



Affordable Housing Committee Staff Report

AGENDA TITLE: Consideration of the proposed loan from the Affordable Housing Fund in support of The Lyla affordable apartment complex
Project location: along Bruceville Road north of Laguna Blvd

MEETING DATE: August 30, 2021

PREPARED BY: Sarah Bontrager, Housing and Public Services Manager

RECOMMENDED ACTION:

Staff recommends that the Affordable Housing Committee (Committee) complete its independent review of the loan application for The Lyla affordable apartment complex (Project) and make one of the following recommendations:

1. Staff continue to negotiate or collect additional information from the Pacific West Communities (PWC), with the loan being considered by the Committee again at a future date;
2. The City Council approve the loan;
3. The City Council deny the loan; or
4. Such other recommendation as deemed appropriate by the Committee.

BACKGROUND INFORMATION:

In February 2021, the City released an RFP soliciting eligible multifamily affordable housing projects. The RFP had two phases, the first of which was focused on identifying a project that would submit a 9% tax credit financing application in the July 2021 funding round and the second of which allowed proposals using any other funding sources.

The Committee met on June 30 to review the seven proposals received and requested loan applications from two affordable housing projects:

- Cornerstone Village, an 84-unit family project proposed by The John Stewart Company and Bethesda (JSCo/Bethesda). The project will have 21 units for people with intellectual and/or developmental disabilities, nine units of permanent supportive housing for people experiencing homelessness, and 53 units of family housing.
- The Lyla, a 294-unit family project proposed by PWC. The project will have a mix of studio, one-, two-, and three-bedroom units, including some for people earning 80% of the area median income.

The loan application provides additional information with which to consider a project. Review of the loan application focuses on the strength of the development team and the finances and viability of the individual project. The selected developers filed their loan applications by the July 26th deadline.

Following submittal of loan applications, on July 28, the Council adopted a Municipal Code amendment that

requires the collection of park fees by the Cosumnes Community Services District (CCSD) on non-mapped, multifamily developments. Both projects would be subject to the park fee, which neither developer anticipated paying the fee in their original proposals. As a result, the City provided each developer with the opportunity to revise their pro forma and financial expectations to accurately reflect current impact and building fees. However, due to the intricacies of calculating the park fee, the exact park fees are unknown at this time and could ultimately be lower or higher than estimated. PWC requested an additional \$2,000,000, bringing their total loan request to \$6,000,000. JSCo/Bethesda requested an additional \$500,000, bringing their total request to \$3,436,000.

At its August 11 meeting, the Committee reviewed the two loan applications, including the revisions to account for updated impact and building fee information. At that time, staff provided a detailed project summary of each project and its strengths and weaknesses (see the attachments to the staff report for the August 11 meeting). The Committee provided direction to staff to enter into loan negotiations with each of the developers, with Cornerstone Village receiving a loan of \$3,436,000. The Committee asked staff to work with PWC on a final loan amount for The Lyla project. The Committee also asked staff to explore options for addressing the impact of the park fee, such as offering fee waivers to the affected developers.

Financial Status

At the time the RFP was released, staff estimated that about \$8 million would be available to fund two to three affordable housing projects. In June, the Council made a \$4 million commitment to the Villages at Bilby project under Phase I of the RFP, leaving about \$4 million available. At the June 30th Committee meeting, the Committee members asked staff to evaluate whether there was any capacity to provide additional funding in order to fund two projects.

After review of the Affordable Housing Fund balance, and accounting for funding needed to support commitments to existing projects and the City's efforts to develop land it acquired for affordable housing, staff estimated there was about \$7 million that could be devoted to funding projects. That amount was adequate to fund the two projects with their original requests, which together totaled a little less than \$7 million. However, with the revision of the project budgets to account for updated building and impact fees, the total requests for funding now are about \$9.5 million.

This \$9.5 million amount exceeds available funding. While the Affordable Housing Fund, absent changes to structure or development pace, will continue to accrue funds, the City's strategy in recent years has shifted to strategic acquisition of property. The City now owns or is in contract to own three sites (about 15 buildable acres) on which it intends to solicit development partners to build innovative types of affordable housing. Future revenues of the AHF are needed for those properties. Allocating future revenue to fund projects today will substantially delay the City's ability to develop one or more of those City-owned projects.

ANALYSIS:

On August 11, the Committee asked staff to enter into loan negotiations with the two selected developers. The outcome of loan negotiations is a loan term sheet that is used to prepare the loan documents, including a Loan Agreement, Regulatory Agreement, Promissory Note, Deed of Trust, and Subordination Agreement. The intention of the loan term sheet is to protect the City's position and minimize risk, as well as to clarify the City's expectations for the developer and the senior lender.

The loan term sheet is a form of conditional loan commitment. Commitment of City or other local funds increases competitiveness for State and federal tax credit financing. For the City's funds to be a factor in the scoring of the application, the Developer must include "conclusive evidence that any public funds have been

firmly committed to the proposed project and require no further approvals.” Loan commitments may be subject only to conditions within the control of the applicant.

Project Status

PWC anticipates applying for 4% tax credits and tax-exempt bonds for The Lyla project in the September 9, 2021 funding round. In order to include City funding in their application, the City Council must approve a loan commitment at their September 8 meeting. The imminent deadline limited the time to negotiate loan terms.

JSCo/Bethesda’s project funding sources have their first deadline in November 2021, and staff continues to work with them to negotiate loan terms. Staff anticipates bringing a loan term sheet forward to the Committee for review in September.

Loan Terms

Staff’s chief goals in loan negotiations included the following:

- Ensuring that the City is providing the minimum amount of “gap financing” needed by a project to make it financially feasible;
- Mitigating risk to the City;
- Ensuring the long-term maintenance of the project;
- Promoting future affordable housing options, both by requiring meaningful repayment and operating in a way that encourages people to move up and on from affordable housing when they can afford market-rate housing; and
- Providing cost controls to improve transparency in a situation where the construction contractor is a related entity of the Developer.

Staff spent considerable time and effort working with the Developer to negotiate loan terms, with the primary goal of reducing the amount of funding required of the City to a level that is in line with available funding and which doesn’t negatively impact the City’s ability to develop affordable housing projects on City-owned land. Unfortunately, the Developer was unwilling to consider anything less than a \$6 million loan.

Staff’s assessment is that there are multiple measures that could be used to reduce the initial outlay of cash required for this Project. Strategies that staff explored with the Developer included the following:

- **Waiving the park fee.** Providing a waiver of the estimated park fee would reduce the requested loan amount by \$2 million. This would reduce the amount of funding available to CCSD to construct new parks. Additionally, pursuant to State law, a fee waiver in this amount would be considered public funding and would trigger payment of prevailing wage on the Project. The Project budget did not contemplate paying prevailing wage and the Developer was not interested in exploring that option further.
- **Long-term deferral of the park fee.** Providing a long-term deferral of the park fee could reduce the requested loan amount by \$2 million. Under this structure, the park fee would be paid from residual receipts, reducing the amount of residual receipts payments to the City in future years. CCSD would be required to approve this approach, under which they would likely not see payment for at least 10 years. CCSD was not in favor of this strategy, both because of the long-term payment and due to a lack of staff knowledge on reviewing and tracking affordable housing project financials. A long-term fee deferral may also be considered public funding that would trigger payment of prevailing wage on the Project, unless interest is charged on the deferred amount at market-rate.

- **Requiring the Developer to contribute a certain amount of their developer fee as equity.** Staff's previously shared assessment was that the effective developer fee (total developer fee less contributed equity) on the Project exceeds the maximum allowed by the City, which is 10% of development cost, less the developer fee itself. Contributing a portion of the developer fee as equity to the project is a common strategy seen in several of the proposals the City received, including the JSCo/Bethesda proposal and a proposal from a for-profit developer. This strategy could reduce the need for City financing by about \$2.5 million.

In this case, the Developer indicated that such a strategy would have a negative tax impact and/or would be an undesirable business decision. Staff explored the idea of using a nonprofit partner to alleviate the tax impact, but this was not the Developer's preference.

However, the Developer did agree to update the payment structure so that the portion of the developer fee over 10% does not impact the City's payments. Once the developer fee hits the 10% mark, the City will start to receive payment of 50% of residual receipts, calculated before accounting for any outstanding deferred developer fee payment. At that point, the amount of the deferred developer fee remaining will be paid from the Developer's 50% share of residual receipts. In the pro forma provided, that would result in payments of approximately \$225,000 to the City in Year 8. Though not provided to staff, the Developer also indicated that they use a version of the pro forma with a rosier financial picture, under which payments to the City would come sooner.

- **Requiring that any amount of water, sewer, or drainage fee waivers received from governmental entities be used to offset the amount of the City's loan.** Previous projects have benefitted from such waivers; Gardens at Quail Run I received about \$1.2 million in waivers from three Sacramento County agencies. Based on the affordability level of the units, staff estimates that this strategy could reduce the amount of City subsidy needed by about \$1.2-1.5 million. The availability of these waivers is currently unclear. After many years of adequate capacity, the annual cap on waivers has begun to be reached in the region. The Sacramento Housing and Redevelopment Agency plans to coordinate with the County to propose an increase in the cap or outright suspension of a cap; if approved, this may allow this Project to qualify for waivers. When proposed to the Developer, the Developer expressed interest in pursuing the waivers but was not willing to account for them via any reduction to the City's loan amount.
- **Require the amount of the developer fee associated with the park fee to be contributed to the project as equity.** This could reduce the City's loan amount by approximately \$300,000 if the park fee were to be the estimated \$2 million. In the August 11 meeting, this was offered by the Developer as an option, but in further discussions, the Developer indicated they would not do this.

Overall, the Developer represented that reducing the loan amount below \$6 million through various cost savings or loan reduction provisions, including some of those described above, could have a negative implication for the Developer in future financing rounds. The terms drafted may make it difficult for the City to recover the cost differential if the park fee came in lower than anticipated. As a result, staff is proposing a strategy whereby either a) the loan amount would be reduced by that differential, after coordination with TCAC and CDLAC, or b) the differential would be paid back as a principal payment on the loan within 30 days of project stabilization. However, any cost savings on the park fee, whether by reduction of the loan amount or principal payment, are unlikely to bring the ultimate loan amount of financial outlay in line with available funding.

A draft loan term sheet is attached for the Committee’s review (Attachment 2). The Developer indicated their acceptance of the terms.

Highlights of the loan terms include the following:

- Loan amount of \$6 million in total, which would be reduced via either a loan reduction or a principal payment if the amount of the actual park fee is less than estimated;
- Interest rate of 4%;
- City commitment extends for three consecutive tax credit submittals or until December 31, 2022, whichever is later;
- Disbursements tied to project framing completion, construction completion, cost certification, and project stabilization;
- Provisions to assist the City in ensuring that the project’s costs are reasonable;
- A requirement to provide 15 hours per week of on-site social services;
- Requirements related to insuring and reporting on the property; and
- A Regulatory Agreement that will restrict the units as affordable for a period of 55 years.

Options

The Committee’s responsibility is to perform an independent review of the loan application and return the loan package to staff with their recommendation. The Committee has the following options:

1. Provide direction to staff to collect additional information requested from the Developer and continue loan terms negotiation. With this choice, the loan would be presented to the Committee again at a future date.
2. Make a recommendation for loan approval by the City Council.
3. Make a recommendation for loan denial by the City Council.
4. Make such other recommendation as deemed appropriate by the Committee.

Next Steps

If the Committee chooses to recommend that the Council approve or deny the loan, the Council is expected to consider the item on September 8. If approved by Council, this timeframe will allow the Developer to apply for tax credit financing in the September 8 funding round. In the event the Committee asks for additional information or continued negotiation, the Developer would not be able to obtain a loan commitment from the City in order to apply for tax credit financing on September 8. The next opportunity to apply for funding is expected to be in early 2022.

ENVIRONMENTAL DETERMINATION:

CEQA requires analysis of agency approvals of discretionary “projects.” A “project,” under CEQA, is defined as “the whole of an action, which has a potential for resulting in either a direct physical change in the environment, or a reasonably foreseeable indirect physical change in the environment.” The proposed Project is a project under CEQA.

The Project requires no further review under the California Environmental Quality Act (CEQA) pursuant to Sections 15162 (Subsequent EIRs and Negative Declarations) and 15183 (Projects Consistent with a Community Plan, General Plan, or Zoning) of Title 14 of the California Code of Regulations (State CEQA Guidelines). State CEQA Guidelines Section 15183 (Public Resources Code §21083.3), provides that projects

that are consistent with a Community Plan, General Plan or Zoning for which an EIR has been certified “shall not require additional environmental review, except as might be necessary to examine whether there are project-specific significant effects which are peculiar to the project or its site.”

On May 12, 2021, the City Council certified a Subsequent EIR for the Housing Element Update and Safety Element Update, which analyzed the Project site for the development of high-density residential use (State Clearinghouse No. 2020069032). In February 2019, the City Council adopted a new General Plan which relied on Vehicle Miles Traveled (VMT) as a measure of transportation impacts. The Project is high density low-income housing on a high-density housing site as designated in the Housing Element, which is exempt from VMT analysis.

The Lyla Project is being undertaken pursuant to and in conformity with the 2021 General Plan Housing Element. No special circumstances exist and no changes in the project have occurred that would necessitate the preparation of subsequent environmental review. No additional environmental impacts have been identified for the Lyla Project other than those previously disclosed and analyzed in the Housing Element Update SEIR. The Lyla Project is subject to the Housing Element Update Mitigation Monitoring and Reporting Program. Consequently, pursuant to CEQA Guidelines Section 15183, no further environmental review is required for this project.

Additionally, State CEQA Guidelines Section 15162 (Subsequent EIRs and Negative Declarations) requires that when an EIR has been certified for an adopted project, no subsequent EIR shall be prepared for that project unless the lead agency determines, on the basis of substantial evidence in light of the whole record, that one or more of the following exists:

1. Substantial changes are proposed in the project which will require major revisions of the previous EIR due to the involvement of new significant environmental effects or a substantial increase in the severity of previously identified significant effects;
2. Substantial changes occur with respect to the circumstances under which the project is undertaken which will require major revisions of the previous EIR due to the involvement of new significant environmental effects or a substantial increase in the severity of previously identified significant effects; or
3. New information of substantial importance, which was not known and could not have been known with exercise of reasonable diligence at the time of the previous EIR was certified as complete shows any of the following:
 - a. The project will have one or more significant on discussed in the previous EIR;
 - b. Significant effects previously examined will be substantially more severe than shown in the previous EIR;
 - c. Mitigation measures or alternatives previously found not to be feasible would in fact be feasible and would substantially reduce one or more significant effects of the project, but the project proponents decline to adopt the mitigation measure or alternative; or
 - d. Mitigation measures or alternatives which are considerably different from those analyzed in the previous EIR would substantially reduce one or more significant effects on the environment, but the project proponents decline to adopt the mitigation measures or alternative.

Staff has reviewed the Project and analyzed it based upon the above provisions in Section 15162 of the State CEQA Guidelines. The Lyla Project is being undertaken pursuant to and in conformity with the Housing Element Update. There are no substantial changes in the Project from that analyzed in the 2021 SEIR and no

new significant environmental effects, or substantial increase in the severity of previously identified significant effects. No new information of substantial importance has been identified. Further, since no changes to the EIR are necessary to support the Project, the City is not required to prepare an Addendum to the EIR as required by State CEQA Guidelines Section 15164. Therefore, the prior EIR is sufficient to support the proposed action and no further environmental review is required.

FISCAL IMPACT:

Staff originally estimated that about \$8 million would be available under the RFP, which included two phases. An existing commitment of \$4 million to the Villages at Bilby project means about \$4 million is available under the second phase of the RFP; however, at the Committee's request, staff reviewed the Affordable Housing Fund balance and believes about \$7 million is reasonably available to devote to these two requests, which amount is in addition to the \$4 million previously committed to the Villages at Bilby.

At its August 11 meeting, the Committee indicated it wanted to fund the JSCo/Bethesda project at \$3,436,000. That would leave \$3,564,000 available to fund The Lyla project. Despite staff's repeated efforts to reduce the budget in line with the available funding, the Developer was not amenable to receiving anything less than \$6 million in support of the Project.

The loan term sheet presented to the Committee includes a loan amount of \$6 million. That amount exceeds the estimated available funding by approximately \$2.5 million. Providing a loan in that amount would require borrowing against future revenues of the Affordable Housing Fund, which are uncertain, and which would inhibit the City's ability to complete other priority affordable housing projects. Staff believes the Project could be built with a lower commitment of funding from the City and included strategies in this report that might be used to bring the loan amount in line with available funding (for example, reducing the loan amount by the value of fee waivers received, requiring a certain amount of contributed equity). The simplest strategy to reduce the financial outlay on this Project is simply setting the loan value at a lower amount.

If approved, the conditional loan commitment will reserve the monies for the length of the commitment period and preclude other projects from consideration.

There is adequate budget in the Affordable Housing Fund to cover staff costs associated with making one or more loans, including the creation of loan documents to secure the City's investment. The cost of staff time to process loans is small in comparison to the value of the loans, and the cost of staffing to support the goals of the Affordable Housing Fund is budgeted annually. The proposed annual payments on the loan are projected to cover staff costs associated with long-term monitoring of the project's physical and financial condition.

No General Fund contribution is anticipated for the loan or for the project monitoring and oversight.

ATTACHMENTS:

1. Draft loan term sheet – The Lyla