LOAN APPLICATION EVALUATION
THE LYLA – THE PACIFIC COMPANIES

Project Summary

A summary of key project features for The Lyla project proposed by Pacific West Communities (PWC) is shown in Table 1. Note that the cost information and loan request have been updated to accurately reflect current City impact fees.

Table 1
The Lyla Project Summary

<table>
<tr><th></th><th colspan="6">The Lyla</th></tr>
<tr><td>Developer</td><td colspan="6">Pacific West Communities, Inc.
Idaho-based for-profit affordable housing developer with more than 140 affordable properties in the Western US. In Elk Grove, they have developed three projects: Avery Gardens (opened in 2015), Bow Street Apartments (2019), and Gardens at Quail Run (2021). A fourth project, Gardens at Quail Run II, is moving forward without City subsidy.</td></tr>
<tr><td>Nonprofit Partner</td><td colspan="6">Riverside Charitable Corporation
Southern California-based nonprofit focused on assisting with the development of affordable housing. They will provide on-site social services at the project under the LifeSTEPS model.</td></tr>
<tr><td>Location</td><td colspan="6">9140/9142/9144/9146/9148 Bruceville Rd and 7235 Laguna Blvd (along Bruceville Rd between Big Horn Blvd and Laguna Blvd)</td></tr>
<tr><td>Nearby amenities</td><td colspan="6">Adjacent uses are shopping centers, multifamily market-rate housing, and single-family homes. Excellent proximity to shopping, services, and transit. Close to middle and high schools.</td></tr>
<tr><td>Type of project</td><td colspan="6">Family</td></tr>
<tr><td rowspan="7">Affordable unit description[1]</td><td>Affordability Level (% of AMI)</td><td>Total</td><td>Studio</td><td>1BD</td><td>2BD</td><td>3BD</td></tr>
<tr><td>30%</td><td>30</td><td>5</td><td>10</td><td>8</td><td>7</td></tr>
<tr><td>40%</td><td>-</td><td>-</td><td>-</td><td>-</td><td>-</td></tr>
<tr><td>50%</td><td>30</td><td>5</td><td>10</td><td>8</td><td>7</td></tr>
<tr><td>60%</td><td>173</td><td>30</td><td>55</td><td>44</td><td>44</td></tr>
<tr><td>80%</td><td>58</td><td>10</td><td>18</td><td>13</td><td>17</td></tr>
<tr><td>TOTAL</td><td>291</td><td>50</td><td>93</td><td>73</td><td>75</td></tr>
<tr><td>Total number affordable units</td><td colspan="6">291</td></tr>
<tr><td>Total residential square footage</td><td colspan="6">222,950</td></tr>
<tr><td>Total project cost[2]</td><td colspan="6">$103,713,894</td></tr>
<tr><td>Construction cost</td><td colspan="6">$63,504,289</td></tr>
<tr><td>Cost per unit</td><td colspan="6">$352,768</td></tr>
<tr><td>Cost per residential sq. ft.</td><td colspan="6">$465,18</td></tr>
<tr><td>Developer fee</td><td colspan="6">$12,909,343 (12.45%)</td></tr>
<tr><td>Loan request[2]</td><td colspan="6">$6,000,000</td></tr>
<tr><td>City subsidy per affordable unit</td><td colspan="6">$20,619 (6%)</td></tr>
<tr><td>Other financing/subsidy[3]</td><td colspan="6">$66,584,551 – 4% tax credits
$24,600,000 – tax-exempt bonds
$6,529,343 – deferred developer fee</td></tr>
<tr><td>Project amenities</td><td colspan="6">Swimming pool, community room, children’s play area</td></tr>
</table>

Social services offered	Minimum of 15 hours per week of on-site supportive services, including up to 10 hours per week of after-school programming
Site control status	Grant deed dated 10/29/2019

1 The project also includes three two-bedroom manager units, which are not income-restricted.
2 As compared to the original proposal, the total project cost has increased about $2.3 million, $2 million of which is increased impact fees related to parks and $300K of which is an increase to the developer fee. The overall loan request to the City increased from $4 million to $6 million.
3 As proposed, the City's financing will be junior to the tax credit and tax-exempt bond financing.

Loan Application
PWC's loan application (**Attachment 3.1**) builds off the information submitted in their proposal (**Attachment 3.2**). The components of the loan application are dictated by the Affordable Housing Loan Program Guidelines. The following items were not submitted:

- *Market study.* A complete market study is underway but has not yet been completed. However, a preliminary market survey demonstrated a strong market for the proposed project. Similar projects reviewed by the market study preparer indicated similar properties report a 0% vacancy rate. Based on this and the City's review of vacancy rates at its other projects, it is highly likely that the complete market study will show adequate demand for the units.

- *As-built property appraisal.* This appraisal identifies the "as is" value of the land, and prospective market values of the property when complete and when stabilized under both the restricted rent and unrestricted rent scenarios. PWC indicated that this appraisal is typically initiated by the lender. As negotiated with on past transactions with PWC, the City could require the as-built appraisal be a condition of the loan closing, but the City's conditional commitment cannot be tied to the value identified in the appraisal because that is not a factor within PWC's control.

Loan Underwriting
The goal of the City's underwriting process is to evaluate the financial feasibility of the project, including PWC's ability to develop the site as presented and to maintain the project in both the short-term and the long-term. Highlights of staff's underwriting efforts are noted below in the Project Strengths and Project Weaknesses sections.

<u>Project Strengths</u>
The Lyla application has several strengths:

- *Experience.* Developer has significant experience designing, funding, constructing, and managing affordable housing projects in California and other states. Since 1998, Developer has developed nearly 10,000 units of affordable housing in more than 160 projects representing over $2 billion in total development costs, and has an additional 40 projects and 5,000 units under development. The Pacific Companies, of which Developer is a part, is a vertically integrated firm, including their Pacific West Architecture and Pacific West Builders, which will serve as the architect and general contractor on this project. Developer's track record demonstrates an ability to consistently obtain LIHTC awards and the accompanying private and public financing to complete their projects.

Riverside Charitable Corporation, the nonprofit partner, is based in Tustin but has a local presence in the Sacramento region. They provide services to residents at six of the City's other affordable housing properties and to more than 100 properties in California.

- *Location.* The project is in close proximity to middle and high schools, and is particularly close to the Laguna Community Park and Wackford Center, which would prove to be an added off-site amenity for residents of the project. The project is also very near the Target shopping center, which includes a full-service grocery. A Walgreen's pharmacy is on an adjacent site. The Laguna and Bruceville corridors are well-served by transit.

- *Unit affordability.* Overall this project is less affordable than other affordable housing projects built in Elk Grove in recent years, with most units targeted to households earning 60% to 80% of area median income. However, there currently are no units in the City's affordable housing inventory targeting households at 80% of area median income, so this project adds a resource for those households at a time when market-rate rents are increasingly unaffordable. It also provides an opportunity to adjust household rents to higher levels in the event household income increases, with the goal of helping households move on to market-rate housing.

- *Unit size.* The unit mix includes a greater percentage of studio and one-bedroom units than other family projects, potentially catering to younger workers and seniors. The project also includes 50 studio units, a unit size that does not currently exist within the City.

- *Partnership to address homelessness.* PWC committed to partnering with the City to address homelessness, including by moving homeless Elk Grove households to the top of the waitlist for any unit for which they are qualified. A similar partnership on Gardens at Quail Run so far has resulted in ten Elk Grove homeless households (including six families with children) being placed in units they can afford.

- *Revenue and operating cost assumptions.* The project's revenue and operating cost assumptions are in line with the standards of TCAC and past performance on the Developer's Avery Gardens and Bow Street projects. At least in the short term, revenue is likely to exceed projections substantially as a result of lower than projected vacancy rates. The pro forma projects an industry standard vacancy rate of 5%, but similar affordable projects currently have 0% vacancy rates.

- *On-site property management.* The project accounts for on-site property management by setting aside three non-income-restricted unit for a member of the property management staff. The proposed property management firm, Aperto Property Management, has experience managing market-rate and affordable multifamily units. Aperto manages the Bow Street Apartments and the Gardens at Quail Run and their staff have worked cooperatively with the City on lease-up and other issues.

<u>Project Weaknesses</u>

A key goal of the City's affordable housing programs is ensuring that units remain an excellent resource for low-income households over the duration of the project's life. However, in addition to the strengths noted above, The Lyla application has several weaknesses, mainly related to financial assumptions.

These weaknesses may impact the project's ability to remain viable throughout the 55-year affordability period. Specifically, staff has identified the following weaknesses:

- *The proposed developer fee significantly exceeds the City's standard*. The City's standard maximum for developer fees is 10% of total project cost. While the developer fee proposed by PWC ($12,909,343 or 12.45%) is allowed under TCAC/CDLAC regulations, it is common for developers to forgo or contribute some of the developer fee as equity to the project. PWC's developer fee is an outlier among the seven proposals the City received, where effective developer fees for the other seven projects ranged from 5.3% to 10.1%, with an average of 7.4%. Four of the proposals did include forgone or contributed developer fees, including John Stewart Co/Bethesda's Cornerstone Village.

- *There is a disparity between the projected increases in rental revenue and the increase in operating expenses.* PWC assumed that rents would rise at 2.5% annually, and that most operating expenses would rise at 3.5% annually, which is consistent with TCAC standards. In the current economic climate, a 2.5% increase in annual rents is likely, but in a less strong economic environment, increases in revenue may be dependent on increasing Section 8 receipts and/or maintaining a lower than standard vacancy rate. In the event operating costs continue to increase at a rate outpacing revenue increases, the project's net operating income will decline, which may lead to a situation where the property cannot be adequately managed or maintained.

- *A softening of the rental market may make studio units difficult to rent.* The project contains 50 studio units (about 17% of the total units). While demand for affordable housing of all sizes is currently strong in the region, market demand does tend to fluctuate over time. In a market with normal or high vacancy rates, studio units tend to be less popular than one- and two-bedroom units. At the 60% level, the rent differential between a studio and one-bedroom is only $51 per month.

- *The proposed replacement reserve contribution of $250 per unit per year is inadequate to maintain the project over the 55-year affordability period.* Although this contribution is within TCAC guidelines, at this rate it would take more than 870 years before the replacement reserves equal the non-inflation-adjusted construction cost of the project. Additionally, while it's reasonably certain construction costs will rise over time, the replacement reserve contributions are not adjusted, meaning the amount they will be able to cover will decline as the project ages. Underfunding the replacement reserves creates a situation where the project may not be able to be maintained in line with the City's standards during the entirety of the affordability period.

- *The project's services budget is likely inadequate.* The project budgets just $36,000 annually to provide resident services to 291 affordable housing units. For comparison, the Villages at Bilby (125 affordable units) budgeted $30,000 a year to provide social services, and Cornerstone Village (83 affordable units) plans for $85,000 a year.

- *The likelihood of the City receiving significant loan repayment throughout the loan term is small.* A residual receipts payment structure is proposed, with payments to the City being made only after full payment of all deferred developer fee. As proposed, the City would not see any payment until Year 15, though payments are projected to be substantial at that time (about

$360,000 in Year 16). However, by Year 15, given the low amount of the replacement reserve contribution, it's likely that the project's necessary budget for maintenance and upgrades would significantly erode the City's projected payments.

Additionally, under this structure, the loan would not be amortizing and the annual payments to the City would not be equal to annual interest on the loan, creating a scenario where the loan balance continues to grow. If rents fail to increase at the predicted pace, if expenses are greater than estimated, and/or if vacancy is higher than anticipated, it is possible the City would not receive any payment at all. Historically, this has been the case for the majority of the City's residual receipts loans.