Edwin M. Lee
Mayor

Olson Lee
Director

February 13, 2017

Ms. Angela Calvillo, Clerk of the Board
Honorable Supervisor Farrell
Board of Supervisors
City and County of San Francisco
City Hall, Room 244
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Re: Supplemental Transmittal Relating to Transmittal of BOS File No: 161066 – 950-974 Market Street and 180 Jones Street / BOS File No. 161066

Dear Ms. Calvillo and Honorable Supervisor Farrell:

At the Board of Supervisors' Land Use Committee meeting of February 6, 2017, Supervisor Farrell asked staff to further analyze the financial implications of the Ordinance in the above-referenced file. This legislation would, among other things, replace the affordable housing obligations of the developer of 950-974 Market Street ("Developer") under Planning Code Section 415 with an obligation to fund affordable housing at 180 Jones Street.

Pursuant to a request from the Planning Commission, staff from the Mayor's Office of Housing and Community Development (MOHCD) and the Planning Department submitted an initial analysis on December 9, 2016, using what information they had regarding the principal project's financing, which found that the Ordinance would benefit the Developer. The Developer responded via a letter to the Board on December 15, 2016, but no additional request for analysis was forthcoming from any City department, commission, or the Board.

Based upon additional information provided by the Developer on February 8, 2017, as well as recent changes to the Ordinance, we have revised our analysis and find that the Developer will not benefit financially as a consequence of implementing the Ordinance. This revision is driven mainly by our acceptance of more modest sales price projections than we originally assumed and the Developer's recent agreement to provide an additional $1 million in "gift" funding to the City. The narrative below explains the rationale for our revised opinion.

As background, the Developer originally proposed to satisfy Section 415 by building 31 units of on-site affordable condominiums. The community requested, instead, that the Developer acquire 180 Jones Street and provide additional funding to build 68 studio housing units at that site. Supervisor Kim introduced the project's Ordinance to facilitate this request, which included additional elements, such as an exemption of certain square footage values from the calculation of gross floor area; additional funding supplied by the Developer beyond the Section 415 in-lieu fee obligation; and a waiver of grey water system requirements. Staff catalogued these "credits" and "losses" in its December 9 letter as follows:

Original Analysis Submitted by MOHCD / Planning, December 9, 2016

TABLE 1: ON-SITE INCLUSIONARY UNITS (31, OWNERSHIP)

		5.50%
PROJECT COSTS	Construction & Soft Costs	(175,138,000)
	NP Water Fee	(1,750,000)
	Section 415 Fee	-
	Gift Fee	
	TDR Payment	-
	JHLF	(400,000)
	Total Costs	**(177,288,000)**
PROJECT REVENUES	Projected BMR Revenue (2019$)	10,282,461
	Less Sales Costs	(565,535)
	Projected Mkt Rate Revenue (2019$)	192,916,903
	Less Sales Costs	(10,610,430)
	Total Revenue	**192,023,399**
	Surplus / (Loss)	**14,735,399**

TABLE 2: PROJECT WITH ORDINANCE (68 BMRS at 180 JONES)

PROJECT COSTS	Construction & Soft Costs	(175,138,000)
	NP Water Fee	(1,750,000)
	Section 415 Fee	(15,002,196)
	TDR Payment	(700,000)
	JHLF	(400,000)
	Total Costs	**(192,990,196)**
ORDINANCE CREDITS & DEBITS	Non-Potable Water Cost	1,750,000
	TDR Payment	700,000
	Value of Delayed 415 In-Lieu Fee Pmt	800,000
	Gift to City	(2,000,000)
	Total Credit / (Debit)	**1,250,000**
PROJECT REVENUE	Projected Mkt-Rate Revenue (2019$)	220,999,838
	Less Sales Costs	(12,154,991)
	Total Revenue	**208,844,847**
	Surplus / (Loss)	**17,104,651**

We found there to be a net benefit to the Developer of approximately $2.37 million.

Now, with additional information available regarding the Developer's financial carrying costs, sales absorption rate, and reconsidered market data on likely condominium sales pricing, we are revising our analysis as follows below.

Revised Analysis, Based Upon Additional Project Financing Information, 2/9/17

	TABLE 1: ON-SITE INCLUSIONARY UNITS (31, OWNERSHIP)		***Footnote***
		5.50%	
PROJECT COSTS	Construction & Soft Costs	(175,138,000)	
	NP Water Fee	(1,750,000)	
	Section 415 Fee	-	
	Gift Fee		
	TDR Payment	-	
	JHLF	(400,000)	
	Total Costs	**(177,288,000)**	
PROJECT REVENUES	Projected BMR Revenue (2019$)	10,282,461	
	Less Sales Costs	(565,535)	
	Projected Mkt Rate Revenue (2019$)	181,041,282	1
	Less Sales Costs	(9,957,271)	
	Total Revenue	**180,800,937**	
	Surplus / (Loss)	**3,512,937**	
	TABLE 2: PROJECT WITH ORDINANCE (68 BMRS at 180 JONES)		
PROJECT COSTS	Construction & Soft Costs	(175,138,000)	
	NP Water Fee	(1,750,000)	
	Section 415 Fee	(15,002,196)	
	TDR Payment	(700,000)	
	JHLF	(400,000)	
	Add'l Financing Cost re: Sec 415 Fee + Gift	(800,000)	2
	Total Costs	**(193,790,196)**	
ORDINANCE CREDITS AND DEBITS	Non-Potable Water Cost	1,750,000	3
	TDR Payment	700,000	4
	Value of Delayed 415 In-Lieu Fee Pmt	1,600,000	5
	Gift to City	(2,700,000)	6
	Total Credit / (Debit)	**1,350,000**	
PROJECT REVENUE	Projected Mkt-Rate Revenue (2019$)	207,400,757	7
	Less Sales Costs	(11,407,042)	
	Total Revenue	**195,993,715**	
	Surplus / (Loss)	**3,553,519**	
	Additional TLGBQ Fee	**(300,000)**	8
	Final Surplus / (Loss)	**3,253,519**	
	Surplus / (Loss) With On-Site Inclusionary	**3,512,937**	
	Surplus / (Loss) With Proposed Ordinance	**3,253,519**	
	Surplus / (Loss) of Ordinance vs. On-Site	**(259,418)**	
	Less Benefit of Payment at TCO	**(1,600,000)**	
	Total Surplus / (Loss) of Ordinance vs. On-Site	**(1,859,418)**	

In sum, while maintaining the application of all previously assumed “credits” and “losses”, the revised analysis shows that the Developer will spend approximately $260,000 more by fulfilling the terms of the Ordinance than building on-site units. As previously stated, this change is driven largely by the Developer’s payment of $1 million more in gift funds than they had offered in December, as well as the revised sales price inflation factor. In addition, if the Board accepts as a policy matter the proposition that a “credit” for providing the bulk of the Inclusionary funding at TCO should not apply because the Developer never contemplated accessing the in-lieu option under Section 415 (which requires fee payments at first construction documents), then the Developer will spend approximately $1.86 million more by fulfilling the terms of the Ordinance rather than building on-site units.

Please find further explanation below for the highlighted line-items in the revised table.

1. **Sales Pricing**: In our original analysis, and citing a financial study completed by Seifel Consulting, we assumed a sales price inflation rate of 3.9% per year. While this rate reflected prior years’ trends in San Francisco’s housing market (since approximately 2010), we agree with the Developer’s counterpoint that 2016 saw stabilizing and even reduced home prices. We therefore accept the Developer’s proposed inflation rate of 1.2% per year to achieve the projected 2019 sales pricing.

2. **Inclusionary Fees Carrying Costs**: The developer will incur additional financing costs in order to pay the Section 415 value + the gift funds to MOHCD at TCO. Since we did not have the developer's cost of funds, nor their sales absorption rate in our original analysis, we did not previously include this cost. We do agree, however, that it is a real expense. Please note that our estimation of this costs, $800,000, differs from the value put forth by the developer, $1.6 million. The discrepancy lies in the developer's assertion that it must carry the full interest expense for the entirety of the sales absorption period, or 18-20 months. We would expect, however, that as each month of sales proceeds, the residential portion of the construction loan is paid down, so that the interest expense attributable to the fees is prorated over the sales absorption period. Also note that the developer has merged its commercial construction financing (i.e., the hotel), with the residential financing, so a typical residential construction loan take-out is not in play here. Still, we believe that the $800,000 fairly reflects the carrying cost of the fees if the residential portion of the construction loan is repaid.

3. **Grey Water System**: The Ordinance gives a credit for otherwise-required installation of a grey water reuse system. There is agreement between City staff and the project sponsor about the value of the waiver at approximately $1,751,000. The developer asserted in their December 15, 2016 letter that the grey water system cost should not be required because "if it weren't for the delay due to a façade redesign ordered by Planning staff, the [project] would have met the October 31, 2016 deadline to be exempted from the Non-Potable Water System". Planning staff has rebutted this argument for the following reasons:

    - Design review was not atypical for this scale and complexity of project. Extensive effort was made on the part of both Planning staff and Commissioners to help successfully and efficiently advance the project, resulting in a significantly expedited review given the magnitude and sensitivity of the project.
    - The design issues and their potential impact to the project were not new to the project: Discussions with the team about the likely schedule given the Commission calendar and the need to resolve design issues emerged as early as April 2016. Additionally, design issues were not limited to “façade redesign”, but included other concerns, including

ground-floor activation, lobby and internal circulation, and the design and public accessibility of plaza areas.

- Given the time necessary to review the project for permitting purposes, there was no likelihood of the project getting through Planning Commission and building permitting in time to meet the procedural thresholds required prior to the greywater provisions taking effect.
- While concerns related to construction timing were raised earlier in the review process, no timing issues related to the greywater ordinance were raised until the negotiation of the benefits package, just prior to the Ordinance taking effect.

  We believe it remains a policy decision whether to so-exempt, but should not be based on review process deficiencies as a basis.

4. **TDR Payment**: The Ordinance gives a credit for otherwise-required TDR fees. There is agreement between City staff and the project sponsor about on the value of the waiver at $700,000. The developer has asserted that this fee should not be assessed because of their willingness to build on-site inclusionary housing. Planning Code Section 124(f) allows an exemption for on-site Below Market Rate Units. Following the introduction of the Ordinance, this floor area (26,576 sq. ft.) was proposed for use as market-rate units, which would not otherwise be permitted. We believe this remains a policy decision. That said, there is agreement by all parties that the cost of this payment, if applied, would be established by the required price of $25 per square foot as set by Board Resolution Number 16-14.

5. **Value of Delayed Section 415 Payment to TCO**: The issue here is calculating a benefit that might accrue to the Developer by allowing a delay in payment of approximately $11.3 million due under Section 415 from first construction documents, which is standard, to TCO. We did not have the developer's cost of funds when we initially calculated this benefit, so estimated a very conservative discount rate of 3.5%. Recalculating the savings at the Developer's cost of borrowing, 7.96%, yields a potential benefit of $1.6 million. However, the developer has asserted that we should not be comparing the Ordinance to typical in-lieu fee requirements under Section 415, because they never proposed to “fee-out”. The apt comparison is, instead, on-site inclusionary costs relative to costs incurred under the proposed ordinance. We think this is a legitimate argument.

6. **Gift to City**: This value has increased by $700,000 since December.

7. **Sales Pricing**: See #1, above. This value assumes annual inflation on sales pricing at 1.2%.

8. **Gift to the City, TLGBQ**: This is a new expense.

Please feel free to contact us if you have any questions or require additional information.

Sincerely,

Kate Hartley
Deputy Director – Housing

cc: Honorable Supervisor Katy Tang
Honorable Supervisor Aaron Peskin
Honorable Supervisor Jane Kim
Olson Lee, Director, Mayor's Office of Housing and Community Development
AnMarie Rodgers, Senior Policy Advisor, Planning Department