



COUNCIL REPORT

DATE: May 14, 2024
CATEGORY: New Business
DEPT.: Housing
TITLE: **Lot 12 Affordable Housing Development—Supplemental City Funding and Project Modifications**

RECOMMENDATION

1. Appropriate \$5 million from the City’s Below-Market-Rate (BMR) housing funds to the Lot 12 affordable housing project to supplement City funding already allocated to the project. (Five votes required)
2. Authorize the City Manager or designee to amend the Lot 12 Lease Disposition, Development, and Loan Agreement with MV Lot 12 Housing Partners, L.P., a California limited partnership, and execute any related documents to incorporate the supplemental City funding, modifications to the project’s unit mix related to affordability levels, incorporating units for the intellectually and developmentally disabled, and other related administrative changes.

BACKGROUND

Developer Selection Process and Key Project Milestones

On May 19, 2020, the City Council selected the joint team of Related Affordable and Alta Housing, operating as MV Lot 12 Housing Partners, L.P., as the preferred developer (Developer) to redevelop Lot 12, a City-owned public parking lot, into a 100% affordable housing project (see Attachment 1). This selection concluded a competitive developer selection process that included a Request for Qualifications (RFQ) and Request for Proposals (RFP). The Lot 12 priorities incorporated into the RFQ/RFP were determined through a series of Council Study Sessions (see Attachment 2 for the RFP).

Subsequently, the City worked closely with the Developer to advance the project, which included the Senate Bill (SB) 35 streamlined ministerial approval process. Key project milestones include:

- October 13, 2020—Council Study Session on remaining Lot 12 development priorities.

- January to February 2021—Submittal for first round of informal review by City staff, including Development Review Committee (DRC) input.
- February 2021—Execution of the exclusive right to negotiate agreement (ERNA).
- March to April 2021—Initiation and completion of tribal consultation process as required by SB 35.
- April 13, 2021—Council approval of a \$1.3 million predevelopment loan to help pay for upfront project costs. This amount is part of, not in addition to, the City’s total subsidy contribution to the project that will be discussed later in this report.
- End of May to June 2021—Resubmittal for a second round of informal review by City staff and DRC input.
- June 22, 2021—Closed Session held for Council to provide direction on project price and terms.
- August 24, 2021—Council approval of key deal terms, direction on project design and architecture, and authorization to submit a formal planning application through the SB 35 process.
- January 2022—Execution of the project’s lease disposition, development, and loan agreement (LDDLA), which includes the terms of the project. Developer submittal of SB 35 planning application.
- April 2022—Project was approved via the SB 35 ministerial process.

Project Components

The Developer has included the following key components for the Lot 12 project:

- 120 units (119 affordable units and one manager’s unit):
 - Units affordable to households earning between 30% and 80% of area median income (AMI).
 - Includes 20 rapid rehousing units.
 - Half of the units are two- and three-bedroom units to serve larger households.

- Ground-floor nonresidential commercial space.
- Resident-serving community space.
- Placemaking qualities through project design themes, public art, and quality pedestrian experience.
- Replacing the 160 public parking spaces currently on Lot 12 via an in-lieu payment to the City.

The project meets all of the RFP criteria.

Project Financing and Remaining Funding Gap

Through March 2024, the Developer had successfully secured several critical financing sources, including:

- \$9.75 million in Measure A funding from the County. Lot 12 is part of the portfolio of projects funded by the Measure A Memorandum of Understanding between the City and the County.
- 25 project-based vouchers from the Santa Clara County Housing Authority.
- \$2.5 million in predevelopment funding from Destination: Home. This predevelopment funding, which was offered as unsecured support due to the City's existing ownership of the property, helped Destination: Home create a new loan product that is currently being used to support several other deeply affordable housing projects throughout Santa Clara County where the land is publicly held.
- \$12.25 million from the City, which includes \$4.25 million in City housing funds as well as \$8 million in funding attained through SB 129 (State Budget Act of 2021) made possible by State Senator Josh Becker.

However, the Developer has not been successful in securing additional funding to close the funding gap. In 2022 and 2023, the Developer submitted applications for remaining funding needed under the Super Notice of Funding Availability issued by the California Department of Housing and Community Development (HCD). Due to the extraordinary demand and competitiveness for the funding, the Developer was not successful in either attempt. Additionally, project costs have increased significantly due to the pandemic and economic conditions such as higher interest rates and construction costs.

In March 2024, the Developer notified the County and City that it had a \$36 million funding gap. The Developer proposed several strategies that include significantly reducing overall project costs and securing additional funding, including supplemental funding from the County and City. The Analysis section below summarizes the Developer’s strategy to close the gap and advance the project.

ANALYSIS

Affordable housing developers across the region are operating in an extraordinarily difficult environment. Development costs increased significantly during the pandemic, and there is more competition than ever before for very limited affordable housing funds. For example, the County Office of Supportive Housing noted during the April 16, 2024 Board of Supervisors Meeting that there are 17 Measure A projects that are “stuck” and have not been able to move forward. Furthermore, it is anticipated that crucial state housing funds will decrease next year.

This has resulted in developers and funding partners (such as the County and cities) having to explore multiple different strategies to advance projects and developers looking for every possible opportunity to reduce project costs. Even seemingly small cost-reduction opportunities are identified as necessary to get projects across the threshold into financial viability as soon as possible.

Finally, Lot 12 is unique in that the RFQ/RFP process began before the pandemic and used the economic assumptions that were present at that time. Projects that began after the pandemic had the benefit of factoring in at the outset significant changes in market conditions, project costs, and changes in funding programs. Therefore, the Lot 12 project may need more financial assistance and design modifications to bring down costs than for projects that began after the pandemic started, as the Lot 12 project has faced a much greater range of uncertainty and changes in economic assumptions.

Closing the Remaining Gap

The Developer has proactively identified several key strategies to close the \$36 million funding gap, including: (1) securing federal and state tax credits and tax-exempt bond financing; (2) amending the project permit to modify the project’s floor plan/layout, other design elements, and the Construction Management Plan (CMP) to reduce development costs; (3) increasing the income levels of certain units; and (4) including units for intellectually and developmentally disabled persons. These items are provided to Council for informational purposes as modifications to the project will be implemented through the ministerial SB 35 process. Without these collective project modifications, which are necessary to significantly reduce development costs and achieve economic feasibility, the project will not be able to move forward.

1. Securing approximately \$17 million in federal and state tax credit program and tax-exempt bond financing.

As noted above, the Developer was not successful in securing HCD funding over the past two years. Due to anticipated decreases in state funding for affordable housing next fiscal year, securing all necessary funding sources this year would maximize the Developer's ability to advance the Lot 12 project.

This means that instead of continuing to apply for HCD funding, the Developer shifted its efforts towards securing federal and state tax credits and tax-exempt bond financing. The Developer submitted its tax credit application on April 22, in advance of the April 23, 2024 deadline.

Summary: If awarded, the Developer's tax credit/bond financing application would bring in approximately \$17 million of external funding.

2. Reducing project costs by up to \$9 million through modifications to the approved project through the SB 35 ministerial process, including:

A. Modifying the project floor plan (unit layout) and other design elements to reduce approximately \$8 million in costs, including:

- Shifting the eight ground-floor residential units from the Mercy, Bryant, and California Streets frontages to the second floor facing the interior courtyard and relocating community-serving spaces, such as common amenity rooms, laundry rooms, and service rooms, from the second floor to the ground-floor, street-facing areas.
- Removal of all residential unit stoops along Mercy, Bryant, and California Streets (due to the ground-floor unit relocation discussed above).
- Increasing the height of the building from two to three stories along Mercy Street, adjacent to the two-story apartment complex, to maintain overall unit count, while relocating ground-floor units.
- Making other design changes primarily related to materials, window trim elements, and site elements, in limited areas of the project.

These changes are expected to collectively reduce project costs by approximately \$8 million; \$6 million of which is due to cost reductions from moving the ground-floor residential units to the second floor. Projects with residential units on more than four levels must pay (higher) commercial wage rates for the entire building.

Moving the ground-floor units to upper levels will allow the project to pay (lower) residential wage rates for the four upper levels and commercial wage rates on the ground level only.

Summary: These project design changes will result in an estimated \$8 million reduction in project costs. Staff will collaborate with the Developer to finalize the project design changes, while remaining compliant with the Lot 12 RFP requirements and consistent with the overall design intent of the previously approved SB 35 project, including key design themes for high-quality pedestrian experience, neighborhood interface, and placemaking elements.

B. Modifying the project's Construction Management Plan to reduce \$1 million in costs, as follows:

- **Partial street closure along Bryant Street**—In an effort to reduce construction costs, the Developer elected to utilize smaller forklifts rather than a tower crane to move materials throughout the construction process and is seeking to use a portion of Bryant Street for construction staging activities. The Developer is working with staff to modify the Construction Management Plan (CMP) to reduce costs while striving to limit construction-related impacts on California Street and Mercy Street and the surrounding neighborhood. The Developer's proposed modified CMP is described below and illustrated in Attachment 3:
 - Part of Bryant Street closed off and used for construction delivery and staging, including access for forklifts to move materials around during construction.
 - Physical barriers installed in the street to separate the construction area.
 - Sidewalk closure along the project frontage on Bryant Street.
 - No on-street parking on both sides of Bryant Street.
 - Restricting Bryant Street to one-way (northbound) vehicular traffic, which would allow vehicular and pedestrian access to be maintained for the existing businesses on the east side of Bryant Street.

The one-way street restriction along Bryant Street would occur for approximately 22 months of the 24-month construction period. During this time, there would be an increase in the volume of traffic on the adjacent streets, particularly California Street, Mercy Street, Castro Street, and Franklin

Street, due to the detour. Additionally, temporary signal modifications and striping work at the intersection of Bryant Street and California Street would be required, and there will be an increase in delay times at this intersection.

Staff is supportive of providing this one-time exception to allow use of the City's right-of-way for construction staging because the City is a partner in this 100% affordable housing development, which is being constructed on City-owned land and is receiving funding from the City.

Summary: These changes to the CMP will result in an estimated \$1 million reduction in project costs. Combined with the \$8 million in cost reductions by modifying the project floor plan/layout, the cumulative project permit changes would reduce project costs by approximately \$9 million. The project would remain compliant with the Lot 12 RFP requirements.

3. Modify the income levels to create eight units at 80% AMI.

The Lot 12 project includes a wide range of income levels to address various housing needs and affordability levels. The Developer proposes to take eight units currently set at 60% AMI and increase them to 80% AMI. This would increase the rents of those units and project revenues, thereby increasing the development's economic viability while still serving low-income households.

Summary: This increase in AMI levels would increase the project's economic feasibility. The project would remain compliant with the RFP affordability requirements.

4. Include 15 units for the intellectually and developmentally disabled units.

The Developer proposes to include 15 intellectually and developmentally disabled (I/DD) units as part of the 120-unit Lot 12 project. Including this special-needs population would allow the project to qualify for additional County funding (discussed further below). Additionally, there is a need for I/DD units as this is an underserved population. Finally, the Developer has existing affordable housing projects that include I/DD units and has experience serving this population.

Summary: Including I/DD units allowed the Developer to secure supplemental County funding, and the Developer has experience serving this population. The project would remain compliant with the RFP requirements.

Assuming a successful tax credit application, these efforts combined will reduce the funding gap to \$10 million.

Supplemental County Funding

In March 2024, the Developer approached both the County and City to discuss potential opportunities to close the remaining \$10 million gap. In order for the project to submit an application for the April 2024 round for federal and state tax credits as discussed above, the Developer must demonstrate that—but for the tax credits—all other funding sources have been secured.

County staff identified funding that would allow the agency to contribute an additional \$5 million if the City could fund the remaining \$5 million gap. City staff confirmed that City housing funds are available, pending City Council approval of providing supplemental funding to the project. However, May 14 was the earliest meeting date that Council could hear this item, which is after the April 23 tax credit application submittal deadline.

Given the timing of these events, County staff brought forward a recommendation to the Board of Supervisors on April 16, 2024 to increase the maximum County loan amount by up to \$10 million, from \$9,750,000 to \$19,750,000. Approximately \$7 million of the \$10 million increase would come from the County's Measure A funds. Additionally, up to \$3 million would come from the County's funds for intellectual and/or developmental disabilities and their families, which would support the 15 I/DD units to be added to the project as noted above. The Board unanimously approved the increased loan amount.

The \$10 million increase in the County's maximum loan amount allowed the Developer to bridge the \$10 million gap necessary to submit its tax credit application on April 22. The final County loan amount for Lot 12 will be lower than \$19,750,000, pending Council consideration of \$5 million in supplemental City funding.

Supplemental City Funding

Lot 12 is a key project in the City's affordable housing pipeline. It will bring an additional 119 units of new affordable housing (plus one manager's unit) to address a wide range of housing needs and is included in the City's Housing Element Sites Inventory.

As noted in the Background section, the City has already contributed \$4.25 million in housing funds plus \$8 million in SB 129 funding awarded to the City. Staff has confirmed that the City does have sufficient housing funds to provide an additional \$5 million to the Lot 12 project. This would bring the City's total direct financial contribution for the Lot 12 project to \$17.25 million. Additionally, the City is contributing the full Lot 12 land value to the project. Without \$5 million in supplemental City funding, the project will not be able to move forward.

NEXT STEPS

If Council approves the supplemental City funding, staff will work with the Developer to amend the LDDLA. The Developer will also submit an application for a modification to the approved SB 35 permit, which will be through a similar ministerial approval process. Staff will work with the Developer to amend the project while retaining the project goals and will continue to work with the Developer on their building permit application. If the tax credit financing is awarded to the project, it is anticipated that the project would start construction in Q1 2025, with an estimated completion date in Q1 2027.

FISCAL IMPACT

Council's approval of supplemental City funding will not have an impact on the City's General Fund. The additional \$5 million will come from the City's BMR funds. There is approximately \$17 million in unrestricted housing funds, which is sufficient to provide supplemental funding for the Lot 12 project.

CONCLUSION

Lot 12 remains a key project in the City's affordable housing pipeline and is an identified site in the City's Housing Element sites inventory. However, the project has a \$36 million funding gap. The Developer is implementing several strategies to close the gap to move the project forward, including: (1) securing federal and state tax credits and tax-exempt bond financing; (2) amending the project permit to modify the project's floor plan/layout, other design elements, and the CMP to reduce development costs; (3) increasing the income levels of certain units; and (4) including units for I/DD persons. Additionally, on April 16, 2024, the County increased its funding contribution to the Lot 12 project, and the Developer is also requesting \$5 million in supplemental funding from the City. Due to an extraordinarily difficult development environment, all of these strategies, including the supplemental City funding, are required to move the project forward.

ALTERNATIVES

1. Do not approve \$5 million in supplemental funding from the City's BMR funds and recommend a different funding amount, which would require the Developer to identify other funding sources.
2. Provide other direction.

PUBLIC NOTICING—Agenda posting.

Prepared by:

Wayne Chen
Housing Director

Approved by:

Dawn S. Cameron
Acting Assistant City Manager/Community
Development Director

Approved by:

Kimbra McCarthy
City Manager

WC/1/CAM
821-05-14-24CR
203250

- Attachments:
1. May 19, 2020—City Council Selection of Preferred Lot 12 Developer
 2. Lot 12 Request for Proposals
 3. Map of Proposed Partial Closure of Bryant Street