TO: HONORABLE CITY COUNCIL
FROM: CITY MANAGER
DEPARTMENT: PLANNING AND COMMUNITY ENVIRONMENT
DATE: JULY 17, 2006
CMR: 282:06

SUBJECT: APPROVAL OF DEFERRAL OF REPAYMENT OF CITY LOANS FOR ARASTRADERO PARK APARTMENTS

RECOMMENDATION
Staff recommends that the City Council defer repayment of the Arastradero Park Apartments Corporation (APAC) existing debt to the City; modify the repayment terms to reflect APAC’s new first mortgage loans and expected repayment date in 2041 and authorize the City Manager to approve the subordination agreement for refinancing a loan not to exceed $8,000,000.

BACKGROUND
Arastradero Park Apartments is a Section 236 apartment complex consisting of 66 apartments located at 574 Arastradero Road in Palo Alto. The property was acquired in 1995 by Arastradero Park Apartments Corporation (APAC), a single-purpose entity created by the Palo Alto Housing Corporation. APAC acquired the property through a HUD supplemental mortgage loan in exchange for preserving affordable housing at the property. The City of Palo Alto assisted APAC in its purchase of the property by making an acquisition loan of $305,000 and a subsequent loan of $286,380 for repairs not included in HUD’s original scope of work, with both City loans being subject and subordinate to the HUD-insured loans.

DISCUSSION
APAC has requested that the City defer the repayment of the two City loans to allow refinancing a new HUD mortgage to accomplish major renovation of the property and to take advantage of lower interest rates (Attachment A). The refinancing transaction is expected to raise about $8,000,000 for repairs and improvements and will also result in a reduction of the property’s annual debt service costs. APAC is still waiting for a final commitment on the loan from HUD. Because of that the exact amount of the loan has yet to be determined since the interest rate will not be locked until the HUD commitment. The transaction is fully consistent with the property’s Use Agreement required by HUD in 1995, which mandates use of Arastradero Park Apartments as an affordable housing project for its remaining economic life. A refinancing commitment under HUD’s Section 223(f) program for a new 35-year loan (through year 2041) is pending at HUD, and this and other required HUD approvals are expected to be obtained by August 1, 2006.
Under the existing City loan terms, payments are to be made on a surplus cash basis upon maturity of the Section 241(f) loan which occurs on May 1, 2035. Upon refinancing the property, the City has the option to require prepayment of its debt but such prepayment is not mandatory. If the City were to require prepayment, then APAC would not be able to complete any significant renovations to the property (a reason for the refinancing) since 85% of the net transaction proceeds would have to be paid to the City instead of being used for property renovations.

Staff is supportive of deferring payment of the two existing City CDBG loans to allow the refinancing. This would enable APAC to obtain current low interest rates, secure funds for repairs and renovation of the complex and improve the quality of the City’s affordable housing stock. Since the City loans would remain in place accruing interest with repayment deferred, the City’s interest would remain protected.

**RESOURCE IMPACT**
The deferral of the loan repayment will not have any impact on the City’s General Fund since the loans were CDBG-funded. Repayment will result in CDBG program income which would be used as funding for projects supporting low-income households. The improvement for the APAC units would qualify for those funds.

**ENVIRONMENTAL REVIEW**
Deferral of the repayment and modification of the repayment terms is not considered a project under CEQA.

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**ATTACHMENTS:**
Attachment A: Request for Deferral and Continued Subordination of City Loans  
Attachment B: Subordination Agreement