

REPORT TO COUNCIL

SUBJECT

Consider First Community Housing Proposal for \$6 Million in Housing Mitigation Funds for Redevelopment of Orchard Gardens Apartments at 245 W. Weddell Drive, Resulting in an 87-Unit Affordable Housing Project (Continued from March 15, 2016.)

BACKGROUND

On March 5, 2015, staff issued a Request for Proposals (RFP) for new affordable housing projects to be funded with the City's Housing Mitigation Funds (HMF). A total of \$9 million in HMF was made available through that RFP. Staff has received one proposal in response to that RFP, which was distributed broadly to housing developers throughout the County. Applications for affordable housing projects will be accepted on an ongoing basis until the funds are fully awarded.

The sole proposal received to date is from First Community Housing (FCH), a non-profit housing developer based in San Jose. Orchard Gardens, located at 245 W. Weddell Drive, is the only FCH-developed property in Sunnyvale. Most of the other FCH properties are located in San Jose, although there are several in nearby communities, including Mountain View and Morgan Hill. The FCH proposal is described briefly below, with the results of the staff review and proposed funding recommendation. Pertinent sections of the proposal are provided in Attachment 1, Proposal Summary.

Orchard Gardens is an existing affordable rental property acquired in 1998 by an affiliate of FCH, Parkview Apartment Associates, LP ("Parkview"). At the time of the 1998 acquisition, the property included 32 apartments in two buildings built in 1961 as a market-rate rental project. Parkview/FCH added another 30 units in two new buildings on the site shortly after the acquisition, with City assistance, and renamed the property Orchard Gardens. Since that time the entire project has been operated as affordable rental housing. There are currently three outstanding City loans on the property dating from that time, consisting of HOME, CDBG, and HMF funds, with a combined outstanding balance of nearly \$1.6 million, with loan terms ending in 2030.

FCH's proposal has a number of favorable attributes that address goals and objectives of the RFP. The staff scoring committee gave it an average score of 81 points (out of 100). Some of these strong attributes include its proposed commitment of half of the completed units (43) to special needs tenants, its deep income targeting of some of the units, proposed sustainability features, infill nature, and reuse of an existing site. The staff scoring worksheet is provided in Attachment 2. The applicant presented the proposal to the Housing and Human Services Commission (HHSC) at its January 20, 2016 meeting. The HHSC voted 4-0 (with one absence) to recommend that Council approve a conditional award of \$6 million to FCH for this project. The Commissioners also recommended that Sunnyvale residents and/or workers be given priority for the affordable units in this project, to the extent possible (e.g., within the limits of fair housing requirements). Minutes of that meeting are

provided in Attachment 3.

EXISTING POLICY

General Plan, Housing Element, Goal A

Assist in the provision of adequate housing to meet the diverse needs of Sunnyvale's households of all income levels.

- Policy A.1 Encourage diversity in the type, size, price and tenure of residential development in Sunnyvale, including single-family homes, townhomes, apartments, mixed-use housing, transit-oriented development, and live-work housing.
- Policy A.2 Facilitate the development of affordable housing through regulatory incentives and concessions, and/or financial assistance.

ENVIRONMENTAL REVIEW

CEQA review of the project will be conducted by the Planning Division as part of the development review process, when there is sufficient information for meaningful environmental analysis. The creation of a conditional funding mechanism for the proposed project in no way obligates the City to ultimately approve the project. (CEQA Guidelines Section 15378(b)(4).) The City will retain discretion to approve or disapprove the project after consideration of the environmental impacts. The proposed award will be conditioned on the project's completing the environmental review and obtaining all required entitlements and development permits.

DISCUSSION

Proposal Summary

The proposal consists of a request for \$6 million for the redevelopment of Orchard Gardens, a 62-unit development. The proposed project would include demolition of the 32 oldest units, rehabilitation of the remaining 30 existing units, and construction of a new four-story, 57-unit building designed for LEED platinum certification. The property is zoned as R-4/PD, allowing up to 62 units on this site. The proposed project would qualify for a 35 percent density bonus under State law, and a 5 percent bonus under the City's green building incentive. In combination, these programs could provide a density bonus of 25 units, allowing a total of 87 units to be provided on the site.

The demolition of the two oldest buildings would be done in two phases, one 16-unit building at a time, to minimize the need for off-site tenant relocation. The redeveloped property would include a total of 87 units at completion, increasing the amount of affordable housing on the site by a net 25 units, using the density bonus as noted above. Fifty percent of the total units at completion would be reserved for developmentally disabled households. FCH has experience developing housing for developmentally disabled tenants in partnership with several local service providers, including Housing Choices Coalition, that assist FCH with referrals of eligible applicants for the units, and provision of on-site services. Upon completion, thirty-one of the units, or 36% of the total, would be affordable to lower-income households earning between fifty to eighty percent (50-80%) of area median income. Of the remaining units, 18 would be restricted to extremely low income (ELI) and 36 would be restricted to very low income (VLI) levels, and one unit would be unrestricted, for the on-site property manager. The completed project, as proposed, would include a range of one- to three-bedroom units.

The total cost of the redevelopment project is currently estimated at slightly over \$34 million. The

requested \$6 million in City financing would constitute roughly 18% of that total cost, and would be provided in the form of a 55-year loan, with an affordability restriction placed on the property for a fifty-five year term, as discussed in more detail below. These are relatively standard terms for public agency financing of affordable housing developments in California at this time, including both local and state agency funding, and are consistent with the City's current practice. A nexus study completed for the City in 2014 showed that slightly over \$300,000 was required at that time to subsidize a newly built rental unit to be affordable to a very low income household. The request of \$6 million equates to a new City subsidy of approximately \$69,000 per unit, or 23 percent of the subsidy amount determined by the nexus study.

Applicant Background

FCH develops, constructs and manages multi-family, affordable housing, and aims to deliver high quality projects on time and within budget. FCH focuses on sustainable, energy-efficient project design and green building materials. It has often used the design-build process to develop its projects and has a long-standing relationship with its general contractor.

Proposal Analysis

Project Readiness

FCH has submitted a Preliminary Review application with a conceptual redevelopment proposal; this application has been reviewed by the staff Project Review Committee (PRC) for comment and feedback. The proposed project has been modified slightly to address the comments and suggestions of the PRC regarding maximum number of units, site plan, and related planning issues. FCH has not yet prepared a formal planning application or completed conceptual design of the project, but has informed staff it will complete these tasks if the City conditionally agrees to provide the requested \$6 million in funding for development of the project. In addition, the project's proposed financing plan is still in the early phase, and may change somewhat as various new funding opportunities arise and/or others prove infeasible. This is not unusual for proposals at this stage, and, if awarded, staff would work with FCH in its efforts to obtain matching funds and refine its financing plan as needed to adapt to the evolving funding landscape.

Design-Build Concept

One aspect of the FCH proposal, its plan to use the "design-build" development method, required special consideration by staff, as this method has not been used in past City-assisted housing projects, due to the City's long-standing Charter provision and procurement policies that require competitive bidding of all city construction projects (i.e., public works projects). However, City-assisted affordable housing projects are not the same as public works projects since the City is not the owner of the project and state law provides affordable housing projects with more flexibility in certain areas than what is available for City-owned public works projects.

"Design-build" means that a project's development team includes the general construction contractor (builder) from the beginning of the design effort, so that the contractor can fully understand the project concept and provide practical input to the architect and engineer on feasibility and value engineering suggestions during the design process, rather than after plans have been largely completed. In this method, there is no competitive bidding to identify the construction contractor, because either a bidding process, or a private negotiation as in the case of the FCH proposal, has occurred prior to the project design phase.

Design-build differs from the contractor procurement process typically used in most development

projects, particularly in public works projects, which is often called the “design-bid-build” process. Using this method, the development team typically includes only design professionals, such as architects and engineers, as well as the property owner/developer, until the project plans are substantially complete, at which time they are competitively bid out to general contractors (and sub-contractors) interested in building the project.

There are advantages and disadvantages to each of these methods, but in recent years there has been increasing interest in the design-build method in both the public and private sectors. Various studies have identified its pros and cons compared to the more traditional design-bid-build method. The State has passed legislation in recent years allowing use of design-build procurement for certain types of public works projects, and the League of California Cities has also provided recent guidance to local agencies on the topic. For this reason, after discussing the proposal internally between the Community Development Department, the Finance Department and the Offices of the City Attorney and City Manager, staff has concluded that it might be worthwhile to consider allowing FCH to use design-build on the proposed project as a sort of pilot project. However, if FCH were to later request any federal funds for the project from the City, such as CDBG or HOME, the City’s standard construction bidding requirements would apply, based on federal procurement regulations for those funds, or else the project would be ineligible for those funds.

The FCH proposal includes using FCH’s long-time general contractor, Branagh Construction, which also prepared the construction cost estimates for the proposal, to build the project. In addition, as explained in Attachment 4, a letter from FCH, some subcontractors have also already been identified and included in the design team; however they are not guaranteed to be selected for the construction phase. As explained in Attachment 4, FCH believes that using the design-build method minimizes change orders, can prevent increases in the total project cost during the construction phase, and incentivizes the builder to maximize cost savings.

To address concerns about possible conflicts of interest and price competitiveness, staff has suggested, and FCH has agreed, to hiring a neutral, third-party construction cost estimator with value engineering expertise, who is not affiliated with the design firm or the general contractor, to review and comment on the proposed construction budget for the project and suggest any additional value engineering to further reduce project costs. FCH has suggested three possible consultants for the City’s consideration for this purpose. The City may either approve one of these, or advise FCH to implement an open RFP process to select a qualified consultant for this purpose. This third-party value engineering analysis will be presented to Council as part of the final approval for the HMF loan.

Proposed Loan Terms

The proposal requests a City loan of \$6 million in HMF. The applicant has agreed to the City’s terms typically used for housing loans of this type, which include: three percent (3%) simple annual interest, deferred for a term of approximately 55 years, with residual receipt payments, as defined in the promissory note, due annually from any available “surplus” cash flow, and a mandatory affordability term of 55 years. The term of affordability runs with the land for the term, and does not terminate early if the loan is paid off early.

In addition to the requested new loan, the proposal would leave in place the three existing City loans (HOME, CDBG, and Housing Mitigation Funds), which currently have a total outstanding balance of nearly \$1.6 million. These loans also require residual receipts payments. The first payment of residual receipts, covering a small portion of the interest accrued to date, was received by the City in

2014. It is not unusual for subsidized affordable projects like Orchard Gardens to make no residual receipts payments for the first ten to fifteen years or so of the loan term, as it takes a while for the very modest annual rent increases, limited by the affordability restrictions, to begin to exceed the project operating expenses and senior debt service in order to generate the “surplus cash” that is used to make these payments.

The cash flow projection in the FCH proposal (see pages 18-1 of Attachment 1) shows that residual receipts payments to the City under the proposed new loan would begin in Year 1 after the new project is completed, and would continue, increasing slightly each year, for the 30-year projection period. It also projects that the payments under the existing City loans would pause for the first 13 years after project completion, and then start again in Year 14 and continuing throughout the remaining years of the projection. This projection is based on a worst-case scenario, such as a 10 percent vacancy rate, and no project-based vouchers or other rent subsidy program, which typically lead to higher rent receipts for the project. Vacancies in recent years tend to be only short-term to allow for turnover, and rental income tends to be slightly better than projected. However, lenders require conservative assumptions such as the 10 percent vacancy rate to be used for cash flow projections as part of the underwriting process. In addition, the City could choose to direct the owner to use the available residual receipts to first pay down the existing loans rather than make payments toward the new loan, if desired.

The terms of the three existing City loans end in 2030, while the new loan would end 55 years from the completion of the project. The existing loan terms will most likely need to be extended to coincide with the end of the term of the new loan to avoid creating financial hardships for the project in 2030. Staff will explore all of the above underwriting issues in more detail with the applicant and recommend options to address them after a thorough project underwriting process has been completed, before any final loan commitment is prepared for Council consideration.

The City will not issue a final funding commitment until all the standard funding conditions are completed, including appropriate environmental review, obtaining all required permits and entitlements, and obtaining written commitments for all other financing required for the project, except for the tax credits and/or tax-exempt bonds. Staff has discussed the proposed terms for this funding commitment with the applicant, summarized in Attachment 5, and feels the proposed terms are favorable to the applicant and the City. The conditional commitment shall be valid for a two-year term in order to allow adequate time for completion of the funding conditions.

FISCAL IMPACT

The recommended action will not impact the General fund. The action would conditionally commit \$6 million from the Housing Mitigation Fund to this project for a period of up to two years based on the terms described in Attachment 5. This fund exists for the purpose of funding affordable housing projects of this type, so the recommended action is consistent with its purpose and various city policies regarding affordable housing. The requested funding is available under the line item of “Future Housing Projects” in the Housing Fund for which a total of \$9.25 million is planned for FY 2016/17 in the Long-Term Financial Plan. If the requested commitment is approved staff will include the funding for this project in the Recommended Projects Budget for FY 2016/17.

PUBLIC CONTACT

Public contact was made by posting the Council agenda on the City's official-notice bulletin board outside City Hall, at the Sunnyvale Senior Center, Community Center and Department of Public

Safety; and by making the agenda and report available at the Sunnyvale Public Library, the Office of the City Clerk and on the City's website.

ALTERNATIVES

1. Award a two-year conditional commitment of HMF in the amount of \$6 million to FCH for redevelopment of Orchard Gardens Apartments at 245 W. Weddell Drive in Sunnyvale, generally consistent with the terms described in Attachment 5, and direct staff to include the funds committed to this project in the FY 2016-17 Projects Budget.
2. Award a conditional funding commitment to FCH with modified terms.
3. Provide other direction to staff regarding this proposal.

RECOMMENDATION

Alternative 1: Award a two-year conditional commitment of HMF in the amount of \$6 million to FCH for redevelopment of Orchard Gardens Apartments at 245 W. Weddell Drive in Sunnyvale, generally consistent with the terms described in Attachment 5 to the report, and direct staff to include the funds committed to this project in the FY 2016-17 Projects Budget.

The proposed Orchard Gardens project is consistent with the goals of the RFP, the City's Housing Element, and related local and regional housing and land use policies and plans. The project addresses a number of City priorities, such as: providing housing for extremely low income and special needs households, improving the existing housing stock, and addressing sustainability concerns, such as reducing energy and water use in housing developments. In addition, the project appears to qualify for a variety of sources of matching funds needed to finance the remainder of the project cost.

As noted in Attachment 4, the applicant proposes to use the design-build approach rather than using a competitive bidding process, for a variety of reasons explained in the letter. Although this approach has not been used by the City previously, staff has done initial research on the topic, and feels that there could be value to the City in allowing this method to be used for this project, on a pilot basis at least, subject to Council approval.

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ATTACHMENTS

1. Proposal Summary
2. Scoring Worksheet
3. Minutes of January 20, 2016 Housing and Human Services Commission Meeting
4. Letter Regarding Design-Build Process
5. Proposed Terms of Conditional Commitment