

For Housing Authority Meeting of: November 5, 2019

CITY OF SANTA ROSA
HOUSING AUTHORITY

TO: HOUSING AUTHORITY COMMISSIONERS
FROM: NANCY MANCHESTER, PROGRAM SPECIALIST II
HOUSING & COMMUNITY SERVICES
SUBJECT: BURBANK HOUSING DEVELOPMENT CORPORATION LOAN
MODIFICATION REQUEST – LANTANA PLACE HOMES (2979
DUTTON MEADOW, FORMERLY 2975 DUTTON MEADOW) –
APN 043-121-013

AGENDA ACTION: RESOLUTION

RECOMMENDATION

It is recommended by the Housing & Community Services Department that the Housing Authority, by resolution, approve Burbank Housing Development's (BHDC) request to modify Housing Authority Loan Nos. 9032-1825-07, 9932-1835-07, 9932-2075-10, 9932-2781-17, 9932-2791-17, 9932-2801-17, and 9932-2801-17 (Loan), in the total principal amount of \$7,078,703 for Lantana Place Homes (Project) as follows: (a) Forgive all interest accrued on the Loan in an approximate amount of \$992,500 (final amount to be determined as of the date of Loan Modification); (b) Modify the existing Promissory Note and Deed of Trust to reduce the total amount to \$3,502,944 at 0% interest until the units are sold; (c) Enter into a new unsecured Promissory Note in the amount of up to \$3,575,759; (d) Upon sale of the individual units, convert the \$3,502,944 into down payment assistance for each home purchaser at 3% simple interest, deferred payment, for a term of 30 years; and (e) Adopt alternative criteria pursuant to California Health and Safety Code Section 50052.5(c) allowing alternative income-to-housing cost ratios of up to 40% for the Project.

EXECUTIVE SUMMARY

BHDC is requesting a loan modification to forgive the accrued interest, convert the interest rate of the secured Loan to zero percent until the units are sold, and reduce the encumbrance on the Property by \$3,575,759 through a new, unsecured Promissory Note. The Housing Authority (Authority) has provided loans to Burbank Housing Development Corporation (BHDC) totaling \$7,078,073 for Lantana Place Homes, a 48-unit homeownership project located at 2979 Dutton Meadow (Project). Since 2007, Lantana Place has evolved from a 100-unit multifamily rental complex to the current 48-unit homeownership project. The Project was recast as homeownership in 2017 to address: (a) the financing gaps for rental housing associated with the suspension of the

state's Multifamily Housing Program and the dissolution of statewide redevelopment programs, (b) the U.S. Department of Housing & Urban Development (HUD)'s inquiry into the delayed status of the Project; and (c) rising construction costs. Since the Project was recast as ownership housing, the construction costs have continued to increase, causing a short-term over-encumbrance with the addition of the anticipated construction loan to be secured by the Property.

BACKGROUND

1. On December 17, 2007, the Authority provided BHDC with a loan of \$1,878,703 (\$1.4 million in CDBG funds) to assist with acquisition and pre-development costs for Lantana Place, a 100-unit multifamily rental complex for low-, very low-, and extremely low-income households. To meet the anticipated development cost of \$32 million, BHDC planned to finance the project with 4% tax credits, tax-exempt bonds, Affordable Housing Program (AHP) Funds, and funds from the state's Multi-Family Housing Program; BHDC also planned to apply for additional funding from the Authority.
2. On August 23, 2010, the Authority approved revision of the project from 100 to 96 units and a further advance to BHDC for \$500,000 in low/mod funds primarily from Southwest Project Area redevelopment funds.
3. In April 2017, the City was contacted by the HUD Inspector General (IG) regarding the duration of time that Community Development Block Grant (CDBG) funds had not resulted in constructed units. As a result of the inquiry, and to assist in the project's successful completion, BHDC and staff collaborated to recommend to the Housing Authority a revision of the Project from rental units to homeownership units.
4. On July 11, 2017, the Authority approved a second further advance in the amount of \$3.4 million to BHDC, and approved revision of the 96 multifamily rental unit project to 48 homeownership units for low- and moderate-income households. Furthermore, the Authority approved conversion of the existing Loan to "silent seconds" for down payment assistance for a term of 30 years, deferred payment, at 3% simple interest. The total development budget for the Project was identified as \$23 million.
5. On October 22, 2018, the Authority approved a third further advance to BHDC in the amount of \$1.3 million. Due to increasing construction costs, the total development budget for the Project was \$26.2 million, an increase of 13% since 2017.
6. The continual increase in construction costs has resulted in \$4.8 million in "sunk costs" associated with the original work related to the multifamily project and \$1.2 million invested to date on the current home ownership project by BHDC. With the addition of \$19.1 million in construction financing expected in November 2019, the 48 homes would need to sell for a price that is 20% higher than market-rate and not affordable to the targeted households, anticipated to be those earning 70% to 95%

of AMI. These factors have led BHDC to submit a request to modify its Authority loans.

7. The loan modification request includes:
 - a. Forgiveness of all accrued interest, \$992,415 as of October 28, 2019, and suspension of interest accrual on the Loans;
 - b. Modification of the existing Deed of Trust to continue to secure \$3,502,944 against the Property at zero percent interest until the funds convert to down payment assistance at 3% interest;
 - c. Entering into a new, unsecured Promissory Note in the amount of \$3,575,759, at 0.5% interest with monthly repayment of the loan from BHDC's operating income; and,
 - d. Consideration of adoption of alternative "front-end" criteria allowing income-to housing cost ratios of up to 40% for income-qualified home purchasers.
8. This request can be illustrated as follows:

Original Total Loan Principal	\$7,078,703
Less New, Unsecured Promissory Note backed by BHDC	-\$3,575,759
Loan Balance For Down Payment Assistance to be Secured by Deed of Trust Recorded on Individual Parcels at Sale	\$3,502,944

PRIOR HOUSING AUTHORITY REVIEW

- Resolution No. 1402 (December 17, 2007) approved \$1,878,703 in loan funds to BHDC for a 100-unit multifamily rental project (99 affordable units and 1 manager unit);
- Resolution No. 1495 (August 23, 2010) approved a further advance of \$500,000 to BHDC and a revision of the project to 96 units;
- Resolution No. 1635 (July 11, 2017) approved a second further advance of \$3,400,000 to BHDC, a revision of the Project to 48 homeownership units, and conversion of the loan to silent seconds; and
- Resolution No. 1655 (October 22, 2018) approved a third further advance of \$1,300,000 to BHDC for predevelopment and construction of Lantana Place

Homes and reiterated approval for conversion of the loan funds to silent second mortgage assistance loans.

ANALYSIS

1. The Project is a 48-unit homeownership project for low- and moderate-income households, with 25 units targeted to low-income households (80% of Area Median Income (AMI) or less) and 23 units targeted to moderate-income households (120% of AMI or less). BHDC is qualifying households at income levels between 70% and 95% of AMI, making the Project affordable to homebuyers at lower income levels.
2. BHDC is in the process of finalizing construction financing in the amount of up to \$19.1 million through the Rural Community Assistance Corporation (RCAC) with a targeted closing date in mid-November.
3. The appraised value of the completed Project is \$23,945,000. To make the Project feasible, provide the required affordability levels, and ensure the Project can secure construction financing, BHDC is requesting a modification to its Authority Loan.
4. The Authority is being asked to forgive accrued interest on the existing Loan in conjunction with accepting a new, unsecured Promissory Note from BHDC that will require monthly amortized payments of \$6,198 at 0.5% interest. Based on a sampling of residual cash payment loans from the Housing Authority's loan portfolio, the Authority will be receiving approximately \$74,000 per year versus payments of \$95,000 per year on a typical Housing Authority multifamily loan with a principal balance of \$6,900,000. The amortized payments will also provide certainty of current repayment, which is not the case with loans that are repaid through residual cash receipts.
5. The Authority has two applicable existing policies in place for use in evaluating this loan modification request: the Low-Income Housing Production Subsidy Program (LIHP) and the Housing Authority's Loan Modification Criteria:
 - a. The LIHP allows Authority loans to project sponsors to be on such terms as the Housing Authority may decide in each individual case. Non-interest loans are allowed. The LIHP also requires loans to be evidenced by a promissory note and loan agreement and to be secured by a deed of trust on the property undergoing development, except where the Authority judges no security or alternative security to be acceptable; and
 - b. The Loan Modification Criteria require review of financial statements and operating budget for the subject property to determine borrower's capacity to debt-service the loan and comply with regulatory terms. Additionally, the Loan Modification Criteria allow for conversion of loans to grants in the event of major damage to the project, i.e. fire, flood.

6. By approving the restructuring of BHDC's Loan, the Authority is ensuring that the Project will proceed and achieve the Authority's goal of producing affordable units. Furthermore, approval of the restructuring avoids potential repayment to HUD of the fair market value of the property; the current appraisal of the undeveloped parcel is approximately \$1.7 million.
7. While the new Promissory Note from BHDC will be unsecured, it will nonetheless be an outstanding financial obligation of BHDC; BHDC has demonstrated that it has the resources and assets available to service the debt.
8. While most of the Loan Modification Criteria do not apply to this Project, the "analysis of all debt on the property to ascertain loan-to-value and the Housing Authority's lien priority" is applicable. The current appraised value of the vacant land with an approved Tentative Map is \$1,728,000, resulting in a 410% loan-to-value, however, the Authority's Deed of Trust is currently in first lien position. Authority funds have been used to obtain the entitlements and permits for the Project. Once the Final Map is recorded and the site work complete, the value of the Property increases to \$3,990,000.
9. The Authority has discretion to waive all or a portion of its policies for the reasons stated above.
10. BHDC and staff have analyzed reverting the Project to a multi-family development and do not recommend reversion for the following reasons:
 - a. The Project would have to be redesigned and re-entitled as a multi-family project, including design review approval and environmental review, a process that would take nine to 12 months to complete and incur additional costs;
 - b. The Project would have to meet new building and energy code requirements that will become effective January 1, 2020, which would increase construction costs;
 - c. Improvement plans and building plans would need to be prepared and approved, taking approximately six to nine months to complete;
 - d. Approximately \$1.2 million in "sunk costs" toward the current Project would not be realized; and
 - e. HUD would likely act to recover the CDBG funds invested in the Project and would likely require the Authority to reimburse HUD, resulting in additional expenses that will not produce housing units.
11. The pending addition of the construction loan combined with the Authority's Loan will cause the Property to become over-encumbered by approximately \$3.5 million. The construction lender is requiring BHDC to reduce the encumbrance prior to closing of the construction loan. Failure to resolve the over-encumbrance will prevent BHDC from obtaining construction financing and commencing construction of the units.

12. BHDC's construction budget for the Project includes a construction management cost of \$74,000 to offset the cost of BHDC Construction Management staff providing on-site supervision for construction of the Project. The construction budget also includes a developer fee of \$800,000 that will be held by the construction lender and paid out upon completion of specific milestones; the majority of the fee, \$600,000, will be held until final completion of the Project.
13. Staff sought the assistance of consultant Keyser Marsten and Associates (KMA) in reviewing this request. KMA concurred with the forgiveness of interest on the Authority Loans, limiting the amount of the secured Authority Loan to the amount that will be converted to downpayment assistance, and shifting the remaining principal to become a stand-alone loan secured by BHDC's assets as described below. KMA recommends, and BHDC meets, a two to one ratio for debt coverage on the new unsecured stand-alone Promissory Note.
14. The proposed \$3,575,759 unsecured loan to be repaid through BHDC's operating income will have the following terms:
 - a. 0.5% interest from the date of the Promissory Note;
 - b. 55-year term with monthly payments of \$6,198 and the balance due in 30 years (a "balloon payment"); and
 - c. Payments deferred for two years from the date of the Promissory Note.
15. The \$3,502,944 in secured down payment assistance will be at 3% simple interest, deferred until sale of the units or the end of the 30-year term. If all 48 down payment assistance loans, in the average amount of \$73,000 each, remain in place for 30 years, the Authority could receive up to \$3.1 million in interest revenue, or approximately \$64,500 per unit.
16. HUD does not provide homeownership income-to-expense ratios ("front-end ratios"), instead relying on the Federal Housing Administration (FHA) and the local jurisdiction to set prudent limits. The Authority has typically used 30% as the front-end ratio for homeownership programs, however, California Health and Safety Code Section 50052.5(c) allows local agencies to adopt alternative front-end percentages for agency-assisted housing developments. The Cities of Campbell, Emeryville, Roseville, and Sunnyvale, and the City and County of San Francisco, permit front-end ratios from 30% - 40% depending on household income level. The lower end of the income range has lower ratios while the ratios increase as the purchaser's income level increases. BHDC's financing analysis for Lantana is based on front-end ratios of 30.4% to 38.7% for Lantana, therefore, BHDC is requesting that the Authority adopt an alternative front-end ratio of up to 40% for Lantana based on §50052.5(c).
17. BHDC has applied for Round 2 of the state's CalHome Disaster Assistance Program. If the funds are awarded, they will be used to offset a portion of the

Authority's down payment assistance and may result in partial repayment of the principal secured by the Property at close of escrow for each of the 48 units. Additionally, if the CalHome funds are awarded, the front-end ratio range will become lower, ranging from 29.3% to 32.7%.

18. Approval of BHDC's loan modification request will relieve the over-encumbrance of the property, allowing BHDC to secure its construction financing and commence construction of the units.

FISCAL IMPACT

If the accrued interest on the Authority's Loan is forgiven, those funds would not be repaid to the Authority, however, the portion of the Loan proposed for down payment assistance will accrue interest and, at loan maturity, would provide additional resources for production or preservation of affordable housing. The new Promissory Note, at 0.5% percent interest will result in monthly payments of approximately \$6,198 (\$74,376 per year) that will be put back into the Housing Authority's Affordable Housing Production budget over the course of the 30-year repayment term.

ENVIRONMENTAL IMPACT

CDBG funds were invested in Lantana Place in 2008 for acquisition and predevelopment for a new multifamily housing development. Subsequently, the project was changed to a homeownership development with fewer units. A new Environmental Assessment ("EA") was prepared to reflect the change, and a Finding of No Significant Impact ("FONSI") was published on August 17, 2018.

The project has been found in compliance with the California Environmental Quality Act ("CEQA"). Pursuant to CEQA Guidelines Section 15061(b)(3) and 15378, there is no possibility that the proposed activity may have significant effects on the environment, so no further environmental review is required.

COUNCIL/BOARD/COMMISSION/COMMITTEE REVIEW AND RECOMMENDATIONS

Not applicable

NOTIFICATION

- Larry Florin – Burbank Housing Development Corporation
LFlorin@burbankhousing.org
- Karen Massey – Burbank Housing Development Corporation
KMassey@burbankhousing.org
- Jeff Moline – Burbank Housing Development Corporation
JMoline@burbankhousing.org

- Peter Schellinger, Burbank Housing Development Corporation
PSchellinger@burbankhousing.org

ATTACHMENTS

- Attachment 1 – Burbank Housing Development Corporation Request for Loan Modification
- Attachment 2 – Project Financial Information
- Resolution

CONTACT

Nancy Manchester, nmanchester@srcity.org, 707-543-4339