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## FINANCE

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### **Overview**

To develop a financially viable SRO in expensive Palo Alto, CARE will negotiate a favorable ground lease with the VTA and obtain financing from a variety of local, state, and private resources. CARE proposes to finance the development of Camino Crossroads using 9 percent tax credits, a conventional mortgage from CalFed and public soft loans (including City, Housing Trust, and AHP monies). Additional funds for transportation related improvements would be obtained from the Metropolitan Transportation Commission. The total development cost for Camino Crossroads will be \$5.5 million, or \$141,744 per unit. All development and operating expenses described in this section have been reviewed for accuracy by developers and contractors active in the Palo Alto area.

### **Selection of Financing Approach**

Initially, CARE considered two options for financing the development of Camino Crossroads: 9 percent tax credits and 4 percent tax credits combined with tax-exempt bonds. However, assuming CHFA involvement in a tax-exempt bond deal in order to meet CDLAC's 90-day bond issuance and sale requirement, CHFA's stringent SRO design criteria combined with the subsidy impact associated with obtaining less tax credit equity make the 4 percent tax credits a less attractive option. Therefore, CARE has opted to focus all of its financing efforts on securing 9 percent tax credits. CARE appreciates the inherent risk of this strategy, but believes that Camino Crossroads will be especially competitive in the tax credit allocation process.

In 2001, four of seven TCAC applicants from Santa Clara County were awarded 9 percent tax credits. TCAC scores for projects receiving a tax credit allocation ranged from 150 to 159. Of the seven Santa Clara applications, Mid-Peninsula's Riverwood Project was the only SRO application. This project scored 158 points, and was granted its full 9 percent tax credit request. Based on self-scoring, CARE expects that Camino Crossroads will score 152 points. Although this is somewhat lower than the 158 points received by Mid-Peninsula's winning project, it is important to recognize changes in the TCAC scoring procedure. For 2002, SROs will not be given an additional five points for the Lowest Income analysis. In addition, although Camino Crossroads is not located in a Revitalization Area, it will receive Balanced Community points to offset this scoring loss. Taking these changes into consideration, CARE expects that Camino Crossroads will be highly competitive for 9 percent tax credits.

CARE would apply for tax credits in July 2003. If Camino Crossroads does not receive 9 percent tax credits in its first application to TCAC, CARE would reapply in March 2004. If its second application is unsuccessful, CARE will reconsider using 4 percent tax credits. However, using 4 percent credits in combination with a CHFA bond issue will require significant modifications to the existing Camino Crossroads design. To avoid deviating from the preferred design, CARE will strive to make Camino Crossroads as competitive as possible for 9 percent tax credits.

CARE has also looked into the possibility of receiving a Project Based Section 8 allocation. CARE team members spoke with Candace Capogrossi at the County of Santa Clara Housing Authority, and based on the phone conversation, it appears that Camino Crossroads could be eligible for Project Based Assistance. Assuming that 25 percent of the units, the maximum possible, could achieve the HUD Fair Market Rent levels (\$1,131/month for an efficiency unit in Palo Alto), a PBA allocation would result in an additional \$60,000 in gross income per year—nearly doubling projected NOI. However, CARE has not incorporated these cash flows into the analysis, as discussions with the Housing Authority were at a very preliminary stage. Should Camino Crossroads move forward, CARE would further explore the possibility of PBA. If this strategy were successful, CARE would first use the additional income to more quickly pay back its residual interest holders, the Housing Trust, the City, and AHP (in that order). Once loan repayment was achieved, CARE, with permission from CalFed, would lower rents.

### Project Costs

The total development cost for Camino Crossroads is \$5.5 million, or \$141,895 per unit. Major project costs are highlighted in this section. A comprehensive development proforma and operating proforma are included as Appendix 11.

	<b>Total</b>	<b>Per SF</b>	<b>Per Unit</b>	<b>Percent of Total</b>
<b>Hard Costs</b>	\$3,313,741	\$ 195	\$ 84,968	60%
<b>Soft Costs</b>	\$2,216,749	\$ 131	\$ 56,840	40%
<b>Total Project Costs</b>	\$5,533,930	\$ 326	\$ 141,895	100%

***Hard Costs***

Hard costs for Camino Crossroads contribute \$3.3 million, or 60 percent of the total development cost. These costs include demolition of the existing VTA parking area, building construction, podium and parking construction, resident furnishings, appliances, site improvements, transit related improvements, and landscaping. Hard costs for Camino Crossroads were estimated under the assumption that the project will be subject to prevailing wage.

***Soft Costs***

Soft costs for Camino Crossroads amount to \$2.2 million, or 40 percent of total project costs. The most financially significant soft costs are architectural services, local permits and fees, construction period interest, and the developer fee. Also included in the soft cost total are soil surveys and environmental testing, appraisal fees, insurance, loan application fees, TCAC application and monitoring fees, title and escrow fees, the marketing budget, a capitalized operating reserve, and a soft cost contingency.

***Site Acquisition***

The VTA site, one of 16 sites that the City of Palo Alto recently included in an RFQ for potential developers, presents a unique development opportunity, as well as site control challenges. Although the VTA has historically been reluctant to sell Park and Ride properties, the agency has demonstrated a clear willingness to sign long-term land leases to support the development of affordable housing. In fact, as recently as 1999 the VTA granted Eden Housing a 75-year ground lease for development of an affordable housing community on VTA property. In keeping with this precedent, CARE intends to approach the VTA and request a 75-year ground lease that will be senior to the primary mortgage (more on the lease/mortgage structure below). The Eden Ground Lease calls for payments of \$34,247/acre/year. For this project, CARE opted to base the financial analysis on the Eden lease, as opposed to beginning negotiations directly with the VTA. CARE has built in a 25 percent cushion on this lease rate and has assumed a rate of \$42,808/acre/year. In return for this favorable rate, CARE will provide the VTA with ten parking spaces in the Camino Crossroads parking garage and an enhanced bus stop fronting El Camino Real. Though the current parking lot has 36 spaces, CARE has analyzed the actual use of the VTA lot, and based on the results (noted previously), CARE believes that 10 spaces would satisfy the actual demand for the park and ride. Partnership with CARE will create cash flow for the VTA, the ability to continue meeting park-and-ride demand, and an attractive bus stop shielded from the busy El Camino / Page Mill intersection.

***Project Sources***

As noted, CARE will fund the project's estimated \$5.5 million development cost using a conventional mortgage, 9 percent tax credits, and public soft loans (including City, Housing Trust of Santa Clara County,

and AHP monies). Additional funds for transit related improvements would be obtained from the Metropolitan Transportation Commission. Details for each funding source are included below. Support letters and self-scoring reports for TCAC and AHP are included in Appendix 6.

***Pre-Development Funding (\$376,163)***

<b>Source</b>	<b>Amount</b>	<b>Type</b>	<b>Rate</b>	<b>Repayment</b>	<b>Term</b>
Low Income Housing Fund	\$281,163	Loan	7.75%	Balloon	12 months
Housing Trust	\$95,000	Loan	2.00%	Balloon	18 months

- *LIHF*—CARE will utilize \$281,163 in pre-development funds made available by the Low Income Housing Fund to carry out preliminary site analysis and design work. Because CARE will not have site control at the time of the loan, the pre-development loan will be secured by the Mid-Peninsula Housing Coalition. With \$10 million in short term assets, Mid Peninsula will provide ample security to allow a greater loan amount (vs. \$250,000 limit if unsecured) and a more attractive borrowing rate (7.75 percent vs. 10 percent).
- *Housing Trust of Santa Clara County*—CARE will be eligible for \$95,000 in Trust funds through the Housing Trust Homelessness Component. The Housing Trust makes these funds available to developments that will offer permanent rental housing to, among other demographics, single adults earning at or below 35 percent AMI.

***Construction Funding (\$4,640,413)***

<b>Source</b>	<b>Amount</b>	<b>Type</b>	<b>Rate</b>	<b>Repayment</b>	<b>Term</b>
Bank of America Construction Loan	\$3,780,553	Loan	Prime+1%	Balloon	16 months
City of Palo Alto Commercial In-Lieu Fund	\$324,203	Loan	3%	Residual Receipts	40 years
Tax Credit Equity	\$540,731	Equity	N/A	N/A	N/A

- *Bank of America (\$3,780,553)*—Camino Crossroads will secure a construction loan from Bank of America. This loan, in the amount of \$3,780,553, will be carried at prime + 1 percent for 16 months. An origination fee of 1 percent, and other fees totaling \$20,000 have been incorporated in the Camino Crossroads source and use statements. Bank of America will hold first deed of trust as collateral on this loan.

- *City of Palo Alto Commercial In-Lieu Fund (\$324,203)*—The City of Palo Alto will contribute to Camino Crossroads through the Commercial In-Lieu Fees fund, which is funded by fees the City charges to market rate developers to help support affordable housing initiatives. The City has allowed CARE to allocate these funds as needed across construction and permanent sources. Of the \$608,202 required for Camino Crossroads, (the City has made available \$900,000), \$324,203 will be used for construction eventually rolling over into a permanent source.
- *Tax Credits (\$540,731)*—CARE has discussed Camino Crossroads with Barney Deasy and Dan Kiernan at Merritt Capital. Camino Crossroads' expected operating results would yield a return to tax credit investors of approximately 8.25 percent, meeting Merritt's return target. Merritt Capital is familiar with SRO tax credit investments, and would make an outstanding equity partner for this development. CARE would expect the tax credit partner to contribute a total of \$3,604,875, and Camino Crossroads would require 15 percent of that amount, or \$540,731, to be paid-in during construction. The tax credit analysis reflects current assumptions on tax credit yield (conservatively estimated at \$.81 based on conversations with Joel Rubenzahl at Community Economics) and the IRS tax credit percentage, currently 8.2 percent. Camino Crossroads should receive a 20 percent increase in threshold basis, due to high wage rates and the below-grade parking. CARE would also expect a 30 percent increase in eligible basis for developing Camino Crossroads in a high cost area.

### ***Permanent Funding (\$5,533,990)***

<b>Source</b>	<b>Amount</b>	<b>Type</b>	<b>Rate</b>	<b>Repayment</b>	<b>Term</b>
CalFed Mortgage	\$724,805	Loan	8%	Amort.	30 years
Tax Credits	\$3,608,482	Equity	N/A	N/A	N/A
Commercial In-Lieu Fund	\$608,203	Loan	3%	Residual	40 years
Housing Trust	\$300,000	Loan	0%	Residual	55 years
AHP	\$195,000	Loan	0%	Fully Deferred	30 years
MTC HIP Funds	\$97,500	Grant	N/A	N/A	N/A

- *CalFed Mortgage (\$724,805)*—Camino Crossroads will secure a conventional first mortgage from CalFed. As noted previously, CARE has based the Ground Lease structure on an existing lease between the VTA and Eden Housing. This lease included an unsubordinated Ground Lease, and to be conservative, the development assumes a similar unsubordinated Ground Lease for Camino Crossroads. Undeniably, this creates security issues for the mortgage lender, which CARE has tried to address in a number of ways. First, CARE has explored a Letter of Credit structure with Mid Peninsula Bank (a letter of support from Mid

Peninsula Bank is included in Appendix 5). Under such a structure, Mid Peninsula Bank would issue a five to ten year LC in an amount equal to the present value of the lease payments over the five to ten years. It would be expected that once certain operating/coverage targets were achieved, the LC would be eliminated. However, specific targets would need to be negotiated. This LC would secure CalFed in the event of a shortfall in net income and would place CalFed in an economically senior position to the VTA. Mid Peninsula Housing Coalition would in turn, guarantee the LC on an unsecured basis. There are numerous mechanical questions that would need to be addressed in such a structure, and while CARE received preliminary agreement on the concept from both CalFed and Mid Peninsula Bank, much additional work (with the promise of actual fees) would need to be completed. At this point, the critical finance partners (CARE, as the potential developer, CalFed, and Mid Peninsula Bank) simply do not know all of the answers. Second, certain legal remedies such as giving CalFed the right to purchase the land in a default situation, could be incorporated into the documents to strengthen CalFed's position.

- *9 percent Tax Credits (\$3,604,875 in LP Credits; \$3,608 in GP credits)*—Based on 2001 TCAC allocations and application self-scoring, CARE expects Camino Crossroads to be highly competitive for 9 percent tax credits. As described previously, the development pro forma for Camino Crossroads includes \$3.6 million in tax credit equity from Merritt Capital, with \$540,731 in capital contributions during construction.
- *Housing Trust (Homelessness Component)*: Camino Crossroads will be eligible for up to \$400,000 in funding (\$25,000 per unit at or below 35 percent AMI) from the Housing Trust of Santa Clara County's Homelessness Component. Based on CARE's current projections, only \$300,000 of this amount would be needed. These funds are available on a rolling basis and would be used to fund units set aside for tenants earning at or below 35 percent AMI. Although the loan carries a 55-year term, CARE's analysis indicates that it would be repaid in year 51.
- *Palo Alto City Public Subsidies (\$602,237)*—The \$319,129 of Palo Alto Commercial In-Lieu funds drawn during construction will be rolled over to permanent financing. In addition, \$283,108 will be drawn down to cover permanent costs.
- *Affordable Housing Program*—Based on self-scoring results, Camino Crossroads will be eligible and competitive for \$195,000 in AHP funds. These funds may be used for most costs associated with project predevelopment, development, and lease-up. CARE's self-scoring of

the AHP funding application resulted in a total score of 60.58 points. Because all applications with more than 59 points were funded last year, CARE believes that it has a competitive case for winning the requested \$195,000 funds for Camino Crossroads. CalFed would be the sponsoring member for this AHP application. The scoring breakdown is described in Appendix 6.

- *Metropolitan Transportation Commission HIP Funds (\$97,500)*—Camino Crossroads would be eligible for up to \$97,500 in HIP funding. HIP funds would be used to support enhancement of the existing VTA bus stop. Specifically, funds would go toward improving the streetscape, installing bicycle facilities, installing lighting, planting trees and building the bus waiting plaza. The City of Palo Alto would serve as sponsor for Camino Crossroads, and would provide the required 11.5 percent match in local funds.
- *Metropolitan Transportation Commission TLC Funds*—TLC Funds are not currently listed as a source for Camino Crossroads, but CARE would explore this source further if the project moves forward. Specifically, CARE would seek a capital grant of \$250,000 to pay for construction of 10 VTA parking spaces in Camino Crossroads' covered parking garage. CARE believes that these parking spaces should qualify for TLC funding, since the proposed use of funds meets all five of the MTC's project selection criteria. Specifically, Camino Crossroads will be developed through a collaborative planning process, will encourage pedestrian, transit and bicycle trips, will provide for compact development, will be part of the community's development activities, and will enhance the community's mobility, identity and quality of life. At the time of writing this report, CARE's contacts at the MTC were uncertain whether or not the construction of VTA parking would be eligible under the TLC program. CARE elected to take a conservative approach and not include any TLC grant funding in the Camino Crossroads proforma. However, if a TLC grant becomes available, it should be noted that development of Camino Crossroads would be even more financially attractive. In this scenario, CARE would reduce its loan request from the Housing Trust and/or AHP, to allow those programs to disburse their funds to other projects.

## **Project Operations**

### ***Project Rents***

Camino Crossroads will be a 100 percent affordable development with unit rents designated according to the following schedule:

- 10 percent of units at 30 percent AMI (4 Units)
- 30 percent of units at 35 percent AMI (12 Units)

- 30 percent of units at 40 percent AMI (12 Units)
- 20 percent of units at 45 percent AMI (8 Units)
- 10 percent of units at 50 percent AMI (3 Units)

Based on this distribution, tenant rents will range from \$504 to \$840 per month and will be affordable and attractive to the target market. Average affordability at Camino Crossroads is 39 percent AMI, meeting TCAC's requirement that SROs maintain average affordability of 40 percent AMI.

### ***Operating Expense Assumptions***

Operating expenses for Camino Crossroads were projected using recent data from Mid Peninsula Housing Coalition's Riverwood SRO project, currently under construction. All operating assumptions conform to funding source guidelines. Note that a 10 percent vacancy rate has been assumed to adjust for the highly transient nature of the SRO population. Annual operating expense is projected to be \$4,115 per unit.

### ***Long-Term Affordability and Ownership***

CARE's ground lease with the VTA will last for 75 years at a minimum, ensuring long-term affordability at Camino Crossroads. Camino Crossroads would also be subject to the State's TCAC's 55 year affordability restriction.

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## **CONCLUSION**

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CARE is proud to enter this proposal for consideration in the 2002 Bank of America Low Income Housing Challenge. This proposal for Camino Crossroads represents the culmination of a sincere and diligent effort to address one of the most pressing issues facing Palo Alto today. This project not only brings new affordable housing to the area but does so in a way which

- Responds directly to Palo Alto's call for more low income housing
- Puts an underutilized VTA Park and Ride Lot to a higher and better use
- Fosters a feeling of communal well-being both within the development and the surrounding neighborhood
- Promotes a balanced community and social integration by creating homes and providing life-enriching services
- And is financially feasible and attractive

CARE is tremendously grateful to all the non-profit, private, and public organizations that have assisted in developing the proposal for Camino Crossroads. CARE hopes that this proposal might someday become a reality.

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