



MEMORANDUM

To: Molly Rattigan, Deputy County Executive Officer
Nancy Johnson, Housing and Community Development Program Manager
Sylva Darbinian, Deputy County Counsel

CC: Barbara Kautz, Counsel to County of Napa, Goldfarb and Lipman

From: Liz Tracey, Senior Principal, LeSar Development Consultants

Date: November 23, 2016

Re: Review of Turley Flats Loan Request for \$650,000

Project Background

The Turley Flats project is a proposed affordable housing development that has requested County of Napa (“County”) funds in the amount of \$650,000. Developer is Calistoga Affordable Housing (CAH). It has not yet been reviewed by the County Board of Supervisors or the County’s Housing Commission, and reflects a substantial increase in the original loan request to the County of \$140,000. The development intends to provide 8 apartment units affordable to low-income families earning 75% of area median income (“AMI”). The project site is on a 9,500 square foot lot at 1105 Pope Street in the City of St. Helena, in the County of Napa. Total development budget is \$3.1mm.

The project is currently structured with donated land by Larry Turley, a local vintner, cash and fee waiver financing from the City of St. Helena in the amount of \$640,000, in addition to \$1.4mm in debt financing. CAH intends to commence construction the Spring of 2017. The plans involve modular construction, with infrastructure and installation of the units at the site.

The County has requested that LeSar Development Consultants (LDC) review the updated development proforma in order to 1) assess the feasibility of the project given the proposed funding structure, and 2) analyze the risk profile of the transaction and the sponsor, given that this would be CAH’s first transaction with County of Napa, and CAH’s third project developed overall.

From CAH, we received an application package to the County of Napa from CAH dated October 11, 2016, containing:

- CAH’s internally prepared balance sheet as of August of 2016, articles of incorporation, evidence of 501(c)(3) status, and audit for its Lakewood project.
- Other items submitted as part of its application package to the County, including site plans, project location and description, construction bids, development budget and project proforma, funding commitments from the City of St Helena and First Community Bank, and a description of CAH’s experience and financial capacity.

Prospects for Calistoga Affordable Housing

LDC had the opportunity to speak about CAH with Nancy Johnson at the County, and with Larry Kromann, CAH's acting CEO. The organization is run by a volunteer board with one part time administrative assistant. Mr. Kromann plans to relocate to the Sacramento area for family reasons in the next year, but has stated that he intends to continue his oversight of CAH until it can locate a non profit developer that is willing to take over CAH's assets and liabilities. To date, no organization that has been approached by CAH has expressed interest.

Our findings from the analysis and discussions with CAH, along with our recommendation for the next steps are as follows:

A. Development Budget and Proforma

1. Sources

a) County of Napa Loan

The project proforma shows the County of Napa providing \$650,000 in funding for the proposed development.

b) City of St. Helena

The project proforma shows the City of St. Helena providing \$640,000 in total sources of funding for the proposed development, including a fee waiver for \$189,000, and cash subsidy for the remaining \$451,000.

c) Federal and State Sources

The development team investigated the potential for an investment through the Low Income Housing Tax Credit program, but discovered that at 8 units, the project was too small a size to make such an investment feasible. Similarly, the developer determined it was very unlikely to receive other funding from the State of California, particularly given the relatively modest affordability levels it is proposing.

d) Alternative Funding Sources

No alternative funding sources have been identified for the Turley Flats project.

2. Uses

a) Development Budget

The development budget has a construction contingency of 4.3% of hard costs, which is below the 5% standard for new construction projects. The submitted construction bid recommended a 15% hard cost contingency. In addition, there will be some coordination needed between the manufacturer of the modular units, HybirdBuilt, and the general contractor, Helmer and Sons. A project manager, Paul Coates, is being budgeted for \$35,000 to provide oversight to the construction.

The County of Napa should request a copy of any plan cost review prepared on behalf of the construction and permanent lender, First Community Bank. If such a plan and cost review is not available, Napa can require CAH to defer its \$60,000 developer fee until the project is complete, which can provide for a modest amount of cushion should there be cost overruns during construction.

Legal fees: \$5,000 is budgeted to pay for legal fees. The term sheet from First Community Bank stipulates that legal fees must be paid by borrower, and does not provide an estimate, but it is likely that their legal costs would exceed the budgeted amount. CAH reports that it does not intend to hire its own counsel to review bank loan documentation, or documents from the City of St. Helena and the County of Napa. Despite the lack of counsel on the borrower side, the project's legal fee is likely to be higher than the \$5,000 budgeted.

Currently approximately \$14,000 is set aside for soft cost contingency, which is less than a 5% of soft costs that is standard for projects of this type.

b) Operating Proforma

Operating Expenses

The proforma for the Turley Flats project showed operating expenses in the amount of \$5,175 per unit per year. This operating budget appears is just under minimum TCAC requirements for large family operating costs, set at \$5,200 in the North and East Bay Region. Reserves for replacements is set at \$600 per year, a high level but justified given the relatively small property size.

Taxes

The developer's proforma showing income and expenses assumes \$100 per year in taxes. As a non-profit developer building a project with a charitable purpose, the development should have no trouble qualifying for a welfare exemption for real estate taxes. However, the amount should be confirmed.

Property Management Fee

CAH plans to contract with Crown Realty, a local property management firm that also manages its 8-unit Lakewood property. Management fees are set at \$6,900 per year, below 5% of gross annual rental income considered a minimum industry standard for property management. In addition, the annual management fee is very low for a small property that often must pay a higher amount as a percentage of rents collected to a property management firm. CAH explains it has a similar arrangement with Crown Realty for its Lakewood property, and also explains that CAH may perform some of the property management itself to save costs. Given the lack of full time staff at CAH and the reliance on the volunteer board, this line item is particularly low.

Bank Loan Payment

The term sheet reviewed from First Community Bank stipulates an interest rate during construction of Prime plus 2.0%, or 5.5% currently. The permanent rate is at YTCM (Five-Year Treasury Constant Maturity, currently 1.66%) plus 4%, with a floor of 5.5% and ceiling of 7%. Rate is fixed for each 5 year period, with a first reset in 2022 (assuming completion of the project in 2017), and a second in 2027. The loan amount stipulated is \$1.3mm, or 80% of the appraised value. The loan term is 15 years, with amortization of 30 years. The proforma provided by CAH shows debt service using a fixed 5.5% rate, a 35-year amortization, with no increase in the rate at year 5, and a higher loan amount at \$1.4mm. In addition, it is also not clear what options the property would have to refinance at year 15, when the loan term expires.

A recent discussion with CAH indicates that a fixed rate of interest, and longer amortization period, will be requested, in addition to an increase in the loan amount.

3. Income Targeting

The current unit affordability level ranges from 75% AMI for all units. An appraisal prepared in 2015 provided by Larry Kromann demonstrates good demand for the property at the approximate proposed rent levels of \$1,481 for a 2 BR unit, and \$1,709 for a 3 BR unit (however it should be noted that the appraisal assumed rent restrictions at 80% AMI, instead of the proposed 75% of AMI).

B. Risk Profile

Development Team – Calistoga Affordable Housing

CAH is a small affordable housing development firm that was founded in 2001. It owns one other 8-unit property, Lakewood, in Calistoga, and co-developed one other property with Burbank Housing.

Financial Review

CAH provided its internally prepared financial statements as of August of 2016. Their financials show effectively no cash balances, as all its liquid assets are operating and security deposit accounts for its Lakewood property. Total assets are just over \$1.1mm, liabilities are \$800,000, and net assets are \$293,500. The information submitted includes a statement from CAH that much of the organization's financial reserves have been depleted by the recession that began in 2008, and that the organization relies on income from its Lakewood project to pay its ongoing operating expenses. A profit and loss statement was not provided. Should the Turley Flats project experience a cost overrun, even a modest one, CAH would not be in a position to fund the increase, and would need to turn to its public sector partners to complete the project.

In addition, CAH does not have a staff, but rather relies on a volunteer board, principally Larry Kromann, its board president and acting CEO of CAH. In its statement accompanying its financial statements, CAH is relying on the hiring of consultants to do cost analysis, construction feasibility, and other development tasks.

Conclusion

Based on LDC's review of the Turley Flats proposal, including development budget and proforma, financial statements and development experience and future prospects of CAH, there is significant risk in proceeding with a loan to this development. Additional resources should be committed to this project.

This elevated risk is due to:

1. a development budget with little cushion,
2. a proforma with low operating expense for its size,
3. CAH's relatively low level of financial resources and development experience
4. uncertainty with respect to property oversight once the Turley Flats project is operational

The County of Napa should discuss with the developer and the City of St. Helena what additional resources can be explored to support the Turley Flats project. These resources could include additional public sector or other grant funding, and potentially a partnership with another local developer to help ensure the project can be completed on time and within budget.

For example, an additional \$500,000—if such funding could be secured—could provide a cushion against cost overruns, provide some additional developer fee to incentivize a joint partnership with a stronger developer, and enable a lower permanent loan amount to help ensure the property generates sufficient cash flow from operations.