CITY OF MERCED
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MERCED, CA 95340

Housing Successor Expenditure & Property Disposition Options

City of Merced
Acting as the Housing Successor to the Merced Redevelopment Agency

March 27, 2019

RSG, INC.
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INTRODUCTION

All California redevelopment agencies were dissolved in 2012 by Assembly Bill x1 26. The City of Merced ("City") acts as the Housing Successor Agency ("Housing Successor") to the former Redevelopment Agency of the City of Merced ("Former Agency"). Several housing assets were transferred from the Former Agency to the Housing Successor as part of the redevelopment dissolution process. Current Housing Successor Assets include nine vacant properties, $1.4 million in Low and Moderate Income Housing Asset Funds ("Housing Asset Funds"), and over $8 million in loans receivable. The Housing Successor anticipates that one additional vacant property will be transferred from the Former Agency pending approval by various agencies.

Health and Safety Code ("HSC") Section 34176.1 sets legal restrictions on Housing Successor expenditures and activities. RSG, Inc. ("RSG") evaluated options for spending Housing Asset Funds and disposing of Housing Successor properties within these restrictions. This report presents RSG's findings and recommendations based on a review of available assets, the estimated revenue stream from loans receivable, City housing needs and priorities, and property readiness. The purpose is to help City leaders create a strategy that maximizes how funds and properties are leveraged to meet the City's housing goals while complying with the law.

HOUSING SUCCESSOR ASSETS

As of June 30, 2018, the Housing Asset Fund had a cash balance of $1,480,788, plus $8,064,678 in outstanding loans receivable. Revenues come primarily from loan repayments and investment earnings. All revenues generated by Housing Successor assets must be deposited into the Housing Asset Fund and are subject to expenditure restrictions. Merced intends to dedicate $1.2 million to the Childs Court Apartments, a 100-125 unit affordable housing development proposed on Childs Avenue and B Street. Remaining funds and future revenues may be designated for other projects.

PROPERTIES

The Housing Successor owns nine vacant properties, listed in Table 1 and displayed in maps in Appendix A. All properties are zoned residential. The Housing Successor anticipates that one additional vacant property at 26 W. 18th Street will be transferred from the Former Agency to the Housing Successor. The property was purchased by the Former Agency with Low and Moderate Income Housing Funds. The City recently located records documenting this in order to formally transfer the property to the Housing Successor. The transfer is pending review and approval by the Designated Local Authority to the Merced Redevelopment Agency ("DLA"), the Oversight Board to the DLA ("Oversight Board"), and the California Department of Finance. The property is included as Site 10 throughout this report, however its inclusion in the Housing Successor's disposition strategy is pending the property's formal transfer.

Table 1. Housing Successor Land Inventory

#	Address	Lot S.F.
1	1823 I Street	2,100
2	1815 I Street	2,400
3	205 W. 18th Street	3,000
4	211 W. 18th Street	7,500
5	202 W. 19th Street	7,500
6	1744 I Street	5,000
7	49 W. 18th Street	10,800
8	150 W. 19th Street	7,500
9	73 South R Street	20,416
10	26 W. 18 Street *(pending DOF approval)*	7,500

Source: City of Merced

State law requires the City to initiate affordable housing development on or sell Housing Successor properties by February 25, 2023[1]. Former Agency properties are not subject to the Surplus Land Act; they have their own development and disposition requirements pursuant to the Dissolution Act. If the properties are sold, sales proceeds must be deposited into the Housing Asset Fund for use on eligible expenses pursuant to HSC 34176.1(e) and 33334.16. RSG has examined which properties are the most suitable for development and which the Housing Successor should consider selling to help provide additional gap financing subsidies. This is discussed under the "Property Disposition & Expenditure Options" section.

REVENUES FROM OUTSTANDING LOANS

The Housing Successor administers 18 loans receivable issued by the Former Agency with an outstanding balance of over $8 million. They consist of five developer loans payable from residual receipts and 13 homeowner loans (detailed in Appendix B). RSG reviewed loan agreements and payment history to determine potential revenues and inform expenditure recommendations. Loan repayments have generated between $46,000 and $536,000 in annual revenues over the last five years. Future revenues will vary each year based on loan terms and ability to pay, however they are generally expected to be less than $200,000 per year.

Developer Loans & Residual Receipts

The Housing Successor administers loans issued to four affordable housing developers by the Former Agency:

<u>Merced Lofts, LLC</u>: The former Agency issued a $1.3 million loan to Merced Lofts, LLC in 2004 in exchange for building a multi-use project, including 11 low and moderate income rental units. The property has since been sold, and the loan has a remaining balance owed of $150,000 pursuant to a negotiated settlement. The payment is pending and will be deposited into the Housing Asset Fund.

<u>Central Valley Coalition for Affordable Housing</u>: Two loans were issued to the Central Valley Coalition for Affordable Housing in exchange for constructing or rehabilitating two homes affordable to low and moderate income households. An $80,000 loan was issued in 1998 and a $65,000 loan was issued in 2001. Both loans

[1] The disposition deadline was extended to this date by adoption of City Council Resolution 2018-67.

require fixed monthly payments. As of June 30, 2018, the first loan had an outstanding balance of $4,156 and is expected to be paid off in Fiscal Year 2018-19. The second loan had an outstanding balance of $31,251 and is expected to be paid off by Fiscal Year 2024-25.

Merced Senior Investors (Sierra Meadows Apartments): The former Agency issued a $1.3 million loan in 1994 to subsidize development of the Sierra Meadows Apartments, which has 100 senior units, built by Affordable Housing Development Corporation ("AHDC"). The loan is backed by the former Agency's purchase of Housing Authority of the City of Fresno Multifamily Housing Revenue Bonds ("Fresno Bonds"). The loan had an outstanding balance of $376,732 as of June 30, 2018. The loan is payable annually from residual receipts.

The second amendment to the DDA notes that, "within thirty (30) days of the conclusion of the 20th year following the Occupancy Date, the Agency shall execute and deliver to Redeveloper certification that Redeveloper shall possess no further obligation to repay the Agency loans provided for in this section." The Occupancy Date is defined as the date a Certificate of Occupancy or Certificate of Completion is received, whichever first occurs. The Certificate of Completion is dated July 8, 1999. As a result, the last payment is expected on or slightly before July 8, 2019, after which the City will need to deliver the certification described above to AHDC. The City will need to ensure that the former Agency's portion of the Fresno Bonds are retired.

Merced Pacific Associates (Woodbridge Place Apartments): This property has four outstanding loans due to the Housing Successor and payable annually from residual receipts. The outstanding balance due to the Housing Successor as of June 30, 2018 was approximately $7.4 million. All loans were issued under a single Disposition and Development Agreement ("DDA"); two additional loans were issued under the DDA using HOME and Neighborhood Stabilization Program funds that are due back to the City but not the Housing Successor. There is no forgiveness clause in the DDA.[2]

Residual receipts payments from the Sierra Meadows Apartments and Woodbridge Place Apartments vary each year based on available net operating income. Total payments owed for the past three years have ranged between $96,000 to $147,000 annually for both properties combined. RSG reviewed residual receipts calculations made by Merced Senior Investors and Merced Pacific Associates from 2015 through 2017 and determined that a difference of $9,462 is owed by Merced Seniors Investors for these years, as detailed in the following discussion.

Sierra Meadows Apartments

The Sierra Meadows Apartments DDA, dated April 5, 1994 and amended several times in 1997, issued a loan from the Former Agency for $1,334,346. The loan, as amended, accrues annual simple interest at 6% and provides for the Housing Successor to receive 65% of "net cash flow" (income minus eligible expenses) as payment on the loan.

RSG reviewed audited financial statements to verify developer payments made in 2015, 2016, and 2017, and found that a total difference of $9,462 is owed to the Housing Successor as in Table 2.

[2] DOF denied the transfer of the Merced Pacific Associate loans to the Housing Successor during its review of a Housing Asset Transfer Form in 2012 because the Former Agency was not party to the loan agreements. The loan documents are between Merced Pacific Associates and the City of Merced Public Financing and Economic Development Authority ("PFEDA"). However the City accounts for these loans in the Housing Asset Fund because they were issued under a Disposition and Development Agreement by the Former Agency. Housing Successor staff is conducting further research into whether these loans receivable should be accounted for in a different fund. The loan repayments would still be made to the City and available for affordable housing but would not be subject to Housing Asset Fund restrictions imposed by Senate Bill 341 and related legislation.

Table 2. Sierra Meadows Residual Receipts Reconciliation

	2015	2016	2017	Total
Payment Made	110,785	139,102	73,375[3]	323,262
RSG Calculation	122,827	117,022	92,875	332,724
Difference	*$ 12,042*	*$ (22,080)*	*$ 19,500*	*$ 9,462*

Source: RSG calculations based on property's Audited Financial Statements

The developer's payment calculations differ because they include non-qualifying expenses including an Asset Management Fee and a Managing General Partner ("MGP") Fee. Other fees are subtracted, but then adjusted in the net cash flow calculation. AHDC explained that it takes this approach, because it calculates the net cash flow on a cash basis.

City staff, RSG, and AHDC staff met on March 18, 2019 to discuss the status of the loan. AHDC verbally agreed to pay the City the 3-year difference shown in Table 2 and to exclude the Asset Management Fee and the MGP Fee in its last payment. RSG and the City are in the process of confirming this agreement with AHDC in writing.

Woodbridge Apartments

The Woodbridge Apartments DDA, dated March 7, 2011, issued six loans totaling $10,446,000. Each loan is repaid from residual receipts in the following order: (1) Agency Construction Loan, (2) Agency Participation Loan #1, (3) Agency Participation Loan #2, (4) Energy Efficiency Loan, (5) HOME Loan, and (6) Neighborhood Stabilization Funds Loan. There are currently five outstanding loans, as the Agency Construction Loan required interest-only payments until completion of construction. The remaining balance was converted to the Agency Participation Loans. The loans accrue annual simple interest at different rates ranging from 2.5% - 5.95%. The DDA provides for the Housing Successor to receive 50% of annual residual receipts until the loans are repaid. RSG reviewed audited financial statements for 2015, 2016, and 2017 to determine if any payments are owed to the Housing Successor for these years. The Deferred Developer Fee was a qualifying expense that required several years for repayment. After repaying the Deferred Developer Fee in 2016, the developer made one payment of $52,505 to the City. This exceeds RSG's calculation of $36,356 owed for the complete 3-year period. The difference in calculations, shown in Table 3, results primarily from how the deferred developer fee is applied.

Table 3. Woodbridge Residual Receipts Reconciliation

	2015	2016	2017	Total
Payment Made	-	-	52,505	52,505
RSG Calculation	3,339	29,713	3,304	36,356
Difference	*$ 3,339*	*$ 29,713*	*-$ 49,201*	*-$ 16,149*

Source: RSG calculations based on property's Audited Financial Statements

The developer used the net cash flow calculation to determine the maximum deferred developer fee, made in the next year. RSG subtracted the deferred developer fee based on the year in which the payment was made. RSG received the developer's calculations on March 8, 2019 and is in the process of identifying other reasons for the difference in calculations.

[3] At the time this report was written, the Housing Successor only received $32,848 from the trustee for the 2017 payment. RSG is researching when the remaining balance will be distributed to the Housing Successor.

The difference in the Sierra Meadows calculations has been resolved. RSG continues to coordinate with the Woodbridge developer to understand their calculations better. RSG may revise its Woodbridge calculations, which could lead to the identification of items needing reconciliation.

Homeowner Loans

The Housing Successor administers 13 outstanding homeowner loans issued by the Former Agency for first-time homebuyer and rehabilitation programs. Appendix B contains details on each loan. The outstanding balance as of June 30, 2018, was approximately $513,000. Although most loans require monthly payments, many loan holders are unable to make regular payments. Over half of the loans (7 out of 13) are forgivable at the City's discretion or upon sale. The City does not intend to forgive loans and collects payments based on loan holders' ability to pay. RSG estimates annual home owner loans repayments could net approximately $15,000 in annual revenues in the short-term, decreasing as loans are paid off. This is based on the aggregate sum of revenues received over the past two years for each loan, the monthly payments owed, and outstanding loan balances. Actual repayments will vary based on borrower ability to pay and loan payoffs.

SUMMARY OF AVAILABLE ASSETS

The Housing Successor has over $1.4 million in Housing Asset Funds available, and could have roughly $1.6 million by the end of this fiscal year. The Housing Successor is designating $1.2 million for the proposed Childs Court Apartments. Remaining funds of approximately $400,000 and future revenues may be designated for other projects. Annual revenues have ranged between $141,000 and $586,000 over the last five years. Revenues are primarily from loan repayments, which vary each year based on loan terms and borrower ability to pay. Loan repayments are generally estimated to be less than $200,000 per year in the future and will decrease as loans are paid off. This is based on a rough estimate of loan repayments that could be received in Fiscal Year 2018-19 from residual receipts ($151,000 for both Sierra Meadows and Woodbridge), the Central Valley Coalition for Affordable Housing ($9,321), and homeowner loans ($15,000). Please note that actual revenues will vary depending on net operating revenues and borrower ability to pay.

The Housing Successor also has nine vacant properties that can be sold or developed with affordable housing. If any properties are sold, the proceeds must be deposited into the Housing Asset Fund to spend as required by law.

The following section describes Housing Asset Fund requirements that limit how Housing Asset Funds may be spent.

HOUSING ASSET FUND REQUIREMENTS

The City must consider legal requirements when deciding how to spend Housing Asset Funds. To date, Merced had only spent Housing Asset Funds on administrative and monitoring expenses within its annual allowance.

PROJECT-RELATED EXPENSES

If Housing Asset Funds are used to assist projects,[4] they:

- Must be spent to improve housing options affordable to households at or below 80% of the Area Median Income ("AMI"). Housing Asset Funds may not assist moderate income households.

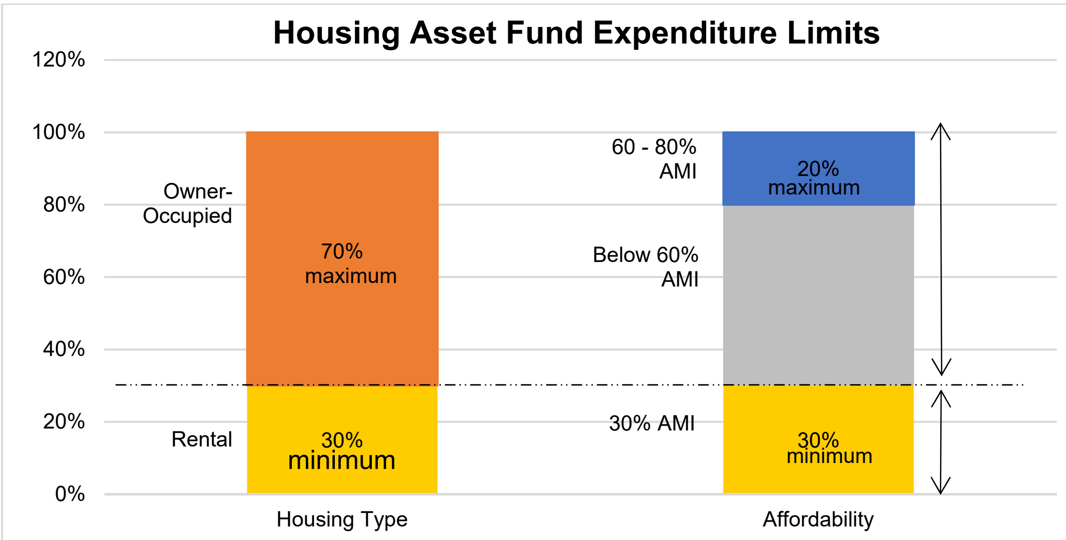
- Within every five-year compliance period (the first cycle is January 1, 2014 to June 30, 2019):

- At least 30% must be spent on rental housing for extremely low-income households (up to 30% AMI).

[4] Projects are any affordable housing activities that are not administrative or related to compliance monitoring.

- No more than 20% may be spent on the development of housing affordable to low-income households (60-80% AMI)

- May be spent on assisting deed-restricted senior rental housing, only if in the prior 10 years no more than 50% of the deed-restricted rental units assisted by the Former Agency, Housing Successor, or City, are restricted to seniors. No senior units have been assisted by Merced in the previous 10 years.



It is important to note that a development agreement could be drafted to commit Housing Asset Funds to subsidize a specific income level(s). For example, if the Housing Successor assisted a 10-unit project with only two extremely low income rental units, Housing Asset Funds could be dedicated to only subsidizing the extremely low income units. The financial structure would need to be reasonable based on the amount of gap financing required to subsidize the dedicated units and the amount of Housing Asset Funds committed in relation to the total project cost.

If Housing Asset Funds are used to assist a project, the City should require regulatory agreements to legally restrict units by income-level and age, for a period of 55 years for rental housing and 45 years for ownership housing.

The Housing Successor may spend an additional $250,000 per year on homeless prevention and rapid rehousing services[5] if the former redevelopment agency did not have any remaining inclusionary or replacement housing production requirements. Further research is required on the Former Agency's replacement and inclusionary housing obligations to determine if Merced is eligible for this expense.

ADMINISTRATION & COMPLIANCE MONITORING CAP

Housing Asset Funds may also be spent on administrative and compliance monitoring expenses, which are capped at $200,000 per year (adjusted annually for inflation) or 5% of the value of land and loans receivable. Merced's annual allowance for Fiscal Year 2017-18 was $455,122.

[5] Includes services for individuals and families who are homeless or would be homeless but for the Agency's assistance, such as the provision of short-term or medium-term rental assistance or housing relocation and stabilization services.

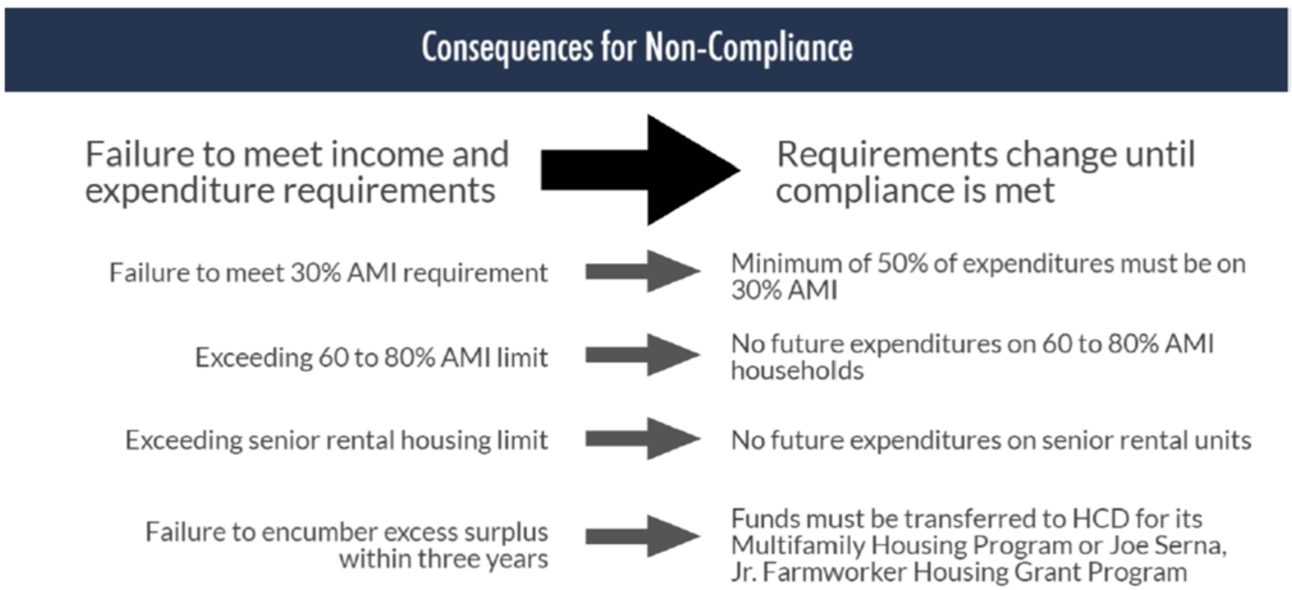
EXCESS SURPLUS

The Housing Asset Fund must be spent so it does not accumulate an excess surplus, defined as an unencumbered amount exceeding the greater of $1 million or the aggregate amount deposited into the account during the preceding four fiscal years. If the Housing Successor has an excess surplus, it must be spent or encumbered within three fiscal years or remitted to HCD for statewide expenditures on the Multifamily Housing Program or the Joe Serna, Jr. Farmworker Housing Grant Program. The intent is to prevent agencies from accumulating Housing Asset Funds without spending them.

Based on the Housing Asset Fund's balance as of June 30, 2018, Merced has an excess surplus of $359,163. However, an excess surplus is not anticipated after Merced encumbers $1.2 million to the Childs Court Apartments.

CONSEQUENCES FOR NON-COMPLIANCE

The following chart summarizes consequences for non-compliance with various requirements. Essentially, Housing Asset Fund expenditures will be limited to spending on the required categories until in compliance.



SPENDING IN NEIGHBORING JURISDICTIONS

Another option Merced could consider in the future is partnering with neighboring jurisdictions to fund affordable housing. State Law permits two or more housing successors within neighboring jurisdictions, or within 15 miles of each other in a single metropolitan statistical area and county, to enter into an agreement to transfer Housing Asset Funds to develop transit priority projects, permanent supportive housing, housing for agricultural employees, or special needs housing.[6] The transferred funds may only assist rental units affordable to households earning 60% AMI or less. Credits for affordable unit production (including those applied to RHNA allocations) would need to be negotiated in the agreement based on the amount of assistance provided by each jurisdiction.

The following conditions must be met:

[6] See Health & Safety Code Section 34176.1(c)(2) for more specific details about eligible projects.

- The transfer of funds may not cause or exacerbate racial, ethnic, or economic segregation (an official finding must be made in a public hearing based on substantial evidence);

- The development must not be in a census tract where more than 50% of the population is very low income, unless it is within half a mile of a major transit stop/corridor;

- The development must not reduce the number of housing units or reduce affordability of housing units on the development site;

- The transferring housing successor shall not have any outstanding inclusionary housing production obligations that were unfulfilled by the former redevelopment agency;[7] and

- The jurisdictions must have an approved Housing Element and be up to date on required annual progress reports.

Up to $1 million may be transferred per fiscal year. Transferred funds not encumbered within two years shall be transferred to HCD for expenditure on the Multifamily Housing Program or the Joe Serna, Jr. Farmworker Housing Grant Program.

SUMMARY OF REQUIREMENTS

The most important requirements to remember are:

- Any project-related expense will trigger a requirement to spend 30% of Housing Asset Funds on extremely low income rental housing each five-year compliance period;

- Housing Asset Funds may not assist moderate income households; and

- Up to 50% of rental units may be restricted to seniors within a ten-year period.

The following section identifies the City's needs and priorities based on an analysis of the City's demographics, housing market affordability, Housing Element goals, and discussions with City staff.

CITY HOUSING NEEDS & PRIORITIES

Merced is the largest City in Merced County with a population of 86,750.[8] Home to the University of California Merced, the City has experienced fast-paced growth and is facing a housing shortage for residents across all income groups. The City's current Housing Element identifies six goals based on an assessment of the City's background, demographics, history, and housing stock. The goals center around increasing affordable and fair housing opportunities for Merced's residents through new construction, rehabilitation, financial assistance programs, and coordinating innovative efforts with public and private partners. Student and migrant farmworker housing are particular concerns. City staff would like to leverage the Housing Successor Agency's assets to address the community's housing needs, particularly for multifamily rental housing.

MERCED HOUSING PRODUCTION REQUIREMENTS (RHNA)

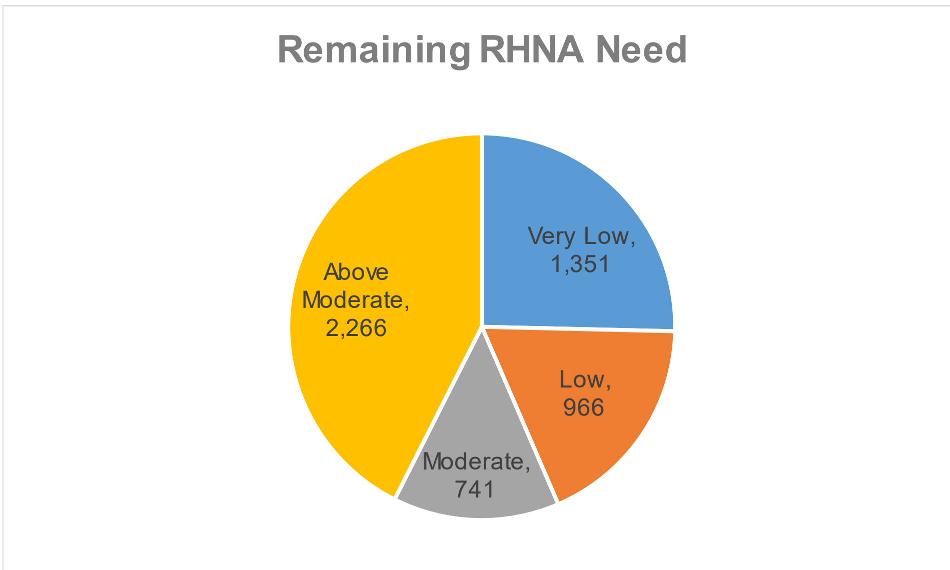
Every city in California is assigned a housing unit production target by the State called the Regional Housing Needs Allocation ("RHNA"). It is designed to ensure that cities are encouraging housing production to meet their population's needs by income level. Merced's share for 2015-2023 is 5,551 units, of which 3,203 should be affordable to very low to moderate income households (see Table 4). As of 2018, Merced has a remaining RHNA need of 1,351 very low, 966 low, 741 moderate, and 2,266 above moderate income units.

[7] Merced does not have any outstanding inclusionary housing production obligations.
[8] California Department of Finance Population Estimates, 2018

Table 4. Merced RHNA Allocation Progress (2015-2023)

Income Level	2018 Limit (4-Person HH)	Unit Allocation	Permits Issued 2015-2017	Remaining RHNA Need
Very Low	$29,950	1,351	0	1,351
Low	$47,900	966	0	966
Moderate	$71,900	886	145	741
Above Moderate	n/a	2,348	82	2,266
Total		*5,551*	*227*	*5,324*

Source: City of Merced Housing Element and 2017 Annual Progress Report



Staff would like to maximize the number of units developed on each Housing Successor site to meet its RHNA allocation and address the City's housing shortage.

New Legislative Requirements

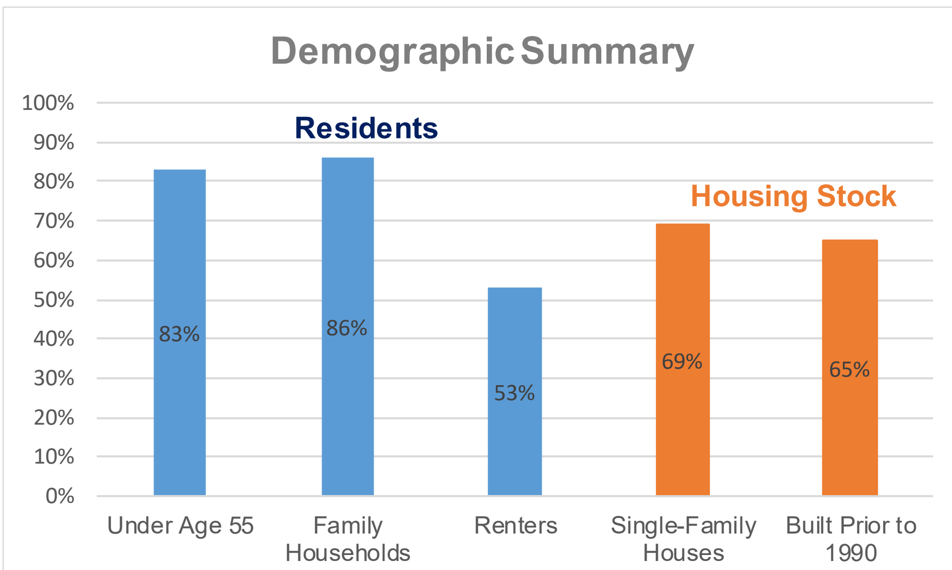
The State Legislature passed a Legislative Housing Package in 2017 that puts new weight on meeting RHNA requirements. Assembly Bill ("AB") 879 and Senate Bill ("SB") 35 placed increased importance on meeting RHNA need and filing Annual Progress Reports tracking housing production. Cities that do not meet their RHNA need or file annual reports can lose local control over affordable multifamily housing development entitlements to a new streamlined ministerial process overseen by the State. According to a SB 35 Statewide Determination Summary published by the California Department of Housing and Community Development ("HCD") in January 2018, developers that propose a multifamily project in Merced with at least 10 percent affordable units are eligible to apply for entitlements through SB 35 instead of the City. This will be the case in Merced until its low to moderate income RHNA need is met.

SB 166 also enacted a "no net loss" requirement to encourage housing production. If a city approves a development on a site identified to accommodate RHNA need in the Housing Element at a lower density or different income level than identified, the city needs to make a written finding that the need can still be met by other sites identified in the housing element, or "identify and make available" other sites to accommodate the need within 180 days. SB 1333, enrolled in September 2018, recently clarified that charter cities such as Merced are subject to these provisions.

Merced's Housing Element identified seven sites owned by the Housing Successor (Sites 1-5, 7, and 8) that could accommodate 17 units to meet RHNA need. Table 6 details the number of units per site later in this report. The City must consider No Net Loss provisions when deciding how to develop or dispose of each site. If fewer affordable units are constructed than identified in the Housing Element, the City must designate a different site to make up for the lost units or make a finding that other sites identified to meet RHNA need can absorb the difference.

DEMOGRAPHICS & AFFORDABILITY

Most Merced's residents are under 55 (83%), with a median age of 28. Although Merced has a large student population, the majority of residents are in family households (86%). While over half (53%) of residents are renters, the majority of Merced's housing stock (69%) are single-family homes. A large portion of the City's housing stock was built prior to 1990 (65%).[9] These demographics point to a need for more multifamily rental housing with two or more bedrooms per unit to house family households.



Source: ESRI Business Analyst Online projections based on 2010 U.S. Census

Housing affordability is defined by the U.S. Department of Housing and Urban Development ("HUD") as spending no more than 30 percent of household income on housing costs. A household that spends more than 30 percent is considered burdened, and leads to issues such as overcrowding, long commutes, and less discretionary spending to support the local economy. Table 5 displays the number of Merced households by income range and supportable monthly housing costs. A household needs to make approximately $51,000 annually to afford the average rent in Merced or $67,000 to purchase a home at the median list price. Based on 2018 median household incomes, less than half (44%) of Merced households can afford average rents, and roughly one-third (36%) can afford homeownership. This suggests that many residents need assistance to afford rental housing and obtain homeownership.

[9] Demographics from ESRI Business Analyst Online projections based on United States Census

Table 5. Supportable Monthly Housing Costs for Merced Residents (2018)

	Income Range	# Households	% Households	Cost @ 30% of HH Income
	$0-$15,000	4,518	17%	$0-$375
	$15,000 - $24,999	3,388	13%	$375-$625
	$25,000-$34,999	3,182	12%	$625-$875
	$35,000-$49,999	3,432	13%	$875-$1,250
	$50,000-$74,999	4,081	16%	$1,250-$1,875
	$75,000-$99,999	2,682	10%	$1,875-$2,500
	$100,000-$149,000	2,889	11%	$2,500-$3,750
	$150,000-$199,000	1,024	4%	$3,750-$5,000
	$200,000+	896	3%	$5,000+
		26,092	**100%**	

Affordability Analysis (June 2018)

Ownership	
Median List Price	$279,900
Estimated Monthly Mortgage[1]	$1,652
Income Needed @ 30% Income to Housing Cost	$66,080
Approximate % Households That Can Afford Homeownership	**36%**
Rental	
Average Rent	$1,284
Income Needed @ 30% Income to Housing Cost	$51,360
Approximate % Households That Can Afford Average Rent	**44%**

[1]Assumes 10% down payment with a 30-year fixed mortgage at 4.3% interest. Includes principal & interest, taxes, insurance, and PMI.

Source: ESRI Business Analyst projections based on 2010 U.S. Census, Zillow.com

SUMMARY OF HOUSING NEEDS & PRIORITIES

Merced has a need for new housing units at all income levels, however affordable housing is a particular concern as more than half (56%) of the City's households are housing cost burdened. Although over half (53%) of residents are renters, the majority of Merced's housing stock (69%) are single-family homes. Focusing Housing Successor efforts on increasing the supply of affordable rental housing would address the affordable housing shortage, meet RHNA need, achieve Housing Element Goals related to housing construction and affordability, align with staff goals, and meet Housing Asset Fund expenditure requirements.

PROPERTY DISPOSITION & EXPENDITURE OPTIONS

This section makes Housing Asset Fund property disposition and expenditure recommendations based on RSG's evaluation of the Housing Successor's available assets, legal requirements, and City needs.

PROPERTY DISPOSITION OPTIONS

Merced owns nine Housing Successor properties transferred from the Former Agency, plus one pending transfer, that are all residentially zoned and located near the downtown core. State law requires the Housing Successor to initiate affordable housing development on or sell Housing Successor properties by February 25, 2023. Former Agency properties are not subject to the Surplus Land Act; they have their own development and disposition requirements pursuant to the Dissolution Act. If the properties are sold, sales proceeds must be deposited into the Housing Asset Fund for use on eligible expenses pursuant to HSC 34176.1 and 33334.16.

RSG recommends confirming with legal counsel if Housing Successor land is subject to the same income and age proportionality requirements as Housing Asset Funds. For example, if a property is donated to be developed with affordable housing without any Housing Asset Fund financial assistance, the property may not need to have extremely low income rental units. Attorneys have different opinions on this issue, however in RSG's experience they have generally found that land itself is not subject to income and age requirements.

RSG reviewed the location and high-level development feasibility factors of each Housing Successor property. Additionally, City staff prepared a Project Charter considering the potential use of the nine properties formally transferred to the Housing Successor (it did not include Site 10 pending transfer). RSG took this into consideration when making its recommendations for property disposition options.

The Project Charter, as summarized in Table 6, details disposition and development options for each property. In general, the options are to:

1) Sell the properties and deposit sales proceeds into the Housing Asset Fund for future affordable housing projects (*All Sites*);

2) Partner with a non-profit(s) to develop affordable housing units (*All Sites*); or

3) Combine sites for scattered site development by entering into an Exclusive Negotiating Agreement with a local Community Housing Development Organization ("CHDO") to design and develop 40-50 units (*Sites 1-7*).

Table 6. Housing Successor Property Disposition Charter

#	Address	Lot S.F.	No Net Loss Units	Use Considered by City
1	1823 I Street	2,100	1	Sites 1-5 are considered one large site to combine and sell, or to partner with a developer to construct a multifamily project (25 units).
2	1815 I Street	2,400	1	
3	205 W. 18th Street	3,000	1	
4	211 W. 18th Street	7,500	3	
5	202 W. 19th Street	7,500	3	
6	1744 I Street	5,000	0	Construct up to two units, or combine with Sites 1-5 and 7 for scattered site development (40-50 units).
7	49 W. 18th Street	10,800	5	Construct up to seven units, or combine with Sites 1-6 for scattered site development (40-50 units).
8	150 W. 19th Street	7,500	3	Construct one unit, or swap with CVCAH for a site adjacent to Site 5 and pursue scattered site development.
9	73 South R Street	20,416	0	Construct up to three units, or sell to City to construct a youth facility or expand a neighboring park.

It appears that Sites 1-8 have the greatest potential for affordable housing development and could accommodate up to 40-50 units. However, this would be a scattered site development which has some potential drawbacks. Affordable housing developers each have their own basic thresholds for projects, and the number of units a project yields has significant importance. Sites 1-8 include both contiguous and non-contiguous parcels totaling 1.05 acres. Most institutional developers have a minimum threshold of a one to two contiguous acres or a project that will result in 50 or more units. Requirements vary from developer to developer as they each have their own business plan. Unfortunately, only about a third of the total site consists of contiguous parcels. The scattered parcels and the limited amount of contiguous space may curb the interest from the development community.

Although not very popular in the development community, a scattered site project is an option. If an affordable housing scenario is pursued, TCAC allows a scattered site project if it meets certain requirements, such as the proximity of the parcels. From a building stand point, developers would prefer contiguous parcels and not every developer will want to pursue a scattered site scenario. RSG can see a scattered site scenario gaining the most interest from the developer community if the Housing Successor provides the gap financing and the developer doesn't have to compete for financing sources with other developers. RSG suggests that the Housing Successor issue a Request for Proposals to solicit developer proposals to develop Sites 1-8.

The Project Charter states that Site 8 (150 W. 19th St.) includes an additional option to swap the site for a property owned by the Central Valley Coalition for Affordable Housing at 210 W. 19th St ("CVCAH Site"), which is adjacent to Site 5 (202 W. 19th St.). CVCAH would relocate a house from its current site to Site 8. Then, the CVCAH Site could be transferred to the City merged with Site 5 (202 W. 19th Street), and potentially with Sites 1-7 for scattered site development as described above. If developers are not interested in Site 8 for scattered site development, RSG suggests that the Housing Successor consider selling this property to generate revenue that can be invested into other affordable housing development.

The Project Charter states that Site 9 (73 South R St.) has two alternatives to being sold or developed as housing. It could be sold to the City for the development of a youth facility or expansion of a neighboring park. A youth facility, however, would require the City to acquire an adjacent parcel and the cost of land assembly could be prohibitive. RSG believes that this site is too small to attract a developer or be financially feasible. The Housing Successor should consider selling this property to the City and reinvesting the funds into the scattered sites project.

Site 10 located at 26 W. 18th Street was not included in the Project Charter because its transfer to the Housing Successor is pending formal approval by the DLA, Oversight Board, and DOF. Housing Successor staff is discussing this action with DLA staff. If Site 10 is approved for transfer, RSG recommends offering Site 10 for scattered site development along with Sites 1-8. If developers are not interested in scattered site development, the property may be sold so the sales proceeds can fund other affordable housing efforts.

The City's Housing Element designated Sites 1-5, 7, and 8 to accommodate RHNA need with 17 units total. As mentioned earlier, the City must consider No Net Loss provisions when deciding how to develop or dispose of each site. If fewer affordable units are constructed than identified in the Housing Element, the City must designate a different site to make up for the lost units or make a finding that other sites identified in the Housing Element to meet RHNA need can absorb the difference.

EXPENDITURE OPTIONS

Affordable housing development program options generally include, but are not limited to, new construction, substantial or minor rehabilitation, homebuyer assistance, rental subsidy, land banking, rehabilitation financing, and purchase of affordable housing covenants. While Merced has a need to increase housing stock for all income levels, there is a particular need to provide more affordable rental housing. RSG recommends applying Housing Successor Funds and contributing land to subsidize new construction of affordable rental housing. Partnering with affordable housing developers will leverage Housing Asset Funds with other funding sources to maximize the number of affordable units that can be constructed. It will also fulfill legal requirements to assist extremely low income rental housing with Housing Asset Funds. Merced has already designated $1.2 million of its Housing Asset Fund balance to the proposed Childs Court Apartments.

As of June 30, 2018, the Housing Asset Fund had a cash balance of $1,480,788. The balance is projected to be roughly $1.6 million by the end of the current fiscal year. To estimate how many units the Housing Successor could fund, RSG calculated an estimated per unit subsidy gap for new construction of rental and ownership housing. Table 7 on the following page shows the estimated amount of gap financing required is $160,000 to $250,000 for constructing affordable ownership units and $130,000 to $220,000 for constructing affordable rental units. If the Childs Court Apartments are not able to move forward, the Housing Successor's $1.2 million could be used to help fund an estimated 5-9 ownership units or 6-11 rental units depending on level of affordability.

A scattered site development with 40-50 units would require other gap financing sources such as County, State or Federal subsidies, or a donation of Housing Successor properties, especially considering that $1.2 million of Housing Asset Funds have already been designated for the Childs Court Apartments. Partnering with developers that can draw from other funding sources is required to meet the City's goals. Appendix C lists other gap financing funding sources that a developer could pursue.

Please note this is a high-level financial analysis based on market conditions and a review of recent TCAC projects in the Central Valley. A more detailed financial analysis can be completed upon request of the City Council. The purpose of the assessment is to provide a cursory review of program options to assist the City in evaluating the potential impacts of its housing policy decisions.

Table 7. Subsidy Gap for New Construction

Program Opportunity	Per Unit Subsidy Gap (Extremely Low to Low)	Advantages	Disadvantages
New Construction Assistance- Ownership: Encourage developers to include affordable ownership units by providing gap financing in the form of money or land.	\$160,000 to \$250,000	• Creates more housing units • Encourages development in Merced • 45-year affordability covenant • Assistance can be in the form of a loan • Incentivizes home ownership	• Strict resale requirements requiring oversight • Large financial investment • Increased density • Does not satisfy 30% AMI rental expenditure requirement
New Construction Assistance - Rental: Encourage developers to include affordable rental units in rental developments by providing gap financing in the form of money or land.	\$130,000 to \$220,000	• Creates more rental units • Encourages development in Merced • Availability to leverage funds with other sources • Typically, a greater demand for affordable rental units than ownership • 55-year affordability covenant	• Concentrates affordable housing units if 100% affordable • Long process to assemble land and develop • Increased density

SUMMARY & RECOMMENDATIONS

Merced's $1.4 million in Housing Asset Funds will be best utilized when leveraged with other funding sources by developer partners to construct affordable multifamily rental housing. The Housing Successor has designated $1.2 million of Housing Asset Funds for the proposed Childs Court Apartments. Remaining funds are available to assist other affordable housing efforts. RSG recommends approaching local affordable housing developers to gauge their interest in pursuing scattered site development on Sites 1-8. The land could be donated or sold for a low price in exchange for a lien on the property and combined with available Housing Asset Funds to help subsidize affordability. If developers are not interested in scattered site development but are interested in combing Sites 1-5 to build one contiguous development, Sites 6-8 should be sold so the sales proceeds can assist other affordable housing activities. RSG recommends selling Site 9 due to its limited size (the City's Project Charter estimated that three units could be built on this property with current zoning), and to increase the amount of funding available to subsidize affordable housing development on Sites 1-8 or other Housing Successor projects. Table 8 summarizes RSG's property disposition recommendations. The Housing Successor must initiate development on or sell these sites by February 25, 2023.

Table 8. Property Disposition Recommendations

#	Address	Lot S.F.	No Net Loss Units	Recommended Strategy
1	1823 I Street	2,100	1	Apply available Housing Asset Fund balance to subsidize construction of multifamily rental housing on these sites. Approach developers to measure interest in scattered site development on Sites 1-8. If scattered site development is not feasible, pursue a smaller development on Sites 1-5. If developers are not interested in developing Site 5 because it is across the street, consider selling Site 5 to increase funds available to subsidize a smaller development on contiguous Sites 1-4.
2	1815 I Street	2,400	1	
3	205 W. 18th Street	3,000	1	
4	211 W. 18th Street	7,500	3	
5	202 W. 19th Street	7,500	3	
6	1744 I Street	5,000	0	Combine with Sites 1-5, 7, and 8 to pursue scattered site development (40-50 units). Sell if scattered site development in not feasible.
7	49 W. 18th Street	10,800	5	Combine with Sites 1-6 and 8 to pursue scattered site development (40-50 units). Sell if scattered site development in not feasible.
8	150 W. 19th Street	7,500	3	Combined with Sites 1-7 to pursue scattered site development. Sell to increase amount of Housing Asset Funds available to entice developers to pursue scattered site development.
9	73 South R Street	20,416	0	Sell to increase amount of Housing Asset Funds available to entice developers to pursue scattered site development.
10	26 W. 18th Street *(pending formal approval of transfer)*	7,500	0	If the Oversight Board and DOF formally approve the transfer of this property to the Housing Successor, it could be packaged with Sites 1-8 to offer for scattered site development or sold.

Any financial assistance[10] provided from the Housing Asset Fund must meet income proportionality requirements within each five-year compliance period (currently January 1, 2014 through June 30, 2019):

- At least 30% spent on extremely low income (30% AMI) rental housing;
- No more than 20% spent on low income (60-80% AMI) housing; and
- May not assist moderate income households.

In addition, no more than 50% of deed-restricted rental units assisted by the Former Agency, Housing Successor, or City may be restricted to seniors in the prior ten years. Development agreements can be drafted to commit Housing Asset Funds to subsidize units at specific income levels if reasonable based on the overall

[10] Legal counsel should be consulted to confirm if Housing Successor land is also be subject to income and age proportionality requirements.

project cost and financing. It is important to spend as many Housing Asset Funds as possible within the next three years to avoid giving up excess surplus to HCD.

Merced has a strong need for affordable housing. More than half the City's households are housing cost burdened. Although over half of the City's residents are renters, most of Merced's housing stock are single-family homes. Focusing Housing Successor efforts on increasing the City's supply of affordable rental housing would address Merced's affordable housing shortage, fulfill remaining RHNA need, achieve Housing Element and staff goals, and meet Housing Asset Fund expenditure requirements.

APPENDIX A: PROPERTY MAPS


Merced Housing Properties
Write a description for your map.
Legend
Properties
W Childs Ave
West Ave
R St
Q St
Fig Ave
Woodward Ave
9
Home Ave
S West Ave
S T St
South S Street
S R St
Parkwest St
McGregor St
Windsor Ave
Google Earth
© 2018 Google
700 ft
N

APPENDIX B. DEVELOPER AND HOMEOWNER LOAN DETAILS

Appendix B-1. Developer Loans

Borrower	Property	Principal	Interest Rate	Agreement Date	Term Ends	Repayment Terms	Forgiveness Clause	Balance as of 7/1/18
Central Valley Coalition	214 W. 19th Street	$80,000	5.0%	5/28/1998	Until paid off	Fixed monthly payment	None	$4,156
Central Valley Coalition	161 W. 18th Street	$65,000	5.0%	5/21/2001	20 years after home is built	Fixed monthly payment[1]	None	$31,251
Merced Lofts LLC	500 Block of Main St	$1,298,250	n/a	6/29/2004	Ended upon property sale in 2018	Annual Residual Receipts	Loan cancelled upon property sale; balance due pursuant to negotiated settlement	$150,000
Merced Senior Investors	Sierra Meadows	$1,334,346	6.0%	5/2/1994	7/8/2019	Annual Residual Receipts	No obligation to repay 20 years from Occupancy Date	$376,732
Merced Pacific Associates[1]	Woodbridge Place	$6,146,000				Annual Residual Receipts, each loan repaid in order of priority based on available Net Cash Flow	None	$7,406,860
Participation Loan A		*$800,000*	*2.5%*	*9/8/2011*	*9/8/2041*			*$880,000*
Participation Loan B		*$4,888,500*	*5.95%*	*9/8/2011*	*9/8/2051*			*$6,051,963*
Energy Efficiency (DOE)		*$157,500*	*5.95%*	*9/8/2011*	*9/8/2051*			*$197,328*
Construction Loan of $3,000,000 converted to Participation Loan B.		*$3,000,000*	*5.95%*	*9/8/2011*	*9/8/2051*	Construction Loan accrued Interest from 11/01/11 – 05/17/13		*$277,570*
TOTAL		**$8,923,596**						**$7,968,998**

[1]DOF denied the transfer of the Merced Pacific Associate loans to the Housing Successor because the Former Agency was not party to the loan agreements, however the City accounts for these loans in the Housing Asset Fund because they were issued under a Disposition and Development Agreement by the Former Agency. Housing Successor staff is conducting further research into whether these loans receivable should be accounted for in a different fund and not be subject to the requirements imposed by SB 341 and related legislation.

Appendix B-2. Homeowner Loans

Borrower	Principal	Interest Rate	Agreement Date	Term Ends	Repayment Terms	Forgiveness Clause	Balance as of 7/1/18
Hanson, D. & I.	$29,000	5%	4/1/1997	Until Paid Off	Monthly	None	$58,423
	$68,920	5%	6/19/1997	Until Paid Off	Monthly	None	*Combined w/ above*
Ferrel, R.	$71,028	5%	9/19/1997	2/1/2023	Monthly	City Discretion	$45,278
Herrera, F. & E.	$8,385	4%	5/21/1998	5/21/2018	Monthly	None	$62
Cruz, S.	$8,196	5%	1/26/1999	1/26/2019	Monthly	Partially if sold	$212
Rodriguez, H. & L.	$59,416	5%	8/9/1999	2/1/2024	Monthly	City Discretion	$86,648
Vaughn, F. (H.W.)	$39,926	5%	1/26/2000	6/1/2025	Monthly	City Discretion	$15,784
Garza, O.	$135,846	5%	8/14/2000	1/1/2034	Monthly	City Discretion	$125,959
Zamora, L.	$24,233	5%	9/13/2000	1/1/2026	Monthly	City Discretion	$22,423
Lee, J.	$99,885	0%	4/5/2002	Until Paid Off	50% due upon project completion, then monthly payments	None	$10,781
Garcia, S. & A.	$79,000	3%	10/5/2005	Until Paid Off	Monthly	None	$41,714
Garcia, S. & A.	$88,477	3%	10/5/2005	10/5/2025	Monthly	City Discretion	$88,477
Truong, H. & N.L.	$16,700	0%	8/18/2008	Until Paid Off	Full payment due at close of escrow or completion of development, whichever comes first	None	$16,700
TOTAL	**$729,011**						**$512,462**

APPENDIX C: GAP FINANCING FUNDING SOURCES

A typical affordable housing project stacks multiple funding sources to reduce its financing gap. The following table describes funding sources that may be available to developers to leverage the City's resources.

Funding Source	Description
Low & Moderate Income Housing Asset Fund	• The Housing Successor's Housing Asset Fund contains approximately $2.9 million. • These funds can be used to support affordable housing development, subject to the SB 341 expenditure limits. A minimum of 30% must go towards households earning 30% or less of the AMI, and a maximum of 20% may go towards households earning between 60% and 80% of the AMI. No expenditures on 81% AMI or above. • Options for affordable housing programs generally include, but are not limited to, new construction, substantial or minor rehabilitation, homebuyer assistance, rental subsidy, and purchase of affordable housing covenants and existing for-sale and rental units. • Can be used on rental and ownership units.
9% Tax Credits	• One of the more attractive financing resources is 9% federal tax credit financing that generally offers the most amount of capital to a housing project. Funds are awarded by the California Tax Credit Allocation Committee, allocated from private organizations' purchases of federal and state tax credits. • This financing source is competitive, and there are only two rounds a year, so there is risk that a project may not win these credits. Some developments apply for years and never win credits. These credits also require a deeper affordability which may or may not be the developer's preference. • In 2016 and 2017, two Riverside County projects received funding for 9% federal tax credits. Both projects are new construction, as opposed to acquisition and rehabilitation. • Can be used on rental units only.
4% Tax Credits	• Using tax exempt bonds, 4% tax credits are non-competitive and generally do not offer nearly the same level of subsidy as 9% tax credits. The tax credits are utilized for affordable housing projects; to help finance new construction and rehabilitate existing affordable housing. The source is typically combined with several gap financing resources, which would leverage the City's money. • One challenge is that, when combined with more restrictive funding like the Housing Asset Funds, where at least 30% must be expended on extremely low-income units, the affordability requirement is more restrictive than the typical 4% tax credit-financed project. (The typical 4% tax credit project designates 90% of the units at 60% of AMI and the remaining 10% of the units at 50% of AMI.) The City would not receive additional tax credit equity for including extremely low-income units and would need to fund the deeper affordability from its own funds. • Between 2016 and 2017, no projects in Riverside County received funding for 4% federal tax credits. • Can be used on rental units only.
Veterans Housing and Homeless Prevention Program (VHHP)	• VHHP is a funding source available to projects occupied by veterans. Projects are required to have at least 45% of assisted units available to Extremely Low-Income Veterans, with rents not exceeding 30% of the 30% Area Median Income (AMI) limit. Occupants are eligible veterans that are either individuals with disabilities or recently homeless. Supportive services are provided for issues such as drug addiction and mental illness. • A recently opened Project that was financed by VHHP funding is Mather Veterans Village located in Rancho Cordova. The Project is the first of three phases located at the former Mather Air Force Base. The floor plans include

	44 one-bedroom & six two-bedroom units, and the Project is fully occupied. The Department of Veterans Affairs covers clinical services including counseling and medical care. The Veterans Resource Center screens tenants, after which applications are submitted to the Developer. • Can be used on rental units only.
Affordable Housing and Sustainable Communities Program (AHSC)	• In recent years, the State's AHSC program has been a sought-after source for affordable housing financing but not all projects are eligible for this competitive program. • This source of funding is very complex. Half of the points are based on a development's Green House Gas (GHG) reduction. An applicant would need to hire an engineer that specializes in GHG reduction to calculate this. • Can be used on rental and ownership units.
Project Based Vouchers (PBV's)	• Section 8 PBV's subsidize rents for qualifying tenants. PBV's remain with the property as compared to tenant-based vouchers that remain with the tenant. • The PBV rent amount is based on comparable properties in the local market. Assistance will be the difference between 30% of the family's monthly-adjusted income and the lower of either the gross rent or the applicable payment standard. • Can be used on rental units only.
Mental Health Services Act (MHSA)	• The MHSA special needs housing program loan product was developed by the California Housing Finance Agency (CalHFA). CalHFA also administers the program providing underwriting, construction monitoring, and asset management services. • Developments must serve either (a) homeless or chronically homeless individuals with a mental illness, or (b) homeless or chronically homeless individuals with a mental illness and their families. Developments may not discriminate against or exclude individuals who have barriers to housing, including a history of poor credit, limited housing history, evictions, substance use, and criminal backgrounds. • Developments must serve Department of Mental Health MHSA-eligible consumers with incomes that are lower than 30% of the Area Median Income. (Tenants will pay 30% of their income toward the rent.) • Can be used on rental units only.