CITY COUNCIL AND HOUSING AUTHORITY AGENDA REPORT

MEETING DATE: **December 10, 2013** **ITEM NUMBER:** 1

SUBJECT: **HOMELESS SUPPORTIVE HOUSING PROJECT: DEVELOPMENT MODEL OPTIONS**

DATE: **DECEMBER 3, 2013**

FROM: **DEVELOPMENT SERVICES DEPARTMENT/HOUSING & COMMUNITY DEVELOPMENT DIVISION**

PRESENTATION BY: **RICHARD FRANCIS, ASSISTANT CHIEF EXECUTIVE OFFICER**
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RECOMMENDATION:

Staff requests that City Council provide feedback regarding the preferred development model for Costa Mesa homeless resident supportive housing. The priority recommendations and secondary recommendations are as follows:

Priority Recommendations

1. Pursue the new construction of an "integrated" affordable housing project on property owned by the City of Costa Mesa (City). Approximately 50% of the units in the project would be rented to homeless residents and 50% of the units would be rented to very-low income households earning less than 50% of the Orange County median income.

2. New construction of a supportive housing project that is rented exclusively to homeless residents. The project would be constructed on property owned by the City.

Secondary Recommendations

1. Acquisition of an existing motel and converting it for the supportive housing project.

2. Acquisition and rehabilitation of small apartment projects on scattered sites for rental to homeless tenants.

3. The creation of a tenant based rental assistance program that provides rent subsidies for homeless tenants to be used at market-rate apartment projects.

BACKGROUND:

Homeless Task Force Goals

The City formed a Homeless Task Force in January 2011 to address the challenges created by the homeless population in Costa Mesa. The Homeless Task Force members included representatives from the faith communities, business owners, social workers, mental health experts, police officers, and residents. The goal of the Homeless Task Force was to "establish

realistic strategies and make recommendations that address the needs of the Costa Mesa community, residents, business, and the homeless."
The Housing Task Force ultimately established nine goals that were adopted by the City. Goal six (6) calls for the creation of a supportive housing project and a possible access center. Goal six (6) further calls for City staff to develop a financing strategy for supportive housing using available City funds, and outside assistance sources targeted to the provision of housing for the homeless.

RFQ for Homeless and Pre-Homeless Services

In September 2012, the Housing Authority distributed a RFQ for Homeless and Pre-Homeless Services. Six (6) responses were received by the RFQ submission deadline. On April 2, 2013, the City selected the development Team of Mercy House CHDO, Inc. and Wakeland Housing and Development Corporation (Mercy/Wakeland Team) to provide supportive housing to the Costa Mesa homeless population, and authorized staff to negotiate the terms of a predevelopment loan commitment.

Predevelopment Loan

On May 21, 2013, the City Council and the Costa Mesa Housing Authority Board (together, Council) approved the Community Housing Organization (CHDO) Predevelopment Loan and Commitment of HOME Program Funds Agreement (Predevelopment Agreement). The Predevelopment Agreement provided the Mercy/Wakeland Team with a Predevelopment Loan of up to $500,000 that is to be funded with HOME Program funds provided to the City by the United States Department of Housing and Urban Development (HUD). On July 16, 2013, the Council agreed to increase the Predevelopment Loan amount to $585,257.

Funding Issues

The Predevelopment Loan is subject to a project schedule imposed by HUD. HUD may de-obligate these funds if they are not used according to the current HOME commitment schedule.
The Wakeland/Mercy Team has been anticipating that Mental Housing Services Act (MHSA) funding will be available to assist the supportive housing project. Staff was recently informed by the County of Orange, which administers the MHSA program, that both a capital contribution and an operating subsidy will be reserved for the project if the Mercy/Wakeland Team submits a signed purchase and sale agreement no later than February 28, 2014.

Site Selection Process

Section 3.1 of the Predevelopment Agreement contemplates that the Mercy/Wakeland Team will undertake a "site selection process" that includes a few land use alternatives. In turn, the Mercy/Wakeland Team is required to present these options for consideration and approval by the Council. A key issue related to the search for an appropriate site is the February 28, 2014 deadline the County has imposed for site control. If this deadline is not met, the City will not be able to utilize the approximately $3 million in MHSA funding for the project.

The Mercy/Wakeland Team has been diligently searching for available motel, apartment, and vacant land properties throughout Costa Mesa. Both staff and the Mercy/Wakeland Team have reviewed up to 10 properties including motels, apartments, commercial properties and vacant land. To date, the Mercy/Wakeland Team has only been able to find two vacant properties being offered for sale, and no motel properties or small apartment complexes are currently available for sale. To supplement the Mercy/Wakeland Team's site selection activities, staff has identified several City-owned properties that could potentially be used for the development.

ANALYSIS:

The Mercy/Wakeland Team response to the RFQ identified the following options for creating a supportive housing project for homeless Costa Mesa residents:

1. The conversion of an existing motel into a rental housing project; and

2. The new development of a rental housing project.

Since the Mercy/Wakeland Team was selected by the City Council, the Team has been working with a committee of City staff to evaluate additional options for providing housing to the Costa Mesa homeless population. The additional options currently being considered are:

1. The acquisition and renovation of one or more small-scale apartment projects; and

2. The creation of a tenant based rental assistance program that would provide rental subsidies to homeless individuals for use in renting apartments in market-rate projects.

The Mercy/Wakeland Team has prepared conceptual plans and financial pro formas to provide a comparative analysis of the financial gap associated with the five options. The characteristics of the supportive housing options currently being considered by the Mercy/Wakeland Team are summarized in the following sections of this Staff Report.

Base Options

Option 1: Motel Conversion Project

Description

Under this option, an existing motel with approximately 50 rooms would be acquired. The motel rooms would then be consolidated into 30 to 40 housing units homeless residents.

Advantages and Constraints

The advantages of the motel conversion option include:

1. **Community Revitalization**: The primary advantage of this model is that it could provide a “two-for-one” benefit of removing a problem motel and providing supportive housing for the homeless.

2. **Community Support**: This model may face less community opposition as it is renovating an existing use, as opposed to creating a new use.

3. **Funds Leveraging**: This project could potentially utilize Low Income Housing Tax Credits to fund up to 50% of the total project cost.

This model also faces several constraints, including:

1. **Limited Supply**: Currently, there are no motels for sale in Costa Mesa. Additionally, having a public entity involved in the purchase could significantly raise the price should one become available.

2. **Design Limitations**: When selecting a motel for conversion, it is important that the selected motel be a good candidate for creating a quality supportive housing project. Key features include a design that allows for a high level of security, rooms that are large enough to serve as stand alone studios or capable of being combined into larger rooms, and the ability to add community space for resident services. Without these features, the project's design may limit its ultimate success.

3. **Limited Cash Flow**: As a project in which 100% of the units would be rented to homeless residents, the rent income will be extremely low. This results in the need to fund a large operating and service reserve.

4. **Relocation**: Federal and state relocation law requires that long-term motel tenants (those who have resided at the hotel 30 days or more) be provided with relocation benefits upon being displaced. Relocation costs can be prohibitively expensive if a large number of extremely low-income households need to be moved out to allow for the new supportive housing project.

Option 2: New Construction of a 100% Supportive Housing Project

<u>Description</u>

Under this option, a vacant or underutilized site would be acquired for the construction of a project targeted exclusively to homeless residents. This analysis is based on a project density of 20 units per acre, with the project size ranging from 20 to 40 units.

<u>Advantages and Constraints</u>

The primary advantages associated with this option are:

1. **Efficient Design**: The primary advantage of this model is that it allows the project to be custom designed to meet the needs of the residents and the community.

2. **Funds Leveraging**: This option can be structured to be competitive for Low Income Housing Tax Credits, which significantly reduces the funding gap generated by the project.

Constraints this model faces include:

1. **Limited Sites**: There is very little vacant and underutilized land for sale in Costa Mesa.

2. **Community Opposition**: New construction projects may face greater community opposition than a "renovation" project.

3. **Limited Cash Flow**: As a project in which 100% of the units would be rented to homeless residents, the rent income will be extremely low. This results in the need to fund a large operating and service reserve.

Option 3: New Construction of an “Integrated” Affordable Housing Project

Description

Under this option, a vacant or underutilized site would be acquired for the construction of an “integrated” housing development. This scenario allocates 50% of the units to homeless tenants and 50% of the units to very-low income households earning less than 50% of the Orange County median income. For policy reasons, the Mercy/Wakeland Team has set the minimum project size at 30 units and the maximum project size at 40 units. The project density is set at 20 units per acre.

Advantages and Constraints

In addition to the advantages it shares with Option 2, an integrated new construction project offers the following benefits:

1. **Tenant Benefits**: Proponents of the integrated or “mixed-tenancy” housing model state that supportive housing clients benefit from living and interacting with a broader mix of residents.

2. **Move-Up Options**: This model provides supportive housing tenants with an option to “move up” within the development, possibly graduating to a higher income unit.

3. **Financial Viability**: This type of project is the most financially viable, as the higher rents generated by the non-supportive housing units can help to offset the lower supportive housing rents.

Constraints faced by this model include:

1. **Reduced Homeless Prevention Benefits**: Fewer homeless people would be housed in comparison to Options 1 or 2.

2. **Leasing Issues**: It can be difficult to market the non-supportive housing units in a project that includes a large number of supportive housing units. It is imperative that the project be extremely well-designed and managed to mitigate this problem.

Alternate Options

Option 1: Acquisition and Renovation of Small Apartment Buildings

Description

Under this option, up to eight (8) existing apartment units in one (1) or two (2) buildings would be acquired and lightly renovated. The completed units would be used to provide supportive housing over a 15-year term.

Advantages and Constraints

The primary advantages to this option are:

1. **Reduced Community Opposition**: There is a potential that smaller scattered projects might generate less community opposition than a larger single project.

2. **Lowest Total Cost**: The total cost associated with a smaller project, subject to a relatively short covenant period, is the lowest of the options being tested.

Constraints faced by this model include:

1. **Limited Supply**: Currently, there are no four (4) to eight (8) unit rental projects for sale in Costa Mesa.

2. **Reduced Homeless Prevention Benefits**: Under this option, a maximum of eight homeless residents will receive housing, and the units will only be provided for a limited period.

3. **No On-Site Services**: Service delivery may be less effective and less cost efficient when it cannot be provided on site. It is likely that the burden of coordinating the provision of the services needed by the tenants will fall on the City staff.

4. **Limited Pool of Developers**: Experienced and well-qualified nonprofit housing developers typically require a minimum threshold project size in order to achieve management and operating cost efficiencies. A four (4) to eight (8) unit project would likely only draw interest from small, less experienced developers.

5. **Inefficient Use of Funds**: The project is too small to generate a significant amount of net proceeds from the Low Income Housing Tax Credit program. As a result, there would be little to no leveraging of public funds. While this option generates the lowest total financial gap, it assists the fewest number of homeless tenants for the shortest period of time.

Option 2: Develop a Tenant Based Rental Assistance Program

Description

Under this option, the homeless tenant will be given rental assistance on a monthly basis, allowing them to rent an apartment in a market-rate project. The tenant’s contribution to the rent will be set at approximately 30% of their monthly income, with the rental assistance program paying the difference between the tenant’s payment and the actual rent charged for the market-rate unit.

In a tenant based rental assistance program, tenants are typically provided with assistance in locating a unit, moving assistance, utilities service set up, and obtaining household supplies and furnishings. The tenants are also provided with ongoing case management and support services to help the person integrate into the community and handle problems that may arise with meeting tenancy obligations.

This option is modeled on the existing Shelter Plus Care program offered by HUD. The costs associated with operating this type of program include the rental assistance costs and the supportive services costs. Typically, clients are able to utilize the rental assistance for two years.

Advantages and Constraints

The primary advantage to this option is that it does not require identification of a development site. Instead, homeless clients are housed at existing apartment projects located throughout the City.

The constraints can be summarized as follows:

1. **Project Cost**: The other options being evaluated demonstrate a one-time financial gap. A tenant based rental assistance program requires a City subsidy every year in which the program is offered.

2. **Funds Leveraging**: This type of program does not qualify for the use of leveraging funds such as Low Income Housing Tax Credits or MHSA funding.

3. **Service Delivery**: Under this option, a project is not developed and no developer will be included in the process. Therefore, the burden of identifying service providers and coordinating the provision of these services will fall on the City staff.

4. **Unit Quality**: There is no guaranty that tenants will choose to live in well-managed projects that are equipped to accommodate residents with a complex array of mental health and other issues.

Financial Gap Analyses

Financial gap analyses were prepared for each of the five options being studied. The following assumptions were used in the analysis:

1. All of the project costs and financial gap estimates should be considered broad estimates. In particular, the property acquisition costs represent a variable that can potentially fall within a wide cost range. The analyses are presented only to show the relative cost of the various options for planning purposes. The cost estimates will be refined after a development option is selected and a development site has been identified.

2. The following outside funding sources are anticipated to be available to the motel conversion and new construction options:

   a. If the project site is located in close proximity to a wide range of amenities, such as transit, grocery stores and parks, the project will have a strong potential for receiving the competitively awarded 9% Low Income Housing Tax Credits and State of California Low Income Housing Tax Credits.

   b. The County has indicated a willingness to provide MHSA funds for up to 25% of the units in the project, at an amount equaling approximately $250,000 per qualifying unit. However, these funds can only be accessed for the project if the Mercy/Wakeland Team secures site control by February 28, 2014.

3. The City has committed the following assistance funding to the project:

   a. The City has committed to provide $585,000 in HOME Program funds to the project.

   b. The City has agreed to contribute $1 million in General Fund revenue to the project.

4. The project could potentially be developed on property currently owned by the City. It is assumed that the conveyance would be structured as a long-term ground lease that would carry nominal annual lease payment.

The financial gap analyses for each of the Options being analyzed (after taking into account the above mentioned financial resources) are presented in Attachment 1 of this Staff Report. The following tables summarize the results of the analyses:

	Description / Assistance Sources	Financial Gap without an Identified Funding Source
Base Options		
Option 1	Motel Conversion Project: HOME and City General Fund Assistance	30 Units: $6,315,000 40 Units: $5,415,000
Option 2	New Construction of a 100% Supportive Housing Project	
Alternative A	MHSA, HOME and City General Fund Assistance	20 Units: $6,365,000 40 Units: $6,615,000
Alternative B	Alternative A Funding Sources + Contribution of City-Owned Land	20 Units: $3,865,000 40 Units: $1,615,000
Option 3	New Construction of an Integrated Affordable Housing Project	
Alternative A	MHSA, HOME and City General Fund Assistance	30 Units: $5,015,000 40 Units: $5,315,000
Alternative B	Alternative A Funding Sources + Contribution of City-Owned Land	30 Units: $1,265,000 40 Units: $315,000

	Description / Assistance Sources	Financial Gap without an Identified Funding Source
Alternate Options		
Option 1	Acquisition and Renovation of Small Apartment Buildings: HOME and City General Fund Assistance	4 Units: $0 8 Units: $815,000
Option 2	Tenant Based Rental Assistance Program (15 Years): HOME and City General Fund Assistance	10 Households: $1,715,000 20 Households: $4,565,000

As can be seen in the preceding tables, all but one of the options exhibits a significant financial gap after all the identified funding sources are considered. Funding sources that could potentially be used to fill some or all of the remaining financial gaps include:

1. The Mercy/Wakeland Team has indicated that they will undertake fundraising activities to assist the project.

2. The County may have assistance funds available for supportive services that will be offered via a Notice of Funding Availability (NOFA).

3. HUD-VASH vouchers may be available. These vouchers provide rental assistance, case management and clinical services to qualifying veterans.

4. The City could agree to commit additional General Fund revenue to the project.

5. The City could obtain a Section 108 loan from HUD equal to up to five times the City's annual allocation of Community Development Block Grant (CDBG) Funds.[1]

Choosing an Appropriate Site/Access to MHSA Funds

If the City wishes to obtain MHSA funds to assist the project, the Mercy/Wakeland Team must secure site control no later than February 28, 2014. To meet this deadline, the Council will need to approve the site by early February and approve a site control agreement such as a purchase option by mid-February.

If the City wishes to forego the MHSA funds, it will be possible to reconvene the Homeless Task Force to review and evaluate potential sites identified by the Mercy/Wakeland Team. The sites recommended by the Homeless Taskforce would then be recommended to the Council for consideration.

ALTERNATIVES CONSIDERED:

The Council could direct the staff to pursue an alternative homeless prevention strategy. If this course is selected, it will likely be necessary to undertake a RFQ/RFP process to select a new development team. In addition, the HOME Program Funds commitment provided by HUD would expire, and it is likely that the City would be required to return the funds to the federal treasury. Further, the City will miss the deadline for procuring MHSA funds. Thus, it would be necessary to identify a new funding strategy for the alternative project or program.

FISCAL REVIEW:

The City has committed to provide a $585,257 Predevelopment Loan to the project. It is anticipated that future HOME Program funds received by the City, City General Fund, and the contribution of City-owned land may be committed to the supportive housing project when and if the business terms of an affordable housing agreement are negotiated among the parties and presented to the Council for review and action.

LEGAL REVIEW:

Special Counsel Mrs. Celeste Brady will be counsel in the future negotiations with the Mercy/Wakeland Team in consultation with the City Attorney.

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[1] Based on CDBG regulations, it is likely that these funds could only be used to assist the motel conversion and acquisition and renovation options.

CONCLUSION:

Staff desires input from the City regarding the type of supportive housing model that is the most efficient and appropriate model for the City of Costa Mesa.

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ATTACHMENTS: 1 Financial Gap Analyses