



CITY OF SANTA BARBARA

FINANCE COMMITTEE AGENDA REPORT

AGENDA DATE: October 21, 2008

TO: Finance Committee

FROM: Housing and Redevelopment Division, Community Development Department

SUBJECT: Loan Increase For Mental Health Association's Affordable Housing Project At 617 Garden Street

RECOMMENDATION:

That the Finance Committee consider and recommend to the Agency Board approval of an increase of \$1,200,000 in Redevelopment Agency Housing Contingency funds to the existing loan to the Mental Health Association in Santa Barbara County for development of an affordable housing project at 617 Garden Street.

EXECUTIVE SUMMARY:

The Mental Health Association in Santa Barbara County (MHA), with assistance from the City's Housing Authority, is rapidly bringing this high-priority community project to completion. This complex project features affordable housing for low income downtown workers and MHA clients that will be managed by the Housing Authority, as well as office and program space for MHA and additional office space.

Since August 2006, when the Agency provided a permanent loan of \$5.1 million to construct the housing, total development costs for the whole project have increased roughly \$2.5 million (10 percent) over the \$24.6 million budget. MHA has secured funding for about one-half of the increased costs and requests \$1.2 million from the Agency to cover the remaining portion of the cost increase that is attributed to the housing. The requested additional funds for this critical community-serving project result in a local housing subsidy cost per unit of \$123,529 that is not out of the ordinary for the Agency. Securing the additional funding as soon as possible is very important, as critical completion deadlines are approaching.

DISCUSSION:

Background

MHA acquired the property at 617 Garden Street in 2001. In 2006, the adjacent 35-space surface parking lot was conveyed by the Agency to MHA to facilitate construction of a mixed-use building with 113,000 square feet of gross floor area for the uses listed below.

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This complex building will be split into three separate condominiums with different ownerships and will have an expected total of six separate user groups.

- 12 affordable rental units for low income downtown workers;
- 38 affordable rental units for very-low income MHA clients (and 1 manager's unit);
- Office space of about 5,000 square feet for MHA and another nonprofit;
- Fellowship Club space of about 5,200 square feet for MHA clients;
- Office space of approximately 3,000 square feet to be acquired by the city of Santa Barbara; and
- Subterranean and surface level parking with a total of 110 parking spaces (including 35 replacement parking spaces for use by City employees).

The City and Agency have provided strong support to the project over the years. (The following dates indicate when approvals were granted; details can be found in the corresponding agenda reports.)

- The City granted the project community priority designation/allocation of 4,000 square feet of commercial space (July 15, 2003);
- The Agency provided a \$385,000 predevelopment loan (October 28, 2003) that has since been repaid;
- The City's Planning Commission approved the project's design (January 27, 2005);
- The Agency approved transferring its surface parking lot at 627 Garden Street (October 18, 2005);
- The Agency approved a \$4.6 million permanent loan (October 18, 2005);
- The Agency approved an increase to its loan to \$5.1 million (August 8, 2006) prior to the start of construction, due to rising construction costs; and
- The City approved exercising its option to purchase office space in the new building (July 15, 2008).

The Agency's existing \$5.1 million permanent loan has been used exclusively for the development of the affordable housing. The loan is a typical Agency loan with 3 percent interest, deferred residual receipts payments, and a balloon payment due at the end of the loan's 30-year term. Under the terms of the City's 60-year affordability covenant, tenant income will be limited to 80 percent of Area Median Income adjusted annually (\$43,600 for a single person for 2008), and rents will be limited to 60 percent of Area Median Income adjusted annually (\$891 for a 1-bedroom apartment for 2008). However, rents and incomes will actually be limited to lower levels, as required by regulations governing other funding sources for the project.

Project Status

The Housing Authority got involved in the project relatively recently and has provided valuable assistance to MHA in helping manage costs and complete the project on schedule. The Housing Authority's involvement is long term, as it will provide property management services for the residential portion of the project as well. Construction is nearing completion, with target dates of November for partial commercial occupancy and December for residential occupancy. (Both occupancies are expected to be accomplished with a Temporary Certificate of Occupancy.)

Total Development Cost Increase

Total development costs that were budgeted for the project have increased over the course of construction. The total development cost was originally estimated to be \$24,660,000. The total development cost is now \$27,150,000 – which reflects an increase of \$2,490,000 (or 10.1 percent).

Most of the cost increase is attributable to hard construction cost increases due to increases in materials (concrete, steel, wood, stucco) and labor. The balance of the cost increase is attributable to soft cost increases, which are due to the complexity of in-fill site development of a large complex project.

It is important to separate costs attributed to constructing the residential portion of the project from costs attributed to constructing the commercial portion, since Agency Housing Contingency funds can only be spent on creating affordable housing. Based on the relative size of the two portions of the project, \$2,200,000 of the increase is attributed to the housing and \$290,000 is attributed to the commercial.

Proposed Residential Financing

Staff had made it clear that additional funding would only be considered as a last resort to fill a final gap after MHA exhausted all of its other options. MHA succeeded in finding State funding that would cover a large portion of the \$2.2 million increase attributed to the housing.

MHA expects to receive funding in the amount of \$1 million from the State's Mental Health Services Act (Proposition 63). These are brand-new funds dedicated to the creation of affordable special needs housing that will come in the form of 55-year deferred residual receipts loan. The State is very supportive of the project, as it will be one of the very first projects to be completed using these funds.

MHA requests that the Agency fund the balance of the residential cost increase. The proposed increase would result in an Agency per unit subsidy for the project of \$123,529 – an amount that is not inconsistent with recent subsidies for affordable housing projects with comparable degrees of affordability and complexity, such as the St Vincent's project completed by Mercy Housing in 2007 (\$102,353 per unit) or the Casas Las Granadas project completed by Peoples' Self-Help Housing in 2008 (\$131,750 per unit).

The permanent project financing for the residential portion of the project is now proposed to be as follows (listed in order of priority on title):

SBB&Trust Loan (residential portion):	3,390,000
Agency Loan w/ proposed increase:	6,300,000
State Mental Health Services Loan:	1,000,000
Federal Home Loan Bank AHP Program:	357,000
Low Income Housing Tax Credits:	9,549,756
Deferred Developer Fee:	<u>1,396,706</u>
Total:	\$21,993,462

All of the above loans, including the Agency loan (increased as proposed), would be well secured by the value of the newly constructed residential property. This favorable security

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position is made possible by the cash infusion of nearly \$10 million to the project coming from the Low Income Housing Tax Credits. However, these funds are in jeopardy, as a critical completion deadline is rapidly approaching. Should the residential portion of the project not be occupied by December 31, 2008, then MHA could lose their tax credit funding. With the Housing Authority's involvement in the project, staff has been assured that this deadline will be met. Critical to meeting that deadline, however, is approval of the requested Agency loan increase. Moreover, the prompt infusion of additional Agency funds would enable MHA to avoid incurring costly interest debt from other short-term financing sources.

There is sufficient affordable housing funding to cover the \$1.2 million requested by MHA. There is currently a total of \$4.9 million in Agency and HOME funds. After deducting expected requests from projects in the pipeline, including the \$1.2 million requested by MHA, this would leave a balance of approximately \$2.7 million. This balance, when coupled with housing set-asides from future tax increment income and future awards of HOME funds, would be more than sufficient to cover future requests expected from the Housing Authority for projects to be developed on the Haagen Printing and Bradley properties.

Proposed Commercial Financing

MHA intends to convert its original permanent loan with Santa Barbara Bank & Trust from a taxable to a tax-exempt basis. This will reduce the loan's interest rate and enable MHA to borrow an additional \$290,000 in principal, which will be used to cover the portion of the cost increases attributed to the commercial space. Accordingly, a TEFRA hearing for the proposed bond financing will be included in the Joint City Council/Agency Board meeting scheduled for October 28, 2008. The TEFRA hearing before the Council is a requirement of federal law for tax exempt financings. The council has held numerous such hearings, and no financial obligation on the part of the City or the Agency is implied or created.

Conclusion

The cost increases are unfortunate but unavoidable. The project is nearing completion, with critical deadlines approaching for the tax credit funding. Staff supports the requested loan increase as it is reasonable and essential and requests that the Finance Committee recommend its approval to the Agency Board. The community is well served by continuing City/Agency support for a project that redevelops the area, further strengthens a vital human service agency, enhances services provided to a special needs population that is increasingly challenged, and creates 51 units of much-needed affordable housing.

ATTACHMENT: Letter from Mental Health Association

PREPARED BY: Dave Gustafson, Housing and Redevelopment Manager/Assistant
Community Development Director/ SK

SUBMITTED BY: Paul Casey, Community Development Director

APPROVED BY: City Administrator's Office



Mental
Health
Association

in Santa Barbara County

Creating Hope Through Understanding

ATTACHMENT

September 25, 2008

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Mr. David Gustafson, Housing and Redevelopment Manager
Housing and Redevelopment Division
City of Santa Barbara
630 Garden St.
Santa Barbara, CA 93101

RE: REQUEST FOR ADDITIONAL CITY SUBSIDY FOR THE COMPLETION OF
GARDEN STREET APARTMENTS

Dear Dave:

This letter requesting additional subsidy for our Garden Street Apartments project has been prepared in consultation with the City Housing Authority. As you will recall, the Mental Health Association (MHA) sought and secured assistance from the Housing Authority to manage our project's complicated financing and construction issues seven months after construction began. While the MHA has always had the right goals with respect to this project, we quickly learned that a project of this magnitude is not easily built out by a small non profit that is not a developer. Suffice it to say, with the Housing Authority's advice and assistance, we have the project back on schedule, preserved its Low Income Housing Tax Credits (a major albeit complicated source of project equity), and shaved some of our ever rising development costs. We are now in the home stretch and are doing everything possible to complete the project by its December 1st due date.

Unfortunately, finalizing the project's financial structure and filling identified funding gaps due to unanticipated cost overruns remains a significant hurdle. The funding gap we are trying to fill for all phases of the project is approximately \$2.49 million.

This letter seeks additional City subsidy of \$1.2 million for completion of the 51 low income rental housing units that are part of the project. As you know, this project is much more than an apartment complex of 51 units. It is very large and includes two office condominiums and underground parking of 110 spaces. Condominium 1 is the housing portion--51 low income rental units for downtown workers and clients of MHA. Condominium 2 is the Mental Health Association's (MHA) new Fellowship Club for clients and its offices. Condominium 3 is new office space that the City is purchasing from MHA. All totaled, the subterranean parking and three stories of above grade building results in a gross floor area of 113,000 square feet.

The original budget for the entire project was \$24.66 million. The new projected budget is \$27.15 million. The Housing Authority has concluded that our original budget was faulty in certain areas. Many of the line items for architecture, engineering, survey work and legal had been underestimated and were quickly exceeded. While the Housing Authority has assisted us in implementing cost saving measures and pursuing value engineering wherever possible, the project remains over budget. In addition to the aforementioned soft costs being over budget, construction supervision, site work, structural concrete, foundation work, finish carpentry and rough plumbing are significantly over budget. Given that our "construction approach" with Trabucco General Incorporated is formatted on a subcontractor bid plus management fee basis and material costs have increased dramatically over the past year, these cost overruns are real and unavoidable.

Mr. David Gustafson
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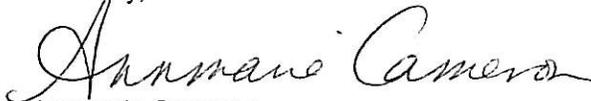
In looking at the housing portion of the project's budget, it was originally set at \$21.6 million and included a contingency allowance of \$536,000. Final costs are now projected at \$23.8 million—an additional \$2.2 million. The details of these rising costs are shown on the enclosed spread sheets. With the contingency now fully expended and additional remaining costs of \$2.2 million to complete the housing portion, we have been exploring all avenues to bridge this gap. We are pleased to report that we have secured \$1 million in Mental Health Services Act funding (Prop 63 monies) from the County. This leaves a balance of \$1.2 million; and we have explored every option available before making this request.

In terms of overall City subsidy for the housing units in this project, \$5.1 million has been pledged to date—or \$100,000 per unit. This added request of \$1.2 million, if approved, will take the City's subsidy to \$123,530 per unit. While we are not pleased about having to make this request, we believe that on a per unit basis we are in a "safe harbor" given past City subsidy on similar low rent housing developments of a complex nature.

The remaining \$290,000 in added overall project costs we face are being applied to Condominium 2 which will house our Fellowship Club and MHA offices. That is being addressed by converting our original permanent loan for Condo 2 from a taxable to tax exempt basis, and using the savings on interest rates to increase the loan amount. Tax exempt debt comes at a significantly lower interest rate such that we can incur and service a higher debt for this portion of the project. Because the purchase agreement with the City for Condominium 3 is fixed at \$1.164 million, there is no method for allocating higher construction costs to that portion of the project.

Thank you for considering this request. Should you or your staff have any questions about this letter or the enclosed spread sheets, please do not hesitate to contact me. The Mental Health Association greatly appreciates the assistance that you and your talented staff have brought to this important project and the support the City has provided us in helping to serve our community's most vulnerable citizens.

Sincerely,



Annmarie Cameron
Executive Director, Mental Health Association in Santa Barbara County

encls.

cc: R. Pearson
R. Fredericks
S.Szymanski
G. Lyons