THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Review of Swift Apartments Bridge to Home Loan Recommendation Increase

OVERVIEW

On March 25, 2025, the City Council will hear a Bridge to Home loan recommendation for the Swift Avenue Apartments (the Swift project) of $5.7 million in federal Community Development Block Grant (CDBG) funds. The Economic Development Department (EDD), which administers the Bridge to Home program, increased the proposed loan by $1.7 million from an initial recommendation of $4.0 million to backfill a recent reduction in project funding from another City-funded affordable housing funding program, administered by the San Diego Housing Commission (SDHC). As part of the proposed Council actions on this item, EDD is requesting authority to fund the $1.7 million loan increase using a $6.0 million allocation of federal CDBG funds intended for SDHC, per Council's final budget actions on the FY 2025 Adopted Budget. If approved, this action would reduce the anticipated SDHC CDBG allocation to $4.3 million. This report provides background on the City's two affordable housing funding programs, allocations included in the FY 2025 Adopted Budget, federal requirements for CDBG funds, along with a discussion of the item that will be considered by Council and our recommendation for Council consideration.

BACKGROUND

City Funds for Affordable Housing Are Awarded Through Two Separate Programs

To create or rehabilitate affordable housing, developers generally seek out various funding sources from different entities to finance projects. SDHC makes affordable housing funding opportunities available to developers through Notices of Funding Availability (NOFAs) made up of various SDHC-controlled resources, as well as City resources transferred to SDHC. SDHC provides "gap financing" in the form of below-market-interest-rate loans which fill the void between total development cost and the funds the developer can obtain from primary bank loans, tax credit equity, and other lenders and project sources.

In FY 2021, the City developed a second program, known as the Bridge to Home Program, to award City funds for affordable housing. The Bridge to Home Program is administered by EDD. Since then, five rounds of Bridge to Home NOFAs have been issued, drawing from City funding sources distinct from those awarded through the SDHC NOFAs.

Both NOFAs Have Different Subsidy Caps

In November 2022, our Office released IBA Report 22-30, which, among other things, analyzed the impacts of the City having two separate programs to award City funds for affordable housing. The report noted potential issues when a project receives funding from both the Bridge to Home and SDHC NOFAs, specifically related to potentially high amounts of City subsidies per unit. The total subsidy per unit is derived from taking the total loan funds awarded to a project and dividing it by the number of units a project will produce. For its own funds, SDHC has set a subsidy per unit cap of $76,800 to ensure that funds can be spread to as many projects as possible and encourage developers to identify alternative funding. The Round Four Bridge to Home NOFA stated "It is currently estimated that the City's NOFA will provide no more than $100,000 per unit, prioritizing projects needing less funding per unit, and may elect to place a cap on the total amount awarded per project based upon demand and available funds."

IBA Report 22-30 highlighted that projects applying for both the Bridge to Home and SDHC NOFAs could have combined subsidies across all City funds in excess of $100,000, even when the respective NOFAs would likely cap subsidies at or below $100,000 per unit. Following our report, SDHC began including in their FY 2024 an additional subsidy cap of $100,000 per unit *applied across all* City funding sources. In contrast, the Bridge to Home NOFA does not include a cap across all City funds. According to SDHC, the $100,000 per unit cap has resulted in SDHC loan reductions three times in the past on projects receiving funding from both NOFAs, with developers able to secure alternative funding each time.

Council Approved Contingency Language for SDHC to Receive $6.0 Million From CDBG

During FY 2025 budget development, City funds typically included in the SDHC NOFA from the City's Affordable Housing Fund (AHF)[1] were used to cover City homelessness expenditures. As a result, $6.0 million from AHF proposed for the next SDHC NOFA was instead redirected to the City's operational budget. Final Council actions in the FY 2025 Budget Resolution (R-315627) included the following language: "Approve $6,000,000 in Community Development Block Grants for the San Diego Housing Commission Notice of Funding Availability contingent upon the Kettner & Vine 1,000 bed shelter project not proceeding." This action was intended to backfill the SDHC NOFA in the event that the Kettner and Vine proposal did not move forward. Given that the City is no longer pursuing permanent shelter at Kettner and Vine, Council's final budget action

[1] The Affordable Housing Fund consists of fees the City charges to residential and commercial development to support affordable housing, as well as first-time homebuying and homelessness programs. The Fund is administered by the San Diego Housing Commission.

indicates that these CDBG funds should be made available to SDHC for their next NOFA, targeted for release in the fall, subject to the availability of funds.[2]

Federal CDBG Timeliness Test

The City receives federal CDBG funds to support specified activities, such as acquisition or rehabilitation of affordable housing, building or improving public facilities, community economic development, and publicly oriented services including homelessness support. Jurisdictions receiving CDBG funds must comply with federal "timely performance" requirements, also known as a "timeliness test," to ensure that CDBG-funded activities are being carried out in a timely manner. Specifically, the jurisdiction must carry a balance no greater than 1.5 times its annual grant allocation prior to May 2nd of each year.

According to EDD staff, the City has been unable to meet the CDBG timelessness test for the last three years largely due to two main factors: (1) CDBG is often identified as gap funding for the City's park and library projects, but project delays due to increasing construction costs have resulted in committed but unexpended CDBG funds for public works projects that have not yet begun construction and (2) the FY 2025 Annual Action Plan for CDBG funds budgeted $10.4 million for tenant improvements associated with the previously mentioned permanent shelter proposed at Kettner and Vine, which the City is not pursuing – resulting in additional unexpended CDBG funds.[3] For the latter, contingency language was included to redirect the $10.4 million if no longer needed for tenant improvements with up to $6.0 million allocated to the SDHC NOFA and up to $4.4 million for the Round 5 Bridge to Home NOFA, per the Council Resolution (R-315633).

The City's FY 2025 annual CDBG grant allocation is estimated at $11.3 million, meaning the carrying balance must not be greater than $16.9 million. EDD estimated at one point needing to spend an additional roughly $40.0 million to meet the timeliness test for FY 2025. Although our Office requested an updated CDBG spending target from EDD, the Department was unable to provide an update as of the time of this writing due to limited staffing resources. Nevertheless, the Department expects the Bridge to Home loan recommendations to assist in meeting timeliness requirements. For instance, the Round 4 Bridge to Home NOFA recommended CDBG acquisition funding for the Swift Avenue Apartments. The Round 5 NOFA is expected to award $18.4 million in CDBG acquisition funding including reprogrammed CDBG funds from various programs and projects with unexpended funds or unallocated balances. EDD has noted that not meeting the timeliness test for a fourth year may result in stricter federal scrutiny and potentially risk future reductions to the City's annual CDBG grant entitlement.

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[2] As an initial step, City and SDHC would need a memorandum of understanding (MOU) for SDHC to access CDBG funds, which could take at least three months. At the time of this writing, SDHC and EDD staff have not yet begun developing the needed MOU.

[3] Additional carrying balance of the City's CDBG funds can also be attributed to (1) project delays and higher costs following the pandemic and (2) debt obligation payments from the former redevelopment agency.

We note that CDBG acquisition funds are only considered expended under the timelessness test after funds are drawn down, following acquisition closing. According to EDD, the Bridge to Home loan recommendations using CDBG funds are being brought before Council by the end of March to allow time for the close of acquisition and drawing down of funds to count towards the timeliness requirements prior to a May 2nd deadline. Council will have an opportunity to request an update on the City's timeliness performance when Council hears the drafted FY 2026 Annual Action Plan, targeted for April 2025.

FISCAL AND POLICY DISCUSSION

SDHC $100,000/Unit Cap Led to a $2.3 Million Loan Reduction for the Swift Project

When the Round 4 Bridge to Home loan recommendations were presented to Economic Development and Intergovernmental Relations Committee on December 11, 2024, the Swift project initially had a loan recommendation of $4.0 million from CDBG funds. The Swift project also had a SDHC loan recommendation of $4.0 million drawn from federal HOME funds. With 57 units proposed (including one manager's unit), the Swift project would have received $140,000 per unit in subsidies across all City funds, which exceeds SDHC's cap across City funds of $100,000 per unit.[4] As a result, on January 28, 2025, SDHC reduced its loan for the project by $2.3 million to $1.7 million to align with the SDHC $100,000 subsidy cap.

EDD Plans to Use $1.7 Million from SDHC's CDBG Allocation to Backfill Loan Reduction

EDD intends to partially backfill the SDHC loan reduction on the Swift project by increasing the Bridge to Home loan recommendation by $1.7 million, resulting in an up to $5.7 million loan from CDBG, but the increased CDBG loan amount is proposed to be taken from the $6.0 million in CDBG funds that were to fall to SDHC per the FY 2025 Adopted Budget. This would reduce the SDHC CDBG allocation to $4.3 million. Notably, the Swift project is still in the process of seeking additional financing and aims to apply for State funds in April 2025 and State tax credits in September 2025. The developer has time to explore options to backfill the SDHC loan reduction prior to applying for State tax credits – therefore, the EDD loan increase preempts the developer's attempts to identify alternative funding sources. If the developer can secure alternative funds to fully backfill the SDHC loan reduction, the Bridge to Home loan increase may not be necessary. According to EDD, this loan increase is necessary for the City to meet the CDBG timeliness requirements and to make the project more competitive for an application for State funds in April.

As Council's resolution adopting the FY 2025 Budget noted that SDHC should be provided with a $6.0 million CDBG allocation for its next NOFA in the event that the Kettner and Vine shelter proposal did not move forward, EDD's plan to reduce the SDHC CDBG allocation appears inconsistent with Council intent and Council's final budget actions. As we have not received an updated accounting of CDBG funds above the timeliness threshold or funds anticipated to be drawn down by the May 2nd deadline, it remains unclear how necessary the

[4] For reference, total development costs with acquisition for the Swift project are estimated to be $41.8 million or $734,000 per unit. Without a SDHC loan reduction, a combined $140,000 per unit subsidy from Bridge to Home and SDHC loans would result in City funds subsidizing 19.1% of the total development cost.

reduction to the SDHC CDBG allocation is to meet the timeliness test or support the Swift loan increase. According to the staff report, EDD recommends the SDHC allocation be reduced since SDHC's next NOFA will not be released until fall 2025 with timelines for a yet-to-be-identified CDBG-funded project acquisition likely extending into FY 2026.

Notably, the circumstances around the SDHC NOFA timelines have not changed since Council took final budget actions to backfill the SDHC NOFA funds contingent on Kettner and Vine not advancing. The SDHC NOFA is typically released in the fall with previously awarded developer loans disbursed based on when certain project milestones are met. Rather, the timing of the Kettner and Vine decision and the pending progress to make the $6.0 million CDBG allocation available have resulted in CDBG funds being delayed until SDHC issues its next NOFA likely this fall. **Council may wish to ask EDD for clarification on whether the $1.7 million Swift loan increase *needs* to be drawn from the SDHC CDBG allocation or whether other CDBG funds can be made available for this purpose, which may still allow EDD to better meet timeliness while also preserving the $6.0 million CDBG allocation Council intended for SDHC.**

After receiving further clarification, *if* Council wishes to preserve Council's intent and maintain its final budget actions per the adopted FY 2025 Budget Resolution, we recommend Council make a motion stating that approving the Bridge to Home loan for the Swift Avenue Apartments should not result in any reduction to the $6.0 million in CDBG funds, and that those funds in full should be made available to SDHC as soon as possible. Additionally, the staff report outlines staff recommendations to use the remaining $4.3 million balance of the $6.0 million SDHC CDBG allocation for an upcoming State Homekey+ project proposal, rather than the next SDHC NOFA. Council may wish seek clarity on EDD's plan to use the remaining balance for a future Homekey+ project and evaluate whether this is consistent with Council's intent.

Increased Coordination of Both City NOFAs is Warranted

Regarding the differences in the Bridge to Home and SDHC NOFA rules, EDD and SDHC staff have agreed to revisit the maximum subsidy caps in the coming weeks with the overarching goal of aligning subsidy caps in both NOFAs at an appropriate amount and avoiding unanticipated loan reductions in the future. It would be a great benefit to the City, SDHC, and affordable housing developers to improve coordination and streamline processes across the City's two NOFAs to ultimately maximize the use of funds and number of projects funded with limited City affordable housing funds.

CONCLUSION

On March 25, 2025, the City Council will hear an item recommending a $5.7 million Bridge to Home loan recommendation for the Swift Avenue Apartments. This is a $1.7 million increase from the initial loan recommendation, and that increase is proposed to come from federal CDBG funds. As part of the proposed Council actions, EDD is requesting authority to draw the $1.7 million loan increase from a $6.0 million allocation of federal CDBG funds that was directed to SDHC during Council's final budget actions. This is not clearly aligned with Council's intent in the FY 2025 Adopted Budget and may not be necessary given that the developer has time to explore alternative funding options prior to applying for State tax credits in September 2025. However, it may be helpful in spending down City CDBG funds subject to imminent spending deadlines. Council may wish to clarify whether there are other CDBG funds available without urgent timeliness issues that can be used for the contemplated $1.7 million reduction to SDHC's future NOFA as well as the Department's plan to use the remaining balance for a future Homekey+ project and consider how this plan aligns with Council's intent. Upon further clarification, if Council wishes to maintain its intended final budget action to backfill the SDHC Affordable Housing NOFA with funding that would have otherwise gone to the Kettner and Vine proposal, we recommend Council action stipulate that approving the Bridge to Home loan for the Swift project should not result in any reduction to the $6.0 million CDBG allocation intended for SDHC and that the full $6.0 million CDBG allocation should be made available to SDHC as expeditiously as possible.

Our Office appreciates the early notification EDD provided on this issue and their working with us to provide answers to our questions.

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