MEMORANDUM

Date: January 26, 2024

To: Sarah Collard, PhD, Director, County of Siskiyou HHSA

 Maddelyn Bryan, Project Coordinator- Housing Programs, County of Siskiyou HHSA

From: James Coles, Principal, Housing Tools

RE: Mountain Townhomes- Project Assessment for Potential County Participation

**Introduction**

The County of Siskiyou (County) has requested that Housing Tools conduct a preliminary assessment of the Mountain Townhomes project to be developed by Danco (Project). The purpose of this assessment is to determine the feasibility and value of County participation in the Project. This participation may come in the form of funding and/or the delivery of behavioral health services.

**Developer**

Danco is a for-profit affordable housing developer with over 25 years of experience building, owning, and operating affordable rental housing. Most of their projects are located in the North State, but they have also built projects throughout California. Their portfolio includes 62 projects. Danco has developed 15 permanent supportive housing projects, many of which have been funded by the Homekey program. The firm has extensive experience with the Low Income Housing Tax Credit program, and a variety of State of California funding sources. Danco is based in Arcata, California.

**Project Overview**

Danco is proposing to develop an affordable housing project called Mountain Townhomes in Mount Shasta. The project will be new construction and consist of 25 rental units, with one unit reserved for an on-site manager, for low income families on an infill property at the northwest part of downtown. The unit mix and target population is summarized in the table below. It will include at least three and up to six units targeting individuals and families experiencing chronic homelessness, as defined in Health & Safety Code, Section 50675.14 and the HUD CoC NOFO.

**Unit Mix**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **No. of Units** | **Bedrooms** | **Bathrooms** | **% of AMI** | **Monthly Net Rent** | **Target Population** |
| 1 | 1 | 1 | 30% | $464 | Individuals and families experiencing chronic homelessness (HSC 50675.14) |
| 1 | 1 | 1 | 50% | $773 | Very Low Income Families |
| 2 | 2 | 1 | 30% | $557 | Individuals and families experiencing chronic homelessness (HSC 50675.14) |
| 2 | 2 | 1.5 | 40% | $743 | Very Low Income Families |
| 7 | 2 | 1.5 | 50% | $928 | Very Low Income Families |
| 2 | 2 | 1.5 | 60% | $1,114 | Low Income Families |
| 1 | 3 | 2 | 30% | $643 | Very Low Income Families |
| 1 | 3 | 2 | 40% | $858 | Very Low Income Families |
| 5 | 3 | 2 | 50% | $1,072 | Very Low Income Families |
| 2 | 3 | 2 | 60% | $1,287 | Low Income Families |
| 1 | 3 | 2 | Manager |  |  |
| 25 |  |  |  |  |  |

Note: Rents are those included Danco’s financial projections provided on 1/25/24, not the market study completed in April 2023.

**Site**

Danco has entered into a purchase agreement with a private party to purchase a property located at 735 Chestnut Street in Mount Shasta for $695,000. The purchase agreement was initially executed on August 18, 2021 with a one-year term until close of escrow and a six-month extension option. Addendum No. 2 states that the purchase price will be $430,000 per the appraisal and that the Buyer (Danco) will reimburse the Seller $265,000 in design and engineering costs at close of escrow. The agreement was amended three additional times to extend the escrow close date to December 31, 2024 upon non-refundable deposits into escrow by the Buyer.

Per an appraisal dated August 30, 2021, the subject property at 735 Chestnut Street, Mount Shasta was valued at $430,000. The site is identified as APN 057-112-010-000 and is 1.15 net acres in size (1.26 gross acres for planning permit) and rectangular in shape with frontage along Chestnut Street to the southwest and along East Ivy Street to the southeast. It is vacant and vegetated with a mix of trees and bushes on the northwest end and mostly dirt and grasses on the southeast end. It is located in a mixed-use neighborhood on Chestnut Street, northeast of the intersection of Chestnut Street and East Ivy Street, and one block from North Mt Shasta Boulevard. Adjacent uses include a vacant lot and the Cold Creek Inn to the west, commercial uses to the northwest, vacant land to the north and northeast, and a mix of residences and businesses to the southeast, south, and southwest. The railroad runs along the southwest side of North Mt Shasta Boulevard. A STAGE bus stop served by Routes 2 and 3 is one block away at the intersection of East Ivy Street and North Mt Shasta Boulevard. Mount Shasta Super Market, Mercy Medical Center, Mt. Shasta Library, Banner Bank, CVS, Mt. Shasta Elementary School, the Police Station, and Post Office are all located within a half-mile of the site.

**Zoning and Entitlements**

The site is zoned C-1 Downtown Commercial on the Mount Shasta zoning map. This zoning district permits multifamily residential uses and Supportive housing by-right consistent with the R-3 zoning district according to the City of Mount Shasta Municipal Code. The maximum density is 20 dwelling units per acre, not including density bonus. The maximum building height is 45 feet and there are no setback requirements. Minimum open space is 35% of the site. Danco received conditional use permit, architectural review, and CEQA Mitigated Negative Declaration approval for the proposed project on May 16, 2023.

**Design**

The approved architectural plan includes five buildings, with three two-story buildings housing units, a single-story on-site manager’s residence building, and a single-story community building. The site plan shows 26 on-site parking spaces, and 19 diagonal parking spaces along Chestnut Street, as well as a tot lot next to the community building. A main lighted and accessible pedestrian walkway runs down the center of the site parallel to Chestnut Street. The landscaping plants and trees will be non-invasive and drought tolerant.

The design of 23 of the units is in a townhome style, with walk-up entry doors and porches on the exterior of the buildings and two floors for most residences. The other three units consist of two single-floor garden-style apartments, and the on-site manager’s single-story residence. All units include a patio or balcony. The community building includes a community room and kitchen, fitness room, laundry room, bathroom, and office.

The buildings will be wood-frame Type V-B construction on a concrete slab foundation. Each unit will be independently metered for electrical use, with air-source heat pumps providing space heating and cooling. Exterior finishes will include fiber-cement board siding and mat-finish corrugated metal panels, along with exposed wood bracket and beam details. Colors will be earth-toned neutrals with barn-red and mustard accents.

**Market Feasibility**

A market study for the project was completed in April 2023 by Raney Planning & Management, Inc. The project’s highest proposed rents by unit size were 10.2%-28.3% lower than the weighted average of adjusted market rents at comparable properties. It is projected that there will be a demand for 113 units targeting households earning 30%-60% of Area Median Income (AMI) in the year of market entry in 2025, giving the project a capture rate of 18.6% of income qualified households in the Market Area. The Market Area was identified as the Cities of Mount Shasta, Weed, Dunsmuir, and the Towns of McCloud and Gazelle. Given this capture rate, it is projected that the project will be fully occupied within three months or less.

**Financial Feasibility**

Development Uses

The Development Budget provided by Danco on January 25, 2024 shows total costs at $18,755,097, at $750,204 per unit and $674 per building square foot. Construction cost is $7,542,467 at $301,699 per unit and $271 per building square foot. These overall costs are on the higher side when compared to other tax credit projects in the region, but not exorbitant, and fairly reasonable when taking into account that the project has only 25 units and 11 of the units have three bedrooms.

Land cost is shown as $430,000 at $373,913 per acre and $17,200 per unit, which is consistent with the value arrived at by a third-party licensed appraiser.

For construction, General Requirements are 4.4% of total construction cost, and Contractor Overhead and Profit is at 6.3% of total construction cost. These levels are within California Tax Credit Allocation Committee (CTCAC) underwriting standards. Off-site costs are $1,342,600, which will be funded by an Infill Infrastructure Grant (IIG). The Construction Contingency is 5.0% of total construction cost, which meets typical lender requirements. Architectural costs are 8.7% of total construction cost, which is a fairly reasonable level, but a bit on the high side.

As for financing costs, Construction Loan Interest payments are projected at $1,233,111 based on a principal loan amount of $18,560,447, an 8.0% interest rate, and a 20-month period (16 months construction and 4 months of lease-up/stabilization), which is a little lower than my projection at those terms, but with a conservative 8% interest rate it seems reasonable. The origination fee is 1%, which is an industry standard.

Reserves include a $30,000 rent reserve, a $60,394 operating reserve, and a $600,000 capitalized operating subsidy reserve (COSR). The operating reserve is equal to four months of total expenses, which meets the underwriting standard for public funders. The COSR is necessary to cover cash flow deficits over the first 15 years of operations, as is typically required for a small affordable housing project with restricted rents.

The Soft Cost Contingency of $146,015 is typical for a project of the size proposed. Local Development Impact Fees and Permit Processing Fees combined are $1,175,000 at $47,000 per unit, which is higher than typical local impact and permit fees on a per unit basis. Developer Fee is $2,221,318, which is within the range allowable by CTCAC.

Development Sources

Development Sources include $11,320,105 in 9% tax credit equity, $5,000,000 in Competitive PLHA, $1,342,600 in IIG, $901,579.45 in County PLHA, and $192,391 in solar tax credit equity. The tax credit equity assumes a purchase price of $0.865 per $1 of tax credit, which is within the market range for the region.

Operating Budget

Operating Expenses, not including Social Services or Replacement Reserves, are $8,363 per unit annually, which exceeds CTCAC minimum requirements, and are a bit on the high side, but within an acceptable range for a small project with larger units. The Management Fee is $50.87 per unit per month, which is within the market range for an affordable housing project. Replacement Reserve deposits are $500 per unit per year, which meets public funder underwriting standards. Social Services is budgeted at $20,000, or $800 per unit per year. On-staffing will include a 1.0 Full Time Equivalent (FTE) on-site property manager and a part-time Services Coordinator (FTE is not specified).

Cashflow Proforma

The 15-Year Cashflow Proforma shows standard underwriting assumptions of 5.0% vacancy rate, revenue increasing at 2.5% annually, and expenses increasing at 3.5% annually. There are no permanent debt payments. In Year 1, cashflow after payment of all expenses is projected to be $12,782, and by Year 8, cashflow goes negative to -$1,597. This is typical for small affordable rent-restricted projects. In order to address shortfalls in future years, the Development Budget included a COSR capitalized at $600,000. The COSR is projected to be drawn over the 15 years of operations to cover shortfalls, with draws starting at $28,989 in Year 1 and increasing to $45,996 in Year 15. The COSR draws also allow Danco to pay a $2,500 annual Management Fee, a $10,000 annual Limited Partner Asset Management Fee, and residual receipts loan repayments ranging from $8,244 in Year 1 to $16,748 in Year 15. Overall, the Cashflow Proforma presents a feasible project. The margins are thin, as is typical for a small affordable housing project, but the COSR and lack of required debt payments provides adequate security that costs will be covered.

Gap Financing Need

The proforma proposes a County contribution in the form of a $901,579.45 PLHA loan. This loan would carry a 3% simple interest rate and 55-year term with 55-year rent restriction, with repayments and interest fully deferred to the end of the 55-year period, as stipulated by the PLHA program. The 15-Year Cashflow Proforma shows that the County should expect little to no repayment over the first 15 years of operations.

The County’s loan would address two needs for the project: 1) provide gap financing not covered by other sources; and 2) improve the project’s competitiveness for tax credits. The tie-breaker calculation in the tax credit competition is largely based on the proportion of deferred repayment loans, grants, and loans underwritten by rental assistance committed to the project relative to the amount of requested tax credits. Projects that have higher proportions of the development budget funded with deferred repayment loans, grants, and loans underwritten by rental assistance score higher in the tie-breaker and are more likely to be funded.

The Danco proforma shows that the project would score 63.797% in the tie-breaker. The project will compete within the Rural Set-Aside of the tax credit application. Danco has submitted two tax credit applications last year but neither received an award. The funding rounds have been challenging because Mountain Townhomes has competed against projects that have received large commitments of CDBG-DR funds, particularly in Butte County, that have resulted in very high tie-breaker scores for those projects. In the first round of the 2023 9% tax credit competition, the lowest scoring project awarded credits in the Rural Set-Aside was 59.531%. In the second round of the 2023 9% tax credit competition, the lowest scoring project awarded credits in the Rural Set-Aside was 56.418%, and Mountain Townhomes was the highest scoring project in the Rural Set-Aside that was not funded.

In 2024, the amount of credits in the Round 1 Rural Set-Aside is $11,206,806 in annual federal credits, with a 14% apportionment for RHS, HOME, and CDBG-DR projects at $1,568,953. This is about $400,000 more than what was available in the 2023 funding rounds. The amount of tax credit equity available to projects is roughly 10 times these amounts ($112 million in the Rural Set-Aside). The inclusion of CDBG-DR projects in the 14% apportionment of the Rural Set-Aside is a new change in the 2024 CTCAC Regulations.

Mountain Townhomes has an advantage in the CTCAC funding process in that it is a Large Family Housing Type in a High Resource Area. CTCAC has a goal of funding 30% of projects within the Rural Set-Aside that meet these criteria, so these projects may receive priority if that goal is not yet met. County PLHA funding at $901,579.45 will allow Mountain Townhomes to score 63.797% in the tie-breaker. If funding were increased to $1,350,000, the project would score 67.398%. If funding were increased to $1,800,000, the project would score 70.998%.

**Community Benefit**

The $901,579.45 County loan will be the last piece of financing necessary to produce 24 housing units affordable to Extremely Low, Very Low, and Low Income households, including units dedicated to individuals and families experiencing chronic homelessness. We recommend that the County stipulate that the one one-bedroom and two two-bedroom 30% AMI units are dedicated as PSH units for this population. We recommend that the County provide Behavioral Health and Case Management services to the residents of the PSH units.

The County’s per unit subsidy would be $37,500. The location of the project is ideal, near transit and a variety of services, in an area with a shortage of affordable housing. This project would provide much needed affordable housing for families and PSH units in Mount Shasta and the South County.

**Recommendation**

The $901,579.45 in County funds, and the award of $1,342,600 in IIG funds, will help Mountain Townhomes increase its tie-breaker score from 53.367%, which was its score in the 2nd round of 2023, to 63.797% in the 1st round of 2024. In addition, qualifying as a Large Family Housing Type located in a High Resource area gives the project a competitive advantage. Given these factors, we recommend that the County commit a $901,579.45 loan to the project from the 2020 PLHA allocation. This subsidy amount should be sufficient for the project to be awarded tax credits. Should the project not get awarded tax credits in the first round of 2024, it would be able to apply in the second round. Competition from CDBG-DR funded projects should lessen in the second round. Furthermore, the County could consider additional PLHA funding at that time.