Centre City Development Corporation

REPORT NO. CCDC-09-38

DATE ISSUED: November 18, 2009

ATTENTION: Honorable Chair and Members of the Redevelopment Agency
Docket of November 23, 2009

ORIGINATING DEPT.: Centre City Development Corporation

SUBJECT: Cedar Gateway (north side of Cedar Street, between Fifth and Sixth avenues) – First Amendment to the Disposition and Development Agreement – Cortez Redevelopment District of the Expansion Sub Area of the Centre City Redevelopment Project

COUNCIL DISTRICT: 2

REFERENCE: None

STAFF CONTACT: Eri Kameyama, Associate Project Manager, 619-533-7177

REQUESTED ACTION: That the Redevelopment Agency of the City of San Diego ("Agency") approves the proposed First Amendment to the Disposition and Development Agreement (DDA) ("Amendment") between the Agency and Cedar Gateway, L.P. ("Developer") for the Cedar Gateway project ("Project") located on Cedar Street between Fifth and Sixth avenues.

STAFF RECOMMENDATION: That the Agency approves the proposed Amendment between the Agency and Developer, and authorizes the Agency Executive Director to execute the Amendment.

SUMMARY: Cedar Gateway is a proposed 65-unit affordable housing project located on the north side of Cedar Street between Fifth and Sixth avenues. On May 22, 2008, the Agency entered into a DDA with the Developer to assist in acquisition and development of the Project. Due to unexpected changes in the financial markets, adjustments in the Project's financing structure and the ground lease are necessary to make the Project viable. Staff recommends that the DDA and certain attachments be amended to reflect new terms and conditions required by the construction/permanent lenders.

FISCAL CONSIDERATIONS: There is no change in the Agency subsidy for the affordable housing component ($8,926,000). The Agency's contribution for the construction of the first level of underground parking (to be used as public parking) shall be reduced from $1,400,000 to $1,344,000. The funds were available in the Cortez Neighborhood line item of the FY 2009 Centre City Redevelopment Project Area budget and have already been encumbered.

CENTRE CITY DEVELOPMENT CORPORATION RECOMMENDATION: On October 21, 2009, the Centre City Development Corporation Board voted 7-0 to approve the Amendment as recommended by staff.

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS: None.

DEVELOPMENT TEAM

ROLE	FIRM/CONTACT	OWNERSHIP
Developer	Squier Properties LLC Gary Squier, President ROEM Corporation: Marcus Griffin, Director of Finance	Privately owned by Gary Squier and Anita Landecker Privately owned by Robert Emami with family members holding minority stakes
General Contractor	ROEM Builders, Inc. Marcus Griffin, Director of Finance	Privately owned by Robert Emami
Architect	Silber Architects: John Silber, Principal	John Silber (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;
- Increasing the supply of affordable housing for families with children; and
- Developing affordable, permanent supportive housing units for special needs population.

Cedar Gateway is a proposed 65-unit affordable housing project on the north side of Cedar Street between Fifth and Sixth avenues in the Cortez Redevelopment District. The Agency entered into a DDA with the Developer on May 22, 2008 to assist with the site acquisition and development of the Project. The Agency acquired the project site, which consists of a vacant lot and a historic building previously used as a chapel. The Agency plans to rehabilitate the historic building to attract an active commercial use. A Request for Proposals will be issued by the Agency in the future to solicit proposals from potential tenants of the historic building. The Agency will lease the remainder of the site to the Developer with a long-term ground lease to be built and operated as a 65-unit affordable housing project. The Project will include three levels of underground parking, of which the first level will be owned by the Agency and used as public parking for the commercial tenant of the historic building.

The total purchase price of the site was $6,360,000, of which $5,267,000 were allocated to the housing portion and paid out of the Low and Moderate Income Housing Fund ("Low/Mod Fund"). The remaining $1,093,000, allocated to the historic building, was paid out of the Agency's non-Low/Mod Fund ("80% Funds"). The Agency committed a 55-year residual receipts loan with 5% interest rate in the amount of $3,661,000 to the Developer to assist with construction of the housing portion of the Project (from Low/Mod Fund). The costs of the public parking component will be paid by the Agency with the 80% Funds. The total Agency subsidy for the Project, exclusive of the public parking component, is $8,926,000, which includes the site acquisition cost of $5,267,000 and a $3,661,000 loan committed for the housing development.

Subsequent to entering into the DDA with the Agency in May 2008, the Developer diligently pursued funding sources identified in the DDA and obtained commitments/allocations from the following sources (including both construction and permanent sources):

Program:	**By:**	**Amount**
9% Tax Credits	California Tax Credit Allocation Committee (CTCAC)	$16,500,000
Multifamily Housing Program (MHP) Supportive Housing	California Department of Housing and Community Development (HCD)	$3,301,000
Mental Health Services Act (MHSA) Program	California Department of Mental Health & California Housing Finance Agency (CalHFA)	$2,752,000,
Construction loan	CalHFA	$18,800,000
Permanent loan	CalHFA	$2,150,000
Residual Receipts Gap Loan	CalHFA	$325,000
California Recycle Underutilized Sites (CALReUSE) Program (grant)	California Pollution Control Financing Authority	$94,000

In October 2008, the Project received all of the necessary funding commitments to start construction in March 2009. However, the conditions of the overall economy deteriorated rapidly and the shortage of capital in the financial market severely impacted the Project. In November 2008, CalHFA notified the Developer that it can no longer provide the construction and permanent loans that it committed in June 2008 due to the shortage of loan funds.

The Developer was able to secure a commitment from Citicorp USA, Inc. ("Citi") for both construction and permanent financing to replace the CalHFA loans, but with a completely new set of underwriting criteria. The Developer also secured Alliant Capital as the tax credit syndicator for the Project, which offered the most favorable terms among the investors that submitted bids. Reflecting the adverse capital market environment, the underwriting criteria and terms offered by Citi and Alliant Capital were more stringent than those assumed in the original pro forma. The Project encountered additional challenges, described below, which required further restructuring of its financing.

- *Alliant's Inability to Secure a Tax Credit Investor* – Alliant, as a tax credit syndicator, attempted to secure a tax credit investor for the Project. However, the tax credit market deteriorated significantly as fewer investors were interested in benefiting from the Low Income Housing Tax Credit Program. Due to the adverse market conditions, Alliant lacked the ability to secure an investor in time to begin construction before the extended CTCAC deadline.

- *The State Budget Crisis* – In December 2008, the State's Pooled Money Investment Board (PMIB) decided to freeze disbursements of cash to bond-funded programs, including MHP (funded by Propositions 46 and 1C), until the state's budget shortfall is resolved. Citi, as the construction lender, became uncomfortable with proceeding with the Project without knowing the availability of MHP funds as permanent financing on project completion. The situation improved after the state budget was passed in February 2009 and PMIB began issuing bonds. However, because the overall state fiscal situation had not improved, Citi continued to express its concern over the state's ability to fund the Project and was not willing to close without resolution of this issue.

In February 2009, the American Recovery and Reinvestment Act (ARRA) was signed into law, which included programs to assist with development of affordable housing. Tax Credit Assistance Program (TCAP) is one of the programs funded by ARRA, which provides loans in lieu of tax credits to projects that are unable to identify tax credit investors. TCAP also provides additional construction loans to projects with MHP commitments for the amounts of MHP loan commitments, eliminating risks of construction lenders. The Developer applied for TCAP funding in May 2009, and received commitments for a permanent loan in the amount of $14,024,415 and an MHP bridge loan in the amount of $3,301,191. As a result, the two issues mentioned above were resolved. Citi's concern over the state's ability to fund the MHP loan at completion is addressed by the MHP bridge loan. The tax credits were replaced by a permanent loan by TCAP, eliminating the need to secure a tax credit investor.

The Agency's executed DDA must now be revised to reflect the final pro forma with TCAP financing, revisions to the ground lease and the requirements of other lenders, including TCAP, HCD and Citi.

DISCUSSION:

Project Description – The site (23,850 square feet) consists of an entire block bounded by Interstate 5, Cedar Street, Fifth and Sixth avenues (Cortez neighborhood), and is currently occupied by a surface parking lot and a vacant historic building (Attachment A).

The building will be five to seven stories, with three levels of underground parking in a Type III-modified structure over a concrete podium. The Project will consist of 65 units for very-low- and extremely low-income households, ranging from 30 percent to 50 percent of Area Median Income (AMI). Of the 65 units, 42 will be two- and three-bedroom units suitable for families, and 23 will be one-bedroom units set aside as supportive housing for the mentally disabled. In addition, the Project will include 4,342 square feet of ground-floor retail space and one level of public parking owned by the Agency. The adjacent historic building, owned by the Agency, will be rehabilitated for a commercial use.

Housing Impact – The proposed Project will provide 65 affordable rental housing units for very low- and extremely low-income households earning incomes below 50% of area median income. Of the 65 units, 23 units will be set aside as supportive housing units combined with on-site/off-site supportive services for special needs population who are at risk of being homeless. The project includes 26 three-bedroom units (40% of the total units), providing housing for families with children. The project location will ensure the geographic distribution of affordable housing projects in Downtown.

Project Financing

Development Budget – The total development cost as of October 2009 is approximately $33,200,000. The table below compares the final budget (October 2009) to the original budget included in the DDA (May 2008). As shown in the table, there have been significant reductions in hard costs since May 2008 (total savings of $1.4 million, or 6.6 percent, compared to the original budget). In addition, by replacing tax credits with a TCAP loan, there are savings in interest costs during construction. Although the Project has experienced slight increases in indirect and financing costs, the total development cost has decreased by $841,000 since May 2008.

Developer Fee – The Developer increased the developer fee from $1,071,000 to $1,400,000, the maximum fee allowed by CTCAC. The Agency's Transaction Guidelines ("Guidelines") allow developers to take the maximum fees under the Tax Credit program. The Developer agreed to increase the deferred developer fee from $94,000 (8.8 percent of the total fees) to $140,000 (10 percent of the total fees). The Guidelines require up to 20 percent of the fee deferral. Staff believes that 10 percent deferral should be justified considering that the Project includes a significant number of extremely low-income units and the available cash flow for repayments of the deferred fees is limited.

Agency Garage Costs – The Developer reduced the cost to build the public parking level from $1,400,000 to $1,344,000 to reflect the overall direct cost savings.

Development Budget Comparison: May 2008 and October 2009

	Original Budget (May 2008)	Final Budget (Oct 2009)	Change Since May 2008
Acquisition	**$5,265,000**	**$5,265,000**	**$0**
Hard Costs	**$21,832,000**	**$20,401,000**	**($1,431,000)**
Public Garage	**$1,400,000**	**$1,344,000**	**($56,000)**
Soft Costs	**$3,745,000**	**$4,188,000**	**$443,000**
Developer Fee	*$1,071,000*	*$1,400,000*	*$329,000*
Financing Costs	**$1,798,000**	**$2,001,000**	**$203,000**
Loan Fees	*$275,000*	*$483,000*	*$208,000*
Interest During Construction	*$1,255,000*	*$869,000*	*($386,000)*
TCAC/Syndication Fees	*$94,000*	*$109,000*	*$15,000*
Operating Reserves	*$174,000*	*$540,000*	*$366,000*
Total Development Costs	**$34,040,000**	**$33,199,000**	**($841,000)**

Financing Sources – As discussed in the background section of this report, changes have been made in the Project's financing sources. The following table compares the final funding sources (October 2009) to the original sources included in the DDA (May 2008).

Comparison of Sources: May 2008 and October 2009

	Original Budget (May 2008)	Final Budget (Oct 2009)	Change since May 2008
Market Value of Tax Credits	*$14,267,000*	***$0***	***($14,267,000)***
Tax Credit Assistance Program		***$14,024,415***	***$14,024,415***
MHP	*$3,019,000*	***$3,301,191***	***$282,191***
MHSA	*$2,944,000*	***$2,752,000***	***($192,000)***
Supportable Debt	*$1,756,000*	***$2,565,000***	***$809,000***
Net Sales Proceeds – Retail	*$1,374,000*	***$0***	***($1,374,000)***
AHP	*$260,000*	***$0***	***($260,000)***
Cal Reuse Remediation Grant	*$0*	***$94,330***	***$94,330***
Income During Lease-Up	*$0*	***$51,824***	***$51,824***
Agency Garage Purchase	*$1,400,000*	***$1,344,000***	***($56,000)***
Deferred Developer Fee	*$94,000*	***$140,093***	***$46,093***
Total Available Sources	**$25,114,000**	**$24,273,000**	**($841,000)**
Total Development Costs	($34,040,000)	**($33,199,000)**	**$841,000**
Financing Gap	**($8,926,000)**	**($8,926,000)**	**$0**

Below is a summary of the revisions made to the funding sources:

- Market Value of Tax Credits – The tax credits are replaced with a loan from CTCAC (TCAP loan). The loan has a 55-year term with zero interest, and requires residual receipt payments from the Project's net cash flow.

- MHP and MHSA – The amount of funds have been adjusted to the final commitments provided by HCD and CalHFA.

- Supportable Debt and Net Sales Proceeds – The Developer initially planned to sell the ground-floor retail spaces upon completion and assumed the sales proceeds as a source. However, considering the stagnant real estate market and overall economic conditions, the Developer decided to have an option to own and lease the ground-floor retail spaces. Citi (permanent lender) agreed to fully finance the retail component and increased its permanent loan amount. The Developer retains an option to sell the retail spaces and repay the portion of the permanent loan. No prepayment penalty is required by Citi.

- AHP – The Developer's original sources included AHP financing in the amount of $260,000. However, during the underwriting process for the CalHFA construction and permanent financing, the Developer was advised by CalHFA to use its Residual Receipts Gap loan in lieu of AHP because of its favorable terms. The Developer decided not to pursue AHP. Later, CalHFA cancelled all of its loan commitments, including the Residual Receipts Gap loan. AHP is not included as a financing source, but the Developer plans to apply for the program in October 2009. If the Developer receives the AHP commitment before construction closing, the Agency loan amount will be reduced by up to $260,000. If the AHP commitment is made after the construction closing, the disbursement of the Agency funds will be reduced by up to $260,000.

- Cal Reuse Remediation Grant – The Developer applied for the new funding source under Proposition 1C and received $94,000 to cover the site remediation costs.

- Income During Lease Up – Rental income during the lease up period is added as a permanent source to the revised pro forma.

The net reduction in the total available sources ($841,000) is offset by the savings in development costs ($841,000). The funding gap (the Agency subsidy) remains at the same level as the original budget in May 2008. A revised project pro forma, prepared by Keyser Marston Associates, is attached to this report as Attachment B.

Disposition of Property – The Agency acquired the project site in May 2008. Upon construction loan closing, the Agency will enter into a long-term ground lease with the Developer. The Agency originally approved the lease term of 65 years with a 25-year option to extend by the

Developer. However, HCD clarified that the ground-lease term must be a minimum of 70 years for MHP-funded projects. Based on this requirement, staff requests that the ground-lease term be revised to 70 years with a 20-year option to extend, instead of 65 years with a 25-year option to extend. Upon expiration of the ground lease, the Agency will own the housing structure free and clear of encumbrances.

Participation by Agency

The DDA needs to be amended to reflect the new financing structure and to incorporate various requirements by other lenders (Citi, HCD and TCAC). The proposed Amendment includes the following major revisions to the terms and conditions of the DDA:

Revisions to the financial terms:

1. Modify the Project Budget to reflect the updated project costs.

2. Modify the Method of Financing to reflect the updated sources and uses.

3. Include a provision requiring the Developer to pursue AHP funding in the amount of $260,000. The Agency loan amount will be reduced by the AHP funding amount if the AHP award is made before construction closing. The amount of Agency loan disbursements will be reduced by the AHP funding amount if the AHP award is made after construction closing (or the Developer shall repay the Agency for the AHP funding amount).

4. Include a provision to allow establishment of a transitional operating reserve, which is required by other lenders in the event that the MHSA operating subsidy is not renewed in year 21. The Agency shall receive up to 80 percent of the balance of the transitional operating reserve in year 55. If HCD and the permanent lender authorize releases from the reserve prior to year 55, the Agency shall receive up to 80 percent of the released amount. The current development budget includes $300,000 for the initial capitalization of the transitional operating reserve.

5. Revise the total developer fee from $1,071,000 to $1,400,000, and the deferred developer fees from $94,000 to $140,000.

6. Revise the Agency Garage Purchase Price from $1,400,000 to $1,344,000.

7. Allow subordination of the Agency Deed of Trust, securing a $3,661,000 loan, to the deeds securing the TCAP loan ($14,024,400), MHP loan ($3,301,200) and MHSA loan ($2,752,000). These loans are governed by the state regulations, which require that the loans made by local jurisdictions be subordinated to the loans made by these

state agencies unless the locality's loan is more than twice the state loans. (The DDA already allows subordination of the Agency loan to the construction and permanent loans.) Note: Senior lenders' deeds of trust will be recorded against the leasehold interest, as opposed to the fee interest.

8. Allow subordination of the Agency Agreement Affecting Real Property (AARP) to the MHP Regulatory Agreement, as required by its regulations. The Agency AARP will be senior to all liens except for the MHP Regulatory Agreement. (CTCAC and CalHFA allow the Agency AARP to be senior to the TCAP and MHSA Regulatory Agreements.) Note: Senior lien holders' covenants will be recorded against the leasehold interest, as opposed to the fee interest.

9. Amend the term of the ground lease from 65 years to 70 years and the option to extend from 25 years to 20 years.

Other revisions:

10. Reduce the number of parking stalls on the public parking level (first level) from 28 to 26. This change is required to avoid the soldier beams for the shoring wall to encroach onto the adjacent property owned by Caltrans, which does not allow permanent encroachment onto its properties. The garage wall needs to move 2'6" inward, which results in a loss of two parking stalls on the public parking level.

11. Reduce the number of residential parking stalls on the second and third levels from 83 to 73 to accommodate mechanical and utility rooms. This still satisfies requirement of the Centre City Planned District Ordinance (PDO).

12. Modify the Schedule of Performance to incorporate the updated project schedule.

Draft Amendment is attached to this report as Attachment C.

Proposed Schedule of Performance

Action	**Completion Date**
Agency review of Amendment	December 8, 2009
Construction closing (construction loan closing, execution of the Agency Ground Lease)	December 2009
Construction Start	January 2010
Construction Completion	June 2011

Project Benefits – The proposed amendments to the DDA would ensure the Project proceeds and provides the following:

- Affordable rental housing (65 units) for very-low- and extremely low-income families and individuals;
- Twenty-three supportive housing units combined with on-site/off-site supportive services for special needs population who are at risk of being homeless;
- Units reserved for households earning 25% to 50% of area median income;
- A unit mix with 40% three-bedroom units; and
- Geographic distribution of affordable housing projects in downtown.

PROJECT DESCRIPTION

The following is a summary of the project:

Site Area	23,859 sq. ft.
Maximum Floor Area Ratio (FAR) Permitted Minimum Proposed	6.5 4.0 4.09
Stories/Height	5 – 6 stories/83 feet
Amount of Retail Space	4,342 q. ft.
Total Number of Units/Total Residential Square Feet	65 units (total 54,344 residential sq. ft.): 23 one bedroom/one bath (606 sq.ft.) 16 two bedroom/one bath (811 sq.ft.) 26 three bedroom/two bath (1,055 sq.ft.)
Projected rental rates	65 units to be restricted at 30-50% AMI $382-$930 per month (per 2009 income limits)
Number of Units Demolished	None
Inclusionary Housing Ordinance Compliance/ Number of Affordable Units	Provision of 65 affordable rental apartments (7 units are required to be affordable)
Parking Required Proposed	 68 for residential 99 spaces (including 4 tandem stalls) – 26 for commercial/public use – 73 for residential
Assessor's Parcel Nos.	533-334-05, 06

Environmental Impact: This activity is covered under the 2006 Final Environment Impact Report (FEIR) and a Secondary Study conducted for the Project dated April 2008. The effects of the proposed activity were adequately addressed in the FEIR and Secondary Study, and the proposed activity is within the scope of the Project described therein. The revisions to the DDA and Attachments do not implicate any new environmental concerns that are not already addressed in the FEIR and the Secondary Study. Therefore, pursuant to CEQA Guidelines Section 15168, no further environmental documentation is required.

The Developer is required to prepare an Environmental Assessment pursuant to the National Environmental Policy Act (NEPA) to satisfy the requirement of the TCAP regulations. The draft Environmental Assessment with a Finding of No Significant Impact is currently under review by CTCAC. A Notice of Intent to Release Funds will be published for 15 days after approval by CTCAC.

CONCLUSION

Staff recommends that the Agency approve the Amendment. Staff review concludes that the proposed revisions are necessary to allow the Project to proceed.

Respectfully submitted,

Eri Kameyama
Associate Project Manager

Concurred by:

Frank J. Alessi
Executive Vice President & Chief Financial Officer

Attachments: A – Site Map
B – Revised Project Proforma
C – Draft First Amendment

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