LOAN APPLICATION EVALUATION
CORNERSTONE VILLAGE – JOHN STEWART CO / BETHESDA

Project Summary

A summary of key project features for Cornerstone Village project proposed by the John Stewart Company and Bethesda (JSCo/Bethesda) is shown in Table 1. Note that the cost information and loan request have been updated to accurately reflect current City impact fees.

Table 1
Cornerstone Village Project Summary

<table>
<tr><th></th><th>Cornerstone Village</th></tr>
<tr><td>Developer</td><td>John Stewart Company / Bethesda
California-based affordable housing developer with significant experience in developing affordable housing, with more than 6,000 units in northern CA. Has six projects in Sacramento, many built in the last 10 years.</td></tr>
<tr><td>Nonprofit Partner</td><td>Bethesda Lutheran Communities
Wisconsin-based nonprofit focused on supporting affordable housing, particularly for people with intellectual and developmental disabilities. They will provide on-site social services at the project.</td></tr>
<tr><td>Location</td><td>9270 Bruceville Rd (portion of existing Light of the Valley Church property)</td></tr>
<tr><td>Nearby amenities</td><td>Adjacent uses are multifamily housing, single-family homes, and Harriet Eddy Middle School. Excellent proximity to shopping, services, and transit. Close to schools.</td></tr>
<tr><td>Type of project</td><td>Family / special needs</td></tr>
<tr><td>Affordable unit description[1]</td><td>
<table>
<tr><th>Affordability Level (% of AMI)</th><th>Total</th><th>Studio</th><th>1BD</th><th>2BD</th><th>3BD</th></tr>
<tr><td>30%</td><td>56</td><td>-</td><td>37</td><td>10</td><td>9</td></tr>
<tr><td>40%</td><td>-</td><td>-</td><td>-</td><td>-</td><td>-</td></tr>
<tr><td>50%</td><td>12</td><td>-</td><td>-</td><td>4</td><td>8</td></tr>
<tr><td>60%</td><td>-</td><td>-</td><td>-</td><td>-</td><td>-</td></tr>
<tr><td>70%</td><td>15</td><td>-</td><td>5</td><td>6</td><td>4</td></tr>
<tr><td>TOTAL</td><td>83</td><td>-</td><td>42</td><td>20</td><td>21</td></tr>
</table>
</td></tr>
<tr><td>Total number affordable units</td><td>83</td></tr>
<tr><td>Total residential square footage</td><td>74,110</td></tr>
<tr><td>Total project cost</td><td>$51,505,820</td></tr>
<tr><td>Construction cost</td><td>$33,582,841</td></tr>
<tr><td>Cost per unit</td><td>$620,552</td></tr>
<tr><td>Cost per residential sq. ft.</td><td>$694.99</td></tr>
<tr><td>Developer fee[2]</td><td>$2,500,000 (4.85%)</td></tr>
<tr><td>Loan request</td><td>$3,436,000</td></tr>
<tr><td>City subsidy per affordable unit</td><td>$41,398 (7%)</td></tr>
<tr><td>Other financing/subsidy[3]</td><td>$19,570,185 – 4% tax credits
$15,500,000 – HCD MHP
$5,387,000 – permanent loan (bank loan)
$2,748,390 – contributed developer fee
$2,100,000 – DDS capital loan
$1,924,146 – HCD HHC
$840,000 – FHLB AHC</td></tr>
</table>

Project amenities	Clubhouse with community room and four private offices for management and resident life staff, outdoor courtyard
Social services offered	Minimum of 15 hours per week of on-site supportive services, including customized events and classes; budget of $85,000 for services annually supports robust services
Site control status	Purchase agreement expiring 2/2023

1 The project also includes one two-bedroom manager unit, which is not income-restricted.
2 The developer fee is a total of $5,248,390, of which the developer is contributing $2,748,390 as equity to the project, giving an effective developer fee of $2,500,000.
3 As proposed, the City's financing will be junior to the tax credit, MHP, and bank loan financing.
4 As compared to the original proposal, the total project cost has increased about $4.1 million, $3.5 million of which is increased impact fees from the City, parks, and other agencies and $390K of which is an increase to the developer fee. All of the increase in the developer fee will be contributed back to the project as equity. The overall loan request to the City increased by $500,000, from $2.94 million to $3.44 million. The remainder of the increased costs will be absorbed by MHP and tax credit financing.

Loan Application

JSCo/Bethesda's loan application (**Attachment 2.1**) builds off of the information submitted in their proposal (**Attachment 2.2**). The components of the loan application are dictated by the Affordable Housing Loan Program Guidelines. The following items were not submitted:

- *Market study.* A complete market will be commissioned in early 2022, consistent with the requirements for recency of various planned funding sources. However, a rental survey conducted in May 2021 demonstrated a strong market for the housing within the Elk Grove area. Affordable housing and market-rate apartment complexes both showed very low vacancy rates in the survey. The rental survey did not look at other properties with units for adults with intellectual or developmental disabilities, but data from Alta California Regional Center and other local nonprofit agencies suggests adequate demand for these types of units. The market study will confirm demand for all unit types.

- *As-built property appraisal.* This appraisal identifies the "as is" value of the land, and prospective market values of the property when complete and when stabilized under both the restricted rent and unrestricted rent scenarios. JSCo/Bethesda noted that this appraisal is typically initiated by the lender. As negotiated with on past transactions, the City could require the as-built appraisal be a condition of the loan closing, but the City's conditional commitment cannot be tied to the value identified in the appraisal because that is not a factor within the applicant's control.

Loan Underwriting

The goal of the City's underwriting process is to evaluate the financial feasibility of the project, including JSCo/Bethesda's ability to develop the site as presented and to maintain the project in both the short-term and the long-term. Highlights of staff's underwriting efforts are noted below in the Project Strengths and Project Weaknesses sections.

<u>Project Strengths</u>

The Cornerstone Village application has several strengths:

- *Experience.* JSCo has significant experience developing affordable housing and has a longtime presence in California, with a Sacramento office and more than 6,000 units in Northern

California alone. The developer, architect, and construction contractor have worked together on multiple projects in the Sacramento area in the last several years, and are currently working on two projects in Sacramento. JSCo has a strong track record of building projects with complex financing structures, including multiple state and federal funding sources.

Bethesda Cornerstone Village, the real estate arm of Bethesda Lutheran Communities, is based in Wisconsin but has a California presence in the 34 residential facilities they operate for people with intellectual and developmental disabilities (I/DD). This project would be the first of three planned inclusive multifamily communities in the Sacramento area.

- *Location.* The project is in close proximity to middle and high schools, and is near the Laguna Community Park and Wackford Center. The project is also very near the Target shopping center and a Walgreen's, which together include a full-service grocery and pharmacy. The Laguna and Bruceville corridors are well-served by transit.

- *Project type and design.* The project includes 21 units for adults with intellectual and development disabilities, with units integrated throughout the complex and significant community space to offer a broad range of resident life services for all residents. The City currently has no affordable housing specifically for people with disabilities. The need for such housing, especially as parents and other caregivers of I/DD adults age, has often been raised by local services agencies like Elk Grove Adult Community Training and Project RIDE.

  The project will be located on a portion of the Light of the Valley Church site, with the church building being on a separate parcel but integrated into the overall site design, with shared driveway access and courtyard space. This provides two benefits: 1) the partnership expands available space for both groups to offer services and other community benefit activities, and 2) the use of underutilized church property for multifamily use provides a proof of concept and may justify counting church-owned land toward meeting the City's Regional Housing Needs Allocation in the future.

- *Unit affordability.* The majority of the project's units are set aside for people earning 30% of the area median income, including all of the units for I/DD adults and nine units for people experiencing homelessness. Nineteen of the 30% units are two- and three-bedroom units well-suited to families. The project also includes 15 units at the 70% of median income level, which is not an income level currently targeted in Elk Grove's affordable housing. There are few options for low-income households earning more than 60% of median income.

- *Partnership to address homelessness.* JSCo/Bethesda committed to partnering with the City to address homelessness, including by moving homeless Elk Grove households to the top of the waitlist for any unit for which they are qualified. A similar partnership on Gardens at Quail Run so far has resulted in ten Elk Grove homeless households (including six families with children) being placed in units they can afford.

- *Revenue and operating cost assumptions.* The project's revenue and operating cost assumptions are in line with the standards of TCAC. The project budget assumes either Section 8 or HUD 811 vouchers on 30 of the units, which allows very low tenant rents for those units and provides some income certainty even in a softening of the rental market. At least in the short term, revenue is likely to exceed projections substantially as a result of lower than projected vacancy rates. The pro forma projects an industry standard vacancy rate of 5%, but similar affordable projects currently have 0% vacancy rates.

- *On-site property management.* The project accounts for on-site property management by setting aside one non-income-restricted unit for a member of the property management staff. JSCo has an integrated property management division with extensive experience managing affordable multifamily units, and provides management to their own properties as well as third-party management to affordable housing owned by other developers.

- *Robust social services.* Through partnership with Bethesda Cornerstone Village, the project will go beyond the City's minimum of 15 hours a week of on-site social services. Bethesda will employ a full-time Resident Life Director to offer relationship-building and programming that focuses on social events, learning opportunities, fitness, and overall wellness. The services at this project would be more robust than at any other project in Elk Grove.

Project Weaknesses

A key goal of the City's affordable housing programs is ensuring that units remain an excellent resource for low-income households over the duration of the project's life. However, in addition to the strengths noted above, Cornerstone Village application has several weaknesses, mainly related to financial assumptions. These weaknesses may impact the project's ability to remain viable throughout the 55-year affordability period. Specifically, staff has identified the following weaknesses:

- *There is a disparity between the projected increases in rental revenue and the increase in operating expenses.* JsCo/Bethesda assumed that rents would rise at 2.0% annually, and that most operating expenses would rise at 3.0% annually, a discrepancy which is consistent with TCAC standards. In the current economic climate, a 2.0% increase or greater in annual rents is likely, but in a less strong economic environment, increases in revenue may be dependent on increasing Section 8 receipts and/or maintaining a lower than standard vacancy rate. In the event operating costs continue to increase at a rate outpacing revenue increases, the project's net operating income will decline, which may lead to a situation where the property cannot be adequately managed or maintained.

- *The proposed replacement reserve contribution of $500 per unit per year is inadequate to maintain the project over the 55-year affordability period.* Although this contribution is within TCAC guidelines, at this rate it would take more than 800 years before the replacement reserves equal the non-inflation-adjusted construction cost of the project. Additionally, while it's reasonably certain construction costs will rise over time, the replacement reserve contributions are not adjusted, meaning the amount they will be able to cover will decline as the project ages. Underfunding the replacement reserves creates a situation where the project may not be able to be maintained in line with the City's standards during the entirety of the affordability period.

- *The likelihood of the City receiving significant loan repayment throughout the loan term is small.* A residual receipts payment structure (50% of NOI) is proposed. Payments of the 50% residual receipts would be split equally among four lenders, with projected payments to the City ranging from $2,000 in Year 1 to about $15,000 in Year 25. In no year are payments expected to exceed $15,000.

Additionally, under this structure, the loan would not be amortizing and the annual payments to the City would not be equal to annual interest on the loan, creating a scenario where the loan balance continues to grow. If rents fail to increase at the predicted pace, if expenses are greater than estimated, and/or if vacancy is higher than anticipated, it is possible the City would not receive any payment at all. Historically, this has been the case for the majority of the City's residual receipts loans.