



# Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Leslye Krutko

**SUBJECT:** SEE BELOW

**DATE:** March 10, 2009

Approved

Date

3-11-09

**COUNCIL DISTRICT:** Citywide  
**SNI AREA:** N/A

## SUPPLEMENTAL

**SUBJECT: RESPONSE TO QUESTIONS RAISED AT THE MARCH 2, 2009 CITY COUNCIL MEETING REGARDING ITEM 2.3-- SAN CARLOS BOWL**

### REASON FOR SUPPLEMENTAL REPORT

At the meeting of March 3, 2009, questions were raised about Item 2.3, relating to the early disbursement of funds for the San Carlos Bowl Seniors Project. Because of the number and detail of questions posed, it was determined that the item would be deferred to enable staff to provide a complete response. This report responds to these questions.

### BACKGROUND

At the City Council meeting of March 3, 2009, questions were raised about Agenda Item 2.3. This agenda item sought an early release of funds for the San Carlos Bowl senior project to compensate the developer for infrastructure costs incurred. Attached are responses to questions raised by Councilmember Oliverio and by a representative from the Fiesta Lanes Action Coalition, Ms. Terri Balandra.

For the record, it is important to clarify my response to a question posed at the meeting by Councilmember Pete Constant. The Councilmember asked whether these funds had already been committed to the project. The answer to the question is yes. The funds were committed by the Council in 2002 when the project was originally approved. However, while the Department has released funds for acquisition and predevelopment and funds have been reserved for construction costs, the Department has not yet recorded construction loan documents.

HONORABLE MAYOR AND CITY COUNCIL

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San Carlos Bowl**

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In reviewing this request, it is important to consider several facts: (1) the City Council previously approved funding for this project and the funds have been reserved; (2) the funds that were expended are legitimate costs of the senior development and should not be borne by the for-sale project; (3) affordability restrictions have been placed on the project in accordance with State law; and (4) while construction of the project may be delayed due to current market conditions, this project will provide affordable housing opportunities for 99 extremely low-income senior households.

  
**LESLEYE KRUTKO**  
Director of Housing

Attachments

For questions please contact Leslye Krutko, Director of Housing, at 408-535-3851.

## QUESTIONS POSED BY COUNCILMEMBER OLIVERIO

*How many of San Jose's development partners are in financial straits--whether from projects with us or other projects?*

The current economic slowdown has had a severe impact on real estate development, with a near stoppage of construction throughout the City. This time, the economic impact has been felt by both market rate and affordable housing developers. Typically, during market downturns, market-rate housing development is impacted, but affordable housing development is not. However, because the current economic situation is the result of lending industry problems rather than job losses, several key affordable housing funding sources have been impacted. These include:

1. **Low-Income Housing Tax Credits**—Nearly all affordable housing developments access Low-Income Housing Tax Credits as a piece of the housing finance package. Tax credit investor equity has decreased by about 50% in the past three years. Key players, including Fannie Mae and Freddie Mac, are no longer in the tax credit market. Additionally, other corporations that were at one time investing in tax credits are now having financial difficulties that negate the need for a credit on their taxes. This has made it more difficult to access tax credits and has reduced the amount of equity that can be realized.
2. **State Proposition 46 and 1C Funding**— Due to the State's budget problems, it has been unable to issue bonds since last summer. As a result, the State Controller has frozen disbursements on existing commitments as well as new project commitments. The State's Pooled Money Investment Board (made up of the State Treasurer, the State Controller, and the State Director of Finance) indicated on February 18<sup>th</sup> that its ability to issue bonds would be limited and it would be at least several months until funds would be available for multifamily affordable projects. The State is under contract to provide funding to dozens of developments throughout the State, including projects that have been completed and are fully occupied and need to convert from construction financing to permanent financing. In addition, to frozen bond funding from State Propositions, the California Housing Finance Agency (CalHFA) has been unable to issue bonds since last summer.
3. **Commercial Lenders**-- Commercial lenders, many of which are weaker financially due to exposure to real estate risk in their portfolios, are not making commitments.

Multifamily developers derive most of their cash for operations from developer fees that are received when new projects complete construction and successfully convert to their permanent period financing. Some ongoing proceeds are derived from net cash flow from existing project operations. Net cash flow payments to developers vary each year and are quite low on some projects—for instance, those that have extremely low rents, more than one subordinate lender sharing the net cash flow, or a combination of higher-than-expected operating costs or lower revenues. Developers also may use a significant portion of their own cash on predevelopment

activities to investigate whether individual sites make sense to pursue. So the ability to originate new deals timely—to replenish early cash outlays and pay administrative expenses—is extremely important to the financial health of developers.

Single family developers juggle fewer funding sources than do multifamily affordable developers, but are highly exposed to the financial markets' lack of credit availability. Construction lenders are tightening lending standards—some, even in the middle of construction. On the demand side, these developers are being hit particularly hard by San José's real estate market weakness due to the high number of foreclosed properties on the market that compete with new for-sale product. Those developers that produce below-market units also are dependent upon selling to a target group of borrowers who may have more difficulty qualifying for mortgages as lenders tighten their credit standards and take risk-averse actions. The City's soft second mortgages help to market the units, but it is only a small part of the overall picture of what determines project profitability for for-sale projects. As the price points for the new for-sale units have dropped since these projects' financials were first projected, there is little hope for any profit to be realized out of any new for-sale project at this time.

Therefore, developers of all types of units are experiencing financial difficulty at this time. The affordable housing developers that work in San José tend to focus on multifamily projects, but some do have for-sale projects that are experiencing difficulties—a situation that is common to other locations in the Bay Area, California, and the rest of the country.

Some affordable developers may have advantages to weathering the economic storm. Those with flexible business models—they may act as general contractor as well as developer—may be able to derive some ongoing revenues from their general contractor side even if new projects are stalled. Developers with older portfolios that include HUD projects that may be restructured could derive more ongoing project revenues than developers without HUD projects. Clearly, those with a greater amount of liquid assets will be able to better suffer project delays without seriously impacting financial viability.

However, it is too early to tell which developers working in San José are in more serious financial difficulties. As the City provides low-interest gap lending for projects, we would be a likely first stop to any developer that had a project needing additional capital, or for operating capital requests. We are currently working on a request to help restructure one stalled project with a nonprofit developer—1470 North 4<sup>th</sup> Street—which has a CalHFA commitment that has been rescinded due to the Agency's inability to bond. The City Council also approved two requests for early disbursement of predevelopment funds to a for-profit developer at its December 9, 2008 meeting.

But more requests specifically regarding operating support needs may occur for both nonprofit and for-profit developers in the coming months. The Housing Department has taken the initiative to respond, including:

1. Convening a coalition of industry organizations to strategize about affordable housing developers' organizational capacity in San Jose and throughout the State. Organizations include: the Local Initiatives Support Corporation, Enterprise Community Partners, the California Housing Partnership Corporation, the Non-Profit Housing Association, and the

State Department of Housing and Community Development. Since this problem is not unique to San Jose, it is important to work with our partners throughout the State to respond

2. Reviewing options to access short-term capital to replace State funds. The Department has convened meetings with the Finance Department, the City Attorney's Office and our financial advisors to explore possible responses.
3. Investigating ways to restructure deals to provide short-term operating capital to keep projects moving until projects can access funding.

In addition, the Department has recently brought forward land acquisition only loans to ensure that projects under contract can be saved pending the return of the financial markets. This approach—known as land banking—has long been used by housing agencies throughout the nation.

***How many of CSJ projects are at risk if those companies should collapse?***

As mentioned above, nearly every affordable project receives Low-Income Housing Tax Credits. The borrowing entities for these tax credit projects are Limited Partnerships (LP) and are composed of the legal entities of the developer as well as the tax credit investor. If one party to the LP needs to exit, a new member is substituted into the LP. The City has the ability to exercise its legal rights to substitute members in the event something happens to the developer, or to work with the senior lender to do the same.

Tax credit investors, in return for receiving a credit on their taxes, agree to stay in the project for the first 15 years. They have a serious financial interest in ensuring that the project is maintained as an affordable project and that it is financially healthy and in compliance with IRS rules. Otherwise they are at risk of IRS sanctions or losing the benefit of the tax credits during the 15-year tax credit compliance period. As a result, tax credit investors are also a potential safety net for a project that may need help before that time.

Looking at the City's 19 projects that are impacted due to current market conditions, it is helpful to think of them in five distinct groups with different risk profiles, from highest to lowest risk:

1. **Single family deals with City construction loans**--We currently have two projects in this category-- San Carlos Bowl Townhomes and Tierra Encantada Townhomes. In the case of San Carlos Bowl, the City is scheduled to receive a repayment on its loan. Tierra Encantada involves a small amount of funds that will roll into soft second mortgages, so no loan repayment is planned. Due to current market sales prices that can be realized, it is possible that the San Carlos Bowl Townhomes project will not be able to repay the City in full. Additionally, due to the inability of Tierra Encantada to sell units, the developer has requested the ability to rent units until the market returns. Several projects in the City have converted from ownership to rental in recent months.

The Housing Department does not typically make project loan commitments for single family new construction projects; however, in both cases these projects were approved as

a result of the neighborhood process. The San Carlos Bowl project was originally one rental project, but was divided into two separate projects—a senior rental development and a for-sale project—as a result of concerns expressed by neighborhood residents during the planning process.

2. **Multifamily deals with existing City construction/permanent loan commitments that are currently under construction, or are completed and occupied, and are awaiting State funds in order to convert to permanent--** Two projects sponsored by nonprofit developers fall in this category—Casa Feliz and Paseo Senter I. Both will have to delay conversion to permanent period financing if the State delays the disbursement of committed funds for the permanent period from its Multifamily Housing Program.

Delayed conversions incur two types of costs: 1) increased construction interest charges from the senior construction lender and the City; and, 2) potential downward adjustments in the amount of tax credit equity that the investor will pay in due to the project delay, adversely affecting their rates of return. Both of these increased costs will either force the developer to further delay their payment of developer fee into future years, or will create a gap that must be filled by additional funds.

The City can help minimize the potential financing gap by allowing its accrued construction loan to be capitalized into its permanent loan amount, to be paid over time by net cash flow if proceeds are available. It could also lower its interest rate.

Accordingly, in its most recent approvals, the Housing Department has identified in advance lower interest rates that could be applied at the City's sole discretion if the project is delayed. By approving projects in advance with this option, staff eliminates the legal need to negotiate "consideration" (such as additional affordability or greater share of net cash flow) for projects that may not be able to bear additional financial strain.

However, the effect of interest on much larger conventional loans, as well as downward equity adjustments, far outweigh the City's relatively smaller construction interest amount thus increasing the likelihood for funding gaps that must be filled by new funds.

3. **Multifamily deals with existing City construction/permanent loan commitments that have existing State commitments on hold and have not yet started construction--** There are four projects that would be ready to start construction if the State had funds available to honor its commitments under the Infill Infrastructure Grant program and the Multifamily Housing Program—1470 North 4<sup>th</sup> Street, Kings Crossing, Belovida, and Family Supportive Housing. In three of the deals, the State's ability to issue firm commitments that can be honored by a time certain date would allow developers to apply to the State for a tax-exempt bond allocation from the California Debt Limit Allocation Committee (CDLAC) and/or State tax credits from the California Tax Credit Allocation Committee (TCAC). Once bonds and credits were awarded, it also would allow lenders and investors to issue firm commitments to the projects.

Because these projects have not yet started construction, there are only smaller predevelopment or acquisition loans outstanding which would continue to accrue

interest—and increase project costs—given a delay in State funding. The delay may also increase the need for additional gap financing, as tax credit pricing has been reduced over time. This gap would need to be filled by deferred developer fee or additional funds.

In addition, developers may have borne significant predevelopment costs out of their own cash, so the delay in closing construction means that their financial liquidity could suffer while they wait to get reimbursed from construction loan proceeds.

- 4. Multifamily deals with existing City construction/permanent loan commitments that are waiting to obtain other funding commitments and have not yet started construction--** There are three projects that have the City's full funding commitments but do not yet have their competitive 9% federal tax credit awards—90 Archer, McCreery Courtyards, and Cornerstone at Japantown. Given the federal Stimulus bill's affect on the tax credit program, TCAC has delayed the tax credit application rounds.

These projects should not experience long delays because they aren't dependent upon the State's issuance of bonds to fund their programs. However, because of the demand for 9% credits and the State's allocation formula, all three projects will not receive allocations in the next round and will need to reapply in a future round or restructure to a different financial execution.

- 5. Multifamily deals with partial City funding commitments--**There are seven multifamily deals and one single family construction deal that are in earlier stages of development and have obtained only partial funding from the City—for instance, predevelopment loans only, or predevelopment and land financing. The projects are: Willow Glen Woods Senior, Willow Glen Woods Rental, Ford and Monterey, Markham Terrace, Orvieto, 1<sup>st</sup> and Rosemary Family, 1<sup>st</sup> and Rosemary Senior, and 34<sup>th</sup> and San Antonio Family.

At the time the City provides a land acquisition loan to a developer, a lien is recorded against the land. In the case of these eight projects, there is no additional debt and the City's loan is in first position. In the event the project did not move forward, the City has the ability to take back the land and select another developer to complete the project. Obtaining first lien position is the main reason that the City increased its acquisition loan product from 50% loan to cost to 100% in early 2008.

Therefore, the City is in a good position to maintain control of these sites, ensuring that affordable housing is eventually built as required by State Redevelopment law when 20% funds are expended.

***What is the impact of these projects being worth less than the city's investment? Does it matter to San Jose Housing Dept? If so, in what ways does it matter?***

We're interpreting this question to mean "what is the impact if the loan obligation does not pay back as was projected?" The impact will differ depending upon whether it's a single family or

multifamily project, what other funding sources are on the project, and the particulars of each project.

In general, our principle regarding "workout" situations is that there is a shared burden between the City, the developer, and other funders in the project. It also depends upon what the project can bear financially. Some situations might warrant commitment of additional funds, while others would warrant a write-off of principal or interest due. In each situation, staff would have to do a cost/benefit analysis of financial return to the City and broader policy objectives. Solutions would likely follow the different categories defined above:

1. As stated above, single family construction loans are the riskiest category. Either sales prices produce enough revenue to pay back the City or they don't. The City would always be in second position and would typically be paid back only after the senior lender receives repayment in full. An imbalance in a project's sources and uses would result in a funding gap. As our construction loans for single family would typically be full recourse to the borrower, we could decide to go after assets of the developer rather than take a loss, or do a combination of both.
2. For multifamily deals already under construction that might experience delays, the City could agree to reduce its interest rate or to roll some City construction loan interest into the permanent loan amount, allowing it to be paid later. In reality, the two strategies are equivalent financially as projects are usually unable to pay all of their principal and interest during the permanent period anyway, regardless of timing. However, if the timing delay were significant and resulted in downward credit adjusters, and even a decrease in the senior loan amount if the rental market softened at all during that time, the project's financial solution would likely involve a request of additional funds from the City. If so, then we'd require deeper affordability, longer affordability restrictions, or an additional share of net cash flow as consideration.
3. The funding gap that would result for multifamily deals waiting for State commitments to start construction could result from lower tax credit pricing and interest charges during the waiting period. As in #2, the City could be asked for additional funds. In addition, cash shortfalls by developers might produce requests to the City for predevelopment costs for new deals, early disbursements for existing deal commitments, or outright operating subsidies. The Housing Department does not have an operating subsidy program, nor does it have funds without restrictions that could easily be lent for this purpose.
5. For multifamily deals without full City commitments, there is the issue of whether to charge City loan interest, and what to do if there are other early lenders, such as the nonprofit Opportunity Fund, in the project. If the project is delayed long-term, a workout scenario might involve taking back the land in lieu of repayment on the City's acquisition loan. Such a strategy may also involve the City finding funds to take out a senior lender's predevelopment loan so that the City is in full control of the site.

***Could the loans be severed, if we wanted to?***

We take this question to mean, could the loans be forgiven if we wanted to? Yes, the Director has some ability to forgive loans under her Delegation of Authority. A large forgiveness would likely go before the City Council.

***Could the city be required to ante up additional funds in order to maintain a specific loan to value ratio? How would that impact Fund 448?***

If this question refers to a senior lender's LTV ratio, no, the City could not be forced to help maintain a specific LTV. Balancing the budget is the developer's job, not the City's. However, to the extent that the developer cannot produce cash or needs additional funds to support the budget if the lender collapses part of its commitment in order to reduce its LTV, the City is usually the lender of last resort and our help would be enlisted—as it is in the case of San Carlos Bowl.

The Housing Department has multiple funds, of which Fund 448 is one. The source of funds the City commits to a project is determined based on each individual project and available funding. In the case of San Carlos Bowl, the City already agreed to fund this project using funds from Fund 448. The funds requested in the recent action were not new funds, but rather were funds already set aside and available for this project.

***Could there ever be a way that the General Fund had to be tapped if the council wanted to use GF funds?***

The only way that we can envision the General Fund being impacted is if a project that had been funded with restricted housing funds—and therefore had affordability restrictions recorded on the land—did not go forward as planned or if fewer units were built than required by these restrictions. According to Redevelopment Law, these affordability restrictions would need to be moved to a new site and would have to be provided by a source other than the City's 20% fund. In the case of the San Carlos Bowl project, were the senior project not to move forward, the City would have to move the affordability restrictions to a new site at a current cost of approximately \$9.9 million. The Housing Department would have to find a source of funds to address this requirement, or it would become a requirement of the City.

Other than this scenario, it seems unlikely that the General Fund would be tapped to help with these projects.

***What are the legal requirements of our funding sources for completion of the projects?***

Permanent land banking on land purchased with 20% funds is not permitted by State law. The Housing Department has a limit of five years for a project to show some progress towards development. If there is progress noted by the five-year limit, the City Council would then need to authorize another five-year period during which time the City should oversee development progress. Past 10 years, a 'general reasonableness' standard would likely apply for

the City Council to oversee development progress, according to the Office of the City Attorney. As mentioned above, once the City expends affordable housing resources to assist a development and the required affordability restrictions are recorded, the project must be built or the restrictions must be moved to a new site.

At this point, it is unlikely that the City's affordable projects will be delayed for a long period of time. We expect that State funding will become available again in early 2010.

***Do we risk future grant monies if we don't do everything we can to prop up a particular project?***

Although it's not grant funding, if a project received a 9% tax credit award but had a funding gap that went unfilled and the deal could not close, there could be future negative repercussions. The Tax Credit Allocation Committee (TCAC) could assign negative points to the developer for future 9% applications, which would effectively eliminate them from contention on the extremely competitive funding award for as long as TCAC assigned negative points. There could be a negative ramification on the City's reputation with TCAC depending upon the circumstances. Although one would hope TCAC would be lenient due to the difficult markets, and it has recently held short amnesty periods in which developers can return credits without negative ramifications, it has full latitude on how to implement potential penalties.

***Moving forward, what is the City's role going to be in housing developments that we may have already voted on and those to come? Is the City going to "bail out" these development partners? If so, to what extent? When is a company "too far gone" and the city should facilitate a sale? Should the city take over a project ownership if some company defaults and we can't find another partner? Are we preparing for these types of fallouts?***

The current market conditions are not the result of irresponsible developer activity. Our developers have been caught in the middle of a lending crisis that could not have been anticipated. Any assistance we might provide to assist developers to respond to these tough times is therefore not a "bailout," a term that has been used to describe funds provided to lending institutions that have engaged in inappropriate and risky behavior.

Any recommendation the Housing Department might propose to assist a development will depend on circumstances. The goals of any workout would be to:

- Retain Affordability Restrictions
- Minimize risk to current tenants
- Ensure the long-term viability of the project to serve as safe, decent affordable housing
- Maximize the benefit of funds already invested
- Minimize additional outlays of funds

Possible actions that the City may have to take to achieve these goals will vary, but in the past, we have employed each of these strategies when it made sense:

- Lent additional funds

- Participated in a financial restructuring
- Foreclosed upon a property
- Forced a project to be sold
- Helped negotiate with the senior lender to restructure debt
- Helped to replace the General Partner

Our goal is not to take long-term ownership of properties. However, the City could work with the senior lender to facilitate a transfer of the project to another General Partner. When there are tax credits and senior lenders, this would be a more likely resolution than the City stepping into a temporary ownership role.

For example, City Council's recent approval of the Forbearance Agreement with Emergency Housing Consortium demonstrates possible actions that the City could take to help resolve an issue. The Housing Department is overseeing tenant relocation, will move its Affordability Restrictions (using proceeds of the sale of units not assisted with 20% funds), and made small funding commitments for predevelopment activities for the rebuilding of an existing multifamily project. In order to arrive at this solution, the Department negotiated with senior lenders and HUD officials to help a nonprofit work out its troubled portfolio and, in turn, supported its organization's financial restructuring.

With regards to the health of our development partners, it is in the City's best interest to have a variety of financially-healthy development organizations, both for-profit and nonprofit, that work in San José. As mentioned earlier, the City is taking a leadership role in convening relevant industry organizations to discuss possible developer operating subsidy sources. In addition, the Housing Department is working closely with those affordable housing developers active in San José to understand their current financial approach.

The Housing Department has a very regulated environment and is very conservative in managing its funding and very rigorous in managing its loan portfolio. It is important to understand, however, that as a gap lender, the City's funds are typically in a junior position to other debt and are therefore most at risk. However, the City's careful underwriting of its projects and close monitoring of its portfolio ensures that the City's investment is as solid as possible.

## **QUESTIONS FROM MS. TERRI BALANDRA, FIESTA LANES ACTION GROUP**

### ***What is the "normal" standard for releasing this money?***

Funds to reimburse hard cost expenditures are typically paid at or after close of the construction loan. Hard costs must be part of the approved scope of work that the Housing Department staff and construction consultant closely analyze and approve prior to a staff funding commitment recommendation going before the City Council. However, occasionally there are exceptions based on specific project needs.

In the case of the San Carlos Bowl project, the single family and rental projects were conceived of as one project, designed together, obtained entitlements together, and share common infrastructure costs such as the common road, utility lines, etc. This is not uncommon—other projects, such as the family, for-sale, and senior projects on the County's Fairgrounds land on Tully Road, also share common offsite improvements, as will the two projects developed on the site at Ford Road East of Monterey Road.

### ***What would the developer activity have to "do" to usually get this money released?***

Each request for reimbursement involves preparation of a draw package, with bills from each subcontractor for each part of the work performed. Two Housing Department staff members and one external consultant go through the draw package, approve each bill, and decide if the costs are warranted and prudent for project costs to bear. The City signs off on every draw request through the entire construction of the project, even for draws that other funders are disbursing. We are unusually rigorous and assertive for a City; most cities do not employ an internal construction manager as we do.

### ***If the developer were following normal procedure, would the Council have to approve this release?***

No. However, these funds are not new funds. The City Council approved a funding commitment for predevelopment, acquisition, construction and permanent financing for both the senior and townhomes projects on June 25, 2002. The Director of Housing has authority to establish business terms for the construction/permanent commitment. The reason this action was brought before the City Council was to give an update and to request permission to disburse a small amount of the \$33.6 million development budget earlier than usual, before all funders closed their construction financing. Staff erred on the conservative side in bringing this item before the City Council.

### ***When was the last time a similar payment was accelerated? How frequently is it done?***

The vast majority of affordable housing funding approvals only involve a single project, rather than two projects, so this is an unusual request in that it involves two projects under a single City funding commitment from 2002. The two projects were initially proposed as a single rental project. In response to neighborhood opposition, the developers agreed to integrate a for-sale component. But for the commercial tenant

relocation issue, both projects would have been developed at the same time several years ago. If the project had been built as originally proposed, without a for-sale component, or if the development had not been delayed due to relocation negotiations, this request would have been unnecessary, as it is simply reimbursing a hard cost expenditure required by the site's land use entitlements.

***What exactly is the financial condition of the developer?***

This project involves two co-developers, ROEM and CORE. All developers-- whether market-rate developers or affordable housing developers-- are impacted by this bad economy and the state of the financial markets. Sales of the San Carlos Bowl units, while certainly impacted by this challenging market, are proceeding as well as or better than other similar units.

***If the City were not to forward this payment, would the Developer default? How did the Developer demonstrate this?***

We cannot know if the developer would default on its loan obligation to Pacific National Bank. However, the City was directly involved in meetings with Pacific National Bank, CORE, and ROEM in the Fall of 2008. At no time was the issue of default raised. We believe that the possibility of a default is extremely unlikely.

***Is this a convenience to the Developer, or a necessity for the survival of the Developer's company?***

Neither. The request is not to provide financial support to the developer. Rather, the request is to provide reimbursement for infrastructure work completed as required under the entitlement approval for the two projects that legitimately belong to the senior development. The fact that the reimbursement happens to have a side benefit for the townhomes' senior lender, as well as the City as subordinate lender, does not change the reason for the request; it is to reimburse work that was properly completed on behalf of the senior project and that has already been expended.

***What would happen to the project if the Developer's financial condition does not improve and defaults—even with this payment?***

There are two projects involved. If a default were to be called on the townhome project—which is unlikely—Pacific National would take the property and attempt to sell units just as the developers are doing. The City would make every effort to ensure that the moderate-income units remain income-restricted. However, we believe this scenario is unlikely to occur. With the senior development, the City is the only lender. In the event the developer could not proceed with development, the City would take back the property and find another developer to complete the project.

Lending to for-sale projects is risky. The City rarely provides construction financing for for-sale developments, as the City can take a loss if the market is down as it is now. The City would not have entered into this risky venture but for the neighborhood's opposition to the originally proposed rental project on this site. Now that the City is involved in this

deal and the market is suffering, it is appropriate that the City Council take a reasonable measure that benefits the City as well as the other parties in the transaction. Additionally, as stated earlier, the City Council already approved the funding for this project. This is just an early release of funds already approved.

***Will there be enough money in Fund 448 to initiate development of the senior housing at another time?***

The Housing Department has a number of different sources of funds, Fund 448 being one. As stated earlier, the City Council already approved the funding for this project. The Department carefully manages its funding to ensure that funds are available when needed.

***What other projects could be at risk if this \$603,000 is released four years prior to construction?***

No other projects would be put at risk by agreeing to this request. The request is simply to disburse funds early that have already been committed and reserved. The development of the senior site will proceed as soon as the relocation issues are worked out and other financing is obtained. Because of the state of the lending market, it is likely that this project will not proceed until 2010 at the earliest. Comments made by the public at the City Council meeting that inferred that the relocation negotiations have not been progressing are not accurate, so a four-year delay is not likely.

***Since you, Housing Director Krutko, acknowledge in your response this morning that you "understand the community has concerns with the implementation of this project," why did you not contact our District 6 Council Member, or our community, prior to your urgent Consent Item 2.3 request?***

This item was placed on the Consent calendar according to current City policy. The item was posted and distributed in accordance with Sunshine requirements and followed all rules. The agenda item was considered by the City's Rules Committee twice during its weekly review of upcoming Council items. It was not made urgently; rather, it was delayed one week to allow the Department time to complete its detailed due diligence.

Secondly, because this request was to release funds early for work that was anticipated and for a project where funding had already been approved by the City Council, it was not perceived to be a potentially contentious issue worthy of additional outreach. As stated in previous correspondence to Ms. Balandra, the Housing Department has worked with the developers to ensure that they reach out to the neighborhood while construction is underway. We continue to work with the developer to achieve this objective. That being said, we are not aware of a situation where a developer would communicate with neighbors about financing issues related to project progress when there is no change to the project itself and therefore no neighborhood impact.