Centre City
Development
Corporation

REPORT NO. CCDC-08-09
CCDC-08-05

DATE ISSUED: April 23, 2008

ATTENTION: Honorable Chair and Members of the Redevelopment Agency
Council President and City Council
Docket of April 29, 2008

ORIGINATING DEPT.: Centre City Development Corporation

SUBJECT: Ten Fifty B Affordable Housing Project (North side of B Street between 10th and 11th avenues) – Amended and Restated Owner Participation Agreement and Amended and Restated Ground Lease with Affirmed Housing Group – East Village Redevelopment District of the Expansion Sub Area of the Centre City Redevelopment Project -- **JOINT PUBLIC HEARING**

COUNCIL DISTRICT: Two (2)

REFERENCE: None

STAFF CONTACT: Jeff Graham, Assistant Vice President – Redevelopment
(619) 533-7181

REQUESTED ACTION:
Approve an Amended and Restated Owner Participation Agreement ("OPA") and Amended and Restated Ground Lease for the proposed Ten Fifty B Affordable Housing Project, a previously-approved project located on the north side of B Street between 10th and 11th avenues in the East Village Redevelopment District (Attachment A – Site Map).

STAFF RECOMMENDATION:
That the Redevelopment Agency of the City of San Diego ("Agency"):

- Approve the Amended and Restated OPA between the Agency and Affirmed Housing Group ("Developer") for the Ten Fifty B Affordable Housing Project ("Project") with terms and conditions as outlined in this report;

- Approve the Amended and Restated Ground Lease between the Agency and Developer with proposed terms and conditions as outlined in this report; and

- Certify that the Agency has reviewed and previously considered information contained in the Environmental Impact Report and Secondary Study for the project and make certain findings and determinations regarding environmental impacts of the development.

And, that the City Council of the City of San Diego ("City Council"):

- Approve the Amended and Restated Ground Lease between the Agency and Developer with proposed terms and conditions as outlined in this report; and

- Certify that the Agency has reviewed and previously considered information contained in the Environmental Impact Report and Secondary Study for the project; and make certain findings and determinations regarding environmental impacts of the development.

SUMMARY:
The Centre City Development Corporation Board and Agency approved the Project design, original OPA, form of ground lease and environmental Secondary Study for the project on September 19, 2007 and October 9, 2007, respectively (Resolution Numbers R-04209, R-04210, and R-04211).

The Project was the first affordable housing project in which the Agency chose to acquire the land from the Developer, enter into a long-term ground lease for the improvements, but receive insufficient residual cash flow from operations to fully repay the Agency subsidy at loan maturity. Subsequent to Board and Agency approvals, the Developer's tax credit counsel deemed the approved OPA and ground lease terms inconsistent with the syndicators' standard underwriting criteria for tax credit financing in circumstances when a ground lease is a component of the transaction. In order for a partnership to claim tax credits, the partnership must be deemed to be the "owner" of the project for tax purposes. One of the factors in this determination is whether the loans on the project will be considered true debt for federal income tax purposes. If they are not, the funding may be considered additional ownership interest in the Project which could affect the allocation of tax credits.

As a consequence, the Developer is requesting material changes to the terms of the OPA, Agency financing and ground lease. Staff has conducted extensive independent research from multiple qualified sources including Tax Credit Counsels, Tax Credit Accountants and sister Redevelopment Agencies and has concluded that the requested changes are consistent with industry standard underwriting principles and are necessary. The proposed changes will not increase the Agency's total subsidy or subsidy per unit.

On October 9, 2007, the Redevelopment Agency approved an OPA with Affirmed Housing Group, a San Diego-based for-profit real estate development firm specializing in affordable rental housing. The OPA provides for the construction of a 23-story, 229-unit affordable rental housing development on the north side of B Street between 10th and 11th avenues in the East Village Redevelopment District. Pursuant to the approved OPA, a total of 226 units would be restricted for 60 years to provide affordable rents to low- and very-low-income persons. The Developer requested Agency assistance in the amount of $33,975,000 for financing the acquisition and construction of the affordable housing Project.

FISCAL CONSIDERATIONS:
Funds are available in the amount of $33,975,000 in the Redevelopment Agency FY 2008 Low and Moderate Income Housing Fund.

CENTRE CITY DEVELOPMENT CORPORATION RECOMMENDATION:
On March 26, 2008, the Corporation Board of Directors voted 6 – 0 in favor of the staff recommendation.

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:
None.

DEVELOPMENT TEAM

ROLE	FIRM/CONTACT	OWNERSHIP
Developer/General Partner	Affirmed Housing Group/ James Silverwood, President	James Silverwood (Privately Owned)
Tax Credit Investor/Limited Partner	Boston Capital Finance, LLC/ William Fazzano, Vice President	(Privately Owned)
Property Manager	Solari Enterprises/ Bruce Solari, President	Bruce Solari (Privately Owned)
Architect	Martinez + Cutri Architects/ Tony Cutri, Project Architect	Joseph Martinez and Tony Cutri (Privately Owned)

BACKGROUND

The proposed Project advances the Visions and Goals of the Downtown Community Plan and the Objectives of the Centre City Redevelopment Project by:

- Expanding the supply of affordable-rental housing;
- Adding to the range of downtown housing opportunities; and
- Increasing the supply of affordable housing suitable for families with children.

DISCUSSION

Scope of the Project – The Developer proposes to construct and operate a 23-story, 229-unit affordable rental housing development on a 21,780 square-foot site located on the north side of B Street between 10th and 11th avenues ("Site") in downtown's East Village District. The Project would consist of 68 studio, 57 one-bedroom, 34 two-bedroom and 70 three-bedroom units. A total of 226 apartments would be affordable to very low and low-income households earning 25% to 60% of area median income.

The following is a summary of the Project:

Site Area	21,780 square feet
Maximum Floor Area Ratio (FAR) Permitted (1992 Planned District Ordinance) Minimum FAR Required Proposed FAR	10.0 Base + 2.0 Residential Incentive + Exempt Street-Level Retail N/A 11.4
FAR Bonuses Proposed	N/A
Stories / Height	23 stories / 236 feet
Amount of Retail Space	13,450 sq. ft.
Amount of Office Space	N/A
Type of Housing	Apartments
Total Number of Units / Total Residential Square Feet	229 / 182,209 sq. ft.
Types of Units (sizes)	68 studio (465 sf avg.) 57 1-br (648 sf avg.) 34 2-br (887 sf avg.) 70 3-br (1,068 sf avg.) 229 apartments
Projected Rental Rates	$373 – $1,059 per month (226 affordable income-restricted units reserved for families with income 25% to 60% of area-median income and 3 units will be unrestricted managers units)
Number of Units Demolished	0
Inclusionary Housing Ordinance Compliance/ Number of Affordable Units	Provision of 226 affordable apartments
Parking Required Proposed	 115 spaces (0.5/unit) 118 spaces (0.52/unit) 6 spaces (retail)
Assessor's Parcel Nos.	533-064-004

Project Budget and Financing – The Developer's estimated total cost for development and construction of the apartment Project is approximately $88,682,000 (including land, direct and indirect costs). The Developer proposes to finance the affordable housing Project with a combination of housing revenue bonds, tax credits, deferred developer fee, private investment funds, State Multi-family Housing Program ("MHP") funds and a Redevelopment Agency loan as follows:

SOURCES OF FUNDS	CONSTRUCTION	PERMANENT
Housing Revenue Bonds	$45,000,000	$8,318,000
Multi-Family Housing Program	-----	10,000,000
Tax Credits	$4,900,000	33,739,000
Private Investment Funds (to be replaced by State Prop 1C, Federal Home Loan Bank AHP, and other funds)	$2,400,000	2,400,000
Deferred Developer Fee	$250,000	$250,000
Redevelopment Agency Assistance	$33,975,000	$33,975,000
TOTAL	$86,525,000	$88,682,000

The Developer has received conditional approval from the California Department of Housing and Community Development ("HCD") in the full amount ($10,000,000) of their request for financing from MHP funds. The Developer and HCD will continue discussions to resolve the remaining conditions prior to the MHP loan funding upon conversion to permanent financing.

Keyser Marston Associates ("KMA"), economic consultants to the Agency, concluded that the Project's development costs, net-operating income, and financing costs fall within industry standards for a project of this type. The attached pro forma (Attachment B) represents a consensus of the revised OPA and ground lease terms following extensive discussions between staff, KMA, and the Developer.

<u>Revised Terms of OPA and Ground Lease</u>

Property Acquisition and Ground Lease

The Developer has entered into a Purchase and Sale Agreement ("purchase option") with the property owner to acquire the 21,780 square-foot site for $4.4 million or $202 per square foot with the condition that the Developer construct ground-floor retail space in the building and allow the Seller to retain ownership of that portion of the building. The purchase option provides for a closing date on or before March 30, 2008, with rights for the Seller to operate a Burger King restaurant on the Site until close of escrow. The Developer has requested and has been granted an extension of the closing date to May 6, 2008 from the Seller.

Upon completion of construction, the Developer shall transfer ownership of the land to the Agency and receive a $4.4 million reduction in the Agency loan as compensation. Under the proposed revised terms, the Agency would concurrently enter into a 65-year ground lease with an option to extend, at the Developer's discretion, for an additional 25 years, for a total of 90 years. The Developer shall own and operate the residential portion of the Project after completion of Project construction. Upon expiration of the ground lease in Year 91 and thereafter, the Agency would own the residential portion of the building free and clear.

The ground lease payments in Years 1 through 55 have slightly increased from those included in the approved OPA and ground lease. Beginning in Year 56, the annual ground lease payments shall equal the greater of: (a) 10.0% of the Effective Gross Income ("EGI") from the market-rate residential units or (b) $100,000. Annual ground lease payments to the Agency are estimated to equal $1.8 million beginning in Year 56 and will be directly tied to EGI from the market-rate residential units. The Agency's ground lease payments will vary based upon the operating performance of the market-rate residential units.

The following is a comparison of the approved and proposed terms and conditions of the ground lease. (Terms which are proposed to change are reflected in *italicized typeface*.)

Ground Lease Terms	Approved Terms	Proposed Terms
Agency Land Ownership	The Developer shall transfer title to the Developer's portion of land site control to the Agency at completion of project construction, upon a certificate of occupancy.	The Developer shall transfer title to the Developer's portion of land site control to the Agency at completion of project construction, upon a certificate of occupancy.
Lease Term	The Agency shall enter into a 60-year ground lease with the Developer after completion of project construction.	*The Agency shall enter into a 65-year ground lease, with a 25-year option to extend at the Developer's discretion, with the Developer after completion of project construction.*
Lease Payments	The Developer shall pay $25,000 annually in Year 1-5, then $50,000 annually in Year 6-10 and $100,000 annually in Year 11-60.	The Developer shall pay *$27,500* annually in Year 1-5, then *$52,500* annually in Year 6-10 and *$102,500* annually in Year *11-55*. *Beginning in Year 56, the Developer shall pay an amount equal to the greater of: (a) 10.0% of the annual Effective Gross Income from the market-rate residential units or (b) $100,000.*

Ground Lease Terms	Approved Terms	Proposed Terms
Ownership of Improvements	Upon expiration of the ground lease term, the Developer shall transfer its leasehold interest in the residential units to the Agency free and clear, and the Agency will receive 100% of the residential cash flow.	Upon expiration of the ground lease term, the Developer shall transfer its leasehold interest in the residential units to the Agency free and clear, and the Agency will receive 100% of the residential cash flow.

Revised Agency Participation – Under the Amended and Restated OPA, total Agency financial participation would remain at $33,975,000, which equates to an Agency subsidy of approximately $150,000 per affordable unit or $84,000 per bedroom. Of that amount, $4,400,000 shall be disbursed at the time of closing for land acquisition and the remaining $29,575,000 shall be a loan. The term of the loan shall be reduced from 60 years to 55 years to coincide with the expiration of the affordability restrictions.

The interest rate shall increase from 3.0% to 4.0%, simple interest, as compensation to the Agency for an extended ground lease term to 90 years, of which the final 35 years the Project will be operated as market-rate residential units. Upon Agency loan maturity in Year 55, the total payment due to the Agency is estimated to equal $81,660,000, including principal and accrued but unpaid interest. The total payment due to the Agency at loan maturity will vary based on the amount of residual cash flow from operations available to be applied toward the loan. The ability of the Developer to make full payment to the Agency upon the loan's maturity would be accomplished through the sale or refinance of the leasehold interest, a value which will be based on market-rate rents and operating expenses beginning in Year 56.

Agency Option to Acquire Residential Leasehold Interest

Beginning in Year 56 of the ground lease, the Agency shall have the right to acquire the residential leasehold interest in the Project at the greater of (a) the Fair Market Value ("FMV") of the leasehold interests with the consideration of the underlying affordability restrictions and the release thereof beginning in Year 56, or (b) the sum of the remaining non-Agency debt obligations, including accrued but unpaid interest, and taxes. The FMV of the leasehold interest in Year 56 is estimated to equal $113,700,000 based on the discounted cash flow of the remaining value of the market-rate residential leasehold interest. The FMV in Year 56 will be dependent upon many variables including market rents, operating costs, capitalization rates, building conditions and economic conditions in place at that time. The estimated balance of the MHP loan, including accrued but unpaid interest, is estimated to be $24,796,000 at the end of Year 55.

Below is a comparative estimate of the future values upon which the Agency's purchase price of the residential improvements will be based and their respective present values:

	Year 55	Present Value
A. FMV of Leasehold Improvements	$113,710,000	
Less: Agency loan balance	81,660,000	
Agency Cash Required to Purchase	$32,050,000	$4,832,000
B. Balance of Non-Agency obligations	$24,796,000	$3,738,000

Agency Right of First Refusal to Acquire Residential Leasehold Interest

In an effort to minimize the Agency's exposure to possible sharp escalations in the property's FMV, the Agency shall be provided with a Right of First Refusal to acquire the residential leasehold interests. At any time after Year 55 of the ground lease, upon the Developer's receipt of a bona fide offer from a third party, the Agency shall have the right to acquire the residential improvements for a price equal to the outstanding amount of non-Agency debt plus the amount of income taxes that would be incurred by the Developer from the sale.

Agency Right of First Refusal to Acquire Retail Leasehold Interest

Staff is currently negotiating a separate Right of First Refusal with the property's seller for the ground-floor retail portion of the project. Successful negotiation of this separate Agreement is not a condition precedent to the closing of the Agency's subsidy for the project.

In the Event of Foreclosure by Permanent Lender

While the Agency loan shall be subordinated to the construction and permanent financing lenders, the Agency shall have the right to cure in the unlikely event of default by the Developer on the non-Agency obligations. The permanent loans shall be subordinated to the Agency's ground lease, protecting the Agency's fee interest in the land. In the event of foreclosure, the permanent financing lender shall have the right to increase the rental rates on the residential units up to a level affordable by a household earning 60% of Area Median Income ("AMI"). The ground lease payments shall be reduced to one dollar ($1) per year until the end of Year 30.

Revised Schedule of Performance –

Action	Completion Date
CCAC approval of OPA and form of ground lease	September 13, 2007
CCDC Board approval of OPA and form of ground lease	September 19, 2007
Redevelopment Agency approval of OPA and option for ground lease	October 9, 2007
CCDC Board approval of amended OPA and ground lease	March 26, 2008
Redevelopment Agency approval of amended OPA and ground lease	April 29, 2008
Developer to close on construction financing and site acquisition	May 2008
Start Construction	May 2008
Complete Construction	May 2010

Revised Parking Design – As the Developer has proceeded with construction design for the Project, there have been modifications to the design of the underground parking garage that has reduced the amount of parking stalls from 132 to 124 spaces. Of the 124 spaces, 6 spaces are dedicated to the retail portion of the Project. The remaining 118 spaces for the residential units in three levels of underground parking continue to exceed the minimum 115 parking spaces required for the Project (0.5 spaces per unit under the 1992 Planned District Ordinance). Of the 118 spaces, one space shall be dedicated for a shared-use vehicle. While the parking is less than would be required under the 2006 PDO, the Project is located one block from the Smart Corner transit station and adjacent to major bus routes.

In addition, a conflict has been identified between the extent of the garage encroachment into the public sidewalk and existing utilities within the public sidewalk. A major AT&T transmission line is located under the B Street sidewalk that would cost over $430,000 to relocate. As a result, the drive aisles/back-up areas for the parking stalls have been reduced from the City Standard 24 feet to 22 feet. Under the State's Density Bonus Law and the City's regulations enacted pursuant thereto, developers of affordable housing may request one or more "incentives" or "deviations" to the development standards for projects if compliance with the standards would have adverse financial impact on the projects. The first deviation is to be granted by right, with additional deviations potentially subject to discretionary review. The Developer has requested such a deviation for the aisle width which has been granted by staff due to the financial impact of the utility relocation.

Environmental Review – Under the 2006 Final Environmental Impact Report ("FEIR"), an Environmental Secondary Study is prepared for all developments in the Centre City area in order to evaluate the project's compliance with the Downtown Community Plan and Planned District Ordinance and, therefore, the findings and conclusions of the FEIR. The project has been found to be in compliance with those planning documents; therefore, no further environmental review is required.

CONCLUSION

While the requested change in terms to the OPA and ground lease delay the Agency's ability to gain ownership of the residential units without significant costs in Year 55, the Agency will have the potential to receive full repayment of its subsidy, including accrued interest at 4.0%, at the time of the loan's maturity (Year 55). These funds could be applied to the acquisition, construction and rehabilitation of new affordable housing to maintain supply or to exercise the Agency's option to purchase the leasehold interest in the residential units.

Respectfully submitted,

Jeff Graham
Assistant Vice President - Redevelopment

Concurred by:

Nancy C. Graham
President

Attachments:

A – Site Map
B – Pro Forma Analysis
C – 33433 Summary Report
D – Amended and Restated Owner Participation Agreement
E – Amended and Restated Ground Lease
F – Secondary Study

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