

DATE: June 17, 2024

TO: Council Notice of Funding Availability Review Committee

FROM: Deanna Talavera, Senior Housing Officer
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SUBJECT: **Review of Notice of Funding Availability Process**

PURPOSE

The purpose of this memorandum is to provide the Council Notice of Funding Availability (NOFA) Review Committee with a review and update of the NOFA process as stipulated in the City's certified 2023-31 Housing Element Program 4.1.

BACKGROUND

Housing Element Program 4.1.a

Program 4.1 of the Housing Element addresses Development Streamlining and Processing Revisions and includes the following item under the "Milestone and Time Frame" subsection: "Review and update the NOFA process by June 30, 2024."

Subsection 4.1a provides the following program description that provides guidance for the NOFA process review:

"Review and update the City's affordable Housing NOFA process to improve coordination and communication internally (e.g., coordination between Housing, Planning, and other departments and internal processes in Planning and other departments) and with applicants. Encourage affordable housing developers to work with outside funding sources to leverage the City's local funds to the maximum extent possible. Initial steps in the review include additional developer roundtables, garnering consultant advice, and reviewing other public agency best practices. In addition, the City will continue to facilitate and support 100% affordable housing development in the review process by utilizing trained staff in each department and division involved in the development review and building permit processes, and by utilizing streamlining opportunities. The staff members will be trained in processes,

requirements, timelines, and financing specific to affordable housing projects. This responds to input received from affordable housing developers during the outreach process.”

For the purposes of this Housing Element Program, “NOFA process” is defined as the process that begins with the applicant submitting the NOFA application to request City funding and concludes with staff bringing a funding recommendation to the City Council for approval and funding reservation.

City’s NOFA Process

Since 2014, the City has implemented an over-the-counter NOFA process to fund affordable housing projects.¹ “Over-the-counter” means that funding is awarded on a first-come, first-served basis. The primary City funding sources have included Housing Impact Fees (generated from office and high-tech development, as well as hotel and retail development), Below-Market Rate (BMR) Housing Program In-Lieu Fees, and Rental Housing Impact Fees (discontinued in 2018).

As shown in Figure 1 below, the NOFA process includes five steps, including: (1) NOFA application submittal; (2) due diligence; (3) meeting(s) with internal City staff/applicant to review the proposed project and one community meeting; (4) funding recommendation to the NOFA Review Committee; and (5) Council funding approval/reservation. Steps 2 and 3 take the most time, but the amount of time is highly dependent on the quality of the applicants’ NOFA application submitted in Step 1. Steps 1, 2, and 3 are more fully described below:

- **Step 1—NOFA Application.** Submittal requirements include proposed affordable housing program (such as number of units, affordability levels, any special needs), key physical/development characteristics (such as height/floors, square footage, parking, limited site plan information, etc), financing strategy/pro forma, operations/ services/case management, etc. If the application is incomplete or the information submitted is unclear, staff follows up with the applicant to obtain the information.
- **Step 2—Due Diligence.** Includes review of the NOFA application to determine project viability, project financing, any state/federal requirements, alignment with City priorities, etc. Review is conducted by City’s affordable housing consultants and Housing Department staff for initial assessment of whether the project is competitive for external funding and alignment with City priorities. Staff from other City departments, including Community

¹ In addition to the issuance of funding through the NOFA, the City also partners with developers on the development of City-owned sites, such as Lot 12 and 87 East Evelyn Avenue. The selection of a developer is conducted through an intensive Request for Qualifications and Request for Proposals process. These projects do not go through the NOFA process; instead, City funding is negotiated through a development agreement process.

Development, Public Works, etc., assist with an initial assessment of whether the project can be physically built.

- **Step 3—Applicant Meetings.** Staff reviews the project and funding request with the applicant. This may include one or more meetings, depending on the complexity of the project and other factors, before staff is able to determine an appropriate funding recommendation. If additional information is required, how quickly the project continues to move forward depends in part on the applicant’s responsiveness in providing the information. The applicant also holds a community meeting to receive input on the project during this step of the NOFA process.

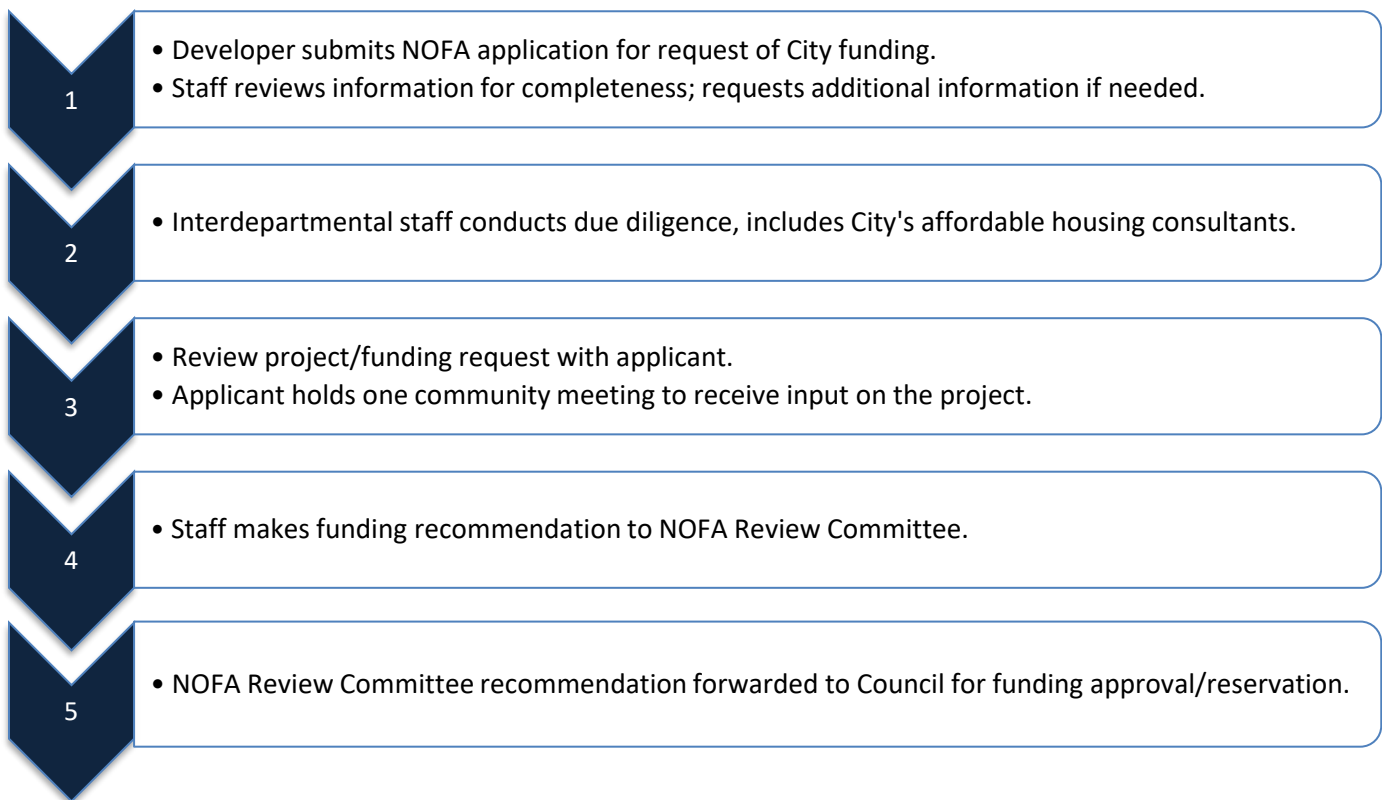


Figure 1: City’s NOFA Process

Streamlining and Process Revisions in the Context of Affordable Housing

Streamlining is commonly focused on reducing the number of steps and, therefore, the overall amount of time it takes to complete a process. This is an important goal for affordable housing because: (1) it usually takes an average of four to six years from concept to project completion; (2) there is a need to add affordable housing as quickly as possible given the significant needs in the community for such housing; and (3) reducing the amount of time can reduce development costs and make projects more feasible.

However, there are several factors that make it difficult in practice to reduce the number of steps and length of time to review projects during the NOFA process, and these factors are primarily out of the City's control. For example, due to the complexity of developing affordable housing and the amount of funding and multiple sources required, significant due diligence and community/public processes are required to ensure that a project is economically viable and meets a wide array of state, federal, and local requirements. Additionally, the viability of affordable housing is highly dependent on economic factors such as interest rates and cost of inputs to development, the availability of external funding such as state funding, and competition for funding. Finally, a project may be constantly iterating/changing particularly during the early stages in determining the project scope. Depending on the nature of the scope changes, the City may need to reevaluate the project, which lengthens the time to conduct due diligence.

Staff's assessment is that the five-step process in Figure 1 is the minimum number of steps necessary to complete the NOFA process. Therefore, the primary opportunity to improve the process is to make each step proceed as smoothly and quickly as possible. Based on staff's research of best practices in other jurisdictions, input from developers, and input from the City's affordable housing consultants, increasing the clarity of the NOFA process/requirements and the review/approval process would provide a material benefit for applicants and can reduce time frames as a by-product. **As a result, staff has focused on actions that are within the City's control to increase the clarity of the NOFA process (Table 1 below).**

Note that certain actions in Table 1 have already been completed as part of the City's philosophy to continuously improve its processes and programs. This will be noted for each item below as relevant. The City's NOFA process will continue to be reviewed to determine potential improvements beyond the completion of this Housing Element item as part of the City's ongoing, continuous improvements approach.

ANALYSIS

This section outlines the actions that the City has already completed, are in progress, will be undertaken as a future item, or that are ongoing in response to each component of Program 4.1.a, as summarized in Table 1 below. The actions identified have been based staff research, input from affordable housing developers, and advice from the City's affordable housing consultants. Where relevant, certain actions will be noted as a continuous improvement item (denoted as "CI" in the table).

Table 1: Summary of Housing Element Program 4.1.a, Actions, and Status

HOUSING ELEMENT COMPONENT	ACTION	STATUS (EST. COMPLETION)
I. Review and update the City's affordable Housing NOFA process	<ul style="list-style-type: none"> • Create underwriting guidelines • Update NOFA Application • Implement online submittal functionality 	<ul style="list-style-type: none"> • Completed/CI* • In progress (Q4 2024) • In progress (Q4 2025)
II. Improve coordination and communication internally	<ul style="list-style-type: none"> • Postproject review 	<ul style="list-style-type: none"> • Ongoing
III. Improve coordination and communication with applicants	<ul style="list-style-type: none"> • Identify key staff on review team and points of contact • Create public facing workflows and document NOFA procedures 	<ul style="list-style-type: none"> • Completed/CI • In progress (Q4 2024)
IV. Encourage developers to leverage City funds	<ul style="list-style-type: none"> • Establish leveraging requirements 	<ul style="list-style-type: none"> • Completed
V. Developer Roundtables	<ul style="list-style-type: none"> • NOFA-specific developer roundtable • Periodic developer meetings 	<ul style="list-style-type: none"> • Completed • Ongoing
VI. Garner Consultant Advice	<ul style="list-style-type: none"> • Economic Advisory Consultant • Affordable Housing Legal Counsel Consultant 	<ul style="list-style-type: none"> • Completed/CI • Completed/CI
VII. Review other agency best practices	<ul style="list-style-type: none"> • Methods of Awarding Funding • Tools that Support Funding Method 	<ul style="list-style-type: none"> • Completed • Completed
VIII. Utilize trained staff in each department and division	<ul style="list-style-type: none"> • Assign City staff with subject matter expertise in their field to the NOFA process • Provide affordable housing training to City staff involved in the NOFA review process 	<ul style="list-style-type: none"> • Completed • Future (Q2 2025)

* "CI" denotes that the item is part of continuous improvement efforts.

I. **Review and update the City's Affordable Housing NOFA process.**

There are three actions associated with this component of Program 4.1.a, which are discussed below.

Create Underwriting Guidelines—Completed/Continuous Improvement

In 2022, the City developed and adopted the Multi-Family Rental Underwriting Guidelines (Guidelines). Affordable housing projects are complicated and require multiple funding sources. Underwriting guidelines provide a set of criteria that the City (and other lenders) use to assess a funding request, such as the experience/financial stability of the applicant, the proposed affordable housing program, financing strategy, terms for providing City funding, etc.

There was a lack of standardization between projects prior to implementing the Guidelines. The City negotiates and conducts due diligence items such as developer fees, residual receipt payments, operating expenses, and loan terms on a project-by-project basis. The Guidelines serve as a tool for staff to standardize project review and expectations.

With input from Housing Staff, the City's Economic Advisory consultant, Seifel Consulting, and the City's Affordable Housing outside legal counsel, Burke Williams & Sorensen, the Guidelines memorialize the following criteria to assess overall project viability and make a funding recommendation:

- Loan eligibility.
- Project feasibility.
- Financial projections.
- Developer experience/qualifications.
- Risk assessment.

While these guidelines greatly improve transparency and certainty for developers seeking City financing and ensure all projects are assessed consistently, they also provide staff and the development teams with the flexibility to modify certain elements as necessary for project feasibility. Therefore, the Guidelines have streamlined the review process by providing greater certainty for developers and reducing the need for extensive negotiation on standard criteria between applicants and the City. The Guidelines are a living document that will be administratively reviewed and updated periodically to respond to changes in economic conditions, regulatory requirements, and best practices.

Update NOFA Application—In Progress (Q4 2024 estimated completion)

The NOFA application was last updated in 2014, when the Notice of Funding Availability was released by the City. The 2014 version of the application is outdated and does not include some of the more detailed information the City currently requires. Applicants often edited the application, resulting in inconsistent and incomplete information. Additionally, the pro formas submitted varied between developers, complicating the analysis of each project's financial projections. These problems led to a lack of standardization, made project reviews time-intensive, and required extensive follow-up with applicants.

As part of this NOFA update and review, staff decided to move away from the 2014 PDF application to a template-based Excel form. This step allows for standardization, data consistency, and time efficiency in the NOFA application process. The updated application includes the following:

- Separate tabs for key project data, like detailed development program.
- Sources and uses summary, public and private funding requests.
- Project pro forma—a financial statement used to project the future financial performance of a development project.

The application will be used by the City's economic advisory consultant and staff to determine project feasibility and the appropriate level of City contribution. These updates will reduce the need for extensive guidance from City staff and minimize back-and-forth requests for additional financial and programmatic information and clarification. The updated application will streamline the NOFA evaluation process by ensuring that all applications follow a consistent format saving time for both applicants and City staff during their review.

Implement Online Submittal Functionality—In Progress (Q4 2025 estimated completion)

NOFA applications are currently only accepted by email, which limits accessibility and transparency of application status. Email submittals make it challenging for staff to follow up and collect missing information as email threads can complicate tracking pending information requests and version control. Further, document retention efforts are more challenging and currently rely on several staff members to ensure updated information is stored diligently and consistently. In addition, applicants are not able to track progress, confirm submittals, or upload updated information at their convenience. Finally, our ability to share information between departments is limited by managing the applications via an inbox.

To improve efficiency and reduce the need for back-and-forth exchanges via email, staff is evaluating options to modify the way NOFA applications are submitted by implementing an

online portal to automate and manage this process. This will likely be implemented in phases. Staff is considering near-term options for online submittals, including utilizing existing City software like Zoom Grants and FormStack. The basic functionality of these systems allows for a centralized platform to submit applications and track progress. Staff will continue to explore options that allow for end-to-end project management. Overall, moving toward online submittals will streamline our NOFA process by allowing for more transparency to track progress and better data management.

II. **Improve coordination and communication internally.**

There is one action associated with this component of Program 4.1.a.

Postproject Review—Ongoing

As discussed in Item VIII below, the City has a cross-departmental team assigned to review projects that come through the NOFA process. The City has recently incorporated a postproject review process for the most recent affordable housing project that just started construction (1265 Montecito Avenue). The team discussed best practices, established how to best coordinate with each other on the project construction loan closing, and reviewed internal processes. This type of review (which will include the NOFA process) will be implemented for all affordable housing projects going forward.

III. **Improve coordination and communication with applicants.**

There are three actions associated with this component of Program 4.1.a which are discussed below.

Identify Key Staff and Points of Contact—Completed/Continuous Improvements

Staff recently updated the NOFA application and the Housing Department's website to identify key staff and points of contact. These changes were made based on developer input. Prior to making these updates, developers did not always know who to contact with NOFA-related questions. Identifying key staff and points of contact for the NOFA program is crucial for enhancing transparency and ensuring a smooth application process. The updated NOFA webpage now features designated key staff members from the Housing Department, notably the Senior Housing Officer, who serves as the primary point of contact for all NOFA projects. This initiative aims to provide applicants with consistent support and guidance throughout the NOFA application review process. By clearly identifying these points of contact, applicants can easily access the necessary support and resources, fostering collaboration and efficiency in the NOFA process.

Create Public Facing Workflows and Document NOFA Procedures—In Progress

Feedback received from NOFA applicants has been that information relating to the workflows and the NOFA process is not readily available. Applicants sometimes are required to meet with staff multiple times in order to understand what the process is and how it would fit into their larger project management schedule.

Staff is in the process of creating public-facing workflow documents that clarify the steps and procedures in the NOFA process. These documents will be posted to the Housing Department's website. The website will also include adding detailed and easily navigable content like the updated NOFA application, the City's Underwriting Guidelines, and potential implementation of an online application portal (as discussed in Item I above). These changes are intended to assist applicants with planning their submissions and in developing their project timelines, ensuring a smoother coordination and communication between the applicant and City staff.

IV. Encourage affordable housing developers to leverage City funds.

There is one action associated with this component of Program 4.1.a.

Establish Leveraging Requirements—Completed/Continuous Improvements

Maximizing external funding remains critically important given the City's estimated funding gap for affordable housing projects. Leveraging of City funds is outlined in the underwriting guidelines and the City's loan amount is determined through an evaluation of the following:

- Need for gap financing based upon affordability levels to be attained;
- Accumulation of appropriate operating and replacement reserves;
- Loan to Value and/or Loan to Cost considerations;
- City's goal to maximize leverage of non-City sources;
- City funding is targeted to 20% of total development costs or a leverage ratio of \$1 in City Subsidy to \$4 in other funding sources.

The City has already established guidelines through continuous improvement efforts that require developers to proactively seek multiple non-City funding sources and leverage such funding sources to the maximum extent possible.

V. Developer Roundtables

There are two actions associated with this component of Program 4.1.a which are discussed below.

NOFA Specific Developer Roundtable—Completed

On June 3, 2024, staff held a roundtable with affordable housing developers who have gone through the City's NOFA process to gather their input regarding their experiences, challenges, and suggestions for improvements. Staff conducted a poll during the roundtable and received nine responses. The survey included four multiple-choice questions; responses are summarized in the charts below as well as in Attachment 1.

Feedback gleaned from the roundtable discussion, supplemented by responses from the survey, highlighted several key points:

- Most effective/beneficial aspects of the NOFA process:
 - Availability of City funding for early, predevelopment activities.
 - Over-the-counter NOFA application process (provided there is increased clarity).
 - Availability of City staff for regular communication and direct support throughout the NOFA application process.
- Most challenging aspect of NOFA process:
 - Lack of clarity about the review process and timeline.
- Top suggested improvements to the NOFA process:
 - Outline of approval process and timeline.
 - Informal project review checklist.

The survey responses align with Table 1 actions that are in progress as part of the NOFA process review, including creating NOFA process workflows which will be posted to the City website. Documentation of process flows along with the updated application and pro forma templates and underwriting guidelines will be responsive to the feedback received by providing transparency and clarity about the NOFA application review and approval process.

Identifying key staff and points of contact to improve coordination and communication internally has been recognized by the survey respondents as a beneficial resource during the NOFA application process. Additionally, the participants discussed the pros and cons of an over-the-counter versus competitive NOFA application. The participants favored an over-the-counter process provided that the City's NOFA process be improved to increase clarity about the process.

The feedback received at the developer roundtable confirmed that the City's NOFA process lacks clarity, but support from staff continues to be the most helpful resource. This input helped inform the actions in Table 1 and Items I and III, in particular.

Periodic Meetings with Affordable Housing Developers—Ongoing

Housing Department staff holds periodic meetings with affordable housing developers to discuss various topics. Examples of recent meetings/topics include discussing fair housing requirements, meeting federal funding requirements, etc. Staff will continue to convene these meetings, which will include opportunities for the developers to provide feedback about the City's affordable housing/NOFA process.

VI. Garner consultant advice

There are two actions associated with this component of Program 4.1.a which are discussed below.

Economic Advisory Consultant—Completed/Continuous Improvement

Staff sought input from the City's long-standing affordable housing economic advisory consultant, Seifel Consulting (Seifel), as part of this review. Seifel assists staff with conducting due diligence related to NOFA applications. This includes evaluating the financing strategy/pro formas that are submitted in the applications, determining the reasonableness of project costs, funding gaps, and assisting staff in making a City funding recommendation. Seifel incorporates a deep understanding of current market conditions, external financing sources, and best practices based on their work with multiple cities throughout the region.

Seifel provided input regarding the funding methods and tools used in other cities (related to Item VII below) as part of reviewing the City's NOFA process. Seifel will also assist with updating the City's NOFA application and producing a financing strategy/pro forma template that developers will be required to complete as part of the application. The new NOFA application and templates will standardize the information the City will receive, which will result in clearer, more consistent, and more complete application submittals. In turn, it is anticipated that the new/improved documents will make the NOFA applications

easier to review, thereby streamlining the due diligence process. Future best practices will be incorporated as part of continuous improvement efforts.

Affordable Housing Legal Counsel—Completed/Continuous Improvement

Staff also sought input from the City's long-standing outside legal counsel, Burke Williams & Sorensen (BWS), as part of this review. BWS specializes in affordable housing projects and drafting/reviewing required transaction documents necessary to facilitate projects, such as loan agreements, regulatory agreements, promissory notes, and deeds of trust. These documents ensure that the City's interests are protected and that the affordability requirements are met. Like Seifel, BWS works on projects throughout the region and incorporates best practices into each project for the City.

BWS's input garnered through this review identified areas of improvement regarding the City's underwriting guidelines (noted in Item I above). BWS also provided helpful input on items that are not specifically related to the NOFA process, such as legal agreements that would occur after the NOFA process. Those updates will be processed as part of continuous improvements.

VII. Reviewing other agency best practices

There are two actions associated with this component of Program 4.1. which are discussed below.

Review Methods of Awarding Funding—Completed

As noted, the City has implemented an over-the-counter NOFA process since 2014. A component of this Housing Element item included staff review of the funding method that other cities in Santa Clara and San Mateo Counties use to fund affordable housing projects. The review confirmed that there are two primary ways of awarding funding: an over-the-counter process (like the City's) or a competitive NOFA process.

The fundamental distinction between the two processes is that a competitive NOFA accepts funding applications only during a specific period of time for a specific amount of funding available, whereas an over-the-counter process accepts applications on an ongoing first-come, first-served basis. Applications for competitive funding are scored, ranked, and awarded to the top scorer(s).

Staff's review did not identify obvious industry standards for how cities determine what funding method to use. The City's affordable housing economic advisory consultant confirmed that how cities choose to fund projects is a highly local one.

Staff recommends that the City continue to implement an over-the-counter NOFA process for the following reasons:

- Timing

Allowing applicants to come forward through an over-the-counter process as soon as they are ready instead of waiting until the next open application period allows projects to move forward as quickly as possible when there is NOFA funding available.

- Flexibility

An over-the-counter process provides both developers and the City greater flexibility than a competitive process. Developers can meet with the City to discuss their projects and funding needs. This allows developers to brainstorm with the City about options for right-sizing a project to make a project feasible depending on market conditions, City priorities, and the amount of City funding available. A competitive process does not provide this flexibility and may cause opportunities to be missed.

- Limited staff capacity

A competitive NOFA process can be time-intensive, and there is limited staff capacity to implement such a process.

- Projected funding gap/Prioritizing City sites

The City has a pipeline of 12 affordable housing projects with a projected funding gap of \$50 million based on the most recent estimates. This gap includes future projects on City-owned sites. Instead of the NOFA process, City-owned sites go through an RFQ/RFP process to select a developer, and the funding amount is determined through negotiations as part of a development agreement. The City Council has prioritized the future City-owned sites before adding new NOFA projects to the pipeline. Therefore, there is no/insufficient City funding available in the foreseeable future for a competitive NOFA process.

Review Tools that Support the Funding Method—Completed

During the review of the funding methods used in other cities, staff also assessed the tools the cities used to support their processes. Examples include whether the cities use standardized templates for funding applications, checklists to assist applicants in completing the applications, documents that describe process and procedures, availability, and ease of accessing information on websites, etc. In some cities, information was more readily available and accessible on their websites. In other cities, information was not

readily available and would have required more staff time to research their funding processes and supporting tools. The experience of researching other cities underscored the importance of having clear, documented information easily accessible and available for applicants, which provides them more clarity and certainty on how to advance their projects.

As a result of this review, staff identified key areas for improvement for the City’s NOFA process, including documenting and developing NOFA steps and procedures, estimated/range of timeframes, creating standardized templates, and making these documents easily accessible on the Housing website. These improvements have been discussed above and will be implemented as part of this NOFA update and review process.

VIII. Utilize trained staff in each department

There are two actions associated with this component of Program 4.1.a.

Assign City staff with subject matter expertise in their field to the NOFA process—Completed

Senior staff from various City departments (Table 2 below) already participate in the due-diligence review of NOFA applications as noted above in Figure 1, Step 2. These reviews ensure the necessary expertise and experience for the City’s NOFA application review, which includes initial assessment of a project’s viability in terms of whether the project can physically be built as well as financial viability. This coordinated effort will continue as an ongoing part of the City’s NOFA process.

Table 2: City Staff Assigned to NOFA Process

Department/Division	Assigned Staff	Expertise/Training
Housing Department	Affordable Housing Manager Senior Housing Officer Housing Officer	Financing/Funding Compliance/Monitoring Fair Housing
Planning Division	Deputy Zoning Administrator Senior Planner Assistant Planner	Entitlement Process Land Use/Zoning Environmental Review
Building Division	Chief Building Official Deputy Building Official Senior Building Inspector	Plan Review Building Codes/Standards
Public Works Department	Principal Civil Engineer Senior Civil Engineer	Infrastructure Planning Traffic Impact Analysis
Finance and Administrative Services Department	Assistant Finance and Administrative Services Director	Funding Availability

**Provide affordable housing training to City staff involved in the NOFA review process—
Future Item**

While many aspects of the design of affordable and market-rate housing are the same, there are key factors that may result in different design considerations/concerns between the two types of housing. For example, affordable housing projects require different external funding sources that have different requirements that need to be met. Such projects must be built to standards that ensure that they are durable for the long term to meet long-term affordable restrictions (typically 55 years or more). Additionally, because affordable housing can be so challenging to finance, there may be an even higher degree of sensitivity than market-rate projects to site plan changes that may add development costs, even if they appear to be minor, because they can individually or cumulatively quickly cause a project to become unfeasible. At the same time, it is important to balance project feasibility with striving to deliver quality affordable housing, which may require figuring out how certain development costs necessary for a quality project must be absorbed. Training/workshops about affordable housing and some of its different funding/design considerations could assist with streamlining the review of NOFA applications as well as through the entitlement and building permit process that would occur after the NOFA process is complete.

One training/workshop will be provided to the above City staff in Fiscal Year 2024-25 to provide an overview of how affordable housing is financed and how such projects may differ from market-rate projects. Periodic workshops will be provided after Fiscal Year 2024-25 as needed to provide a refresher or updates to City staff involved in the NOFA process.

NEXT STEPS

In conclusion, Housing Element Section 4.1a outlined eight components to update the NOFA process. Staff reviewed these objectives and responded to the key action items. Some of the items have been completed, some are ongoing, and others are in progress. This review and update aligns with the Housing Element Program 4.1 objectives and has helped staff identify processes revisions that will better facilitate project reviews, communication, and transparency. Elements of the NOFA process will continue to evolve and will be periodically updated through the City's continuous improvements approach based on best practices and to respond to regulatory changes and feedback from affordable housing developers, the community, and Council priorities.

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