Agenda No. _____
Meeting of November 9, 2004

BELMONT REDEVELOPMENT AGENCY

STAFF REPORT

Response to Questions and Request for Direction on the Emmett House Project

Honorable Chair and Agency Directors

Summary

On September 14, 2004, the Belmont Redevelopment Agency Board directed staff to conduct additional investigation into issues surrounding the Emmett House project. The project thus far has focused on relocating the Emmett House structure from its current location near the southwest corner of Ralston and El Camino Real to the northwest corner of 6th and O'Neill Avenues for development into four affordable residential units.

Responding to the previous pro forma analysis and to public comments received by the Board, it asked for additional information about the following issues:

1. The financial impacts of reducing the number of units to three, two or one.
2. The effect of developing the project for ownership rather than rental housing, and
3. The issues surrounding removing the affordable housing obligation from the properties (both the structure and the 6th & O'Neill lot).

The Board also indicated its interest in having further dialogue with the neighbors.

Staff has investigated the above issues and presents its response in this report. At this point, the project has no specific direction and awaits a decision from the Board. A decision on disposition of the 6th & O'Neill property should be made the no later than December 31, 2004 to maintain compliance with State law.

Background

The Board has reviewed and considered several issues associated with developing the Emmett House for affordable housing. Without reviewing the entire history, the following points are salient:

1. In 1994, the Agency purchased the vacant lot at the northwest corner of 6th

& O'Neill Avenues. The purchase was funded entirely with RDA Housing funds, resulting in the site being limited to development to 100% affordable housing. Flood control improvements were undertaken on the site in 1999, again using Housing Funds.

2. In 1996, the Agency purchased the Emmett House and site near the southwest corner of Ralston and El Camino Real using a mix of Housing and General Redevelopment Funds. Again, use of Housing Funds for the purchase of the structure obligates development of the Emmett House for affordable housing.
3. In February 2002, the Belmont Redevelopment Agency directed staff to prepare a plan for relocating the Emmett House to the lot at 6th and O'Neill Avenues. The plan was to include development of affordable units within the house, reconstruction of the exterior porch and widows walk, and undertaking other site improvements necessary to meet the Building and Zoning Codes.
4. In November 2002, the RDA authorized a contract with Garavaglia Architects to develop plans and an estimate for relocation and remodel of the Emmett House, based on Board direction provided in May.
5. In 2003, staff obtained construction estimate, a survey and a soils and geology report for the relocation and remodel project. A Request for Proposals was also prepared and circulated, but no satisfactory bid was obtained.
6. In June 2004, the Board authorized the preparation of a pro forma analysis of the Emmett House relocation and remodel project.

The pro forma prepared on the project in the summer of 2004 provided information on a number of issues raised by the project, including affordability, ownership, third party financing and revenue split. In response to that analysis and to neighbor comments, additional questions were raised, which are addressed below.

Evaluation of Unit Number and Mix

In response to the Board's request, a supplemental pro forma was prepared by Mid Peninsula Housing for three development options:

- 1 unit (One four-bedroom unit)
- 2 units (Two two-bedroom units)
- 3 units (One two-bedroom and two one-bedrooms unit)

The affordability limit of 50% of County median was used for all options, based on the Board's expressed preference for this limit. Staff has summarized the results below, including a brief re-statement of the four-unit proposal previously reviewed.

Most of the analysis assumptions were unchanged, including rehabilitation costs ($1,188,732) and operating expenses ($20,200 per year). Staff notes that a reduction of the number of units should actually reduce such costs, but additional investigations would be needed to quantify the savings. These studies were not conducted in order that the overall analysis might be expedited. In addition, the savings are not expected to have a

significant affect on the overall results and would be partially offset by redesign and other costs associated with modifying the current plans.

One Unit (Four-bedroom apartment)
If the Emmett House was developed as a single family dwelling with four bedrooms, it could be expected to rent in the first year for $1515 per month (based on 50% of the calculated median income in San Mateo County[1]). As shown in the pro forma (Attachment 1), rental income falls short of total expenses such that the project would require a subsidy from the RDA every year from the start.[2] No third party financing could be supported by the project, and the RDA's contribution would be the full project cost of $1,188,732, plus $80,070 of subsidies for the first fifteen years ($35,691 net present value[3]).[4]

Staff believes that if the Emmett House was to be developed as a single unit, it should not be managed as a rental property. The Agency could avoid creating a long-term subsidy by selling it as a private dwelling, including maintenance restrictions and affordability limits on the future sales price.

Two Units (Two two-bedroom apartments)
If the Emmett House was developed as two two-bedroom apartments, they could be expected to rent in the first year for a total of $2394 per month (based on the median income for two households). As shown in the pro forma, rental income provides a small surplus that would support a modest private loan ($85,712), reducing the City's contribution to $1,103.020. However, the project would require an Agency subsidy beginning the fourteenth year and continuing thereafter. In summary, a two-unit project provides a short-term income stream for both the RDA and a small private mortgage, but ultimately will require continuous financial support from the Agency.

Three Units (Two one-bedroom and one two-bedroom apartments)
If the Emmett House was developed with three apartments – two one-bedroom units and one two-bedroom unit – it could be expected to rent in the first year for a total of $3209 per month (based on the median income for three qualifying households). As shown in the pro forma, rental income provides a surplus that could support a private loan of $198,006, reducing the City's contribution to $990,726. The income stream remains positive well beyond the fifteen-year horizon of the analysis. In summary, a three-unit

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[1] Using higher income levels – say, from a household of four or five – would yield a higher maximum net rent. However, higher rents approach market levels, which would make the Emmett House difficult to rent, because of income reporting requirements and other restrictions.
[2] As noted earlier, it is possible that operating expenses could be less since only one household would be managed (compared with four in the previous analysis). However, savings would be modest since many operating costs, including landscape and exterior maintenance, are fixed regardless of building occupancy. A deficit is likely in any event.
[3] NPV = Net Present Value – the value of the income stream in today's dollars (discounted at 10% per annum.)
[4] Additional costs would be incurred to redesign the plans for a single unit building.

project provides a long-term income stream for both the RDA and a private mortgage, and would not require financial support from the Agency for many years.

Four Units (Four one-bedroom apartments)
This information was previously provided to the Agency and is restated for comparison purposes. Four one-bedroom apartments would generate $4,024 in rent in the first year, support a private mortgage of $310,300, reduce the Agency's contribution to $878,423 and generate a positive income stream for many years. This is the most attractive option from a financial perspective.

The table below allows a comparison of the major factors for each option:

	One Unit	Two Units	Three Units	Four Units
Total Monthly Income (Year 1)	**$1,515**	**$2,394**	**$3,209**	**$4,024**
Cash Flow, NPV (Years 1 – 15)	**– $35,691**	**$4,690**[5]	**$24,169**	**$43,648**
City Contribution	**$1,188,732**	**$1,103,020**	**$990,726**	**$878,432**
Private Mortgage	**0**	**$85,712**	**$198,006**	**$310,300**

Development of Emmett House as "For Sale" Housing
The Board also requested that staff investigate developing the Emmett House as affordable housing for ownership rather than for rent. We believe that much of the same analysis presented above would apply, as follows:

1. The monthly incomes would reflect the ability of the occupants to support mortgages, homeowner association dues, if any, and other expenses. Future sales prices would be controlled to maintain long-term affordability.
2. Project expenses for an ownership project would increase above the estimated $1.19 million to include preparation and recordation of a condominium subdivision and homeowners association C, C & R's[6].
3. Operating expenses – estimated for the rental units at $20,200 for Year 1 – can be expected to be about the same, and would be split between the homeowners association (for physical upkeep) and the Agency (to review income qualifications of prospective buyers, sales contracts, improvement proposals, etc.)

The pro forma for a for-sale project would be different from a rental project because there would be no continuous income stream after the units are sold. Instead, the Agency would fund the project out of pocket (as with the rental project) and receive the proceeds

[5] Cash flow is negative from Year 14 onward.
[6] This would not apply if only one unit was developed, although some administrative expenses would still be incurred.

from the initial sale. The only long-term revenue stream might be from homeowner association dues to cover administrative oversight. In such a case, the City would also be the *de facto* manager of the condominium project to make sure the homeowners association upheld the requirements of the C, C & R's regarding property use and maintenance. Finally, it should be noted that neither the City nor Mid-Pen Housing has the expertise to develop, manage and operate a multi-unit, condominium-type development envisioned by this option. There may be factors that we have not identified affecting the viability of the Emmett House as ownership housing.

Eliminating the Affordable Housing Obligation

The Board requested staff to investigate the option of eliminating the affordable housing obligation from the Emmett House. According to the City's redevelopment attorney, if the Agency no longer desires to use the 6th and O'Neill property or the Emmett House property for affordable housing, it should use its RDA General Funds or other non-housing source to repay the Housing Fund for amounts expended on the Emmett House. This should also include the interest that the Housing funds would have generated had they not be spent on the Emmett House. The following estimates are provided to show the costs of this option:

1. If the 6th & O'Neill property is relieved of the affordability obligation:

Amount of LMI Funds spent on property:			
Purchase in 1994	$200,000		
Flood control improvements in 1999	192,000		
Sub-total		$392,000	
Interest		180,928	
Total Reimbursement, 6th & O'Neill property			**$ 572,928**

2. If the Emmett House structure is relieved of the affordability obligation:

Amount of LMI Funds spent on property:			
Purchase in 1996	$379,453		
Special studies in 2003	44,250		
Sub-total		$423,703	
Interest	103,216		
Less rental income	- 38,186		
Sub-total, net interest		65,030	
Total Reimbursement, Emmett House structure			**$ 488,733**

3. If both properties are relieved of the affordability obligation:
   Total Reimbursement, both properties **$1,061,661**

If the Agency decides to proceed with this option, it should direct staff to prepare a resolution to this effect, including direction to the Agency Finance Officer to repay the Housing Fund and specifying the amount to be repaid and its source. The resolution should also document why it is no longer feasible to develop these properties for affordable housing. The Agency must also count the reimbursement as unencumbered

funds and therefore would be included in determining whether or not the Agency has an "excess surplus" in the Housing Fund – this is an important issue and is discussed below.

Excess Surplus in the Housing Fund

The California Health and Safety Code – which regulates the Belmont Redevelopment Agency – includes a section that addresses when the Agency maintains too high a balance in its Housing Fund[7]. Knows as 'excess surplus', it is defined as the unencumbered part of the Housing Fund that exceeds the greater of either one million dollars ($1,000,000) or the sum of the last four years of annual Housing Fund proceeds. Failure to spend or encumber these funds by contract results in severe sanctions, including:

1. A transfer of the excess surplus to the County Housing Authority
2. A limit on other RDA project spending, and
3. A limit on Agency administrative expenses.

Staff notes that these sanctions have significant impacts on the City. First, the County Housing Authority must spend the transferred funds in Belmont, giving them control over affordable housing priorities in the City. Second, the City would lose significant flexibility in other RDA spending, including capital projects (such as utility undergrounding and streetscape improvements) and administrative expenses (such as staff salaries, code enforcement and economic development). The sanctions are considered so severe that staff is not aware of any agency that has allowed an excess surplus to be generated; however, the reimbursement of the Housing Fund for the Emmett House properties does raise that possibility for the Belmont RDA. If the Board directs staff to reimburse the Housing Fund, we urge the Board to first allow staff to conduct a more detailed investigation of the potential problem of 'excess surplus' and report back our findings.

Disposition of the 6th & O'Neill Property

Staff recently discovered that the site at 6th & O'Neill is subject to a state mandate to be developed for affordable housing or sold within ten years of purchase.[8] According to the five-year extension granted by the Board in 2000 the Agency has until December 31, 2004 to dispose of the site – either by placing the property up for sale, or initiating a project. (If the property is sold, the proceeds are returned to the Housing Fund.) Staff has investigated if additional extensions are possible, but there are no provisions to allow holding properties purchased with Housing Funds for more than ten years. The Agency may direct staff to place the vacant lot for sale or proceed with the relocation project; however, a decision should be made by the end of the year.

Additional Neighborhood Dialogue

At the meeting of September 14, 2004, the Board identified its desire to conduct additional discussions with neighbors of the 6th & O'Neill properties about the use of the property and the Emmett House. With the additional information provided in this report,

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[7] Section 33334.12 of the California Health & Safety Code.

[8] Section 33334.16 of the California Health & Safety Code. This provision applies to two other properties owned by the Agency – 1365 Fifth Avenue and 1085 Sixth Avenue – and the time limits on these properties ends in 2006. The Emmett House structure does not appear to be subject to this limit.

the Board may wish to discuss what further neighborhood discussions it wishes to have, the means in which to have them and other logistical concerns. Staff is available to support any direction desired by the Board, including a full Board hearing, a Board sub-committee, a staff-only meeting or other option.

Fiscal Impact
None at this time.

Recommendation
Staff recommends RDA Board consider the above information and direct staff as appropriate on the following issues:

1. Project Definition
   a. Is the project to remain the relocation of Emmett House to the 6th & O'Neill corner property?
   b. How many units would be developed?
   c. Is it to be rental or ownership housing?
2. Affordability Obligation – Does the Board wish to transfer money from other sources to remove the affordability obligation from:
   a. The Emmett House structure?
   b. The 6th & O'Neill property?
   c. Both properties?
3. Disposition of the 6th & O'Neill property – Does the Board wish to sell the 6th & O'Neill site and return the proceeds to the Housing fund?
4. What kind of additional neighborhood outreach should be conducted?

Public Contact
The staff report forwarded to Belmont Historical Society and notice was mailed to those in attendance at recent public meetings on the subject.

Respectfully submitted,

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Community Development Director	Interim Executive Director

Attachment:
1. Revised pro forma