Good Neighbors
San Diego
Housing Commission

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# REPORT

**DATE:** For the Agenda of August 16, 2002 **ITEM 105**

**REPORT NO:** HCR02-067

**SUBJECT:** Sale of Affordable Housing by Santaluz LLC in the North City Future Urbanizing Area (NCFUA) (Council District 1)

## SUMMARY

**Issue:** Should the Housing Commission support actions to enable for sale housing development in satisfaction of affordable housing requirements in the NCFUA; specifically with regard to the 70 affordable for sale units proposed by Santaluz LLC in the Black Mountain Ranch community?

**Recommendation:** That the Housing Commission recommend Housing Authority to:

1. Allow averaging by developers of income restricted housing to meet the NCFUA affordability restriction of 65% area median income specifically related to the 70 affordable units located within the Santaluz project; and,

2. Authorize the Executive Director of the Housing Authority or the Chief Operating Officer of the Housing Commission, or their designee, to execute all documents necessary to facilitate the development and sale of the 70 affordable for-sale units, income restricted for 55 years as further outlined in this report, subject to the approvals of General Counsel for both the Housing Authority and Housing Commission.

**Fiscal Impact**: The developer will pay the Housing Commission a one-time, upfront, fee of $500 per unit, or a total of $35,000, to cover the Commission's costs of administering the proposed for-sale program. Under the proposed for sale program, the Housing Authority would have the right, but not the obligation, to cure defaults of a borrower who has purchased an affordable unit. It is anticipated that the cost to cure a default would range from $16,000 to $17,000 per unit. Assuming a 10% default rate over the entire 55-year affordability period, the total outlay to cure all defaults would be approximately $112,000 to $119,000, should the Housing Authority choose to cure the defaults. However, upon resale of the defaulted unit(s) to a qualified buyer(s), the Housing Authority should recoup most, if not all, of these costs.

**Affordable Housing Impact**: The project will restrict all 70 for sale dwelling units to households with incomes no greater than 80% of area median income (AMI) ($48,000 for a family of four). The sales price for each unit will be restricted to households earning 75% AMI ($45,075). These qualifying and affordability restrictions will remain in place for 55 years.

**Traffic Impact:** Regional traffic impacts and related mitigations associated with this project were addressed in the Environmental Impact Report for the Black Mountain Ranch (VTM 95-0173) and approved by the City Council.

**Future Related Action(s):** The Housing Commission's recommendations will be forwarded to the Housing Authority for approval at a future Housing Authority meeting. Also, directly related to this item, on September 18, 2002, the City's Planning Department is scheduled to present to the Land Use and Housing Committee of the City Council options, including the concept of income-averaging discussed in this report, to make the sale of affordable housing viable in the NCFUA.

**BACKGROUND**

The Black Mountain Ranch community is located adjacent to, and northwest of, Rancho Penasquitos in the large master planned area of San Diego known as the North City Future Urbanizing Area (NCFUA) . The development of residential dwelling units in this subarea (Subarea 1) of the NCFUA is subject to a 20% set aside of affordable housing that must be reserved for families with household incomes below 65% of area median income (AMI) ($39,050 for a family of four) for a period of fifty-five (55) years. The specific language of the plan provides:

> "A set aside of no less than 20% of the units for occupancy by, and at rates affordable to families, earning no more than 65 percent of the median area income (MAI), adjusted for family size; the calculation of this set aside requirement assumes use of the density bonus laws. However, if the density bonus laws are utilized, the affordable rates shall be reduced to 60 percent of median area income as adjusted for family size in order to comply with the requirements of the law. Provision of housing at 65 percent of MAI, while conforming to the Framework Plan, will not qualify for a density bonus under density bonus law."

**PROJECT NARRATIVE**

The developer of the proposed project, Santaluz LLC (Santaluz), has received discretionary approvals from the Planning Commission and City Council to develop a total of 1,121 dwelling units, 942 units of which may be sold as market rate houses, and 179 units of which must be set aside for affordable housing. As part of its proposal to provide affordable for sale housing, Santaluz has revised its final map to expand the affordable housing site by transferring 10 market rate units for use as affordable units. Thus, Santaluz will now develop a total of 1, 121 dwelling units, 932 of which may be sold as market rate houses, and 189 units of which must be set aside for affordable housing.

Santaluz will develop the 189 affordable units in two phases and locations (the location map is included as Attachment 1). The North site of Black Mountain Ranch will consist of 119 rental units priced at 60% AMI ($36,060 for a family of four). These units will be made available to households earning up to 65% AMI. On the South site of Black Mountain Ranch (site of the proposed project), Santaluz proposes to develop 70 one, two, and three-bedroom condominium units priced at sales prices affordable to households at 75% AMI ($45,075 for a family of four). The 70 units on this site include the 10 extra affordable units deducted from the market rate total – the original site plan called for 60 affordable units. It is proposed that these units be made available to households earning up to 80% of AMI ($48,100 for a family of four).

**AFFORDABILITY LEVELS**

As noted above, the NCFUA requires housing affordable to households earning 65% AMI. To date, all affordable units have been built as rentals. It would be beneficial to have a mix of both rental and for sale housing opportunities, but it is impractical in this high cost area to deliver for sale housing at 65% AMI. For this reason, staff is recommending that the NCFUA requirement be considered as an average affordability level between the two product types. Thus, if some rental units are offered below 65% AMI, some for sale housing could be allowed above 65% AMI (up to a maximum of 80% AMI) for an average affordability not to exceed 65% AMI.

In this case, Santaluz seeks to price the condominium units at 75% AMI because the average pricing of the entire 189 units of affordable housing will remain affordable at the 65% AMI level. Both the for-sale and rental projects will be income restricted for the term of 55 years.

The project proposed by Santaluz would be the first for-sale project in the NCFUA. To date, five affordable rental housing projects totaling 270 units have been developed in the NCFAU; only one project totaling 24 units is completed. The rents on each of these projects are rented at rates affordable to households earning up to 65% of AMI (60% when density bonus rules are in effect) and are available to households earning up to 65% AMI.

## DOCUMENTATION OF AFFORDABILITY REQUIREMENTS

To ensure that the affordable housing restrictions in the NCFUA are kept in place for the full term of 55 years, developers are required to execute certain documents, including, but not limited to: a Master Affordable Housing Agreement (Agreement); a Declaration of Covenants, Conditions, and Restrictions (Declaration); Deed of Trust; an option and first right of refusal and other documentation, as required by the General Counsel of the Commission and the Authority. The Agreements memorialize the developer's affordable housing plan (i.e., siting, phasing, security for performance, timeframe, unit mix, etc.) and any density bonus provisions. The Declaration imposes the income and occupancy restrictions on the property to satisfy the terms of the Agreement. Finally, the Deed of Trust ensures performance of the Agreement.

Lenders who have been asked to provide construction and permanent financing for rental projects in the NCFUA typically seek to place the loan securing their deed of trust in a senior position to the affordable housing documents recorded against the property. While the Housing Authority will not subordinate the Agreement and Declaration, which outline the affordability requirements, subordination of the Deed of Trust has been allowed. This subordination process has worked well with the previously mentioned five affordable rental housing projects. The process does not, however, work well for for-sale projects.

Were Santaluz a rental project, the developer would need only to identify one or two lenders to finance the entire development. However, under a for-sale project, a loan would be required for each of the 70 units being sold. Every time a loan would be required (upon initial sale and all subsequent resales), lenders would ask for a subordination of the Declaration and Agreement. This would allow them, in the case of a default by a borrower, to foreclose their senior deed of trust secured by the property, wipe out the affordable restrictions, and sell the property unencumbered and unrestricted. The Housing Authority, on the other hand, must maintain the affordability restrictions on the property for the entire period of fifty-five (55) years and wants an opportunity to cure defaults with sufficient time to identify another qualified buyer to purchase the unit.

To make a for-sale program viable, the Housing Commission's general counsel, Christensen Schwerdtfeger & Spath LLP, has negotiated an arrangement with the Federal National Mortgage Association ("Fannie Mae") and Washington Mutual, the proposed primary lender for the project, to allow purchasers of loans on the secondary market, such as Fannie Mae, to purchase the affordable for-sale NCFUA loans without requiring a subordination of the Master Agreement or the Declaration of Covenants, Conditions and Restrictions (CC&Rs), which conditions is normally a requirement to the funding of such loans. This has resulted in the ability of the Housing Authority to offer a for sale program with the following parameters:

1. Lenders would subordinate their deed(s) of trust securing purchase money loans on the subject affordable housing site for the entire 55 year restricted period, and;

2. The Housing Authority would, upon receipt of a ninety (90) day notice of default concerning the lender's note and deed of trust, either:

   - cure the default and pursue foreclosure under the Housing Authority's junior deed of trust; or
   - allow the lender's foreclosure to proceed and execute a release of the CC&Rs.

Under this arrangement, the Housing Authority would have the right, but not the obligation, to cure defaults by the borrower and identify another buyer who meets the affordability requirements. The costs of curing a default would involve satisfaction of the outstanding mortgage payments (presumably up to four months); the legal costs for processing the foreclosure; and the marketing costs to attract a new buyer. Staff estimates that, in current dollars, these costs would range from $16,000 to $17,000 per unit. Should the Housing Authority elect not to cure a default, the affordable restrictions for that particular unit would be released and the lender would be allowed to proceed with its foreclosure and sell the property for its full market value, without affordability restrictions. This option of allowing the affordability to be lost should be followed only with compelling justification.

No documentation exists for this proposed affordable for-sale program, as it has never been done elsewhere to staff's knowledge. Christensen Schwerdtfeger & Spath LLP has submitted the legal documents to effectuate the program to Fannie Mae for approval. Presently, Santaluz, Fannie Mae, and Washington Mutual are working with Christensen Schwerdtfeger & Spath LLP to finalize the documents. If approved by the Housing Authority, this program and project could serve as the model for future for-sale affordable housing in the NCFUA.

**RISKS AND MITIGATIONS**

The primary risk associated with the proposed program is the loss of affordable units prior to the 55-year term of restriction should a borrower default on his or her loan commitment. In the case of the Santaluz project, 70 units would be a risk. However, the Housing Authority, through agreements that it would enter into with Fannie Mae and its approved Lenders, would have the opportunity to cure all defaults and, thereby, maintain all units as affordable. Curing the default, and incurring the related costs is a risk that the Housing Authority would have the right, but not the obligation to assume. This risk is minimized or eliminated by the successful resale to a qualified buyer. The ability to offer affordable homeownership in the NCFUA is the benefit gained by accepting this risk.

**ALTERNATIVE**

The Housing Commission could decline to recommend approval of this affordable for-sale housing option. Without this type of for-sale arrangement, the NCFUA would not have a viable vehicle to allow for affordable homeownership. Santaluz would then revert to developing their 70-unit project as a rental.

| Respectfully submitted, | Approved by, |
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| Signature on File with Original Document | |
| Jack D. Farris<br>Manager, Housing Finance & Development | Elizabeth C. Morris<br>Chief Executive Officer |

Attachment: 1: Project Location Map

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