



Affordable Housing Committee Staff Report

AGENDA TITLE: Consideration of the proposed \$4,000,000 loan from the Affordable Housing Fund in support of the Villages at Bilby affordable apartment complex
Project location: approximately the northeast corner of Big Horn Blvd and Bilby Road

MEETING DATE: June 9, 2021

PREPARED BY: Sarah Bontrager, Housing and Public Services Manager

RECOMMENDED ACTION:

Staff recommends that the Affordable Housing Committee (Committee) perform an independent review of the loan application for the Villages at Bilby affordable apartment complex and make one of the following recommendations:

1. Staff continue to negotiate or collect additional information from the developer, 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. Proposals under the second phase of the RFP, which focused on other funding sources, were due May 19.

The Committee met on April 7 to review the two proposals received and voted for the Villages at Bilby affordable housing project, proposed by Pacific West Communities, Inc. (Developer), to move forward to the loan application stage.

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 Developer filed their loan application in early May. Staff subsequently evaluated the project and worked with the Developer to negotiate loan terms.

Villages at Bilby Project Summary

A summary of key project features is shown in Table 1. The project summary is shown for a one-phase project; however, for maximum competitiveness for financing, the Developer may submit the project in two phases. The first phase would have 64 units and the second phase 62 units. The \$4 million loan amount would be split equally between phases.

Table 1
Villages at Bilby Project Summary

Gardens at Quail Run					
Developer	Pacific West Communities, Inc. Idaho-based for-profit affordable housing developer with more than 140 affordable properties in the Western US. In Elk Grove, they have developed three projects: Avery Gardens (opened in 2015), Bow Street Apartments (2019), and Gardens at Quail Run (2021). A fourth project, Gardens at Quail Run II, is moving forward without City subsidy.				
Nonprofit Partner	Riverside Charitable Corporation Southern California-based nonprofit focused on assisting with the development of affordable housing. They will provide on-site social services at the project under the LifeSTEPS model.				
Location	Portion of 10220 W Stockton Blvd (northeast corner of Big Horn Blvd and Bilby Rd)				
Nearby amenities	Will be adjacent to single-family homes and a park (both proposed). Nearest middle/high school about 0.9 miles away; nearest elementary school is 1.4 miles away. Very limited shopping/dining options, though some would likely be built nearby.				
Type of project	Family				
Affordable unit description ¹	Affordability Level (% of AMI)	Total	1BD	2BD	3BD
	30%	14	6	4	4
	40%	20	8	6	6
	50%	51	20	15	16
	60%	40	14	14	12
	TOTAL	125	48	39	38
Total number affordable units	125				
Total residential square footage	99,687				
Total project cost	\$47,599,163				
Construction cost	\$29,591,349				
Cost per unit	\$377,771				
Cost per residential sq. ft.	\$477.49				
Loan request	\$4,000,000 ²				
City subsidy per affordable unit	\$32,000 (8%)				
Other financing/subsidy ³	\$33,769,822 – 9% tax credits \$5,250,000 – permanent loan				
Project amenities	Community building with fitness equipment and computers, swimming pool, bocce ball court, and children’s play area				
Social services offered	Minimum of 15 hours per week of on-site supportive services, including up to 10 hours per week of after-school programming				
Site control status	Purchase agreement expiring December 14, 2022				

- 1 The project also includes one two-bedroom manager unit, which is not income-restricted.
- 2 The project is anticipated to be developed in two phases, with each phase receiving a \$2 million loan.
- 3 As proposed, the City’s financing will be junior to the tax credit Land Use Restrictive Agreement and the \$5.25 million permanent loan. A phased approach would have senior loans of approximately \$2.5 million per phase.

Under a phased approach, each of the phases would be built on legally separate parcels owned by different limited partnerships. The project would be managed and marketed jointly, with residents having reciprocal access to both parcels. The Developer has used this strategy successfully before, including with the Bow Street Apartments, which was a hybrid 4%/9% tax credit project where each financing source required its own parcel and limited partnership.

Conditional Loan Commitment

In order to apply for highly competitive 9% federal and/or state tax credits in the next application round, the Developer must submit an application to the California Tax Credit Allocation Committee (TCAC) by July 1, 2021. 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.

ANALYSIS:

Loan Application

The Developer's loan application (Attachment 1) builds off of the information submitted in their proposal (Attachment 2). The components of the loan application are dictated by the Affordable Housing Loan Program Guidelines. The following items were not submitted:

- *Market study.* A complete market study has not yet been completed. However, a preliminary market study demonstrated a strong market for the proposed project. Similar projects reviewed by the market study preparer indicated similar properties report a 0% vacancy rate. Based on this and the City's review of vacancy rates at its other projects, it is highly likely that the complete market study will show adequate demand for the units.
- *As-built property appraisal.* This appraisal identifies the "as is" value of the land, and prospective market values of the property when complete and when stabilized under both the restricted rent and unrestricted rent scenarios. The Developer indicated that this appraisal is typically initiated by the lender. As negotiated with Bow Street and Gardens at Quail Run, the City could require the as-built appraisal be a condition of the loan closing, but the City's conditional commitment cannot be tied to the value identified in the appraisal because that is not a factor within the Developer's control.

Loan Underwriting

The goal of the City's underwriting process is to evaluate the financial feasibility of the project, including the Developer's ability to develop the site as presented and to maintain the project in both the short-term and the long-term. Highlights of staff's underwriting efforts are noted below in the Project Strengths and Project Weaknesses sections.

Project Strengths

The Villages at Bilby application has several strengths:

- *Experience.* Developer has significant experience designing, funding, constructing, and managing affordable housing projects in California and other states. Since 1998, Developer has developed nearly 10,000 units of affordable housing in more than 160 projects representing over \$2 billion in total development costs, and has an additional 40 projects and 5,000 units under development. The Pacific Companies, of which Developer is a part, is a vertically integrated firm, including their Pacific

West Architecture and Pacific West Builders, which will serve as the architect and general contractor on this project. Developer's track record demonstrates an ability to consistently obtain LIHTC awards and the accompanying private and public financing to complete their projects.

Riverside Charitable Corporation, the nonprofit partner, is based in Tustin but has a local presence in the Sacramento region. They provide services to residents at six of the City's other affordable housing properties and to more than 100 properties in California.

- *Unit affordability.* The project will add units affordable to extremely low-income and very low-income households, with rents as low as \$404 for a one-bedroom and \$547 for a three-bedroom. Overall, 67% of the units will be affordable to households at or below 50% AMI, the population with the most trouble securing housing in Elk Grove.
- *Partnership to address homelessness.* The Developer committed to partnering with the City to address homelessness, including by moving homeless Elk Grove households to the top of the waitlist for any unit for which they are qualified. A similar partnership on Gardens at Quail Run so far has resulted in eight Elk Grove homeless households (including five families with children) being placed in units they can afford.
- *Revenue and operating cost assumptions.* The project's revenue and operating cost assumptions are in line with the standards of TCAC and past performance on the Developer's Avery Gardens and Bow Street projects. At least in the short term, revenue is likely to exceed projections substantially as a result of higher than projected rents and lower than projected vacancy rates. In April, TCAC released 2021 rent levels, which are about 5% higher than the 2020 rents used by the Developer in their pro forma. Additionally, the pro forma projects an industry standard vacancy rate of 5%, but similar affordable projects currently have 0% vacancy rates.
- *On-site property management.* The project accounts for on-site property management by setting aside one non-income-restricted unit for a member of the property management staff. The proposed property management firm, Aperto Property Management, has experience managing market-rate and affordable multifamily units. Aperto manages the Bow Street Apartments and the Gardens at Quail Run and their staff have worked cooperatively with the City on lease-up and other issues.
- *Social services.* Through partnership with Riverside Charitable Corporation, the project will provide a minimum of 15 hours a week of on-site social services, including up to ten hours per week of after-school programming (two hours per weekday, including summer programs). This service requirement, which is greater than that of most other affordable complexes in Elk Grove, will focus on helping households develop skills to move up and out of affordable housing. Riverside Charitable regularly surveys residents to determine what programming will provide the most value, and committed to sharing their social services plan and information on resident participation with the City.

Project Weaknesses

A key goal of the City's affordable housing programs is ensuring that units remain an excellent resource for low-income households over the duration of the project's life. However, in addition to the strengths noted above, the Villages at Bilby application has several weaknesses, mainly related to financial assumptions. These weaknesses may impact the project's ability to remain viable throughout the 55-year affordability period. Specifically, staff has identified the following weaknesses:

- *There is a disparity between the projected increases in rental revenue and the increase in operating expenses.* The Developer assumed that rents would rise at 2.5% annually, and that most operating expenses would rise at 3.5% annually, which is consistent with TCAC standards. In the current economic climate, a 2.5% increase in annual rents is likely, but in a less strong economic environment, increases in revenue may be dependent on increasing Section 8 receipts and/or maintaining a lower than standard vacancy rate. In the event operating costs continue to increase at a rate outpacing revenue increases, the project's net operating income will decline, which may lead to a situation where the property cannot be adequately managed or maintained.
- *The proposed replacement reserve contribution of \$250 per unit per year is inadequate to maintain the project over the 55-year affordability period.* Although this contribution is within TCAC guidelines, at this rate it would take more than 1,800 years before the replacement reserves equal the non-inflation-adjusted construction cost of the project. Underfunding the replacement reserves creates a situation where the project may not be able to be maintained in line with the City's standards during the entirety of the affordability period. In order to partially address this issue, the Developer agreed to inflate the annual reserve deposits in line with operating expenses (3.5% per year) and allowing the City to require a capital needs assessments prior to the transfer of the project to a new owner, and based on the findings, require that reserve deposits be increased to ensure adequacy of reserve deposit to meet the ongoing health and maintenance needs of the project.
- *The likelihood of the City receiving significant loan repayment throughout the loan term is small.* A residual receipts payment structure (50% of NOI) is proposed. Under this structure, the loan would not be amortizing and the annual payments to the City would not be equal to annual interest on the loan, creating a scenario where the loan balance continues to grow. If rents fail to increase at the predicted pace, if expenses are greater than estimated, and/or if vacancy is higher than anticipated, it is possible the City would not receive any payment at all. Historically, this has been the case for the majority of the City's residual receipts loans.
- *Location.* The project is in a new development area and will be adjacent to single-family homes and a proposed park. The nearest elementary school is 1.4 miles away, and it is not near many shopping or dining options. However, it is likely a new elementary school and closer shopping and dining options will be built as the area develops, and affordable housing that exists prior to neighboring uses tends to face less neighborhood opposition. The project is in the highest opportunity zone for TCAC, indicating residents are more likely to have positive economic, educational, and health outcomes.

Loan Terms

The loan term sheet will be used to prepare the loan documents, including, without limitation, 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 phased approach to the project means that the City would be making two loans, one to the limited partnership created for each of the phases. As a result, staff is proposing two loan commitments, one each for Villages at Bilby I (\$2 million) and Villages at Bilby II (\$2 million).

Staff negotiated loan term sheets that include a summary of the key aspects of the loans (Attachments 3 and 4). Staff's chief goals in negotiations included the following:

- 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.

Highlights of the loan terms include the following:

- Loan amount of \$4 million in total (\$2 million per phase);
- Interest rate of 4%;
- City commitment extends for three consecutive tax credit submittals or until December 31, 2022, whichever is shorter, for Villages at Bilby I, and for five consecutive tax credit submittals or until December 31, 2023, whichever is shorter, for Villages at Bilby II;
- 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.

The proposed loan terms are consistent with what the City negotiated on Gardens at Quail Run. The Developer has reviewed both loan term sheets and indicated their acceptance of the terms.

NOTE: Just prior to publication of this staff report, the Developer submitted a new site plan based on new consultation with their architecture and civil engineering firm. The new site plan makes adjustments for open space requirements and Sacramento Regional Transit right-of-way, among other considerations, and necessitated changing the unit mix to replace some one- and two-bedroom units with studio units. Staff requested an updated pro forma and construction cost estimate from the Developer. Supplemental information and analysis on the potential impacts of these changes will be shared with the Committee next week. The unit mix in the loan term sheet for Villages at Bilby I (Attachment 3) may need to be updated to reflect the new proposed unit mix.

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 June 23. This timeframe will allow the Developer to apply for tax credit financing in

the July 1 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 July 1. The next opportunity to apply for funding is expected to be in February/March 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 July 9, 2014, the City Council certified an EIR for the Southeast Policy Area Strategic Plan (State Clearinghouse No. 2013042054). The SEPA EIR analyzed full buildout of SEPA based upon the land plan, development standards, and policies contained in the Community Plan and Special Planning Area, as well as the improvements identified in the accompanying infrastructure master plans.

Additionally, 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 Villages at Bilby Project is being undertaken pursuant to and in conformity with the approved Southeast Policy Area Community Plan and Special Planning Area as well as 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 Villages at Bilby Project other than those previously disclosed and analyzed in the EIR for the Southeast Policy Area Strategic Plan and the Housing Element Update SEIR. The Villages at Bilby Project is subject to the Southeast Policy Area Mitigation Monitoring and Reporting Program and 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 Villages at Bilby Project is being undertaken pursuant to and in conformity with the approved Southeast Policy Area Community Plan and Special Planning Area as well as the 2021 Housing Element Update. There are no substantial changes in the Project from that analyzed in the 2014 EIR and 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:

The Developer requests a conditional loan commitment from the City totaling \$4 million from the Affordable Housing Fund. Staff estimated that about \$8 million would be available under the RFP, which includes two phase. Commitment to this project will mean about \$4 million is available to fund one or more of the seven proposals received under the second phase of the RFP. 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 funding for 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 proposed annual payments on the loan are projected to cover staff costs associated with regular monitoring of the project's physical and financial condition.

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

ATTACHMENTS:

1. Villages at Bilby loan application – Pacific West Communities
2. Villages at Bilby proposal – The Pacific Companies
3. Draft loan term sheet – Villages at Bilby I
4. Draft loan term sheet – Villages at Bilby II