

<p>Item 8 File 18-0163</p>	<p>Department: Office of Economic and Workforce Development (OEWD)</p>
<p>EXECUTIVE SUMMARY</p>	
<p style="text-align: center;">Legislative Objectives</p> <p>The proposed resolution finds that the proposed development of the Balboa Reservoir project is fiscally feasible and responsible under Administrative Code Chapter 29. Approval of the proposed resolution would allow the City and SFPUC to refer the proposed project for environmental review under San Francisco Administrative Code Chapter 31 and the California Environmental Quality Act (CEQA). Referral to environmental review does not commit the City or the Board of Supervisors to final project approval.</p> <p style="text-align: center;">Key Points</p> <ul style="list-style-type: none"> The Balboa Reservoir is a 17-acre site adjacent to San Francisco City College owned by the San Francisco Public Utilities Commission (SFPUC). The site has not been used as a water reservoir and has been identified for residential development. SFPUC selected Reservoir Community Partners, consisting of AvalonBay and the non-profit Bridge Housing, to develop mixed-income housing on the site. The development is approximately 1,100 housing units, of which 50 percent would be market rate and 33 percent would be affordable to low- and moderate-income households, funded by developer equity and project revenues. The remaining 17 percent of housing units would be affordable housing, funded by City and other sources not yet identified. <p style="text-align: center;">Fiscal Impact</p> <ul style="list-style-type: none"> The project is projected to generate annual General Fund revenue for the City of \$4,059,000. In addition, the Balboa Reservoir project will generate \$26,951,000 in one-time development impact and other fees, and \$3,311,000 in sales tax and gross receipts revenues during construction. Based on our review of OEWD’s analysis, our office has determined that the Balboa Reservoir Project meets the basic criteria for fiscal feasibility as required by Administrative Code Chapter 29 <p style="text-align: center;">Policy Consideration</p> <ul style="list-style-type: none"> Based on our understanding of the Balboa Reservoir Project, several issues should be taken into consideration by the Board of Supervisors as the project moves forward. These include the phasing of the market and affordable housing development; the timing and structure of the subsidy to be paid by Reservoir Community Partners to the 33 percent affordable housing development; the funding of the 17 percent additional affordability component; the estimate of future cash flows, rental, and costs; and ensuring affordability requirements are binding “into perpetuity” 	

Recommendations

- Request the Director of the Office of Economic and Workforce Development to include the following standard terms in negotiations of the final development agreement between the City and Community Reservoir Partners, which is subject to future Board of Supervisors approval:
 - Explicit and binding commitments for equitable phasing of market rate and affordable housing development.
 - If Reservoir Community Partners converts existing off-site housing to affordable units in order to expedite the development of affordable housing, (a) the total number of housing units developed on the Balboa Reservoir site cannot be less than 1,100, and (b) 33 percent affordability is assessed on all Balboa Reservoir and off-site housing units developed or converted as part of the project.
 - Provisions that any subsidy made by Reservoir Community Partners to the affordable housing development maximizes financing and minimizes delays, based on a rigorous independent financial assessment of the financing options, including grants, loans, and gap financing.
 - Preparation of a rigorous, independent cash flow analysis, consistent with OEWD policy, to ensure that land price paid to SFPUC and amount and timing of the subsidies made by Reservoir Community Partners to the 33 percent affordable housing development are maximized.
 - Provisions that future owners be bound 'into perpetuity' by the terms of the development agreement.
- Request MOHCD to report back to the Board of Supervisors early in the process of negotiations between the City and Reservoir Community Partners on (a) potential financing sources for the additional 17 percent affordable housing; (b) whether the City will own any land on which 100 percent affordable housing developments are constructed; and (c) conformance of the additional 17 percent affordable housing units to City policy and requirements.
- Approve the proposed resolution.

MANDATE STATEMENT

Administrative Code Chapter 29 requires the Board of Supervisors to conduct a fiscal feasibility analysis of any project (1) that has a total cost exceeding twenty-five million dollars (\$25,000,000), and (2) where the City is expected to incur costs related to project development in excess of \$1,000,000. Chapter 29 requires consideration of five factors: direct and indirect financial benefits to the City including the extent of applicable cost savings or new revenues, including tax revenues, generated by the proposed project; (2) cost of construction; (3) available funding for the project; (4) the long-term operating and maintenance cost of the project; and (5) debt load to be carried by the City or Department.

A determination by the Board of Supervisors that a project is fiscally feasible only finds that the proposed project merits further evaluation and environmental review; a determination of fiscal feasibility does not include a determination the project should be approved.

BACKGROUND

The Balboa Reservoir is a 17-acre site adjacent to San Francisco City College owned by the San Francisco Public Utilities Commission (SFPUC). The site has not been used as a water reservoir and is not identified by the SFPUC as needed to provide water storage in the future. The site has been identified for residential development, and in 2016, the SFPUC issued a Request for Qualifications (RFQ) to solicit developers' interest in acquiring the Balboa Reservoir site for mixed income housing development. The three top-scoring development teams responding to the RFQ were invited to submit proposals for acquisition and development of the site.¹

Based on SFPUC's review of the proposals submitted by the three development teams, the SFPUC authorized an Exclusive Negotiation Agreement (ENA) in November 2017 with Reservoir Community Partners, LLC (Reservoir Community Partners), comprised of AvalonBay Communities (AvalonBay) and Bridge Housing Corporation (Bridge Housing). According to the resolution authorizing the ENA, nothing in the resolution or the ENA commits the SFPUC or the City to approving or implementing the Balboa Reservoir project.

SFPUC and Reservoir Community Partners prepared a Development Overview in February 2018, describing the current status of the Balboa Reservoir project.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution finds that the proposed development of the Balboa Reservoir project is fiscally feasible and responsible under Administrative Code Chapter 29. Approval of the proposed resolution would allow the City and SFPUC to refer the proposed project for environmental review under San Francisco Administrative Code Chapter 31 and the California Environmental Quality Act (CEQA). Referral to environmental review does not commit the City or the Board of Supervisors to final project approval. Nor does approval of the proposed

¹ The three development teams were (1) AvalonBay Communities and Bridge Housing Corporation as master co-developers with Mission Housing, Pacific Union Development Company, and Habitat for Humanity of Greater San Francisco, (2) Emerald Fund and Mercy Housing, and (3) Related California, Sares-Regis Group of Northern California, Tenderloin Neighborhood Corporation, and Curtis Development.

resolution commit the City or the SFPUC to any of the specific terms as outlined in the Development Overview. Final project approval is conditioned upon SFPUC and the Board of Supervisors adopting the CEQA findings and the final terms of the development agreement to be negotiated by the SFPUC, Mayor's Office of Housing and Community Development (MOHCD), and Office of Economic and Workforce Development (OEWD).

As described in the Development Overview, the SFPUC will sell the Balboa Reservoir site at fair market value to Reservoir Community Partners. Reservoir Community Partners will oversee all major aspects of project planning, financing, construction, and post-completion sale, leasing and ongoing maintenance operations. Reservoir Community Partners would divide the site into several separate parcels that would be sold to the various participants in the LLC agreement. These sites will correspond to the portions of the development dedicated to market-rate and affordable housing, respectively.

The price that Reservoir Community Partners will pay SFPUC to acquire the site will be informed by a cash flow analysis that takes into account the development's 33 percent affordability requirement, and by an independent appraisal and appraisal review conducted in accordance with the requirements set out in Administrative Code Chapter 23. According to Mr. Ken Rich, OEWD Director of Development, OEWD has contracted with an independent economic consultant to conduct revenue and cost analysis on behalf of the City.

The RFP for the development of the Balboa Reservoir site called for at least 50 percent of the total housing units to be permanently affordable, with at least (a) 18 percent of units to be affordable to low-income households with income up to 55 percent of area median income (AMI) for rental units and 80 percent of AMI for for-sale units; and (b) 15 percent of units to be affordable to moderate-income households up to 120 percent of AMI.² These provisions conform to the requirements of the voter-approved Proposition K passed in 2015 that at least 33 percent of the total housing units developed on surplus property sold by the City should be affordable with at least 15 percent of rental units affordable to people earning up to 55 percent of the area median income (AMI) and 18 percent affordable to people earning up to 120 percent of the AMI.

According to the Development Overview, Community Reservoir Partners will develop the market rate housing consisting of condominiums and rental units, with rental housing currently proposed to make up the majority – 87.8 percent - of market rate units. The affordable housing component will be developed by Bridge Housing Corporation, Mission Housing, and Habitat for Humanity. Affordable rental units will be developed by Bridge and Mission Housing. For-sale units will be developed by Habitat for Humanity. An additional 15 percent of rental units will be developed exclusively by Bridge Housing for households earning between 80 – 120 percent of AMI. Funding for the required affordable housing component is expected to be paid for with AvalonBay equity and revenues generated by the market-rate portion of the project. No City subsidy will be contributed to this portion of the project. The Development Overview further

² AMI in San Francisco in 2017 was \$115,300 for a four-person household. 55 percent of AMI in 2017 for a four-person household was \$63,400, and 120 percent of AMI in 2017 for a four-person household was \$138,350.

states that Reservoir Community Partners and the City may decide to pursue additional non-City sources of financing such as non-competitive 4 percent federal Low Income Housing Tax Credit (LIHTC), tax exempt bonds, or other state or federal funds.

An additional 17 percent of units may be developed as both rental and for-sale affordable housing contingent upon the City accessing additional funding sources. These housing units, should funding be secured, would be targeted to households earning between 55-120 percent of AMI for rentals, and 105 percent of AMI in the case of for-sale units. These additional units would be developed by Bridge and Mission Housing (rental) and Habitat for Humanity (for sale). Possible funding sources for the additional affordable units are future voter approval of a Gross Receipt Tax, additional project-granted tax revenues (see below), state sources, and future voter approval of affordable housing bonds.

The Development Overview includes a provision stating that Reservoir Community Partners will work with City College to provide housing targeted towards faculty and students at City College. Such provision is contingent upon City College's ability to contribute resources to the project. The Development Overview further states that such contributions will not be used to lower the fair market value of the land when sold by SFPUC to Reservoir Community Partners subsequent to the conclusion of the final development agreement.

All income restrictions for affordable housing units will apply for the life of the Project.

FISCAL FEASIBILITY

Estimated Revenues Generated by the Balboa Reservoir Project

Annual Revenues

According to the February 9, 2018 "Balboa Reservoir Project Findings of Fiscal Responsibility and Feasibility", prepared by Berkson Associates for OEWD, total development cost and assessed value of the Balboa Reservoir project is estimated at \$559,836,000. Due to the inclusion of property tax-exempt low income affordable units (units of households earning up to 80 percent of AMI), the net taxable assessed value is estimated at \$471,805,000.

Total projected annual General Fund revenue that will be realized by the City is \$4,059,000.³ After subtraction of the 20 percent Charter-mandated baseline, annual discretionary General Fund is \$3,247,200. Annual General Fund revenues of \$4,059,000 consist of \$2,682,000 in

³ Local property taxes are apportioned as 65 percent to the City's General Fund, 25 percent to State Educational Revenue Fund (ERAF), and 10 percent to BART, City College of San Francisco, and the Bay Area Air Quality Management District. General Fund revenues of \$4,059,000 generated by the Balboa Reservoir project do not include \$1,053,000 allocated to mandated property tax set asides for the Children's Fund, Library Preservation Fund, or Open Space Fund; San Francisco Municipal Transportation Agency (SFMTA) 80 percent share of parking tax share; and the share of sales tax allocated to public safety, and the San Francisco County Transportation Authority.

property tax, \$567,000 in Property Tax in Lieu of VLF, \$391,000 in property transfer taxes, and \$419,000 in sales tax, parking tax, and gross receipts tax.

One-time Revenues

According to the Berkson report, the Balboa Reservoir project will generate \$26,951,000 in one-time development impact and other fees, including community infrastructure, childcare, transportation, and school district fees, and \$3,311,000 in sales tax and gross receipts revenues during construction.

Estimated Annual Costs to the City

Total estimated annual costs to the City of providing additional police and fire services, and road maintenance to the project sum to \$1,538,000. In addition, \$1,053,000 of General Fund revenue is allocated to mandated set-asides for the Children's Fund, Library Fund, and Open Space Acquisition Fund; San Francisco Municipal Transportation Agency (SFMTA) parking tax share, public safety sales tax share, and San Francisco County Transportation Authority sales tax share.

Other Estimated Benefits

According to the Berkson report, other public benefits of the Balboa Reservoir project include short term construction jobs (estimated to be 2,800 job years), a small number of permanent jobs, and construction of approximately 1,100 units of housing.

Determination of Fiscal Feasibility

Based on our review of the Berkson report our office has determined that the Balboa Reservoir Project meets the basic criteria for fiscal feasibility as required by Administrative Code Chapter 29. As noted above, a determination by the Board of Supervisors that a project is fiscally feasible only finds that the proposed project merits further evaluation and environmental review; a determination of fiscal feasibility does not include a determination the project should be approved.

POLICY CONSIDERATION

Based on our reading of the Development Overview, several issues should be taken into consideration by the Board of Supervisors as the project moves forward.

Project Phasing

One, the Development Overview has language related to the phasing of the project. Consistent with standard City practice, to ensure that Reservoir Community Partners does not front load the market rate component of the project, while delaying the development of the affordable units, the Board of Supervisors should request that OEWD include explicit and binding commitments for equitable phasing of market rate and affordable housing development in negotiations of the final development agreement between the City and Reservoir Community Partners.

Maximizing Onsite Market Rate and Affordable Housing

Two, as written the project has language that would allow Reservoir Community Partners to fulfill portions of the affordable housing component through conversion of nearby off-site housing owed by AvalonBay if doing so would accelerate the availability of affordable housing (p 5). Reservoir Community Partners could potentially seek to use conversion of offsite vacant units in existing properties owned by AvalonBay to fulfill the 33 percent affordable requirement intended by Proposition K. This could potentially result either in reducing (a) the project's net contribution to expanding the City's total housing stock if off-site units are not replaced one-for-one with units onsite; and (b) the total percentage of affordable units below the 33 percent of the project as a whole, when the off-site units are included in the total housing count.

For example, Reservoir Community Partners has proposed that a total of 1,100 units will be made available on-site, of which 363 would be required to be affordable as per the terms of Proposition K (2015). If Reservoir Community Partners provides 100 of these units through conversion of off-site vacant housing units, the net addition of on-site units would reduce by 100 units the overall project contribution to the City's total housing stock unless they are replaced by an equivalent number of on-site units. Moreover, if off-site units are used to free up on-site units and are replaced with market rate units, the net result is of the 1,210 total on-site and off-site units, only 30 percent of this total would be affordable to households earning between 55 percent and 120 percent of AMI, which is not the intention of Proposition K.

Given the City's chronic housing crisis, we recommend that the final development agreement between the City and Reservoir Community Partners contain provisions to maximize both the feasible number of affordable units as a share of total units, *and* the total number of new units. Therefore, the Board of Supervisors should request OEWD to include in negotiations an expectation that if Reservoir Community Partners converts existing off-site housing to affordable units in order to expedite the availability of affordable housing, (a) the total number of housing units developed on the Balboa Reservoir site cannot be less than 1,100, and (b) 33 percent affordability is assessed on the sum total of all Balboa Reservoir and off-site housing units developed or converted as part of the project.

Uncertainty in How the Market Rate Units will subsidize the Affordable Housing Portion of the Balboa Reservoir Project

Third at this stage in the process the structure of the subsidy to fund the 33 percent affordable housing development is not known. The subsidy could potentially be provided by the market-rate portion of the project as a grant, a loan, or gap funding.⁴ The Development Overview states the baseline 33 percent affordability requirement will be paid for by AvalonBay equity contributions and through subsidies provided by the market rate portion of the proposed development.

⁴ Gap funding could mean that the affordable housing developer – Bridge Housing, Mission Housing, or Habitat for Humanity – finances the affordable housing development through loans and other sources, and applies rents from the affordable housing units to the loan payments; and that the market-rate portion of the project funds the gap between the affordable housing rents applied to the loan payments and the total loan payments.

Potential options for the subsidy to the affordable housing development include: (a) Reservoir Community Partners providing the subsidy as an upfront lump sum grant in which they waive all future financial interest; (b) the affordable housing developers being responsible for accessing construction loans and permanent financing, with Reservoir Community Partners subsidizing a portion of interest and principal payments through gap funding; or (c) this subsidy will taking the form of a loan by Reservoir Community Partners to be paid back out of expected future revenues generated by the affordable housing development.

Outright contribution of equity through a grant from Reservoir Community Partners would be the most advantageous option from the vantage point of reducing the total cost of the affordable housing development. This option will be the most expensive from the vantage point of estimating the return to Reservoir Community Partners on the market rate development. Pursuing the second option – e.g. having Reservoir Community Partners offset a share of the cost of debt repayment through redirection of some portion of the rents of the market rate units - has the benefit of reducing long-term financing costs. Conversely, the use of debt, as opposed to upfront equity commitment, will increase the overall development costs of the affordable housing component. Moreover, this option exposes affordable housing developers to risks in the form of higher future funding costs (rising interest rates), and the risk of construction delays due to the time required to secure long-term permanent finance.

If the subsidy is structured as a loan made by Reservoir Community Partners to be repaid out of future revenues, this option would only qualify as a subsidy if the loan is made at well below prevailing market interest rates. Lending against future revenues allows Reservoir Community Partners to recapture a portion of the future cash flows generated by the affordable housing units, and should thus be treated as a component of profit. This fact should be incorporated into any final estimation of the costs and returns on the market rate portion of the proposed development.

Finally, differences in how Reservoir Community Partners allocates the timing and structure of the subsidy (see (a), (b), and (c) above) can give rise to very different estimates of the net rate of return to AvalonBay and overall project profitability. These estimates are what are typically used to assess the viability of requiring new developments to meet City-mandated affordability requirements. They will also be used to estimate the fair market value of the site that will be paid to the SFPUC. The Board of Supervisors should therefore request that OEWD conduct a rigorous independent assessment to ensure the final development agreement is structured to insure inclusion of the maximum possible share of affordable housing units.

Uncertain Financing for Affordable Housing Not Financed by Reservoir Community Partners

Fourth, the development of the additional 17 percent affordable housing does not have identified financing sources. Potential sources identified in the Development Overview for the additional 17 percent affordable housing units include future voter approval of gross receipts taxes and state housing bond ballot measures, General Fund revenues generated by the project, State grants or loans. BRIDGE Housing, Mission Housing, and Habitat for Humanity would be responsible to develop the additional 17 percent affordable housing units.

Also, ownership of the land on which the additional 17 percent of affordable housing would be built has not been defined. The Mayor's Office of Housing and Community Development (MOHCD) could potentially own the land and enter into long term ground leases with affordable housing developers, which is the current practice of MOHCD. The Board of Supervisors should request MOHCD to report back to the Board of Supervisors early in the process of negotiations between the City and Reservoir Community Partners on (a) potential financing sources for the additional 17 percent affordable housing; (b) whether the City will own any land on which 100 percent affordable housing developments are constructed; and (c) conformance of the additional 17 percent affordable housing units to City policy and requirements.

Potential Underestimation of Project Income and Overestimation of Project Costs

Fifth, the cash flow analysis developed as part of the development agreement between the City and Reservoir Community Partners will be used to inform the land price paid to SFPUC, and the amount and timing of the subsidies made by Reservoir Community Partners to the 33 percent affordable housing development. If project income is underestimated or project costs are overestimated, the financial return to the project could be underestimated, resulting in a lower purchase price paid to SFPUC, or lower or delayed subsidy payments. Therefore, OEWD needs a rigorous, independent cash flow analysis, which according to Mr. Rich, is consistent with OEWD's policies.

AvalonBay's Financial Viability

Sixth, based on our review of the online financial reports and SEC filings of AvalonBay, AvalonBay is well capitalized, has a low debt-to-equity ratio, and relatively stable cash flow, indicating that AvalonBay is financial viable. However, given the potential that AvalonBay could sell its position in the Balboa Reservoir project, the Board of Supervisors should request OEWD to include in negotiations of the development agreement between the City and Reservoir Community Partners a requirement that future owners be bound into perpetuity by the terms of the development agreement.

RECOMMENDATIONS

- Request the Director of the Office of Economic and Workforce Development to include the following standard terms in negotiations of the final development agreement between the City and Community Reservoir Partners, which is subject to future Board of Supervisors approval:
 - Explicit and binding commitments for equitable phasing of market rate and affordable housing development.
 - If Reservoir Community Partners converts existing off-site housing to affordable units in order to expedite the development of affordable housing, (a) the total number of housing units developed on the Balboa Reservoir site cannot be less than 1,100, and (b) 33 percent affordability is assessed on all Balboa Reservoir and off-site housing units developed or converted as part of the project.

- Provisions that any subsidy made by Reservoir Community Partners to the affordable housing development maximizes financing and minimizes delays, based on a rigorous independent financial assessment of the financing options, including grants, loans, and gap financing.
- Preparation of a rigorous, independent cash flow analysis, consistent with OEWD policy, to ensure that land price paid to SFPUC and amount and timing of the subsidies made by Reservoir Community Partners to the 33 percent affordable housing development are maximized.
- Provisions that future owners be bound 'into perpetuity' by the terms of the development agreement.
- Request MOHCD to report back to the Board of Supervisors early in the process of negotiations between the City and Reservoir Community Partners on (a) potential financing sources for the additional 17 percent affordable housing; (b) whether the City will own any land on which 100 percent affordable housing developments are constructed; and (c) conformance of the additional 17 percent affordable housing units to City policy and requirements.
- Approve the proposed resolution.