



**SACRAMENTO  
HOUSING AND REDEVELOPMENT  
AGENCY**



5

May 15, 1990

Budget & Finance Committee  
Transportation/Community  
Development Committee  
Sacramento, CA

Honorable Members in Session:

SUBJECT: Residential Hotel Construction and Rehabilitation  
Program

SUMMARY

The attached report is submitted to you for review and recommendation prior to consideration by the City Council and Housing Authority of the City of Sacramento.

RECOMMENDATION

This staff recommends approval of the recommendations outlined in the attached report.

Respectfully submitted,

ROBERT E. SMITH  
Executive Director

TRANSMITTAL TO COMMITTEE:

SOLON WISHAM, JR.  
Assistant City Manager

Attachment



SACRAMENTO  
HOUSING AND REDEVELOPMENT  
AGENCY



May 22, 1990

Redevelopment Agency and  
City Council of the  
City of Sacramento  
Sacramento, California

Honorable Members in Session

SUBJECT: Residential Hotel Construction and Rehabilitation  
Program

SUMMARY

This report recommends that the Redevelopment Agency ("Agency") approve the Residential Hotel Construction and Rehabilitation Program ("the Program") attached as Exhibit A. The report recommends that the Agency give high priority to the allocation of available tax increment funds to the Residential Hotel Program as part of the annual budget process. It also recommends that the Agency authorize and direct staff to:

- a) Reserve the \$1,000,000 tax increment money tentatively allocated in the 1990 budget for Residential Hotel development, and subsequent appropriations, for use on rehabilitation as a first priority and new construction as a second priority. These priorities should carry forward to subsequent allocations.
- b) As budget appropriations become available, prepare and issue Notices of Funds Available (NOFAs) for monies allocated to rehabilitation.
- c) To the extent that new construction monies are available, investigate one or more sites in the Central City area which meet the locational criteria for Residential Hotel new construction described in the Program, commence negotiations on acquisition

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terms and return to the Agency for acquisition approval.

- d) Prepare and submit for Agency approval a Request for Proposals (RFP) for Residential Hotel new construction on the above site(s) based on the criteria and program elements set forth in the Program.

The report also recommends that the City Council direct Agency staff to work with City Planning and Building Inspection staff and report back within four months on:

- a) Amendments to the zoning ordinance necessary to facilitate the construction and rehabilitation of Residential Hotels.
- b) Modifications of the local building codes which would facilitate the construction and rehabilitation of Residential Hotels.

Finally, the report recommends that the City Council direct Agency staff to report back within four months regarding the legal and policy implications of a City-wide Residential Hotel preservation and replacement ordinance.

#### BACKGROUND

Since 1982, the City has had a history of concern and involvement regarding the issue of preservation and development of Residential Hotels (also known as SRO's). Most recently, the reports and recommendations of several task forces and studies were summarized in a staff report presented at the Council's May 4, 1989 meeting. (See Exhibit A - Attachment 1.) At this meeting, the Council adopted thirteen recommendations set forth in the report and directed staff to develop and implement an action program to accomplish these recommendations. The key recommendations as they relate to this Program were as follows:

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- a) Reaffirm recommendations of your Residential Hotel/SRO Financing Task Force and City/County Housing Financing Task Force concerning the maintenance of the current number of Residential Hotels, either through substantial rehabilitation or new construction.
- b) Review all codes, standards and procedures involved in the construction of new Residential Hotels, seeking opportunities to reduce costs while at the same time safeguarding public health and safety.
- c) Commit, through the budgetary process, \$7,000,000 of Downtown Tax Increment Funds over the next five years for new construction and/or for substantial rehabilitation of Residential Hotels as per the recommendations of the Residential Hotel/SRO Financing Task Force.
- d) Strongly discourage private developers from demolishing or converting any of the remaining Residential Hotels without working out a replacement plan. In the event a Residential Hotel is demolished or converted to another use, the Agency should commit a percentage of the Tax Increment funds derived from the new use for 10 years to assist in the construction of replacement Residential Hotel units.
- e) Identify and acquire sites within the City which would be suitable for Residential Hotel construction. The focus, although not exclusively, should be on the Central City.
- f) Issue Notice of Funds Available (NOFA) to the development community, advertise the availability of funds and/or land, and the City's interest in expanding the supply of Residential Hotels.

The attached Residential Hotel Program is consistent with previously adopted policy and should be evaluated within the context of the May 4, 1989 report.

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The 1990 budget allocates \$1,000,000 in tax increment funds for use in the rehabilitation and construction of Residential Hotels. It is anticipated that these funds will be available from the sale of tax allocation bonds this summer. The attached Program represents both a short-term plan to spend the \$1,000,000 effectively, (assuming such funds are not allocated to the immediate acquisition and rehabilitation of structures at risk of being demolished or converted to alternative uses or shut down due to severe code violations) and a long-term plan for expenditure of future funds. Staff recommends that funds be allocated to fund the Program on an annual basis, within the context of the budget process, and as funds become available from such sources as increased tax increments and bond proceeds, etc.

## Proposal Summary

The Proposal contains the following major elements and discussion of issues:

- a) New Construction vs. Rehabilitation: As noted above, staff recommends that funding priority be given to rehabilitation projects. The reasons for this recommendation are multifold, complex, and must be evaluated in the context of the specific project under consideration.

In those cases where rehabilitation is less expensive, the reason is self-explanatory. Given the economies possible in rehabilitation work, this is often the case. With respect to Residential Hotels, however, the condition of the buildings, seismic requirements, etc., may reverse the question, actually making new construction more economical.

There may be other 'non-economic' factors to consider in evaluating the rehabilitation vs. new construction equation. Very significant among these is the difficulty in getting neighborhood acceptance of new Residential Hotels. Existing Residential Hotels have the advantage of being in place, accepted and in locations where the tenants have access to supportive services, etc. Historic preservation is also frequently a consideration. We believe that unless the difference between the rehabilitation and new construction

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costs is very substantial (e.g. greater than 150%) that rehabilitation remains the preferred option. (Reconstruction onsite might also be a preferred option.)

To the extent that new construction monies are available, staff recommends that they be used to acquire site(s), well-distributed within the Central City, according to the criteria outlined in the Program. Staff already has preliminary knowledge of several suitable sites and, if directed by the Agency, would conduct further investigations on them and begin negotiations to acquire one or more of them. In addition, efforts should be taken to include Residential Hotel housing as a part of the housing strategy for the R Street Corridor.

If sites are to be acquired by the Agency, staff would prepare a Request for Proposals (RFP) for development of the sites according to the guidelines outlined in the Program and would then return to the Agency for approval of the sites and the RFP.

Staff recommends remaining open to a full range of options regarding the methodology for subsidizing the new construction projects. (The attached proformas, for example, indicate subsidy by means of providing below-market-rate leases on the land.)

Staff would also assist developers in efforts to obtain State financing. If funding from State or other sources is unavailable, the Agency might also need to provide below-market-rate loans in addition to a land lease or land write-down.

- b) Proposed Program Finance and Underwriting Criteria: The land leases and/or loan stipulations on new construction projects should be very long-term (40+ years) and may be extended in conjunction with an extension of the use restrictions. The base payment will be the equivalent of 3% simple annual interest on the value of the land, payable monthly. The land will be reappraised every 10 years for the purposes of adjusting the payment. Lease payments may be deferred on a case-by-case basis if necessary for project feasibility.

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Loans made by the Agency to finance rehabilitation and new construction projects will carry a minimum term of 30 years, extendable in conjunction with an extension of the use restrictions. The loans will carry a simple interest rate of 3%. Principal and interest may be deferred on a case-by-case basis if necessary for financial feasibility. Upon sale or refinancing, the Agency will share in the capital appreciation of the project in proportion to the amount of the Agency loan relative to original project costs.

For all projects, total encumbrances may not exceed 90% of project costs. For new construction projects and projects entailing acquisition in conjunction with rehabilitation, the owner will be required to put up 5% of total project costs in cash at close of escrow. Administrative expenses may be no more than 5% of total project costs. No outright developer fee will be funded. The project will be required to maintain replacement reserves of 0.6% of total project costs.

Agency regulatory agreements on the projects will require a strong and carefully thought-out management plan aimed specifically at the special considerations of operating a Residential Hotel project. All projects will be required to rent at least 60% of the units to households making less than 50% of median income. For new construction projects, the Agency's goal is to have three tiers of rents in projects it finances, roughly, 30% of 30% of median income, 30% of 35% of median income and 30% of 40% of median income. Amenity levels in the units should be reflective of the above rent differentials (i.e. units with higher rents should in general have a private bath, preferable light exposure, larger living area, etc.) Rents on rehabilitation projects will be restricted by the pre-rehabilitation rent structure and unit amenity levels. Rent increases on both new construction and rehabilitation projects will be tied to the Consumer Price Index.

- c) Program Economics: Preliminary proformas were developed for prototype new construction and rehabilitation projects. (See Exhibit A - Attachments 2 and 3.) These proformas are for illustrative purposes only. The prototype new construction project consisted of 100 units, with three tiers of rents \$200, \$230 and \$262. Land, valued at \$360,000, is leased from

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the Agency at nominal rates. The proforma also assumes an \$988,800 loan from a conventional lender and a \$1,048,700, 3% deferrable loan from an outside source, such as the State. Under this scenario, the proforma indicates total subsidies at \$14,088 per unit, or \$1,408,759 for the entire 100 unit project.

For discussion purposes, it was assumed that the full amount of the lease payment (\$10,800 in years 1 through 9 and \$16,200 in years 10 through 17) is paid annually. The interest on the 3% simple interest loan was deferred for the full timespan of the proforma. Under this scenario, the developer makes a profit in year one. The project's overall internal rate of return (IRR) is 20%, (after tax and including sale of the building in year 17).

Lease payment and loan interest deferrals will be negotiated on a case-by-case basis. Some projects may require full or partial deferrals on the Agency lease payment, as well as any below market interest rate loans.

The proforma for a prototype rehabilitation project assumed a 75 unit project with acquisition costs of \$10,000 per unit and rehabilitation costs of \$15,000 per unit. A conventional loan of \$663,000 and a 3% simple interest deferrable loan of \$1,000,000 from an outside source are assumed. The Agency subsidy is also in the form of a 3% simple interest deferrable loan and is on the order of \$708,000. Total subsidies amount to \$22,777 per unit, or \$2,635,000 for the entire project.

The rehabilitation proforma assumed that the full amount of interest on both the second and the third loan would be deferred for the full timespan of the proforma (17 years). With these deferrals, the developer is able to get a cash-on-cash return beginning in year one. The overall IRR, after tax and including sale in the 17th year, is negative because the owner will lose money upon sale of the property. The after tax IRR when sale is not included is 23%.

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It is of utmost importance to realize that, given the high subsidy per unit required to achieve affordable rents, the \$1,000,000 of tax increment money, and all future allocations of tax increment or other funds, must be leveraged with other local, state and federal resources to achieve any significant level of units.

In particular, financial feasibility of projects could, at least initially, be dependent on the rehabilitation and new construction subsidy programs recently implemented by the State with funds authorized by the Proposition 77 and 84 bond measures. Unfortunately, applications and commitments under both of these programs now exceed the total funds available, although State staff advise developers to still apply for funds if the application is a strong one. The problem appears particularly crucial with the Proposition 84 new construction funds. An additional \$150 million may be available for housing programs if Proposition 107 is passed on the June 1990 ballot. \$100 million of this will go for rental housing new construction, while \$15 million will go for rehabilitation. Staff recommends that the Agency move forward quickly with its Residential Hotel program so that developers will be able to apply under the State programs before funds are depleted.

d) Selection Process: The selection process and criteria for both new construction and rehabilitation projects are roughly similar and are as follows:

- 1) Applications will be submitted to a Selection Committee for review. The Selection Committee will be made up of Agency staff, members of the Housing and Redevelopment Commission and members of the City Planning Commission or staff of the City Planning Department.
- 2) Applications will be evaluated in a two-phase process.
  - In the first phase, the capacity of the applicant and/or applicant's development team to successfully complete the project will be considered based on criteria outlined in the Program. Only those

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applications which sufficiently meet these criteria will be moved onto the next phase.

- In the second phase, the project itself will be evaluated according to design criteria outlined in the Program or, in the case of rehabilitation projects, according to the need for rehabilitation. Other factors will also be considered, such as total development cost per unit, total Agency subsidy per unit, proposed financing package and proposed management plan.
  - 3) The Selection Committee will make a recommendation to the Housing and Redevelopment Commission.
  - 4) The Sacramento Housing and Redevelopment Commission will make a recommendation to the Redevelopment Agency, who will be responsible for final action on the project.
- e) Preservation: Staff recommends that all remaining Residential Hotels be preserved for their present use. Accordingly, should the Agency participate or assist in the demolition or conversion of Residential Hotel units for redevelopment purposes, staff recommends that the Agency make provision for the replacement of the units on a one-for-one basis before or concurrently with the demolition or conversion process. Replacement could be partially financed with tax increment funds derived from the redevelopment of the property. Current redevelopment law does require agencies to replace housing demolished in the redevelopment process, but no specification is made that the type of housing must be the same. In the case of Residential Hotels, staff specifically recommends that the replacement be the same type of unit and take place before or concurrently with the demolition or conversion process.
- Staff also recommends investigation of the legal and policy implications of a City-wide Residential Hotel preservation and replacement ordinance to which all developers, public and private, would be subject.

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## **FINANCIAL DATA**

The 1990 budget already provides for \$1,000,000 of tax increment funds to be used for Residential Hotel construction and rehabilitation, pending the sizing and prioritization for the 1990 Tax Allocation Bond issue. The attached Program provides direction for the expenditure of these and future funds dedicated to Residential Hotels. Adoption of this report is recommended to set up Agency guidelines for Residential Hotel development, even though the 1990-1991 TAB funds may not be available specifically for this Program.

Staff is also recommending that the Agency give high priority to the allocation of available tax increment funds to the Residential Hotel Program as part of the annual budget process. Any future funds would be used as outlined in the attached Program. Again, as specific projects arise, separate reports will be made to the Agency and/or the Housing and Redevelopment Commission as appropriate.

## **MBE/WBE EFFORTS**

The actions proposed in this report have no immediate MBE/WBE impact. The Agency MBE/WBE policy will be applied on a case-by-case basis to individual bids and contracts as they are generated.

## **ENVIRONMENTAL REVIEW**

The proposed approval is a policy action which is exempt from environmental review per CEQA Section 15378(b)(3). However, any sites which are optioned by the Agency or projects proposed for rehabilitation will be subject to full environmental assessment on a case-by-case basis, and re-submitted to the Housing and Redevelopment Commission and/or the Redevelopment Agency for approval.

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## POLICY IMPLICATIONS

The attached proposal is the delineation of a specific Residential Hotel action program for the City of Sacramento. The Program as outlined is the out-growth of over eight years of work of several task forces and studies, as summarized in a staff report presented and adopted at the Council's May 4, 1989 meeting. As such, the Program represents the implementation of policy previously approved by the Council.

By implementation of the rehabilitation portion of the Program, staff is recommending that all existing Residential Hotels be preserved for their present use. This policy is recommended at least until staff has more experience with Residential Hotel new construction and sufficient new units have been built to at a minimum replace units that have been lost by conversion. For a variety of non-economic reasons, primarily related to site location, staff makes this recommendation, even though preservation of existing Residential Hotels may, in some instances, be less cost effective than new construction.

With respect to new construction, staff expects neighborhood resistance, which may delay or even preclude development. In anticipation, staff has attempted to develop site selection criteria (outlined in the report) that are sensitive to neighborhood concerns. For example, recommending that Residential Hotels be located on commercially zoned sites is intended to reduce impacts on residential areas. Few if any, affordable sites are available in the Central Business District (CBD) for the new construction of Residential Hotels. New construction may well need to be on sites outside of the CBD, but still in the Central City. Unfortunately, such sites will be slightly less desirable for Residential Hotel use as they are often less accessible to restaurants, shopping and public transportation and because they are more likely to incur neighborhood opposition.

To the extent that Agency redevelopment decisions later result in the conversion or demolition of a Residential Hotel, staff recommends a policy that requires the Agency to replace the units on a one-for-one basis before or concurrently with the demolition. Such a policy could result in delays and additional subsidies to potential future office developments. In the event projects are

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threatened to be closed due to code violations, the Agency should seriously consider the acquisition of these projects.

## VOTE AND RECOMMENDATION OF COMMISSION

At its meeting of May 7, 1990 the Sacramento Housing and Redevelopment Commission adopted a motion recommending adoption of the attached resolution. The votes were as follows:

AYES: Moose, Simon, Strong, Williams, Wooley, Yew, Simpson

NOES: None

NOT PRESENT TO VOTE: Amundson, Wiggins

ABSENT: Diepenbrock, Pernel

## RECOMMENDATION

Staff recommends that the Agency approve the attached resolution which:

1. Approves the attached Residential Hotel Construction and Rehabilitation Program.
2. Directs staff to:
  - a) Give high priority to the allocation of available tax increment funds to the Residential Hotel Program as part of the annual budget process.
  - b) Reserve the \$1,000,000 tax increment money tentatively allocated in the 1990 budget for Residential Hotel development, and subsequent appropriations, for use on rehabilitation as a first priority and new construction as a second priority.
  - c) To the extent that monies are available, prepare and issue a Notice of Funds Available (NOFA) for monies allocated to rehabilitation.

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- d) To the extent that monies for new construction are available, investigate one or more sites in the Central City area which meet the locational criteria for Residential Hotel new construction described in the Program, commence negotiations on acquisition terms and return to the Agency for acquisition approval.
- e) To the extent that monies for new construction are available, prepare and submit for Agency approval a Request for Proposals (RFP) for Residential Hotel new construction on the above site(s) based on the criteria and program elements set forth in the Program.

Staff also recommends that the City Council direct Agency staff to work with City Planning and Building Inspection staff to report back within four months on:

- a) Amendments to the zoning ordinance necessary to facilitate the construction and rehabilitation of Residential Hotels.
- b) Modifications of the local building codes which would facilitate the construction and rehabilitation of Residential Hotels.

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Finally, staff recommends that the City Council direct Agency staff to report back within four months regarding the legal and policy implications of a City-wide Residential Hotel preservation and replacement ordinance.

Respectfully Submitted,



Robert E. Smith  
Executive Director

TRANSMITTAL TO COUNCIL:

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WALTER J. SLIPE  
City Manager

Contact Person: Tom Lee 440-1357

P: \SHARE\LKS\SRODEV\STAFF

# RESOLUTION NO.

ADOPTED BY THE REDEVELOPMENT AGENCY OF THE CITY OF SACRAMENTO

ON DATE OF \_\_\_\_\_

## SINGLE ROOM OCCUPANCY HOTEL CONSTRUCTION AND REHABILITATION PROGRAM

BE IT RESOLVED BY THE REDEVELOPMENT AGENCY OF THE  
CITY OF SACRAMENTO:

Section 1: The attached Proposal for Single Room  
Occupancy Hotel (SRO) Construction and Rehabilitation Program is  
hereby approved.

Section 2: Staff is authorized and directed to:

(a) Give high priority to the allocation of  
available tax increment funds to the SRO Program as a part of the  
annual budget process.

(b) Reserve the \$1,000,000 of tax increment money  
tentatively allocated in the 1990 Budget for SRO development and  
subsequent appropriating for use on rehabilitation, as a first  
priority and new construction as a second priority.

(c) To the extent monies are available, prepare  
and issue a Notice of Funds Available (NOFA) for monies allocated  
to rehabilitation, provided the funds are not directed to the  
immediate acquisition and rehabilitation of SROs at risk of being  
demolished or converted to alternative uses or closed due to severe  
code violations.

(d) To the extent that monies for new construction  
are available, investigate one or more sites in the Central City  
area which meet the locational criteria for SRO new construction  
described in the Program attached as Exhibit "A", commence  
appraisals on appropriate sites and report back to the Agency for  
acquisition approval.

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FOR CITY CLERK USE ONLY

RESOLUTION NO.: \_\_\_\_\_

DATE ADOPTED: \_\_\_\_\_

(e) To the extent that monies for new construction are available, prepare and submit for Agency approval a Request for Proposals (RFP) for SRO new construction on the above site(s) based on the criteria and program elements set forth in the Program.

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CHAIR

ATTEST:

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SECRETARY

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FOR CITY CLERK USE ONLY

RESOLUTION NO.: \_\_\_\_\_

DATE ADOPTED: \_\_\_\_\_

# RESOLUTION NO.

ADOPTED BY THE SACRAMENTO CITY COUNCIL

ON DATE OF \_\_\_\_\_

## SINGLE ROOM OCCUPANCY HOTEL CONSTRUCTION AND REHABILITATION PROGRAM

NOW, THEREFORE, BE IT RESOLVED BY THE CITY COUNCIL OF THE  
CITY OF SACRAMENTO:

Section 1: Agency staff is directed to work with staff of the City Planning Department and to report back within four months on any amendments to the zoning ordinance necessary to facilitate the construction and rehabilitation of SRO's.

Section 2: Agency staff is directed to work with staff of the Building Inspection Department and to report back within four months on any modifications to the local building codes which would facilitate the construction and rehabilitation of SRO's.

Section 3: Staff of the Housing and Redevelopment Agency is requested to report back within four months regarding the legal and policy implications of a City-wide SRO preservation and replacement ordinance.

\_\_\_\_\_  
MAYOR

ATTEST:

\_\_\_\_\_  
CITY CLERK

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FOR CITY CLERK USE ONLY

RESOLUTION NO.: \_\_\_\_\_

DATE ADOPTED: \_\_\_\_\_