CITY AND COUNTY OF SAN FRANCISCO

BOARD OF SUPERVISORS

BUDGET AND LEGISLATIVE ANALYST

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TO: Budget and Finance Committee

FROM: Budget and Legislative Analyst

SUBJECT: October 16, 2019 Budget and Finance Committee Meeting

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Item 1 **File 19-0920** *(Continued from October 9, 2019)*	**Department:** Real Estate Division

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would authorize the first amendment to the City's lease with Lexington Lion San Francisco LP (Lexington) for 350 Rhode Island Street, providing a $2,600,000 credit to the City in exchange for removing the City's protection from the pass through of increased property taxes from the sale of the property prior to July 2021.

Key Points

- In October 2017, the Board of Supervisors approved a lease between the City as tenant and Lexington, as landlord to relocate the District Attorney's Office and the Police Investigations Unit from the Hall of Justice to 350 Rhode Island Street.
- The owner of 350 Rhode Island is planning to sell the property, which will trigger a re-assessment of the property and an increase in property taxes. Section 4.7 in the current lease provides property tax pass-through protections to the City if the property is sold prior to July 2021, but gives the owner the right to purchase those protections from the City. If the amount of the property tax pass-through protection paid by the owner to the City is underestimated, the City will receive a credit.
- The proposed first amendment to the lease removes Section 4.7. Under the proposed first amendment, the property tax pass-through credit "in no event shall…exceed $2.6 million". The $2.6 million pass-through credit is a negotiated amount, based on the estimated property sale price of $134 million and the resulting property tax increase due to the reassessment of the property at the time of sale. Under the proposed first amendment, the City would not receive additional credit if the increase in property taxes to be passed through to the City exceeds $2.6 million.

Fiscal Impact

- According to the Real Estate Division, the City's determination of the property's market value is approximately $134 million. The property's estimated new assessed value would increase the City's property tax payable by approximately $55,302 per month. The proposed $2,600,000 rent credit is equivalent to approximately 47 months of property tax pass-through protection.
- Although the proposed first amendment to the lease removes Section 4.7 that provides for a credit to the City if the actual increase in property taxes passed through to the City is more than the estimated property tax to be passed through, based on our calculations, the actual increase in property taxes is not likely to be more than the $2.6 million property tax pass-through credit.

Recommendation

- Approve the proposed resolution.

MANDATE STATEMENT

City Charter Section 9.118(b) requires Board of Supervisors approval of amendments to agreements with a fiscal impact of more than $500,000, if the original agreement had a term of more than ten years or an amount of $10 million or more.

BACKGROUND

350 Rhode Island Lease

In October 2017, the Board of Supervisors approved a lease between the City as tenant and Lexington Lion San Francisco LP (Lexington), a Delaware limited partnership, as landlord to relocate the District Attorney's Office and the Police Investigations Unit from the Hall of Justice to 350 Rhode Island Street (File 17-1109). The lease term is for 15 years from July 25, 2018 through July 24, 2033, with one five-year option to renew for a total 20 year term through 2038. The District Attorney's Office is moving into 350 Rhode Island Street in phases, as the leases with existing tenants at that location expire. The District Attorney's Office has completed Phase I of the relocation implementation and is currently moving some of its operation into its leased location at 350 Rhode Island with Phase II completion and full relocation to be completed before the end of 2020. Under the lease agreement, the City to date has paid approximately $5.5 million in rent and operating costs, increasing to $8.9 million by 2020, when the District Attorney's Office moves into all of the leased space in the building. Over the term of the 15-year lease, the City is projected to incur rent and operating costs of $149,467,245.

Commercial property owners are able to pass through property tax increases resulting from the sale of the property.[1] The current lease includes a provision that protects the City from the pass-through of property tax increases that may occur from sale of the property if the sale occurs prior to July 2021.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would authorize the first amendment to the City's lease with Lexington for 350 Rhode Island Street, providing a $2,600,000 credit to the City in exchange for removing the City's protection from the pass through of increased property taxes from the sale of the property prior to July 2021. All other provisions of the current lease agreement will not change.

As noted above, the current lease does not allow the pass-through of increased property taxes if the property is sold prior to July 2021. However, Section 4.7 of the current lease provides for the owner to purchase the value of the property tax pass through ("Proposition 13 Purchase Price"), based on a calculation defined in the lease.

[1] Property taxes are levied based on the assessed value of the property. Under Proposition 13, the assessed value of the property is based on the sale price, and can only increase by 2 percent per year or by the Consumer Price Index (CPI), whichever is lower. Sale of the property triggers a reassessment of the property value, which results in increased property taxes if the assessed value increases.

Pending Building Sale

According to Mr. John Updike, Real Estate Division Special Project Manager, the owner of 350 Rhode Island is planning to sell the property to a new owner, which will trigger a re-assessment of the property and an increase in property taxes. Under the current lease, if the property sells prior to July 25, 2021, the new owner would not be able to pass through the increase in property taxes to the City. Under the proposed first amendment, the new owner could pass-through the increase in property taxes to the City in exchange for $2,600,000 in rent credits.

According to the Real Estate Division, the City only leases a portion of the property located at 350 Rhode Island and the other tenants are private businesses. Therefore, the Real Estate Division would not recommend that the City purchase the 350 Rhode Island property.

FISCAL IMPACT

According to the Real Estate Division, the City's determination of the property's market value is approximately $134 million.[2] As shown below in Table 1, the property's estimated new assessed value would increase the City's share of property taxes for 350 Rhode Island by approximately $55,302 per month. The proposed $2,600,000 rent credit is equivalent to approximately 47 months of property tax pass-through protection.

Table 1: Calculation of Change in Property Taxes

	Estimated Assessed Value	Annual Property Tax[3]	City Share[4]	Property Tax Per Month
Current	$60,000,000	$697,800	$538,074	$44,839
Upon Building Sale[5]	$134,000,000	$1,558,420	$1,201,698	$100,141
Difference	$74,000,000	$860,620	$663,624	$55,302
Value of Rent Credit				$2,600,000
Months of Property Tax Protection[6]				47

Source: Real Estate Division

POLICY CONSIDERATION

Section 4.7 in the current lease provides property tax pass-through protections if the property is sold prior to July 2021, as noted above. The protections would extend through the term of the lease through July 2033. Section 4.7 gives the owner the right to purchase those protections from the City, contingent on the owner paying to the City the amount of the increased property taxes through July 2033. Under Section 2.4, because the purchase of the property tax pass-through protection is based on an estimate of the increase in property taxes from the sale of

[2] The estimated transfer taxes to the City in FY 2019-20 from the proposed sale of 350 Rhode Island are $4 million.
[3] Based on property taxes of 1.163 percent of assessed value.
[4] Based on the City occupying 77.11 percent of the building.
[5] This is Real Estate Division's estimated market value if the building was to be sold today.
[6] Months of Property Tax Protection is calculated by dividing the $2.6 million rent credit by the estimated $55,302 increase in property taxes.

the property, if the amount paid by the owner to the City is underestimated, the City will receive a credit.

The proposed first amendment to the lease removes Section 4.7. Under the proposed first amendment, the property tax pass-through credit "in no event shall…exceed $2.6 million". The $2.6 million pass-through credit is a negotiated amount, based on the estimated property sale price of $134 million and the resulting property tax increase due to the reassessment of the property at the time of sale. Under the proposed first amendment, the City would not receive additional credit if the increase in property taxes to be passed through to the City exceeds $2.6 million.

Based on the Budget and Legislative Analyst's calculations, the $2.6 million property tax pass-through credit under the proposed first amendment is sufficient to compensate the City for an increase in property taxes at the estimated sales price of $134 million. Although the proposed first amendment to the lease removes the Section 4.7 language that provides for a credit to the City if the actual increase in property taxes passed through to the City is more than the estimated property tax to be passed through, based on our calculations, the actual increase in property taxes is not likely to be more than the $2.6 million property tax pass-through credit. [7] Therefore, we recommend approval of the proposed resolution.

RECOMMENDATION

Approve the proposed resolution.

[7] The Budget and Legislative Analyst calculated the net present value of the property tax pass-through to the City at a range of sales prices, and found that the $2.6 million was sufficient to credit the City for the increase in the property tax pass-through.

Item 2 **File 19-0980** *(Continued from October 9, 2019)*	**Department:** Mayor's Office

EXECUTIVE SUMMARY

Legislative Objectives

The proposed resolution would authorize the Director of the Mayor's Office of Housing and Community Development (MOHCD) to execute an amended and restated loan agreement with Mercy Housing California (Mercy) and The Related Companies of California (Related), for a total loan amount not to exceed $18,647,014 to finance the construction of a 167-unit rental housing development for low-income households, known as Sunnydale HOPE SF Block 6.

Key Points

- In 2005, the San Francisco Housing Authority began the HOPE SF project to repair and renovate four public housing sites: Hunters View, Potrero Terrace and Potrero Annex, Sunnydale, and Alice Griffith. The largest of these sites, Sunnydale, is in the Visitacion Valley Neighborhood, and is a 50-acre, 775-unit site home to more than 1,700 people.
- Block 6 will be the second affordable housing development built for the Sunnydale HOPE SF revitalization and will include 167 affordable units, including 75 replacement units for Sunnydale public housing households currently living onsite.

Fiscal Impact

- The funding sources for the proposed gap loan agreement include $4,561,048 of 2015 Proposition A General Obligation Bond proceeds, $5,200,000 of HOME funds, $3,578,947 of CPMC funds, and $5,307,019 of HOPE SF certificates of participation.
- The uses of the proposed gap loan include soft costs, reserves, and developer fees.
- The proposed resolution would increase the City's subsidy for the development of Sunnydale HOPE SF Block 6 to $29,647,014. The total City subsidy per unit would total $177,527, or $121.64 per square foot.
- The total development cost of the Sunnydale HOPE SF Block 6 project is $148,685,657, of which the proposed gap loan amount of $18,647,014 represents 13 percent.

Policy Consideration

- The Sunnydale HOPE SF Block 6 development has an average development cost of $890,333 per unit, or $610 per square foot.

Recommendations

- Because of the increasing costs to develop affordable housing in the City and the pending November 2019 ballot measure to approve $600 million in General Obligation bonds to fund affordable housing development, the Board of Supervisors should amend the resolution to request a report from the MOHCD Acting Executive Director by no later than December 9, 2019, detailing the City's procedures to contain the costs of affordable housing development.
- Approve the proposed resolution as amended.

MANDATE STATEMENT

City Charter Section 9.118(b) states that any contract entered into by a department, board or commission in excess of $10 million or 10 years is subject to Board of Supervisors approval by resolution. Ordinance 202-19, adopted by the Board of Supervisors in August 2019, authorized the Director of the Mayor's Office of Housing and Community Development to enter into loan and grant agreements of more than 10 years without further Board of Supervisors approval if the total loan or grant amount is less than $10 million.

BACKGROUND

Sunnydale HOPE SF History

In 2005, the San Francisco Housing Authority began the HOPE SF project to repair and renovate four public housing sites: Hunters View, Potrero Terrace and Potrero Annex, Sunnydale, and Alice Griffith. The largest of these sites, Sunnydale, is in the Visitacion Valley Neighborhood, and is a 50-acre, 775-unit site home to more than 1,700 people.

In 2006, the Board of Supervisors amended the San Francisco Administrative Code to establish the HOPE SF fund to provide financial assistance to the San Francisco Housing Authority and housing developers for HOPE SF projects (File 07-0849).

In 2007, the San Francisco Housing Authority and HOPE SF released a request for qualifications to develop the four large-scale target sites. The San Francisco Housing Authority selected Mercy Housing California (Mercy) and The Related Companies of California (Related), as co-developers for the Sunnydale development.

In 2016, the Board of Supervisors approved a development agreement between the City, the San Francisco Housing Authority, and Sunnydale Development Co., LLC, for the Sunnydale HOPE SF Project, including the use of impact fees for improvements and other community benefits (File 16-1309).

In January 2017, the Board of Supervisors approved a development agreement and a master development agreement between the City and Mercy and Related, and the Sunnydale HOPE SF Special Use District to facilitate the development of the project (File 16-1164). The development agreement included the phasing plan and master infrastructure plan for the master development. The development agreement also includes language that allows the master developer to form tax credit partnerships for its affordable housing developments and other legally affiliated entities to facilitate the build out of the master plan.

In April 2019, the Board of Supervisors approved a loan agreement with Mercy and Related to finance development of infrastructure improvements for the Sunnydale HOPE SF development (File 19-0315).

Sunnydale HOPE SF Block 6

Block 6 will be the second affordable housing development built for the Sunnydale HOPE SF revitalization. Block 6 will include 167 affordable units (21 one-bedroom, 95 two-bedroom, 40 three-bedroom, and 11 four-bedroom apartments). Seventy-five percent of the units, or 125 units, will be set aside as replacement units for Sunnydale public housing households currently living onsite. The remaining 41 units will be available to households earning up to 60 percent of AMI and will be marketed through the housing lottery. All units are restricted at a maximum income limit of 60 percent of AMI. One unit will be set aside for property management. Construction is expected to start in November 2019 with project completion and full lease up expected by May 2022.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would: (1) authorize the Director of the Mayor's Office of Housing and Community Development (MOHCD) to execute an amended and restated loan agreement with Mercy Housing California (Mercy) and The Related Companies of California (Related), for a total loan amount not to exceed $18,647,014 to partially finance the construction of a 167-unit rental housing development for low-income households, known as Sunnydale HOPE SF Block 6; and (2) find that the loan is consistent with the adopted Mitigation Monitoring and Reporting Program under the California Environmental Quality Act, the City's General Plan, and the priority policies of Planning Code Section 101.1.

FISCAL IMPACT

Funding Sources

In November 2015, the voters of San Francisco approved Proposition A, which provided for the issuance of up to $310 million in general obligation bonds to finance the construction, acquisition, improvement, rehabilitation, preservation, and repair of certain affordable housing improvements. The proposed gap loan agreement includes $4,561,048 of Proposition A funding.

The City is authorized under an agreement with the U.S. Department of Housing and Urban Development (HUD) to distribute HOME Investment Partnership Program funds (HOME Funds) for the specific purpose of increasing the housing stock in the City for low- and very low-income persons. The proposed gap loan agreement includes $5,200,000 of HOME Funds.

In July 2013, the Board of Supervisors approved an ordinance that required Sutter West Bay Hospital to deposit funds into the Citywide Affordable Housing Fund (CPMC Funds) (File 12-0366). The CPMC Funds are to be used for predevelopment and development expenses and administrative costs associated with acquisition, construction, or rehabilitation of permanently affordable housing units in San Francisco. MOHCD is authorized to administer CPMC Funds and enforce agreements relating to them. The proposed gap loan agreement includes $3,578,947 of CPMC Funds.

The City has issued certificates of participation to provide funds for the development of the Sunnydale HOPE SF Block 6 project. The proposed gap loan agreement includes $5,307,019 of HOPE SF certificates of participation.

Uses of Funds

Mercy and Related intend to enter into a long-term ground lease for the property located at 242 Hahn Street with the San Francisco Housing Authority for $15,000 annually. The other uses of the proposed gap loan include soft costs, reserves, and developer fees, as shown in Table 1 below.

The total development cost of the Sunnydale HOPE SF Block 6 project is $148,685,657, of which the proposed gap loan amount of $18,647,014 represents 13 percent.

Table 1: Sources and Uses of Funds for Sunnydale HOPE SF Block 6

Sources	MOHCD Gap Loan (File 19-0980)	Other MOHCD Sources	Non-City Sources	Total
2015 General Obligation Housing Bond	$4,561,048			$4,561,048
HOME Funds	5,200,000			5,200,000
CPMC Funds	3,578,947			3,578,947
HOPE SF Certificates of Participation	5,307,019			5,307,019
MOHCD Infrastructure Loan (File 19-0315)		$11,000,000		11,000,000
Tax-Exempt Permanent Bank Loan			$9,086,000	9,086,000
Tax-Exempt Permanent Bank Loan – Section 8 Tranche			43,107,000	43,107,000
Deferred Developer Fee			5,420,466	5,420,466
LP Equity			60,925,177	60,925,177
General Partner			500,000	500,000
Total	**$18,647,014**	**$11,000,000**	**$119,038,643**	**$148,685,657**
Uses				
Acquisition	$1			$1
Construction (Hard Costs)		$11,000,000	$108,460,561	119,460,561
Soft Costs				
Architecture & Design			3,711,040	3,711,040
Engineering & Environmental Studies	344,000			344,000
Construction Financing Costs	8,327,617		946,576	9,274,193
Permanent Financing Costs	290,965			290,965
Legal Costs	432,193			432,193
Entitlement/Permit Fees	1,968,920			1,968,920
Other Development Costs	2,341,450			2,341,450
Soft Cost Subtotal	13,705,145	-	4,657,616	18,362,761
Soft Cost Contingency (5%)	867,208			867,208
Operating Reserves	1,204,660			1,204,660
Developer Fees	2,870,000		5,920,466	8,790,466
Total	**$18,647,014**	**$11,000,000**	**$119,038,643**	**$148,685,657**
% of Total Development Cost	**13%**	**7%**	**80%**	**100%**

City Subsidy

MOHCD has an existing infrastructure loan agreement with Mercy and Related for Sunnydale HOPE SF Block 6 in the amount of $11,000,000, as noted above. The proposed resolution would increase the City's subsidy for the development of Sunnydale HOPE SF Block 6 to $29,647,014.

The total City subsidy per unit would total $177,527, or $121.64 per square foot, as shown in Table 2 below.

Table 2: City Subsidy for Sunnydale HOPE SF Block 6

Number of units	167
Total building area	243,721 sf
Total City subsidy	$29,647,014
City Subsidy per unit	$177,527
City Subsidy per sf	$121.64

Loan Terms

According to the amended and restated loan agreement, the loan repayment is due on the 57th year of the loan. Loan repayment obligations are limited to the availability of residual receipts, or annual cash flow after operating costs have been paid. Interest not paid to the City each year due to lack of available residual receipts will be forgiven and will not accrue. For any year when the replacement reserve balance is less than 1.5 times the original replacement reserve amount, one-third is retained by the project sponsor, and the other two-thirds is deposited into the replacement reserve. In the event that the replacement reserve balance is greater than 1.5 the original amount, then the City would receive repayment on the loan.

Affordability Restrictions

As mentioned above, the San Francisco Housing Authority intends to ground lease the land to the project sponsor for a term of 57 years. The project sponsor will have an option to extend the ground lease up to 99 years. In addition, MOHCD will have a declaration of restrictions on the property that will ensure that the property stays affordable. According to Ms. Sara Amaral, Senior Project Manager at MOHCD, in the unlikely event that the project sponsor sells the property, MOHCD's loans would be paid back.

POLICY CONSIDERATION

The Sunnydale HOPE SF Block 6 development has an average development cost of $890,333 per unit, or $610 per square foot. According to Ms. Amaral, MOHCD, the project sponsor, and the lender/investors each have representatives that work together to contain costs and engage in value engineering.

Because of the increasing costs to develop affordable housing in the City and the pending November 2019 ballot measure to approve $600 million in General Obligation bonds to fund affordable housing development, the Board of Supervisors should amend the proposed resolution to request a report from the MOHCD Acting Executive Director by no later than December 9, 2019, detailing the City's procedures to contain the costs of affordable housing development.

Because the proposed loan of $18,647,014 to partially finance the development of Block 6 is consistent with other Board of Supervisors actions, we recommend approval of the proposed resolution.

RECOMMENDATIONS

1. Amend the proposed resolution to request a report from the MOHCD Acting Executive Director by no later than December 9, 2019, detailing the City's procedures to contain the costs of affordable housing development.
2. Approve the proposed resolution as amended.

Item 6 **File 19-0881**	**Department:** San Francisco International Airport (Airport)

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would approve a specialty retail concession lease between San Francisco International Airport (Airport) as landlord and MRG San Francisco, LLC as tenant for a term of seven years and initial Minimum Annual Guaranteed (MAG) rent of $225,000.

Key Points

- In October 2018, the Airport Commission authorized Airport staff to conduct a Request for Proposals (RFP) for a specialty retail concession lease in Terminal 2. The Airport received one proposal from MRG San Francisco, which was deemed to have met all the minimum requirements. In March 2019, the Airport Commission approved the proposed lease.
- The proposed resolution would approve a seven-year lease with MRG San Francisco with initial MAG rent of $225,000. MRG San Francisco would pay the greater of the MAG rent or percentage rent based on gross revenues.

Fiscal Impact

- Over the seven-year term of the lease, the Airport would receive at least $1,575,000 in MAG rent. The Airport expects to receive percentage rent, which would exceed the MAG.

Recommendation

- Approve the proposed resolution.

MANDATE STATEMENT

City Charter Section 9.118(c) states that any modification, amendment or termination of a lease that had an initial term of ten years or more, including options to extend, or that had anticipated revenues of $1 million or more is subject to Board of Supervisors approval.

BACKGROUND

In October 2018, the San Francisco International Airport (Airport) Commission authorized Airport staff to conduct a Request for Proposals (RFP) for a specialty retail concession lease in Terminal 2. In December 2018, after holding an informational conference with potential proposers, the Airport Commission approved the minimum requirements and lease specifications and authorized Airport staff to accept proposals. In July 2019, the Airport received one proposal. A three-member panel reviewed the proposal and scored it, as shown in Table 1 below.

Table 1: Proposal and Score for RFP

Proposer	Concept Name	Score
MRG San Francisco, LLC	Hello Karl!	88.50

MRG San Francisco, LLC was deemed to be the only responsive and responsible proposer and was awarded a lease. In March 2019, the Airport Commission approved the lease.

According to Mr. John Reeb, Airport Senior Principal Property Manager, the Airport has a policy limiting each tenant to a maximum of eight leases, which has caused potential vendors to be selective of the opportunities they compete for. MRG had only three Airport leases at the time of the proposal. According to Mr. Reeb, the RFP was advertised through typical channels, including local business publications and national industry periodicals and websites.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve a specialty retail concession[1] lease between the Airport as landlord and MRG San Francisco as tenant, for a term of seven years and Minimum Annual Guaranteed (MAG) rent starting at $225,000 and increasing by CPI each year. Under the lease, MRG San Francisco would pay the greater of the MAG or percentage rent based on gross revenues. The key provisions of the lease are shown in Table 2 below.

[1] Merchandise will include specialty candy, durable goods, and clothes.

Table 2: Key Provisions of Proposed Lease

Location	Terminal 2
Term	7 years
Options to Extend	None[2]
Square Footage	765 square feet
Initial MAG Rent[3]	$225,000
MAG Adjustment	Annually based on Consumer Price Index (CPI)
Percentage Rent (of Gross Revenues)	12% up to $500,000; 14% from $500,000-$1,000,000; 16% over $1,000,000
Minimum Investment[4]	$700 per square foot
Interim Rent During Construction	16% of gross revenues
Deposit	Equal to ½ of initial MAG (subject to mid-term adjustment)
Early Termination	Airport may terminate with 6 months written notice, if space is needed for Airport's Five-Year or Ten-Year Capital Plan
Promotional Charge	$1 per square foot per year
Pest Control Fee	$75 per month, subject to adjustment

According to Mr. Reeb, the lease is anticipated to commence on March 1, 2020. Prior to that MRG will construct upgrades to the site, which are set to occur between November 2019 and March 2020.

FISCAL IMPACT

Over the seven-year term of the lease, the Airport would receive at least $1,575,000 in MAG rent. According to Mr. Reeb, the Airport expects to receive percentage rent, which would exceed the MAG.

RECOMMENDATION

Approve the proposed resolution.

[2] A memo submitted to the Airport Commission stated that the lease includes two 1-year options to extend. According to Mr. Reeb, this was an error. The lease has no options to extend.

[3] According to Mr. Reeb, the Airport sets MAG rents for retail leases at approximately 75 percent of projected percentage rent.

[4] The Minimum Investment Amount is $700 per square foot or $535,500 for the 765 square feet in the proposed lease is the minimum amount MRG must pay to upgrade the existing site.