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: March 20, 2024 Budget and Finance Committee Meeting

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Item 4 File 24-0205	Department: Mayor's Office of Housing and Community Development

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would approve a loan to 936 Geary LP to finance the acquisition and rehabilitation of 936-940 Geary Street, a Small Sites Program Project, in an amount not to exceed $11.8 million.

Key Points

- 936 Geary Street is a six-story building and includes 31 residential studio units and two commercial spaces on the ground floor. Twelve units are newly leased to formerly homeless residents, most of whom are seniors, who were referred by Catholic Charities and receive rental subsidies. Three residential units were vacant as of January 2024. One of the two commercial spaces is vacant, and the other is occupied by a short-term tenant.
- 936 Geary LP, the Project Sponsor, acquired and rehabilitated the property with bridge financing from the San Francisco Housing Accelerator Fund (SFHAF). The Project Sponsor purchased the property in December 2021 for $6,150,000, which reflected the as-is market value consistent with an appraisal conducted in September 2021. The rehabilitation of the building cost $4.55 million and was completed in November 2023. Rehabilitation work included a ground-floor structural retrofit, life-safety upgrades, and unit upgrades.

Fiscal Impact

- The City will provide up to $11.8 million to 936 Geary LP for the project, including $4.4 million in Preservation and Seismic Safety (PASS) loans (37 percent) and a $7.4 million Small Sites Program loan (63 percent). PASS funding is from 2016 General Obligation Bonds, and Small Sites funding is from the Downtown Neighborhoods Fund, 2019 General Obligation Bond funds, and the Affordable Housing Fund.
- The loan amount of $11.8 million is equal to $380,645 per unit, including PASS funding of $141,935 per unit and Small Sites funding of $238,710 per unit. The Small Sites funding is nearly 50 percent lower than the maximum permitted under program guidelines.

Policy Consideration

- The City repays bridge loans at permanent conversion, which may occur after rehabilitation work has been completed. The timing of permanent conversion has implications for preservation projects, including interest costs, oversight, accessibility standards, and procurement. HAF-funded rehabilitation projects are not subject to the same accessibility standards as City-funded projects. The Geary Street entrance is not wheelchair accessible.

Recommendations

- Amend the proposed resolution to reduce the not-to-exceed loan amount from $11.8 million to $11.6 million to reflect the project budget and to state the correct address of the project (936-940 Geary Street) and approve the resolution, as amended.

MANDATE STATEMENT

City Charter Section 9.118(b) states that any contract entered into by a department, board or commission that (1) has a term of more than ten years, (2) requires expenditures of $10 million or more, or (3) requires a modification of more than $500,000 is subject to Board of Supervisors approval.

BACKGROUND

Small Sites Program

The Small Sites Program (SSP), administered by the Mayor's Office of Housing and Community Development (MOHCD), was created in 2014 to provide loans for acquiring and rehabilitating multi-family rental buildings of five to 25 units. The Program has issued two Notices of Funding Availability (NOFA), one in 2014 and an updated one in 2019. MOHCD issued updated guidelines in September 2022. The new guidelines prioritize sites that have between five and 40 units. The program aims to achieve an average of 80 percent Area Median Income (AMI) rents over time as a building experiences tenant turnover; however, MOHCD may make exceptions to the AMI requirement.

PASS Loan Financing

In addition to Small Sites Program loans, some Small Sites projects also receive loans through the Preservation and Seismic Safety (PASS) program. The PASS program was authorized by voters in 2016 and provides low-cost financing to fund the acquisition and preservation of affordable housing and seismic retrofits to existing buildings. The program is funded by $260.7 million in general obligation bonds, including $156.0 million for market-rate loans and $104.7 million for below-market rate interest or deferred interest loans. Unlike other MOHCD permanent loans for affordable housing which are structured as soft debt and repaid through residual receipts, PASS program loans are structured as hard debt, which means they must be repaid every year for the duration of the lending period.

936-940 Geary Street

936 Geary Street is a Small Sites Project located in the Tenderloin. The six-story building includes 31 residential studio units and two commercial spaces on the ground floor. As of January 2024, 28 out of 31 residential units were leased and three units were vacant. Twelve units are newly leased to formerly homeless residents, most of whom are seniors, who were referred by Catholic Charities and receive rental subsidies from MOHCD's Eviction Prevention and Housing Stabilization Programs. One of the two commercial spaces is vacant, and the other is occupied by a short-term tenant who leased the space during construction.

936 Geary LP, the Project Sponsor, acquired and rehabilitated the property with financing from the San Francisco Housing Accelerator Fund (SFHAF)[1] and is now requesting permanent financing from the City. The Project Sponsor purchased the property in December 2021 for $6,150,000 which reflected the as-is market value consistent with an appraisal by Watts, Cohn, and Partner, Inc conducted in September 2021, according to the MOHCD loan evaluation. Rehabilitation of the building cost $4.55 million and was completed in November 2023. Rehabilitation work included a ground floor structural retrofit, a new fire alarm, upgrades to the standpipe connection for fire protection, and unit upgrades, including replacement of kitchens, bathrooms, doors, electric panels, and windows.

936 Geary Limited Partnership

936 Geary LP is comprised of two equal Limited Partners: (1) San Francisco Housing Development Corporation (SFHDC), a nonprofit organization and the managing general partner; and (2) Novin Development Corporation (Novin), a for-profit corporation and the administrative general partner. According to the MOHCD loan evaluation for the proposed loan, this is a unique partnership relative to other Small Sites projects, and it is the first time that a for-profit entity has ownership of a Small Sites property.

Selection

The Project Sponsor applied to the 2019 Small Sites Program NOFA, which awards funding on a rolling basis, and MOHCD determined that the Project was eligible for funding. According to the 2022 Small Sites Program Scoring Rubric, the Project would receive a score of 92 points out of 100 points possible, which exceeds the minimum score of 70 points to receive funding. However, the project was underwritten in 2021 before the scoring rubric was implemented.

In December 2021, MOHCD provided a soft commitment letter to the Project Sponsor that the City would provide up to $11,384,306 in permanent financing to repay the HAF loan. In July 2023, MOHCD provided an updated soft commitment letter that the City would provide up to $12,200,000 in permanent financing.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve a loan to 936 Geary LP to finance the acquisition and rehabilitation of 936-940 Geary Street, a Small Sites Program Project, in an amount not to exceed $11.8 million. The resolution would also (a) affirm the Planning Department’s determination under the California Environmental Quality Act; (b) adopt findings that the proposed transaction is consistent with the General Plan and the eight priority policies of the Planning Code; and (c) authorize the Director of MOCHD to execute loan documents and amend loan documents as

[1] The HAF is a non-profit organization that provides bridge financing for preservation projects after MOHCD provides a soft commitment letter indicating that the City intends to repay the bridge loan.

needed. The proposed resolution incorrectly states that the property is located at 936-940 Geary Avenue rather than 936-940 Geary Street and should be amended to reflect the true address.

According to the MOHCD loan evaluation, the HAF loan expired on February 28, 2024, before the closing of permanent financing due to project delays discussed below. The HAF loan permits a per-diem interest rate to be paid by the Project Sponsor for two months following the loan expiration date. The proposed loan would fund these additional interest costs. If the permanent loan does not close before the two-month period ends, the HAF and the Project Sponsor will negotiate the loan terms for the remaining period until the City's loan closes.

Loan Agreement and Repayment

The proposed loan agreement provides for a loan amount not to exceed $11.8 million, including a Small Sites Program loan of up to $7.4 million and PASS loans totaling up to $4.4 million.

The PASS loan includes three components: (1) a market rate loan; (2) a below market rate loan; and (3) a deferred loan. MOHCD combines PASS market rate loans with PASS affordable loans (below market rate and deferred) to create a blended interest rate and maximize total bond proceeds available for affordable housing preservation projects. The interest rates and repayment terms for the loans are provided in Exhibit 1 below based on the terms in four separate promissory notes (one for each type of PASS loan and one for the SSP loan). The loans mature 40 years after the recordings of the deeds of trust.

Exhibit 1: PASS and SSP Loan Summary for 936-940 Geary Street

Loan	Amount	Annual Interest Rate	Interest Type	Repayment
PASS Market Rate	$2,679,600	3.87%	Compound	Monthly payments
PASS Below Market Rate	1,478,400	0.96%	Compound	Monthly payments
PASS Deferred	242,000	0.96%	Compound	Repayment at Maturity Date, no monthly or annual payments
SSP Loan	7,400,000	3.00%	Simple	Annual Payments, equal to 2/3 of Residual Receipts
Total	**$11,800,000**			

Source: Master Promissory Notes

Required Rents and Option to Purchase

The Declaration of Restrictions, which covers all loan products, outlines required rents for all units for existing tenants. Rents for units that become vacant will be set so that the combined average rents for all units are equal to 30 percent of 80 percent of Area Median Income, or other amounts subject to MOHCD approval. The affordability restrictions have been in place for no less than 99 years.

The Purchase Option Agreement grants the City the option to purchase the property if the owner fails to comply with the affordability restrictions, if the Declaration of Restrictions is terminated, or if the owner receives another offer to purchase the properties after the City's loan is repaid.

Deeds of Trust

Two deeds of trust (one for the PASS funding and one for the SSP loan) secure the loans.

Sponsor Performance

The MOHCD loan evaluation cites sponsor performance issues, including delays in obtaining builder's risk insurance for the owner, delays applying for the welfare tax exemption generating $50,000 in costs to the Project, and construction management issues. According to the MOHCD loan evaluation for the proposed loan, the project experienced delays during construction, permitting, and tenant relocation activities because the general contractor (Novin) was inexperienced. Novin, a General Partner and the general contractor, was responsible for construction management. However, the Project Sponsor ultimately hired a third-party construction manager due to concerns raised by the SFHAF. The project also experienced three months of delays due to unforeseen conditions, including dry rot, no existing framing, and window delivery challenges that delayed window installation. Project delays resulted in increased loan interest and insurance costs. The Sponsor requested and was granted a 13-month loan extension from the HAF.

Due to performance issues and provisions of the limited partnership agreement[2], MOHCD cites concerns about the limited partnership's ownership and management of the property. MOHCD is requiring that the two general partners meet with MOHCD within 90 days of the loan close to discuss the responsibilities of the partners especially regarding asset and property management, including potential changes to the structure of the limited partnership. In addition, MOHCD reserves the right to declare a default if the Project Sponsor does not meet the terms of the loan agreement and to take possession of the Project in the event of a default under Article 19 of the proposed loan agreement.

Due to challenges with this project and other SFHDC acquisition projects, MOHCD will not provide funding to SFHDC for additional Small Sites Projects until MOHCD has determined that SFHDC has sufficient capacity to support projects and until existing projects have been stabilized for two years, according to the MOHCD loan evaluation.

FISCAL IMPACT

The City will provide up to $11.8 million to 936 Geary LP for the acquisition and rehabilitation of the project, including $4.4 million in PASS loans (37 percent) and a $7.4 million Small Sites Program loan (63 percent). Exhibit 2 summarizes the uses of funding for the proposed project.

[2] According to the MOHCD loan evaluation, the Limited Partnership Agreement requires that both general partners agree to modification or termination of the partnership, and the agreement is not explicit regarding how poor performance of either of the partners will be addressed.

Exhibit 2: 936-940 Geary Proposed Uses of Funding

Uses	Amount
Acquisition	$10,701,061
Construction	0
Soft Costs	133,022
Reserves	355,631
Developer Costs	410,000
Total Uses	**$11,599,714**

Source: MOHCD

We recommend amending the proposed resolution to reduce the not-to-exceed loan amount from $11.8 million to $11.6 million to reflect the project budget.

Acquisition costs totaling $10.7 million include $6,150,000 in purchase costs (which was consistent with an appraisal at the time of purchase), and $4.55 million in rehabilitation costs (including $3 million in hard costs and $1.55 million in soft costs). Reserves total $355,631 and include Operating Reserves of $120,631 and Replacement Reserves of $235,000.[3] Total costs also include $410,000 in developer fees and $133,022 in soft costs, including $47,510 in interest costs on the HAF loan for the two-month period following the expiration of the HAF loan.

Funding Sources

PASS funding is from 2016 General Obligation Bonds for the PASS program.

SSP funding is from a combination of sources, including:

- $4,280,000 in Downtown Neighborhoods Fund;
- $1,920,000 in 2019 General Obligation Bond funds; and
- $1,200,000 from the Affordable Housing Fund.

City Subsidy

SSP program guidelines establish the maximum City subsidy per unit for acquisition, rehabilitation, and permanent financing based on the unit type, ranging from $275,000 for each single room occupancy unit up to $550,000 per ADU studio unit. However, the MOHCD Director can approve funding above the maximum guidelines if the project meets minimum scoring requirements.

The not to exceed City loan amount of $11.8 million is equal to $380,645 per unit, including PASS funding of $141,935 per unit and SSP funding of $238,710 per unit. Based on the unit mix of the building and the Project's base score according to the 2022 Small Sites Project Scoring Rubric, the

[3] Operating Reserves support unanticipated operating costs for at least 20 years, such as vacancy rates above 10 percent, and Replacement Reserves support the project's capital needs over time. SSP Guidelines require an operating reserve equal to 25 percent of the first-year operating budget and a replacement reserve equal to the greater of $2,000 per unit or the amount needed to fund replacement costs for the next 10 years (based on an approved Capital Needs Assessment).

SSP funding ($238,710 per unit) is nearly 50 percent lower than the maximum permitted under program guidelines ($465,725 per unit).[4]

Because PASS funding is a hard debt product, there are no comparable guidelines for PASS funding, but PASS loans are constrained and sized based on a minimum debt service coverage ratio of 1.15, a maximum loan-to-value ratio of 90 percent, and a maximum loan-to-cost ratio of 80 percent.

Operating Revenues and Expenses

According to the 20-year cash flow analysis for the project, the project's revenues, together with commercial revenues, are sufficient to cover operating expenses, replacement reserves, and management fees. Project revenues consist of tenant rents and rental subsidies for residents referred by Catholic Charities.[5] The operating budget assumes annual rental income loss of five percent for residential units and 20 percent for commercial space, except in the first year when no rental income for commercial space is assumed. As mentioned above, three out of 31 residential units (10 percent) were vacant as of January 2024, and the Project Sponsor had not yet identified long-term tenants for the two commercial spaces. According to MOHCD staff, the residential vacancy assumption of five percent is lower than the standard of 10 percent for Small Sites Projects because of the size of the project, the stability of the tenancies, and marketing available through DAHLIA.

PASS loans must be repaid according to the terms discussed above. According to the MOHCD loan evaluation, the PASS loans were sized such that no commercial income is needed to make payments. A portion of net income after operating expenses (residual receipts) will be used to repay the Small Sites loan.

POLICY CONSIDERATION

Because the process of securing and closing on purchasing a building needs to move quickly due to industry conditions many affordable housing preservation projects utilize bridge financing to close on a project before permanent City funding is available. The Housing Accelerator Fund is the most common lender for City acquisition and preservation projects and provided bridge financing to the 936 Geary project. The City repays bridge loans at permanent conversion, which may occur after rehabilitation work has been completed. According to MOHCD staff, MOHCD

[4] Maximum subsidy calculated as $350,000 for each of the 31 studio units and two commercial units, multiplied by 125%--the project's base score multiplier based on receiving a base score of 92 per the 2022 Small Sites Project Scoring Rubric.

[5] According to the MOHCD loan evaluation, referred tenants have incomes of less than 60% of AMI and are provided with subsidies that do not expire. The subsidies are sized to reduce rent burden to 50% and may not exceed $1,200 per month. The source of funding for the subsidy is the City's General Fund and is subject to the City's annual budget process.

provides permanent financing after rehabilitation rather than before rehabilitation for Small Sites Projects to ensure all rehabilitation has been completed to code and has passed inspection.

The timing of permanent conversion has implications for preservation projects, including interest costs, oversight, accessibility standards, and procurement. If permanent conversion occurs after rehabilitation, the HAF is responsible for oversight during construction, with MOHCD inspection at commencement of construction, 50 percent completion, and prior to final gap funding, and interest accrues on HAF bridge loans during construction until permanent conversion. According to MOHCD staff, the interest rate for the 936 Geary loan from the HAF was 4.68 percent, resulting in approximately $620,000 in interest costs for the Project.

HAF-funded rehabilitation projects are not subject to the same accessibility standards as City-funded projects. The MOHCD Construction Representative Report provided in the loan evaluation for 936 Geary highlighted accessibility concerns for the building including that the Geary Street entrance is not wheelchair accessible, the elevator has a manual gate and door and would benefit from improved accessibility features, and the kitchen of the ground floor studio unit is not wheelchair accessible. In addition, HAF-funded rehabilitation does not require typical City procurement processes for selection of contractors, such as issuing a request for proposals or checking conflicts of interest.

RECOMMENDATIONS

1. Amend the proposed resolution to reduce the not-to-exceed loan amount from $11,800,000 to $11,600,000 to reflect the project budget and to state the correct address of the project (936-940 Geary Street).
2. Approve the proposed resolution as amended.