



## Affordable Housing Committee Staff Report

**AGENDA TITLE:** Consideration of modifications to the proposed loan from the Affordable Housing Fund in support of the Cornerstone Village affordable apartment complex  
*Project location: along Bruceville Road south of Laguna Blvd*

**MEETING DATE:** June 13, 2023

**PREPARED BY:** Sarah Bontrager, Housing and Public Services Manager

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### **RECOMMENDED ACTION:**

Staff recommends that the Affordable Housing Committee (Committee) review information related to the loan commitment modification request for Cornerstone Village affordable apartment complex (located along Bruceville Road south of Laguna Blvd) and make one of the following recommendations:

1. Staff continue to negotiate or collect additional information from the developer, with the loan commitment modifications being considered by the Affordable Housing Committee again at a future date;
2. The City Council approve the loan commitment modifications;
3. The City Council deny the loan commitment modifications; or
4. Such other recommendation as deemed appropriate by the Committee.

### **BACKGROUND INFORMATION:**

In February 2021, the City released a Request for Proposals (RFP) soliciting eligible multifamily affordable housing projects. The Committee recommended that the City Council make loan commitments to three projects:

- The Villages at Bilby, a 126-unit project that received a loan commitment of \$4,000,000, was not awarded tax credit funding and its loan commitment has expired.
- The Lyla, a 294-unit project that was awarded up to \$6,000,000, closed its financing in late 2022 and is now under construction.
- Cornerstone Village, which received a loan commitment of \$3,436,000, is in the process of securing financing.

Cornerstone Village is an 84-unit family project proposed by The John Stewart Company (JSCo) and Bethesda (collectively, Developer). The project will have 21 units for adults with intellectual and/or developmental disabilities, nine units of permanent supportive housing for people experiencing homelessness, and 53 units of family housing. A full-time resident services coordinator will be on-site to offer programming appealing to the interests of all residents, with some targeted programming for special needs populations. The inclusion of units for adults with intellectual and/or developmental disabilities would be a first for Elk Grove. The project, which is located on land currently owned by Light of the Valley Church, would also be the first affordable housing project to make use of underutilized land owned by a faith-based organization, potentially providing options for future

collaborations on infill housing to meet State-mandated zoning obligations.

### **Loan Commitment**

On December 8, 2021, the Council approved a conditional loan commitment in the amount of \$3,436,000 for the Cornerstone Village project. The loan commitment is evidenced by a loan term sheet, which spells out the major terms that are used to draft 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 approved loan term sheet is included as Attachment 1.

Highlights of the loan terms include the following:

- Loan amount of \$3,436,000;
- Interest rate of 4%;
- City commitment extends until October 31, 2023;
- Disbursements tied to close of construction financing, 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 a full-time resident services coordinator to provide high-quality, on-site social services, including services targeted to formerly homeless households and adults with intellectual and developmental disabilities;
- 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.

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 (in this case, the Developer).

### **ANALYSIS:**

In May 2022, JSCo and AbleLight staff met with City staff to discuss proposed changes to the project. In short, the Developer made four requests:

1. Allow AbleLight to exit the venture, substituting Pacific Housing as the Managing General Partner and LifeSTEPS as the on-site resident services provider. They also proposed adding Alta Regional Center as a service provider for residents with intellectual and developmental disabilities.
2. Increase the City's loan contribution by \$2,000,000, for a total loan amount of \$5,436,000.
3. Extend the date of the loan commitment from October 31, 2023 to December 31, 2024.
4. Make a minor change to the unit mix by adding one two-bedroom unit and removing one one-bedroom unit.

Additional information on each request is covered below.

### **Partnership Changes**

The original proposal included Bethesda/AbleLight as the Managing General Partner and JSCo as the Administrative General Partner. AbleLight was to provide on-site resident services, including a full-time resident services coordinator. AbleLight specializes in providing services to adults with intellectual and developmental disabilities and a primary goal was inclusion of these residents into the community.

In 2022, AbleLight underwent a strategic planning process under the leadership of a new CEO. The result of the planning process was a renewed focus on providing direct services to people with intellectual and developmental disabilities. To protect the rights of people with disabilities, there are restrictions on being both a housing owner and service provider when a person is receiving Medicaid waiver-funded services. AbleLight determined it could not excel in both affordable housing development and direct services and opted to put its resources into direct services, but will stay on with the Cornerstone Village project in a consulting role.

With AbleLight’s exit, JSCo is proposing a new Managing General Partner, Pacific Housing. Pacific Housing is a nonprofit public benefit corporation devoted to developing affordable housing, usually in collaboration with other developers. Pacific Housing serves as the Managing General Partner on five affordable housing projects within Elk Grove, including Avery Gardens, Bow Street, Gardens at Quail Run, Montego Falls, and the Ridge. Pacific Housing will not provide on-site social services at Cornerstone Village. More information on Pacific Housing can be found in Attachment 2.

AbleLight will also be exiting its planned role as the resident services provider. LifeSTEPS is proposed to replace them as the primary service provider, with support from both Lutheran Social Services (for formerly homeless households) and Alta Regional Center (for adults with intellectual and developmental disabilities). LifeSTEPS will provide a full-time on-site resident services coordinator. LifeSTEPS has experience providing services to special needs populations at other projects, including five 100% special needs projects in California (one in Sacramento area). See Attachment 3 for a comprehensive overview of services and qualifications for each of the providers.

JSCo has experience working with LifeSTEPS and Lutheran Social Services (LSS) on many other projects, including 11 LifeSTEPS partnerships in the Sacramento region and three Sacramento-area LSS collaborations. JSCo works with Alta Regional Center on one local project and LifeSTEPS and Alta work together on several other projects.

Pacific Housing, LifeSTEPS, LSS, and Alta all currently work within Elk Grove. Pacific Housing and LifeSTEPS in particular have a significant role in many existing affordable housing projects in the community. Staff does not have significant concerns about the proposed change in team. The loan term sheet did not mention the partners by name, so no updates to the term sheet are required to accommodate this change.

**Loan Increase and Project Financials**

A side-by-side comparison of the pro forma submitted with the loan application and a pro forma prepared by the Developer in May 2023 shows overall increases in project costs and a different funding strategy than initially proposed.

*Proposed Uses of Funding*

The table below shows proposed uses of funding in the original vs. current proposals. Overall, costs have increased significantly. The largest factors driving increases are rising interest rates, exponential increases in builder’s risk insurance, and lower tax credit equity pricing.

Uses of funding	Original - 2021	Proposed 2023	Notes
Acquisition	\$1,925,000	\$1,907,600	
Hard costs	\$33,582,841	\$35,508,694	Rising materials and labor costs
Design	\$2,217,056	\$1,304,580	Overall cost savings
Fees and permits	\$4,619,966	\$2,229,475	Lower impact fees
Financing	\$2,206,655	\$4,945,250	Rising interest rates – construction loan interest has doubled
Developer fee	\$5,248,390	\$6,325,000	Fee is a percentage of other costs <sup>1</sup>

Reserves	\$382,933	\$220,166	Project is setting aside fewer funds
Other soft costs	\$1,322,980	\$2,229,090	Drastically increased cost for builder's risk insurance
<b>TOTAL</b>	<b>\$51,505,820</b>	<b>\$54,669,855</b>	

1 While the developer fee is increasing, the developer also anticipates contributing a higher percentage of the developer fee back to the project, going from 52% to 65%. The developer fee not contributed is falling by \$300,000.

*Proposed Sources of Funding*

The table below shows proposed sources of funding in the original vs. current proposals, alongside the status of each funding source. The funding strategy changed based on the Developer's analysis of competitiveness for various funding sources.

	Original - 2021	Proposed 2023	Status
Tax-exempt first mortgage	\$5,387,000	\$2,500,000	Secured after financing
HCD MHP loan	\$15,500,000	\$10,400,081	Plan to submit application July 12
City of Elk Grove loan	\$3,436,000	\$5,436,000	\$3.436M awarded; \$2M under consideration
HCD HOME loan	-	\$7,000,000	Awarded
DDS multifamily loan	\$2,100,000	\$2,100,000	Awarded
HCD HHC	\$1,924,146	-	No longer eligible <sup>2</sup>
AHP	\$840,000	-	Determined not competitive <sup>3</sup>
Contributed developer fee	\$2,748,390	\$4,125,000	Within developer control
General Partner contribution	\$100	\$100	Within developer control
Tax credit equity - state	\$1,190,141	-	
Tax credit equity - federal	\$18,380,044	\$23,108,673	Can apply only after all other funding (including MHP) is secured
<b>TOTAL</b>	<b>\$51,505,820</b>	<b>\$54,669,854</b>	

1 Sizing of permanent debt is based on interest rates, amount of financial obligations (such as annual property assessments and required payments in HCD loans), and amount of replacement reserve deposits. The decrease in the estimated mortgage debt is largely due to higher interest rates and fluctuating assumptions related to HCD financing.

2 HCD's Housing for Healthy California grant prohibits stacking with HOME money, which the project was recently awarded.

3 The developer scored the project for AHP and with a score of approximately 55.5 determined it is not competitive (typically projects need a score of 61 to be competitive). The score is negatively impacted by not having at least 49% of the units designated as homeless, not having donated land, and because the project is not located in a community revitalization area. Additionally, AHP requires working with an FHLB member bank and that restricts lender options (which impacts financing costs).

*Reasoning for Increased Loan Request*

The Developer has requested that the City consider an additional \$2,000,000 in funding for the project, under the belief that this is the only way to make the project competitive for MHP funding.

The Developer offered the following rationale for the increased City investment:

1. The additional City funding improves the tiebreaker score for the HCD SuperNOFA and for CDLAC tax credits as demonstrating a larger commitment from the local jurisdiction increases the tiebreaker score and makes the project more competitive for an award.
2. The additional City funding eliminates the need for state tax credits, which is important both for improving the tie breaker score and being as competitive as possible for an allocation because if no state tax credits are available by the time they get to the project's funding application in the queue then they will not make an award if the project depends on the state tax credits for feasibility.

3. It is important that the project is as competitive as possible for this round of HCD Multifamily Housing Program (MHP) financing as the Purchase and Sale Agreement with Light of the Valley only extends until 2024.

#### Overall Cost Considerations

If funded at the \$5,436,000 level, the per unit cost would be \$64,714, which higher than past loans the City has made, as shown in the table below.

Project	Total Loan	Number of units	Cost per unit
Bow Street	\$5,000,000	98	\$51,020
Gardens at Quail Run I	\$5,000,000	96	\$52,083
Lyla	\$6,000,000	294	\$20,408
Villages at Bilby <sup>1</sup>	\$4,000,000	126	\$31,746

<sup>1</sup> Villages at Bilby received a loan commitment in 2021 but ultimately did not move forward.

However, this project differs from previously funded projects in some key ways:

- It anticipates paying prevailing wage, which is required by HOME funding and project-based vouchers, both of which the project has secured. None of the previous affordable housing projects in the City have paid prevailing wage.
- It offers deep affordability, with an average affordability of just 36% of area median income. This compares to 50%+ for most prior projects.
- It is being constructed at a time when interest rates and construction costs have increased significantly. If Bow Street and Gardens at Quail Run I had been built under today's market conditions, it is highly likely that the per-unit subsidy needed to make them feasible would exceed \$60,000 per unit.

#### Loan Commitment Extension

The Developer is requesting an extension of the loan commitment to December 31, 2024, a total of 14 months. They plan to apply for MHP funding in July 2023, and if awarded, would be eligible to apply for tax credit financing in the 2024 rounds. They would have an opportunity to secure tax credit financing twice before the funding commitment ended.

Staff does not have major concerns about extending the date of the loan commitment in light of the fact the developer has secured several sources of funding.

#### Unit Mix

The Developer proposes a minor change to the unit mix, adding one two-bedroom unit and removing one one-bedroom unit. This change is needed to ensure that the project qualifies as a family project for financing purposes.

Staff does not have concerns about this change. There is adequate demand for units of all sizes, especially at the affordability levels proposed.

#### Project Status

The Developer has secured partial financing for the project and anticipates pursuing additional funding, including from 4% tax credits/tax-exempt bonds and HCD's MHP program. The application for MHP is due July 12. In order to include an updated City loan commitment in their application for maximum competitiveness, the City Council must approve any loan commitment modifications at the June 28 Council meeting.

### Options

The Committee’s responsibility is to perform an independent review of the loan modification request and make a recommendation to the Council. 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. The delay in consideration would mean that the Council could not approve any loan modifications at their June 28 meeting, and any changes ultimately approved to enhance competitiveness would not be included in the July 12 MHP application.
2. Make a recommendation for loan commitment modification by the City Council. In the event the Committee wishes to make this recommendation, Attachment 6 shows the proposed modifications to the loan term sheet.
3. Make a recommendation for loan commitment modification 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 June 28. If approved by Council, this timeframe will allow the Developer to apply for MHP financing in July with increased chances of success.

### ENVIRONMENTAL DETERMINATION:

The proposed project is a project under Section 15378 of the State California Environmental Quality Act (CEQA) Guidelines. However, the project is exempt pursuant to State CEQA Guidelines Section 15332 (In-Fill Development), as determined by the Planning Commission on June 2, 2022.

### FISCAL IMPACT:

The current balance of the Affordable Housing Fund is approximately \$23.6 million. However, much of this funding is committed, as shown below.

<b>Starting fund balance</b>	<b>\$23,600,000</b>
Lyla	(\$6,000,000)
Cornerstone Village	(\$3,436,000)
RFP – Sheldon Farms North and Old Town sites	(\$6,000,000)
Homebuyer assistance	(\$1,000,000)
<b>Uncommitted fund balance</b>	<b>\$7,164,000</b>

The Affordable Housing Fund has the capacity to increase the loan amount for this project if the Committee desires. However, the Committee must weigh this increased commitment against the potential needs for support for other future projects, including:

- Poppy Grove, on which the Council indicated potential support for funding for enhanced design elements;
- Sheldon Farms South and Elk Grove Florin sites, which the City owns and intends to begin preliminary design work on in late 2023;
- Project Elevate, which is statutorily required to include an affordable housing component; and

- Future strategic land acquisitions.

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

There is adequate budget in the Affordable Housing Fund to cover staff costs associated with making the loan, 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 loan, and the cost of staffing to support the goals of the Affordable Housing Fund is budgeted annually. In the event that the annual payments on the loan are not adequate to cover staff costs associated with long-term monitoring of the project's physical and financial condition, the Affordable Housing Fund has sufficient funding for staffing.

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

**ATTACHMENTS:**

1. Original loan term sheet – December 8, 2021
2. Pacific Housing qualifications
3. Services overview
4. Original project pro forma – August 2021
5. Proposed project pro forma – May 2023
6. Draft loan term sheet reflecting requested changes