

Agenda Report

JUNE 21, 2021

TO: HONORABLE MAYOR AND CITY COUNCIL

THROUGH: ECONOMIC DEVELOPMENT AND TECHNOLOGY COMMITTEE (June 15, 2021)

FROM: William K. Huang, Director of Housing
HOUSING DEPARTMENT

SUBJECT: APPROVAL OF THE KEY BUSINESS TERMS OF AN AFFORDABLE HOUSING LOAN AGREEMENT WITH HERITAGE HOUSING PARTNERS FOR A LOAN IN AN AMOUNT NOT TO EXCEED \$1,540,000 TO ACQUIRE AND REHABILITATE A FIVE-UNIT APARTMENT PROPERTY AT 1421 N. FAIR OAKS AVENUE FOR OPERATION AS AFFORDABLE RENTAL HOUSING

RECOMMENDATION:

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

- 1) Find that the proposed housing financing, acquisition and rehabilitation activity, as described in this agenda report, does not have a significant effect on the environment and has been determined to be categorically exempt under Class 1 (Existing Facilities) (State CEQA Guidelines Section 15301) and Class 26 (Acquisition of Housing) (State CEQA Guidelines Section 15326);
- 2) Approve a budget amendment appropriating \$1,540,000 from the Inclusionary Housing Fund Unappropriated Fund Balance to the Housing Department's FY 2021 operating budget for the HHP Housing Acquisition Project;
- 3) Approve certain key business terms, as described in this agenda report, of the proposed Affordable Housing Loan Agreement with Heritage Housing Partners; and
- 4) Authorize the City Manager to execute any and all documents necessary to effectuate the staff recommendation.

1421 N. FAIR OAKS AVENUE

June 21, 2021

Page 2 of 5

BACKGROUND:

The subject property, located at 1421 N. Fair Oaks Avenue, consists of an apartment building that was originally built in 1885 (the "Property"). The Property lot size is 13,869 sq. ft. The apartment building, which is 2,439 sq. ft., consists of five (5) dwelling units (one 2-bedroom unit, three 1-bedroom units, and one studio unit). Eleven (11) surface parking spaces are on the Property.

The current property owner, Lynnelle Bryant and Lori Dynes ("Owner") remodeled the building for operation as rental housing. The remodeling work included new systems (HVAC, plumbing, electrical), new interior and exterior finishes, new appliances, new exterior stair, and a new asphalt seal coat. Unfortunately, the Owner lost their master lessor and because the Property would not be able to support the construction loan debt without rental revenue, the Owner has elected to put the Property up for sale in March 2021 at the asking price of \$1,450,000. At the time, the Property was valued at \$1,510,000 based on the Owner's appraisal report dated October 2020. This value was supported by a Comparative Market Analysis performed by staff, using recent sales and currently listed comparables. The Property was marketed as a ready-for-occupancy turnkey project with only minor repair items needed.

On March 22, 2021, City Council authorized staff to submit an offer on the Property at the purchase price of \$1,510,000 for City ownership and operation as affordable rental housing. City Council also authorized the expenditure of an additional \$200,000 to perform due diligence, minor repairs, landscaping work, and funding of capitalized reserves. The City submitted its offer on March 31, 2021, but soon after was informed that the Owner accepted an offer from a third party competing buyer. However, the competing buyer subsequently backed out of the transaction. With this second opportunity to acquire the Property, the City submitted an offer of \$1,450,000 which was accepted by the Owner on April 19, 2021.

Staff commenced to perform extensive due diligence on the Property including title review, site survey, zoning and building permit research, environmental studies (including Phase 1, lead-based paint, asbestos, and mold), and building inspections (including termite, roof, foundation). Based on the due diligence findings, staff concluded that instead of a turnkey project, some level of repairs would be necessary before the Property could be placed in service. Accordingly, the City exercised its due diligence contingency to cancel the transaction on May 5, 2021.

However, recognizing the potential for the Property to be used for affordable housing and the Owner's preference for that use, staff referred non-profit developer Heritage Housing Partners (HHP) to the Owner. HHP commenced negotiations with the Owner which resulted in an accepted purchase offer in the amount of \$1,300,000. Upon completion of their due diligence activities, HHP submitted a request to the City on May 28, 2021 for loan assistance in the amount of \$1,540,000. HHP's request package included property inspection reports, a project budget, an annual budget for operation of the Property as affordable rental housing, and a 55-year cash flow analysis. HHP proposes to acquire the Property, make the necessary remediation and repairs, and operate the Property as affordable rental housing targeting persons and families at Low income (80% of the Los Angeles County area median income). HHP intends, but is not

required, to rent units to Very Low income households under one of the City's rental assistance programs (e.g., Section 8).

The total project budget is \$1.54M, consisting of \$1.3M for acquisition, \$186,500 for remediation/repairs, \$40,000 for capitalized replacement/operation reserves, \$10,000 for developer acquisition fee, and \$3,500 for title and escrow costs. The project budget is proposed to be financed entirely with City loan assistance. Per the project pro forma, there would not be sufficient cash flow to fully amortize the City loan by the end of its 55-year term. This is typical for rent-restricted, low income affordable housing projects, particularly for smaller projects which lack financial economies of scale and are not able to competitively leverage other public subsidies (e.g., County funds, bond financing, tax credits, etc.). Refinancing the Property may be an option for HHP to repay the City loan if there is sufficient equity.

Staff analyzed HHP's request and believes that the project financial assumptions are reasonable, the funding amount is in line with the subsidy levels provided by the City on other affordable housing projects, and that the proposed loan assistance for the project is an appropriate use of City housing funds. Accordingly, staff recommends that the City enter into an Affordable Housing Loan Agreement with HHP in connection with the Property. The staff recommendation was reviewed by the Internal Housing Loan Committee on June 10, 2012, which recommended approval.

KEY BUSINESS TERMS OF THE AFFORDABLE HOUSING LOAN AGREEMENT

The proposed Affordable Housing Loan Agreement (the "Loan Agreement") between the City and HHP ("Developer"), in connection with the acquisition, repair, and operation of the Property as affordable rental housing (the "Project"), includes the following key business points:

- 1) **Project Budget:** The estimated total project cost is \$1,540,000, comprised of acquisition, remediation and repairs, capitalized replacement and operating reserves, escrow/title fees, and HHP acquisition fee. This amount shall be financed with the City Loan.
- 2) **City Loan funding, interest, term:** City funding assistance for the Project shall not exceed \$1,540,000 in the form of a loan ("City Loan") drawn from the Inclusionary Housing Trust Fund. The City Loan shall bear interest at the fixed rate of 3.00% per annum, compounded annually, with a 55-year term. City Loan funds shall be used to pay project costs as set forth in the Project Budget.
- 3) **City Loan payment:** Developer shall make annual payments on the City Loan from the Project's residual receipts, if any (where residual receipts equals 50% of net cash flow after operating expenses, property taxes, replacement/operating reserves, and asset management fee, are paid). Developer's share of net cash flow is 50%.
- 4) **City Loan security:** The City Loan shall be secured with a deed of trust recorded against the Property. The City may agree to subordinate its lien position to a conventional permanent loan (after the Project is placed in service)

in the event Developer refinances to pay down the City Loan. Any sale, transfer, refinance, or encumbrance of the Property by Developer shall require the approval of the City.

- 5) **Scope of Development:** Acquisition, remediation, and repairs shall be performed in accordance with a Scope of Development.
- 6) **Schedule of Performance:** The Project milestones and timeframe for their completion shall be performed in accordance with a Schedule of Performance.
- 7) **Regulatory Agreement; Approval of Transfers, Encumbances:** Developer shall comply with rental housing deed restrictions in favor of the City for a term of 55 years ("Regulatory Agreement"). Under the recorded Regulatory Agreement, occupancy of all five (5) dwelling units in the Project shall be restricted to Low income households with rents paid by tenants not to exceed the Low income affordability under the City's Inclusionary housing standards. Any sale, transfer, refinance, or encumbrance of the Property by Developer shall require the approval of the City. In the event of a sale of the Property by Developer, City shall have the right of first refusal to acquire the Property.
- 8) **Marketing, Tenant Selection, and Management Plans:** Developer shall submit to the City for approval a Marketing and Tenant Selection Plan which complies with the City's Local Preference and Priority Guidelines. Developer shall also submit to the City for approval a Property Management Plan for the operation and maintenance of the Project.
- 9) **City policies:** Developer shall comply with all applicable City ordinances, regulations and policies including but not limited to City Minimum Wage standards, "First Source" local hiring requirements, and insurance and indemnification requirements.
- 10) **Reporting:** Developer shall submit to the City the following reports: a) during the Scope of Development period: monthly status reports on compliance with the City's First Source local hiring and Minimum Wage ordinances; b) during the City Loan term: annual operating budget and audited financial statements; c) during the Regulatory Agreement term: annual affordable housing and property management compliance reports.

COUNCIL CONSIDERATION:

The proposed action is consistent with the City's General Plan - Housing Element and the Five-Year Consolidated Plan. It also supports and promotes the quality of life and the local economy -- a goal of the City Council's Strategic Plan.

ENVIRONMENTAL ANALYSIS:

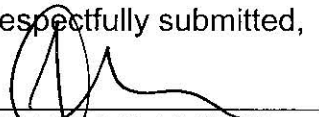
The implementation of the staff recommendation to provide financing for the purchase and rehabilitation of the subject property does not have a significant effect on the environment and has been determined to be categorically exempt under Classes 1

(Existing Facilities) and 26 (Acquisition of Housing) of the State California Environmental Quality Act ("CEQA"), (Sections 15301 and 15326 of the State CEQA Guidelines. Class 1 applies to the repair, maintenance and minor alterations of existing facilities where there is negligible or no expansion of the use. In this instance, the use – residential – will remain the same, and the repairs to the units will not have a significant effect on the environment. Class 26 applies where an agency is acquiring an interest in housing units for housing assistance, as is the case for this project. No unusual circumstances apply to these units, and no exceptions to the exemptions apply. Accordingly, no further CEQA review is required for this activity.

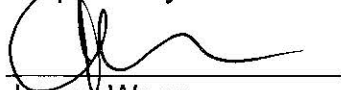
FISCAL IMPACT:

Approval of the subject recommendation will increase the Department's FY 2021 Operating Budget by the amount of \$1,540,000 by transferring said amount from the unappropriated fund balance of the Inclusionary Housing Trust Fund. The proposed City financing to implement HHP's acquisition and rehabilitation of the subject property will be drawn from Inclusionary Housing Trust Fund (Account No. 23916003-816700-51043. The action will reduce the available balance of the Inclusionary Fund to approximately \$1.46 million in non-committed funds available for new project commitments.

Respectfully submitted,


for WILLIAM K. HUANG
Director of Housing

Prepared by:


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Approved by:


STEVE MERMELL
City Manager