Centre City Development Corporation

DATE ISSUED: November 3, 2004 REPORT NO. CCDC-04-39

ATTENTION: Chair and Members of the Redevelopment Agency
Docket of November 9, 2004

SUBJECT: Broadway Square (Broadway & 9th) - Approval of the proposed First Implementation Agreement to the Owner Participation Agreement between the Redevelopment Agency and Broadway & 9th, LP (Bud Fischer) - Core Redevelopment District of the Expansion Sub Area of the Centre City Redevelopment Project

REFERENCE: Proposed First Implementation Agreement
KMA Financial Analysis

STAFF CONTACT: Jeff Zinner, Associate Project Manager

SUMMARY

Issue - Should the Agency approve the First Implementation Agreement to the Owner Participation Agreement between the Redevelopment Agency and Broadway & 9th, LP (Bud Fischer) for the development of the Broadway Square project and authorize the Executive Director or designee to execute the agreement on behalf of the Agency?

Staff Recommendation - That the Agency approve the First Implementation Agreement to the Owner Participation Agreement between the Redevelopment Agency and Broadway & 9th, LP (Bud Fischer) and authorize the Executive Director or designee to execute the agreement on behalf of the Agency.

Centre City Development Corporation Recommendation - On October 20, 2004, this item will be considered by the Corporation Board.

Other Recommendations - None

Fiscal Impact - The Agency previously approved a loan in an amount not to exceed $6,000,000. The proposed Implementation Agreement would modify the terms of the first Agency loan and provide for a second Agency loan in the amount of $4,000,000. The total amount of the Agency loans would be a not to exceed amount of $10,000,000. Funds are available from the Fiscal Year 2005 Centre City Low and Moderate Income Housing fund.

BACKGROUND

This project advances the Visions and Goals of the Centre City Community Plan and the Objectives of the Centre City Redevelopment Project by:

- developing a range of housing to meet the needs of an economically and socially balanced population,
- contributing to the vision of downtown as a major residential neighborhood,
- providing replacement units for potentially lost units,
- creating high-density housing, and
- eliminating underutilized parcels.

The Development Team consists of the following

ROLE/ FIRM	CONTACT	OWNED BY
Developer Broadway and 9th, LP	Bud Fischer, Managing Partner	SJS, LLC Goldberg Family Trust (Privately Owned)
Architect Architects Bundy & Thompson	Dick Bundy	Dick Bundy/David Thompson (Privately Owned)
General Contractor Douglas E. Barnhart	William Sharp, President	Douglas E. Barnhart (Privately Owned)
Loan Servicer Berkshire Mortgage Finance Limited	Martin Meagher	(Privately Owned)
Construction Lender Bank of America	Paul Shipstead	(Publicly Owned)

On March 25, 2003, the Redevelopment Agency approved an Owner Participation Agreement (“OPA”) with Broadway and 9th, LP (Bud Fischer, “Developer”) to construct a 12-story, 394-unit, affordable housing project on a 25,000 square-foot site on the southeast corner of 9th Avenue and Broadway. The project includes a mix of “living units,” one-bedroom and two-bedroom apartments, plus approximately 2,000 square feet of commercial/retail space, and two levels of underground parking.

Since that time, significant progress has been made in terms of design, financing, and towards issuance of building permits for the project. However, the project has also been greatly affected by industry-wide increases in the cost of materials, most notably steel, and has also incurred greater indirect and financing costs. In addition, the site has greatly appreciated in value. These factors had led the Developer to question the financial viability of the project and his desire to proceed. Ultimately, staff and the Developer agreed on the terms presented in this report which will facilitate the development of the project.

Project Status

Design

- Staff and the Developer/Architect have refined the design of the project and believe that it is much improved.
- Upgraded materials (stone) will be used around the entire frontage of the building up to the second story and continue up ten stories along the two tower elements fronting on 9th Avenue.
- The full height window wall system has been retained at the 12th story.
- Staff and the Developer continue to refine colors and placement of faux balcony railings.
- Staff and the Developer have met with the City of San Diego Building Official regarding an issue regarding the use of thru-the-wall air conditioning units. Per the Developer, the inability to use these units would have resulted in an additional $2,000,000 cost impact. However, this issue appears to have been resolved and should have a minimal cost impact.

Permits/Construction

- Developer has completed 100% drawings and submitted to the City of San Diego for building permits. Permits are anticipated to be ready for issuance within 45 - 60 days.
- Developer has negotiated agreements with the adjacent property owners to allow shoring/underpinning activities to occur on the adjacent owner's parcels.
- Plan check has resulted in the loss of one living unit, reducing the total units from 394 to 393.

Costs

- Total project costs are estimated to have increased from $35,922,000 to $43,468,000, excluding land, a difference of $7,546,000.
- Direct project costs are estimated to have increased from $29,151,203 to $34,345,606, a difference of $5,194,403.
- Indirect project costs are estimated to have increased from $3,765,000 to $5,220,617, a difference of $1,455,617, which includes a $1,000,000 increase in the developer fee. Since the developer fee is to be paid from the Developer's share of cash flow, there is no net impact as a result of this change.
- Financing costs are estimated to have increased from $3,005,340 to $3,901,584, a difference of $896,244.

Financing

- On behalf of the Developer, the Housing Authority of the City of San Diego issued bonds in November 2003 in the amount of $29,500,000. However, proceeds have not been expended. Bond proceeds are currently held by a Trustee.
- After completion, the Developer could be responsible for an "equalization payment" if within 90 days of 90% occupancy the project is not performing per pro forma. For example, if on the threshold date, the project only supports $28,500,000, Developer would be required to pay the $1,000,000 difference.
- Fannie Mae will be guaranteeing the bonds. The Developer will need to secure an extension from Fannie Mae to provide additional time for the Developer to start construction. Originally, the Developer had until November 15, 2004 to start.

<u>DISCUSSION</u>

Changes to the Owner Participation Agreement which are addressed by the First Implementation Agreement include the following:

<u>Developer Equity</u>

- In order to help address the cost impacts the project is facing, the Developer will be contributing a total of $2,000,000 in cash equity which represents an increase of $1,555,000 over the original $445,000 of cash equity in the original Agreement.
- The Developer is also contributing the land for the project. In the original Agreement the land was assigned a value of $3,500,000. Currently, this land has a conservative value of $6,250,000 and, in fact, could be worth much more. At a minimum, the value of the Developers land contribution has increased by $2,750,000.

<u>Agency Loan(s)</u>

- Terms of Original Agency Loan would be modified as follows:
    - Term increased from 35 to 55 years.
    - Interest rate decreased from 4% to 2%.
    - Initial three-year period of no payments added. The original Agreement provided for interest only payments in years 1 - 5. The current proposal calls for no payments in years 1 - 3, with interest only payments in years 4 and 5, and amortized payments for the balance of the term subject to the additional principal payments.
    - Additional Principal Payments of $50,000 annually begin in year 21 instead of year 16.
    - Additional principal payments of $100,000 annually begin in year 31 instead of year 26.
- Agency would make a Second Agency Loan in an amount up to $4,000,000 with zero interest.

  - Term would be 55 years with payments beginning upon repayment of First Agency Loan. The balance of the Second Agency Loan would be amortized over remaining years of term.
- Both loans would be repaid by year 55.
- The original Agency loan of $6,000,000 represented a per unit subsidy of $20,547 per restricted unit, or $15,267 per all units. On a per bedroom basis, the subsidy level was $19,543 for the restricted units.
- Based on the proposed total loan amount of $10,000,000, the subsidy per restricted unit would be $34,130, or $20,478 for all units. On a per bedroom basis, the subsidy level for the restricted units would be $32,680.

Rent and Income Restrictions

- Overall, the current proposal essentially retains a balance and range of affordability across all unit types.
- Total number of restricted units remains unchanged.
- There are three significant changes proposed to the rent and income mix.
  - Fifteen Living Units which were at the 80% AMI rent level are changed to 100% AMI rents.
  - Eight one-bedroom units originally at the 60% AMI rent level are changed to 80% AMI rents.
  - The number of market-rate two-bedroom units increased by 2.
- Rent and Income levels shown in the table below are based on 2004 levels.

Comparison of Rent/Income/Unit Mix

Unit Type	Proposed	Original	Income Restriction	Rent Restriction
Living Units	55 172 15 25	55 188 0 25	@ 50% AMI ($24,000/ 1 person) @ 80% AMI ($38,350/ 1 person)* @120% AMI ($53,250/ 1 person) Market Rate	30% of 50% AMI = $534 30% of 80% AMI = $867 30% of 100% AMI = $995 Market Rate
One Bedroom	20 0 18 58	18 8 9 61	@ 50% AMI ($27,400/ 2 persons) @ 60% AMI ($28,860/ 2 persons) @ 80% AMI ($43,850/ 2 persons)* Market Rate	30% of 50% AMI = $605 30% of 60% AMI = $732 30% of 80% AMI = $985 Market Rate
Two Bedroom	7 6 17	8 7 15	@ 50% AMI ($30,850/ 3 persons) @ 80% AMI ($49,300/ 3 persons)* Market Rate	30% of 50% AMI = $677 30% of 80% AMI = $1,105 Market Rate
Restricted Units	293	293	*For 80% rent-restricted units, Developer may income-qualify tenants at up to 100% of AMI.	
Total Units	393	394		

Schedule of Performance

- Project was originally scheduled to begin construction in September 2004.
- That date was changed to November 2004 to accommodate the bond financing schedule.
- The current schedule would have Developer starting construction approximately February/March 2005.

Project Budget

Sources of Funds	Original	Proposed	Change
Tax Exempt Bond	$27,977,000	$28,968,000	$991,000
Developer Equity - Deferred Fee	$1,500,000	$2,500,000	$1,000,000
Developer Equity - Land	$3,500,000	$6,250,000	$2,750,000
Developer Equity - Cash	$445,000	$2,000,000	$1,555,000
Agency Loan (s)	$6,000,000	$10,000,000	$4,000,000
Total Source of Funds	**$39,422,000**	**$49,718,000**	**$10,296,000**

Cost Savings

- Under the original Agreement, the Agency would have received the benefit of any cost savings. As proposed, the Agency would receive the benefit of any cost savings except to the extent that such funds are needed to make the “equalization payment”.

ANALYSIS AND PROJECT BENEFITS

- Keyser Marston Associates (“KMA”), economic consultants to the Agency, have reviewed the proposed transaction and conclude that the level of additional Agency financial assistance is warranted and the Developer’s return is within industry standards for this type of residential development, see KMA analysis attached as Exhibit B.

- Although the Agency will be contributing a much larger sum than originally anticipated, the cost impacts are consistent with what projects have been experiencing industry-wide.

- The Developer is making a substantially larger cash contribution to the project. Unlike many affordable housing projects, the Developer has a sizable equity stake at risk. In addition, the Developer has a proven track record of developing and successfully managing similar type units Downtown.

- On an Internal Rate of Return ("IRR") basis, the Developer's position has not improved. Under the current scenario the Developer would have an IRR, using the original land value of $3,500,000 and including repayment of developer fees, of 20.6%. If land were valued at $6,250,000, which KMA estimated as a reasonable valuation at the time of the bonds were issued, that rate would drop to 14.6% and be even less if land were valued at the Developer's estimate of land value. In the original pro forma the Developer's IRR was 23.4%.

- The Agency funds will be repaid. The net present value of the repayments is approximately $2,000,000.

- The Developer is a for-profit Developer. As a result, this property will remain on the tax rolls and produce substantially more tax increment dollars for the Agency than it currently is producing. The increase in tax increment is estimated to be over $400,000 annually.

- As previously mentioned, on a subsidy per unit basis, this project compares very favorably to other recent projects. At under $35,000 per unit, the project is at the low end of the range of assistance provided.

- From a scheduling perspective, this project is essentially ready to go. Construction can reasonably be expected to be underway within six months.

- In order to continue to meet our affordable housing production requirements, it is essential that the Agency continue to facilitate the development of new affordable housing units to offset the tremendous number of market-rate units being constructed.

- Due to the facts that this project did not originally go through the City of San Diego's Affordable Housing Notice of Funding Availability ("NOFA") process, that the structure of the transaction is much different than the typical NOFA transaction, that time is of the essence due to the potential for additional cost impacts from the possible assessment of Development Impact Fees, and that funds are available from the Centre City Project Low and Moderate Income Housing Fund, it is proposed and recommended that this project not go through the NOFA process for the requested additional funding.

SUMMARY/CONCLUSION

The Broadway Square project represents an opportunity to provide a significant number of affordable housing units Downtown. The proposed Implementation Agreement will allow this worthwhile project to move forward. Construction could start as soon as February/March 2005 with occupancy in 2007. The cost impacts affecting the project are not unique to this project. To help address this situation, the Developer is contributing additional cash equity to the project plus land which has substantially appreciated. Staff recommends approval of the proposed First Implementation Agreement.

Respectfully submitted,

Jeff Zinner
Associate Project Manager

Concurred by:

Peter J. Hall, President

Attachments:
Attachment A: Proposed First Implementation Agreement
Attachment B: KMA Analysis