TO:    HONORABLE CITY COUNCIL

FROM:  CITY MANAGER
        DEPARTMENT: PLANNING AND COMMUNITY ENVIRONMENT

DATE:  JULY 22, 2002

SUBJECT: COUNCIL APPROVAL OF AN AGREEMENT AMONG THE CITY OF PALO ALTO, THE HOUSING AUTHORITY OF THE COUNTY OF SANTA CLARA, AND THE COMMUNITY WORKING GROUP PROVIDING $1,280,000 IN COMMUNITY DEVELOPMENT BLOCK GRANT FUNDS FOR PRE-DEVELOPMENT, SITE ACQUISITION, AND PRE-CONSTRUCTION EXPENSES FOR THE OPPORTUNITY CENTER FOR THE MID-PENNINSULA PROJECT ON ENCINA AVENUE

REPORT IN BRIEF

In previous actions on May 7, 2001 and May 13, 2002, the Council approved a total allocation of $1,280,000 in Community Development Block Grant (CDBG) funds for the Opportunity Center project sponsored by the Community Working Group (CWG). Staff recommends that Council approve the attached interim loan agreement providing the previously allocated $1,280,000 in CDBG funds for pre-development, site acquisition and pre-construction expenses. The Opportunity Center facility as now proposed would provide about 9,000 square feet of space for a center for day use and the delivery of social services for homeless adults and families; and 95-units of permanent and transitional housing. The Opportunity Center would house existing homeless services presently located in inadequate and scattered sites in Palo Alto and the mid-peninsula area. The facility would be located on a 18,178 square foot site at what is presently known as 33, 39 and 45 Encina Avenue between El Camino Real and the Urban Lane entrance to the Palo Alto Medical Clinic. CWG has partnered with the Housing Authority of the County of Santa Clara (Housing Authority) and Innvision to acquire the site, develop and construct the project and operate the facility. CWG has purchased two of the three lots (33 and 39 Encina) needed for the project with private foundation grants. The Housing Authority is in the process of acquiring the third parcel at 45 Encina.
Significant development funding of $3,880,000 has been committed by San Mateo County, the County of Santa Clara, the federal government and private foundation donors. However, major funding still needs to be obtained, primarily the competitive Low Income Housing Tax Credits (over $9 million) and additional private fundraising and charitable donations (about $4.7 million) as part of the estimated $18.6 million development budget. Innvision, an experienced provider of homeless services and transitional housing, would be responsible for operations and ongoing operating costs.
**RECOMMENDATION**
Staff recommends that the City Council:

1. Approve the attached interim funding agreement, which provides a City loan of $1,280,000 for pre-development, site acquisition and pre-construction expenses.

2. Authorize the Mayor to execute the attached agreement in substantially similar form; direct the City Manager to execute any other documents required to complete the transaction and to secure the City’s loan against the property and to administer the provisions of the agreement.

**BACKGROUND**
The impetus for the formation of the Community Working Group (CWG) and the concept of the Opportunity Center project was the flooding of February 1998 that temporarily shut down the Urban Ministry’s drop-in facility located behind the Red Cross building. A broad-based group of community members, service providers, business representatives, local government and religious organization representatives and persons who had experienced homelessness was formed with the goal of developing a mixed use facility to house multiple services for the homeless and those at risk of becoming homeless. From mid-1998 to late 1999, CWG established itself as a non-profit organization, raised over $1.25 million in foundation and individual grants and sought a site for the center.

After an extensive search, purchase contracts were entered into for the two parcels located at 33 and 39 Encina Avenue, which total 13,260 square feet. In November 1999, CWG took title to 33 Encina completing the $655,000 purchase using foundation grants. In September 1999, a purchase contract for 39 Encina was executed by CWG. Escrow closed and CWG became the legal owner on April 17, 2002. CWG paid the $396,000 purchase price with foundation grant funds. 39 Encina is also now owned free of liens, with the exception of a claim by the former subleasee of a right to purchase.

Originally, CWG’s founders planned to construct a 7,800 square foot, one-story facility on the two Encina Avenue lots. They planned a one-stop service facility for homeless persons, including a day center and the provision of functions such as a clothes closet, showers, laundry, meeting and classroom spaces, message center and space for social services including case management and Urban Ministry staff. No overnight shelter beds or housing units were planned initially. The original development budget was about $1.8 million plus land costs. The City provided CWG with a $25,000 planning grant for design studies funded from FY 2000 – 01 CDBG funds.

In response to the urgent need for housing affordable by the intended clients of the service center, the site plan was revised by the end of 2000 to include 55-units of Single Room Occupancy (SRO) housing in a four-story structure with two levels of underground parking. Both single persons and families would be served with separate facilities. The total
development budget expanded to approximately $13 million, to be funded with federal, State, local and private grants and housing tax credits. CWG brought in the Housing Authority of Santa Clara County as lead developer and selected Innvision, an experienced operator of homeless service centers and transitional housing, as the operator. However, this site plan had problems in its layout and cost efficiency. Also, a 55-unit SRO housing development is not an optimum size from the standpoint of ongoing operating costs.

CWG made the decision in the fall of 2001 to pursue acquisition of the adjoining 6,060 square foot parcel at 45 Encina. The additional parcel increases the total site to 18,178 square feet. It allows the construction of 95-units of permanent and transitional housing, a larger service center of 8,900 square feet and 53 parking spaces in two underground levels.

The May 13, 2002 staff report [CMR:253:02] discussed CWG’s attempts to acquire 45 Encina and the claim by the former commercial tenant of 39 Encina of a purchase option. The Housing Authority has agreed to utilize its powers of eminent domain, if necessary, to resolve the site control obstacles. Council also passed a resolution, on May 13, 2002, consenting to the Housing Authority’s business operations within the City, including its use of eminent domain powers to secure clear title to the entire project site. At this time it seems that the proposed development plan is feasible and makes the best use of the property. The site plan takes advantage of the sharing of certain spaces and functions between the service center and the housing achieving efficiencies of space and cost – both development costs and ongoing operating costs.

The project team includes Rob Wellington Quigley, an awarded winning architect who specializes in community facilities and SRO affordable housing. Mr. Quigley designed the Alma Place project. Periodic study sessions have been held with the Architectural Review Board (ARB) to obtain early feedback as the project has evolved. Most recently, on June 6, 2002, the ARB held a pre-application study session on the latest design. The response from the ARB has been constructive and favorable. Principal issues which require further study and development include building height, accommodation for existing protected trees, the design of the Encina elevation and the amount and location of the parking. A neighborhood outreach meeting to discuss the preliminary design and the programmatic concept is also being planned. Meetings have been initiated with the immediately adjoining property owners and businesses including the Palo Alto Medical Clinic.

DISCUSSION
Council previously allocated CWG $480,000 in FY 2001 – 02 CDBG funds to be used for predevelopment, relocation and land acquisition costs. Those funds have been combined with the $800,000 allocated by Council on May 13, 2002 from the FY 2002 – 03 CDBG budget so that a total of $1,280,000 in City CDBG funds are now available and being obligated under the attached agreement. The City’s funds will be provided in the form of a loan that will be administered by the Housing Authority as the contracting entity for all consultants and studies and acting as the fiscal administrator for all contracts and funds. The
City loan will be interest-free, with no payments required during the pre-development period. It will be a joint obligation of both CWG and the Housing Authority, but will only be secured by the land. Prior to the start of construction, or earlier if necessary, the three parties intend to enter into permanent agreements for financing, construction and long-term occupancy and operation of the facility. While the terms of the City’s permanent loan have yet to be negotiated and are dependant upon the requirements of the other financing that is obtained to build the project, it is not likely that the City’s funding will be repaid in the foreseeable future. Unless a substantial amount of Section 8 rental assistance can be provided for the housing units, it is unlikely that the housing component will produce enough positive cash flow to repay secondary debt. Also, if possible, cash flow from the housing will likely be used to support the operations of the homeless service center.

Initially, a deed of trust recorded against 33 and 39 Encina will be the security for the City’s $1.28 million note. The City’s loan amount exceeds the value of those two parcels both using the combined purchase price ($1,051,000) or the current estimated market value for commercial use of about $99 per square foot ($1,198,989). However, actual disbursements to CWG and the Housing Authority will not exceed $350,000 until deposits are made for the acquisition of 45 Encina. Upon acquisition of 45 Encina, that parcel will provide further security for the City’s loan. The value of the entire site, based on a current appraisal is between $1,450,000 (if used for housing) and $1,800,000 (for commercial use).

About $300,000 of City funds will be used for pre-development expenses related to the design studies and the PC zone application. About $700,000 of the City loan is for acquisition and related costs for the 39 and 45 Encina parcels. The remaining $250,000 is to be reserved as a contingency for unforeseen expenses connected with acquisition costs. However, the agreement provides that after completion of the eminent domain proceedings, the unexpended portion of the $250,000 can be transferred to other eligible costs such as architecture and engineering without further Council action. The detailed budget is attached as Exhibit E to the agreement.

Performance Measures
This interim funding agreement is intended to provide City funding immediately to the developers to allow acquisition of the 45 Encina parcel to proceed as quickly as possible and to cover a portion of the costs of the architectural and other consultant studies needed for the zoning entitlements. It is important to the project schedule that the developer secure full control of the site because the City cannot accept the official submittal of PC zone application without the consent of each of the owners of the site. Major performance measures for the developer during the pre-development and site control period are:

- Secure sign-off and closure of testing and clean-up, if necessary, on 33 and 39 Encina and complete final environmental report on 45 Encina; summarize current status of environmental studies, testing and resolution of any issues in a written document to the satisfaction of the City Manager;
- Achieve control of entire site by September 30, 2002, which is defined as legal title, or a
binding purchase contract in the name of CWG or the Housing Authority, or the filing of a request for “Order of Immediate Possession” with the Superior Court. (The agreement allows the City Manager to approve an extension of this deadline to November 30, 2002 providing significant progress has been made towards full site control by September 30, 2002.);

- Submit formal PC zone change application within 30-days of obtaining control of entire site;
- Finalize contracts for county CDBG and/or HOME funding (San Mateo County and Santa Clara County) by December 31, 2002;
- Submit applications for other development funding such as County Housing Trust Fund, Sobrato Fund, additional McKinney Act funds, State homeless program funds, as appropriate;
- Continue analysis of financing alternatives and provide monthly updates to City on revisions to development costs and sources of funding;
- Secure City Manager’s advance consent to the selected financing plan;
- Complete formation of legal ownership, air rights and lease structures and shared use arrangements (such as for the parking and common areas in the facility) prior to start of construction;
- Upon approval by Council of the PC zone:
  - Submit applications for principal construction financing including bank construction loan, permanent bank loan, Low Income Housing Tax Credits, tax-exempt bond allocation, as applicable based on final financing scheme;
  - Apply to City and complete merger of the three parcels and transfer ownership of the land to one entity;
  - Initiate CWG-sponsored fundraising campaign for capital costs and operating fund endowment.

Status of Site Environmental Conditions & Hazardous Material Issues
The developers have completed Phase I environmental studies on all three parcels. The Phase I for 33 and 39 Encina did not find evidence of any underground storage tanks nor did it recommend any soil testing. The former tenant of 33 and 39 Encina is currently in the process of completing Fire Department requirements for a closure plan related to its storage on the site of typical hazardous materials used in auto repair businesses. As part of the closure plan, testing of soil in areas where such materials were stored or used was recently conducted. Preliminary results of the soil tests should be available prior to Council action on this agreement. Any necessary clean-up of 33 and 39 Encina will be the responsibility of CWG and the former tenant. The Phase I on 45 Encina recommends that testing of soil should be completed because the property was used for at least twenty years by a prior tenant as a refrigerator and appliance repair business. The Housing Authority intends to conduct soil testing as soon as it is able to get access to the site. The project development budget includes a significant contingency amount for clean-up in case that is necessary. The City funding agreement also provides that no disbursement of the City loan shall be made until the City Manager is satisfied with the environmental condition of the site and the plans.
and resources for remediation, if any.

Termination of Agreement
The interim agreement terminates on December 31, 2003; the City Manager can approve a one-year extension to the end of 2004. During this period, the developers intend to secure clear ownership of the site, complete all zoning and planning entitlements, and apply for and obtain all financing and donations necessary to construct the project. No compensation for CWG or the Housing Authority is to be made unless the project is actually constructed. Compensation will be from a developer fee built into the project’s permanent funding budget, with the amount and terms of payment subject to City approval as part of the final funding agreements. The interim agreement contains protections for the interests of the City should the developers not meet the performance measures by the termination deadline. The City note becomes due in full or the City can elect to exercise a right to acquire the site in return for forgiving the balance due on the note. In the event of default, interest on the City note accrues at 10 percent per annum.

The agreement also provides guidance for the unlikely situation that the current development team of CWG and the Housing Authority should dissolve and not be able to pursue the project to completion. The City’s primary concern, should this occur, would be to provide the opportunity for another developer to be selected to complete the project as currently planned, or, if that was infeasible, then to proceed with a modified or scaled down project. In this case, the City must approve any substitute entity for either of the developers. Both CWG and the Housing Authority agree to assign to the other party, or to such a substitute developer, their rights to the land, grants and loans for the project, contracts, consultant work and other assets necessary to complete the planned development. This interim agreement does not attempt to describe in full how such a workout would be accomplished. The settlement and disposition of the various assets, work products and other matters would have to be negotiated and would depend, to a large extent, on the circumstances prevailing at that time.

RESOURCE IMPACT
The project’s financing is complex as some sources can only pay for housing costs and others can only pay for the service center. In general, greater resources are potentially available for the housing component than the service center. The preliminary financing plan attempts to utilize the various funding sources so that building the housing essentially helps to support the service center part of the project. The following funding has been committed for site acquisition, pre-development and capital development costs, as of July 2002:

$1,280,000  City of Palo Alto CDBG (FY 01-02 and 02-03)
$1,250,000  Foundation grants [$1,000,000 – Packard Foundation and $250,000 – Peninsula Community Foundation]
$150,000   San Mateo County CDBG (FY01-02)
$300,000   San Mateo County HOME funds (FY 02-03)
$500,000   Santa Clara County HOME funds
$400,000  HUD McKinney Act Supportive Housing Program (SHP) [plus $122,200 for operating costs and administration]

$3,880,000  TOTAL COMMITTED DEVELOPMENT FUNDS

Possibility of Future Additional City Funding
Previously, CWG applied for more City funding than has been recommended by staff and approved by Council. In December 2001, for example, CWG applied for $2,215,000 in City funds, of which $1,000,000 was requested as federal HOME funds from a City application to the State. The HOME application cycle occurs once each year and the next deadline is October 1, 2002. Because the project will not have the PC zone approved by that date, it will not be a viable project for an October 2002 application.

All unexpended and projected City Housing Reserve Funds and the next three years CDBG housing funds are either appropriated to the 53-unit Oak Court family housing or are being held for City acquisition of land for a future multi-family rental project. At this point, the Opportunity Center project has sufficient funding to proceed through the predevelopment phase. After the developer has secured the planning entitlements, sought other funding sources and finalized the financing plan, then, if there was a demonstrated funding gap, the developer would probably return with a request for additional City subsidies.

While the project development budget is being continually refined and should still be considered preliminary, the total cost of the development is estimated presently at approximately $18.6 million. The development costs are allocated between the housing component and the service center as follows:
- $3,400,000  18%  - Services Center
- $15,200,000  82%  - 95-Housing Units

The following sources of financing are being considered at this time:
- 1st Mortgage
- Investor equity (Low Income Housing Tax Credits)
- City of Palo Alto CDBG loan
- Housing Trust of Santa Clara County
- HUD – McKinney Supportive Housing Program
- County of Santa Clara (CDBG & HOME)
- County of San Mateo (CDBG & HOME)
- Packard Foundation
- Peninsula Community Foundation
- Private Donations (for Service Center component)
- General Partner Capital Contribution

TOTAL SOURCES OF FUNDS  $18,639,357
POLICY IMPLICATIONS
The actions recommended in this report implement existing City policies including furthering the Council’s “Top Five” priority of affordable housing. These actions also implement the Council adopted HUD Consolidated Plan and the 2002 – 03 Annual CDBG Action Plan.

TIMELINE
Below is a tentative list of key milestones in the development process, assuming that the formal PC zone process commences in August 2003 and that a tax credit award is received by mid-2003.

- Resolutions of Necessity Adopted by Housing Authority Board (completed) July 16, 2002
- Council approves interim funding agreement July 22, 2002
- Control of entire site achieved August 2002
- PC Zone adopted by Council By March 2003
- Submittal of tax credit application March 2003
- Award of tax credits May 2003
- Building Permit Submittal June 2003
- Council action on permanent funding & regulatory documents July 2003
- Start construction August 2003
- Completion and occupancy End of 2004

ENVIRONMENTAL REVIEW
A federal environmental review under the National Environmental Policy Act (NEPA) has been completed covering the proposed development of 95-units of housing over the homeless service center on the three parcels at 33, 39 and 45 Encina. The City did not receive any comments from the public regarding the NEPA environmental document. HUD’s approval of the release of CDBG funds completes the NEPA environmental review process and allows the Council to obligate the CDBG funds for site acquisition and other project costs under the attached agreement. Staff expects that HUD will issue the release of funds prior to the planned July 22, 2002 agenda date of this staff report.

ATTACHMENTS
A Agreement Between the City of Palo Alto, The Housing Authority of the County of Santa Clara, and the Community Working Group to Fund Pre-Development, Site Acquisition, and Pre-Construction Expenses for Opportunity Center, Inc. for the Mid-Peninsula, a Housing and Homeless Service Center on Encina Avenue, Palo Alto

PREPARED BY: ________________________________
CATHERINE SIEGEL
Housing Coordinator

REVIEWED BY: __________________________________________________

STEPHEN A. EMSLIE
Director of Planning and Community Environment

CITY MANAGER APPROVAL: ________________________________________

EMILY HARRISON
Assistant City Manager

cc: Community Working Group, Inc.
Housing Authority of the County of Santa Clara
Housing & Community Development, County of Santa Clara
Office of Housing, County of San Mateo