



City of Palo Alto

City Council Staff Report

(ID # 10410)

Report Type: Informational Report

Meeting Date: 6/10/2019

Summary Title: Use of Sheridan Apartments' Affordability Reserve Account

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From: City Manager

Lead Department: Planning and Community Environment

EXECUTIVE SUMMARY

This is an informational memorandum and no action is required.

This informational memo describes the establishment by Palo Alto Housing Corporation of a \$2,600,000 Affordability Reserve Account (ARA) for the Sheridan Apartments, and the City Manager's recent approval for the reallocation of those funds to assist the development of the Wilton Court project, consistent with past City Council Actions (CMR [#7803](#) and [#8105](#)). For ease of reference, staff have attached copies of the agreement, amended promissory notes and the City Manager's Reports and actions taken in 2017.

BACKGROUND

On December 8, 1998, the City of Palo Alto and Palo Alto Housing Corporation (PAHC) entered into Loan Agreement to fund the acquisition of Sheridan Apartments for a very-low to low income rental apartment.

The 1998 Loan Agreement for Sheridan apartments, in summary, includes three major components:

1. The City of Palo Alto and PAHC entered into a Loan Agreement for \$2,450,000 for Sheridan Apartments, of which 66% of the funds were from the Community Development Block Grant (CDBG) and the remainder, or 34%, from the City's Residential Housing Fund.
2. Sheridan Apartments also participates in a Housing Assistance (HAP) Contract with the U.S. Department of Housing and Urban Development (HUD) which provides Section 8

vouchers which subsidizes tenants' rent. If PAHC was unable to renew its contract with HUD for Section 8 subsidies, PAHC was to establish an Affordability Reserve Account (ARA) to help supplement the tenant's rent.

3. Per loan agreement, Section 5.1, the ARA was maintained through the deposits of note payments and if applicable, incentive fee payments. Note payments are to be structured through residual receipts – if the property had an excess cash flow after operating costs, the funds were to be paid proportionately to lenders—however as required by the loan agreement, payments were instead deposited into the ARA. The loan agreement specified the ARA to have a threshold amount of \$1,000,000. If PAHC exceeded the threshold amount, PAHC was to then make payments according to the Promissory Note terms and the interest on the note would increase from 3% to 9%.

DISCUSSION

2017 City Council Actions

In 2017, anticipating that ARA was approaching the \$1,000,000 threshold, PAHC proposed to repay the entire outstanding balance of the loan. However, according to CDBG regulation 24 CFR Section 570.902 (a)(i), 60 days prior to the end of the grantee's program year, the total amount of the City's undisbursed CDBG funds or a line of credit cannot exceed 1.5 times the entitlement funds for the current program year. In 2017, the City received a CDBG allocation amount of \$436,309. Using HUD's threshold of 1.5 times, the City could not have more than \$654,463.50. If the City were to receive the repayment of the original loan (over \$2,000,000), the amount in the CDBG fund balance would exceed 1.5 times of the current year allocation. This would have resulted in a reduction of CDBG funds the following year, possibly up to a 100% reduction, jeopardizing the City's CDBG program.

As a result, on March 6, 2017 (CMR #7803), the City Council approved Amendment No. 1 of the Promissory Note to increase the ARA threshold to \$2,600,000. Initially, in the original loan, if the ARA fund was near \$1,000,000, the interest would have increase from 3% to 9% and payment would be due to the City. Raising the threshold delayed this increase in interest and repayment of the original loan. The primary purpose of the first amendment was to permit the City and PAHC to renegotiate and restructure the loans in a manner that would support future development of affordable housing and avoid the need for early repayment, which could jeopardize the City's CDBG program.

Thereafter, on June 5, 2017 (CMR #8105), the City Council approved Amendment No. 2, which restructured the loan agreement and promissory note. Amendment No. 2 stopped interest from accruing as of May 1, 2017 and gave PAHC flexibility in the use of the ARA. If the City determines that the ARA was no longer necessary for its original purpose, PAHC would be able to use the ARA funds on the construction of a new affordable housing project or rehabilitation

of an affordable housing project by March 1, 2030. If PAHC was successful and used the funds to develop an affordable housing project by 2030, it could also seek forgiveness of the loan, which aligns with provisions of the City's more recent affordable housing loans. If PAHC was unable to use the funds by the 2030, the remaining balance would be due to the City.

PAHC Request to Use ARA Funds for Wilton Court Predevelopment

The City Council approved a 100% affordable housing project on 3703-3705 and 3707-3709 El Camino Real, commonly known as Wilton Court in January 2019. The development is designated for households with incomes not to exceed 60% of the area median income (AMI) and 21 units would be set aside for persons with developmental disabilities. Given the deep affordability, the developer, PAHC, is utilizing public funding to develop the project. The project will apply for 4% tax credits, State, County and City funds, however there is still a gap to financing the project in amount of \$3-4 million.

The City Manager recently determined that ARA funds are no longer needed for the Sheridan Apartments as the project has operated positively and PAHC has successfully renewed its HAP contract for an additional 20 years. Given the past Council action allowing PAHC to use the Sheridan Apartments' ARA funds for another affordable housing project, the need of Wilton Court for those funds, PAHC has requested, and the City Manager has approved the use of ARA funds as predevelopment funds for the Wilton Court project.

Attachments:

Attachment A: City Manager's Report #7803

- B) Promissory Note Amendment No. 1
- C) Loan Agreement
- D) Promissory Note

Attachment B: City Manager's Report #8105

- A) Loan Agreement No. 2
- B) Promissory Note Amendment No. 2