merits of the project but also 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.

The City funding is the sole subsidy source for the Decker Court and Gill Court projects, without which the projects would be financially unfeasible at the proposed Low Income affordability level. The City's total subsidy for these two projects is approximately \$335K per unit. This is greater than the City's \$193K per unit subsidy for the recent Summit Grove HHP project (currently under construction), for which subsidies consist of direct City funding and Inclusionary funds received by HHP from developer City Ventures in connection with the transfer of inclusionary housing obligations from the Ambassador campus development). However, Summit Grove also had the financial benefit of non-City subsidies that are attributable to HHP's efforts consisting of \$2,817,750 in New Market Tax Credits equity and \$784,750 in Calhoun funding. Therefore, taking into consideration all subsidy sources, the subsidy level for Summit Grove is approximately \$366K per unit.

Furthermore, for the Decker/Gil projects, 72% of the City's funding would come from federal HOME monies, and the funding level is in compliance with HUD's maximum subsidy limits. HUD imposes strict timelines on the City to commit and disburse HOME funds and it is difficult to identify projects that are eligible for HOME funding and developers with capacity and experience to successfully complete the projects. The use of HOME funds for the Decker and Gill Court projects will enable the City to satisfy HUD's commitment and disbursement requirements for all HOME funds allocated to the City through HUD Program Year 2017. Finally, the projects will provide local benefits: preservation of the Decker House structure (a local historic landmark), local hiring during project construction, and local preference in the selection of home buyers.

The total development cost for the two projects will be \$9,563,963. The City financial investment for the two projects would total \$5,357,981 consisting of \$2.35 million in previously loaned funds, plus \$3.0 million additional requested funding. HHP will obtain a conventional construction loan from Mutual of Omaha in the amount of \$4,180,980 and also provide developer equity in the amount \$25,000. Hence, forty-four percent (44%) of the development of the projects would be financed with private sources. Please see funding sources and uses, Attachment A. The total development costs of the projects are summarized as follows:

<b>Development Cost</b>	<b>Decker Court 1661 N. Fair Oaks</b>	<b>Gill Court 1669 N. Fair Oaks</b>	<b>Consolidated Costs</b>
Hard costs	\$3,225,365	\$2,405,233	\$5,630,598
Soft costs	\$1,150,107	\$902,417	\$2,052,524
Financing costs	\$157,547	\$123,294	\$280,840
Land costs	\$750,000	\$850,000	\$1,600,000
<b>Total</b>	<b>\$5,283,019</b>	<b>\$4,280,944</b>	<b>\$9,563,963</b>

Upon completion of the projects and upon HHP satisfaction of its obligations under the provisions of the Restated Loans, the City will underwrite and originate homebuyer assistance loans in accordance with the City's Homeownership Opportunities Program ("HOP"). The HOP loans for each unit would be in the principal amount of approximately \$334,870, the amount necessary to bridge the gap between market value and affordable housing cost. Please see affordable sales price analysis, Attachment B. The HOP loans would be deferred and bear no interest, but will have a City 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. Each unit will also be deed-restricted to provide the City with a right of first refusal to acquire the property in the event of resale.

The Decker Court project at 1661 N. Fair Oaks Avenue will be a nine-unit development consisting of 2-, 3- and 4-bedroom homes. Included in Decker Court will be the renovated Decker House (two units). The Gill Court project at 1669 N. Fair Oaks Avenue will be a seven-unit development consisting of 3- and 4-bedroom homes. Project renderings and site plans are provided in Attachments C and D, as well as a map showing the location of these two projects relative to other affordable housing projects in the City, Attachment E. Although there are some inefficiencies in separating into two projects, the key advantages to HHP’s proposal are more units and 100% of the units will be available as affordable housing for Low Income families.

The proposed transaction was reviewed by the Internal Housing Loan Committee, which serves the Housing & Career Services Department and is comprised of staff in the City Manager, Housing, Human Services, and Public Works departments. The Committee’s functions include the review of department recommendations which require City Manager or City Council approval, including housing loan transactions, as well as, review of other housing related decisions that do not require City Manager or City Council approval (e.g., single family loan modifications) and Inclusionary Housing Plans.

#### **KEY TERMS OF EACH RESTATED DEVELOPMENT AND LOAN AGREEMENT**

- a) City funding assistance for the project will total \$5,357,981 million consisting of \$1.1 million in federal HOME funds that were committed in 2014 under the original DLA, \$1.25 million in Inclusionary funds that were committed in 2015 under the Amended DLA, and additional funding totaling \$3,007,982 consisting of \$2,782,982 in federal HOME funds and \$225,000 in Inclusionary funds. The City funding shall be provided to HHP in the form of Restated Inclusionary and HOME loans (“Restated Inclusionary Loan” and “Restated HOME Loan”, respectively).
- b) The Restated Inclusionary and HOME Loans shall: 1) be evidenced by Inclusionary and HOME promissory notes, secured by recorded second and third trust deeds, respectively, in favor of the City; 2) have a term of two (2) years; 3) bear 3.00% simple, fixed interest; and 4) provide provisions for subordination to conventional construction financing. Upon HHP’s successful completion of the project, the accrued interest on the loans would be forgiven. (These terms are consistent with the City’s underwriting practice on affordable homeownership projects over the past six years.)
- c) The Restated 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 Decker House relocation, predevelopment, construction, soft costs, financing, and other project development related costs.
- d) HHP shall develop the project in accordance with a schedule of performance with the following key milestones:

- February 2018 Demolition and grading
  - March 2018 Decker House relocation
  - May 2018 City issues building permit, begin construction
  - February 2019 Homebuyer application period begins
  - July 2019 Completion of project construction
  - September 2019 Initial homebuyer move-ins
  - January 2020 All project units sold
- e) Upon completion of the Projects in accordance with the Restated DLAs, HHP's repayment obligations under the **Restated Inclusionary Loan**, in the principal amount of \$1,475,000, shall be recast as homebuyer assistance loans, which the City shall underwrite and originate for the low income buyers. Such loans shall be made in accordance with the City's Homeownership Opportunities Program ("HOP") loan guidelines.
- f) Upon completion of the Projects in accordance with the Restated DLAs, HHP shall repay the **Restated HOME Loan**, in the principal amount of \$3,882,982, from which repayment proceeds the City shall underwrite and originate homebuyer assistance loans for the low income buyers. Such loans shall also be made in accordance with the City's HOP loan guidelines.
- g) The **HOP Loans** shall: 1) have a term of 45 years; 2) bear no (0%) interest but require a City equity share; 3) be deferred for the full loan term; 5) comply with City regulations; and 4) be secured by a recorded trust deed in second lien position (for Inclusionary HOP Loans) and third lien position (for HOME HOP Loan) subordinate to the conventional home purchase mortgage. The estimated contract sale prices set forth in the Restated DLAs are subject to appraisal at the time of sale. Buyers must provide a 5% down payment towards the affordable sales price, and complete a qualified homebuyer education course.
- h) A regulatory agreement in favor of the City shall be recorded against the Projects, binding HHP during the development and unit sales phases of the Projects, and binding homebuyers of the 16 units to owner-occupancy, resale, and other restrictions in compliance with City and federal HOME regulations. The term of each regulatory agreement shall be 45 years.
- i) HHP shall comply with all applicable City ordinances, policies and regulations including the City's First Source Hiring ordinance.

### **ENVIRONMENTAL ANALYSIS:**

The "In-Fill Development Projects" Categorical Exemption under California Environmental Quality Act ("CEQA") Guidelines Section 15332 pertains to projects characterized as in-fill development which meet the following conditions: (a) 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; (b) The proposed development occurs within city limits on a project site of no more than five acres

substantially surrounded by urban uses; (c) The project site has no value, as habitat for endangered, rare or threatened species; (d) Approval of the project would not result in any significant effects relating to traffic, noise, air quality, or water quality; and (e) The site can be adequately served by all required utilities and public services.

It has been determined that the infill housing projects to be developed pursuant to the proposed agreements between the City and HHP are consistent with the Categorical Exemption under CEQA Guidelines Section 15332 and is thereby exempt from CEQA and no further CEQA review is required.

**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 2018 operating budget of the Housing and Career Services Department in the amount of \$3,007,982. The budget increase will come from the Department's HOME and Inclusionary Housing Trust Fund balances, which will result in fund balances of approximately \$200,000 (HOME) and approximately \$4.0 million (Inclusionary) in unreserved monies that are available for other projects.

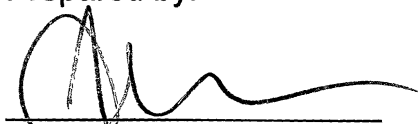
Respectfully submitted,



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Attachments:

Attachment A – Funding Sources and Uses

Attachment B – Sales Price Analysis

Attachment C – Decker Court and Gill Court Project Renderings

Attachment D – Site Plans

Attachment E – City Affordable Housing Map