

MEMORANDUM

TO: Community Investment and Infrastructure Commissioners

FROM: Tiffany Bohee
Executive Director

SUBJECT: Conditionally approving a variation to the Transbay Redevelopment Plan's on-site affordable housing requirement as it applies to the mixed-use project at 181 Fremont Street, subject to approval by the Board of Supervisors of the City and County of San Francisco in its capacity as legislative body for the Successor Agency to the San Francisco Redevelopment Agency, and authorizing the acceptance of a future payment of \$13.85 million to the Successor Agency for use in fulfilling its affordable housing obligations in the Project Area; Transbay Redevelopment Project Area

EXECUTIVE SUMMARY

181 Fremont is a mixed-use, high-rise development project (the "Project") located in Zone Two of the Transbay Redevelopment Project Area ("Project Area") that is being developed by Jay Paul Company (the "Developer"). The Project's 74 residential units are located on the upper 15 floors of the 52-story tower, which is approximately 700 feet in height. The Developer estimates that the homeowner association ("HOA") fees for these units will likely exceed \$2000 per month upon initial sales.

At its meeting on September 12, 2014, the Commission continued its consideration of the resolution of a variation to the Transbay Redevelopment Plan's on-site affordable housing requirement relative to the Project (the "Variation Request"); the resolution includes a condition that the Developer contributes \$13.85 million toward the development of affordable housing in the Project Area. As more fully explained in the Commission Memorandum for the September 12, 2014 meeting attached to this memorandum as Exhibit A, the primary basis for the variation request was that the on-site requirement would create difficulties for maintaining the affordability of the Project's 11 on-site, below-market-rate ("BMR") units because the HOA fees, already high in such developments, will likely increase over time such that the original homebuyers would not be able to afford the payments.

In considering the resolution, the Commission expressed concerns about not giving BMR homebuyers the opportunity to purchase units in the Project despite the high HOA fees, setting a precedent for other housing projects, and the timing of the market analysis undertaken by The Concord Group ("TCG") to calculate the \$13.85 million contribution from the Developer. To that end, staff worked with Mayor's Office of Housing and Community Development ("MOHCD") and TCG to obtain additional information for the Commission's consideration. In sum, this information shows that: 1) the high HOA fees detract from many of the benefits of homeownership and put both the BMR homebuyers and units at risk; 2) approval of the variation

and acceptance of the Developer's contribution is consistent with MOHCD's city-wide practice of allowing for either an in-lieu payment or construction of off-site BMR units, instead of on-site BMR units, except that in this case the payment is significantly higher than the standard in-lieu payment and it must be used in the Project Area; (3) the variation is based on unique characteristics of the Project and will not set a precedent; and (4) TCG's analysis is still valid because there does not appear to have been as much movement in the high end of the real estate market (where the Project is valued), any potential increases in the value of the market-rate units could potentially be mitigated by increases in the BMR units resulting from rising median incomes, and while it is impossible to know what the exact sales prices will be at the time the units will be sold, TCG's analysis is a reasonable estimate of the opportunity cost between the market rate and BMR units.

Staff recommends conditionally approving a variation to the Redevelopment Plan's on-site affordable housing requirement as it applies to the mixed-use project at 181 Fremont Street, subject to approval by the Board of Supervisors in its capacity as legislative body for OCII, and authorizing the acceptance of a future payment of \$13.85 million to OCII for use in fulfilling its affordable housing obligations in the Project Area.

DISCUSSION

Impact of High HOA Fees on BMR Buyers and Units

At the hearing of September 12, 2014, the Commission expressed concerns about not giving BMR homeowners the opportunity to purchase a unit in the Project, even with HOA fees that are expected to be in excess of \$2,000 per month. In response, staff conferred with the MOHCD on its policies and practices relative to BMR units and whether, given the unique characteristics of the Project, MOHCD would recommend that the BMR units remain on-site. Because the Project is located in Zone 2, MOHCD is the public agency responsible for application of the City's Inclusionary Affordable Housing Program to the Project and enforcement of the long-term affordability of the BMR units in the Project. As further detailed in an email dated September 23, 2014 from Maria Benjamin, Director of Homeownership and Below Market Rate Programs for MOHCD (attached as Exhibit B), MOHCD is in support of the Variation Request because of the impacts that the high HOA fees would likely have on the BMR homebuyers and the units themselves, including:

- The HOA fees would be a disproportionately large portion of a homebuyer's monthly housing cost (approximately 84%), and would severely limit the size of a mortgage the homebuyer could carry and the mortgage interest tax deduction, which is a significant benefit of homeownership;
- With HOA fees as a disproportionately large amount of their housing costs, an inclusionary BMR homeowner is at increased risk. HOA fees have historically increased more than inflation. Wealthier market-rate homebuyers, assuming they carry a mortgage, are impacted proportionally less by increasing HOA fees, and may have less incentive to control higher HOA fees;
- BMR unit sales prices would be artificially low (well below \$100,000) due to the extremely high HOA fees, resulting in a small first mortgage for the BMR homebuyer and creating a risk to the BMR homebuyer that a predatory lender would attempt to

make a second mortgage after the initial sale, since the low first mortgage creates the erroneous appearance that the BMR homebuyer has significant equity available to be captured through an infeasible second mortgage or home equity line of credit. This would increase the risk of foreclosure on the BMR unit;

- A very low first mortgage on the BMR unit severely limits the homebuyer's future ability to recoup at sale the money paid down on housing costs over time. Instead, the majority will have been paid toward HOA fees; and
- The BMR homeowner's higher risk also translates to the unit itself. If the unit falls into foreclosure, it has the potential to be lost from MOHCD's affordable portfolio.

Precedence Set by Variation and Impact of Affordable Housing Payment

At the hearing, the Commission also expressed concerns about setting a precedent for other housing projects. The on-site requirement is unique to the Project Area, and was put into place in order to comply with the requirement under Section 5027.1 of the California Public Resources Code (Assembly Bill 812) that 35% of the residential units in the Project Area be available to low and moderate income households (the "Transbay Affordable Housing Obligation"), which was finally and conclusively determined by the Department of Finance to be an enforceable obligation. It was also incorporated into the Redevelopment Plan and the Implementation Agreement. It is highly unlikely likely that approval of the Variation Request would set a precedent in the Project Area given the unique aspects of the Project, namely that: (1) it is the only approved or proposed mixed-use office and housing development within the Project Area; (2) it has the smallest number of residential units of any high rise development in the Project Area; and (3) its residential units are located on the upper 15 floors of the 52-story tower.

In this particular instance, approval of the Variation Request and acceptance of the Developer's contribution would subsidize many more units than would have been delivered on site. Initially staff estimated that up to 55 stand-alone affordable housing units on publicly-owned parcels in the Project Area could be funded. This was based on an assumption of \$250,000 per unit in OCII subsidy. However, based on a review of stand-alone affordable projects underway in the Project Area, the majority of which are rental, the OCII subsidy could be reduced to \$200,000 for a rental project. For example, the project sponsor for Transbay Block 8 (Related California and Tenderloin Neighborhood Development Corporation) is required to develop a stand-alone affordable housing project that requires no more than \$200,000 per unit in OCII subsidy. Therefore if OCII were to use the \$13.85 million payment in a project with subsidy cap such as Block 8, the payment could subsidize over 69 affordable units, a net increase of 58 over the 11 units that would be generated by the Project on site, which would significantly assist OCII in fulfilling the Transbay Affordable Housing Obligation.

The Commission's approval of the Variation Request and acceptance of the Developer's contribution would also be consistent with City's Inclusionary Affordable Housing Program that allows developers to fulfill BMR obligations off-site or pay an in-lieu housing fee, in place of including BMR units on site. However under the City's policy, the in-lieu housing fee is calculated on the difference between the estimated cost to construct a similarly sized unit and the maximum BMR purchase price. If the Project were subject to the City's policy, the Developer would pay approximately \$5.5 million to the City, which would be used by MOHCD to fund affordable housing elsewhere in the City. Under the proposed Variation Request and \$13.85

million payment, the payment of \$13.85 million is based on the Developer's own opportunity cost to build those units on site, resulting in a payment that is over two and a half times the City's in-lieu fee amount.

Timing of TCG Market Analysis

The Commission also inquired about whether the \$13.85 million contribution from the Developer is reflective of today's real estate values, given the price increases that have occurred since the TCG analysis was completed in November 2013. Tim Cornwell of TCG explained that it is difficult to say how much real variation there would be in the values since the analysis was completed, for a number of reasons:

- The Project is unique, and there is a very limited set of comparable properties. While there has been evidence of significant activity and price increases in the middle of the market, there has been less evidence at the high end of the market. It is therefore difficult to say how much, if any, the values for this Project increased over the last year;
- The value of the BMR units may change in the near future, as median incomes are expected to rise. Such increases in value could mitigate any increases in value for the market-rate units; and
- The analysis is based on a development that doesn't yet exist, at a certain fixed point in time. It is not possible to know exactly what the market dynamics will be at the point the units in the Project are sold.

Mr. Cornwell concluded that, given the above consideration, TCG's analysis is still valid.

CALIFORNIA ENVIRONMENTAL QUALITY ACT

The Commission's approval of the Variation Request does not compel any changes in the Project that the Planning Commission previously approved. Rather, approval of the Variation Request merely authorizes Planning Commission and Board of Supervisors to consider a future action that would remove the On-Site Requirement from the Project. Thus, approval of the Variation Request and authorizing the future acceptance of \$13.85 million for the Transbay Affordable Housing Obligation does not constitute a project under the California Environmental Quality Act ("CEQA"), CEQA Guidelines (California Code of Regulations Title 14) Section 15378 (b)(4) because it merely creates a government funding mechanism that does not involve any commitment to a specific project.

STAFF RECOMMENDATION

Staff recommends conditionally approving a variation to the Redevelopment Plan's On-Site Requirement as it applies to the mixed-use project at 181 Fremont Street, subject to approval by the Board of Supervisors in its capacity as legislative body for OCII, and authorizing the acceptance of a future payment of \$13.85 million to OCII for use in fulfilling the Transbay Affordable Housing Obligation.

*(Originated by Christine Maher, Senior Development Specialist, and
Courtney Pash, Acting Transbay Project Manager)*



Tiffany Bohee
Executive Director

Exhibit A: Commission Memorandum of September 12, 2014
Exhibit B: Email from Maria Benjamin, Director of Homeownership and Below
Market Rate Programs for MOHCD, dated September 23, 2014

122-0242014-002

Agenda Item No. 5 (g)
Meeting of September 12, 2014**MEMORANDUM**

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EXECUTIVE SUMMARY

Assembly Bill 812 requires that a total of 35% of the residential units in the Transbay Redevelopment Project Area ("Project Area") be available to low- and moderate-income households. The Redevelopment Plan for the Project Area ("Redevelopment Plan") and several enforceable obligations would fulfill this requirement through the combination of stand-alone and inclusionary housing in the Project Area. Both the Redevelopment Plan and the Planning Code require that all housing developments within the Project Area contain a minimum of 15% on-site affordable housing. Approval of projects on designated development blocks located in Zone One of the Project Area are under the purview of OCII; approval of projects in Zone Two are under the purview of the Planning Department, pursuant to the San Francisco Planning Code.

181 Fremont is a mixed-use, high-rise development project (the "Project") located in Zone Two of the Project Area that is being developed by Jay Paul Company (the "Developer"). The Project, which is currently under construction, was approved by the Planning Commission on December 6, 2012. The Project is unique in that: (1) it is the only approved or proposed mixed-use office and housing development within the Project Area; (2) it has the smallest number of residential units of any high rise development in the Project Area; and (3) its residential units are located on the upper 15 floors of the 52-story tower, which is approximately 700 feet in height. The Developer maintains that given these unique characteristics, the requirement to include the affordable units on-site will create practical difficulties for maintaining the affordability of the units because the homeowners association fees, already high in such developments, will likely increase over time such that the original residents would not be able to afford the payments and thus create an undue hardship for both the Developer and the future owners of the affordable units. The Developer estimates that the homeowner association fees will likely exceed \$2000 per month.

The Developer has therefore asked the Office of Community Investment and Infrastructure (“OCII”), as the successor agency to the San Francisco Redevelopment Agency, to grant a variation from the Redevelopment Plan requirement for on-site affordable housing that would allow the Planning Commission to consider the conversion of the 11 on-site affordable units to market-rate units, on the condition that the Developer contributes \$13.85 million toward the development of affordable housing in the Project Area.

The Redevelopment Plan gives the Commission the ability to grant a variation from this requirement if: (1) enforcement otherwise result in practical difficulties for development creating undue hardship for the property owner; (2) enforcement would constitute an unreasonable limitation beyond the intent of the Plan, the Design for Development or the Development Controls and Design Guidelines; and (3) there are unique physical constraints or other extraordinary circumstances applicable to the property. The Redevelopment Plan also gives the Commission the authority to condition its approval of a variation as necessary to secure the goals of the Redevelopment Plan and related documents.

Staff has analyzed the Developer’s request, and made findings as required by the Redevelopment Plan that: (1) enforcement of the on-site housing requirement creates practical difficulties for maintaining the affordability of the units, thereby creating undue hardship for the Developer, the future homeowners, and the Mayor’s of Housing Community Development; (2) this hardship constitutes an unreasonable limitation beyond the intent of the Redevelopment Plan to create affordable housing for the longest feasible time, as required under the Community Redevelopment Law; and (3) extraordinary circumstances, in particular the small number of for-sale units at the top of the high-rise tower, apply to the Project. Additionally, the \$13.85 million affordable housing fee, which was determined based on a market analysis by a real estate economics firm retained by OCII, can be used to subsidize the equivalent of up to 55 stand-alone affordable housing units on publicly-owned parcels in the Project Area and thus significantly assist OCII in fulfilling the 35% affordable housing requirement.

As required by Board of Supervisors Ordinance No. 215-12, the Commission’s approval of the Variation Request would be subject to approval by the Board of Supervisors of the City and County of San Francisco (“Board of Supervisors”), in its capacity as legislative body for OCII, because it constitutes a material change to OCII’s affordable housing program. Additionally, because the Project is located in Zone Two of the Project Area, the Planning Commission and Board of Supervisors will consider approving a development agreement with the Developer that is consistent with this action.

Staff recommends conditionally approving a variation to the Redevelopment Plan’s on-site affordable housing requirement as it applies to the mixed-use project at 181 Fremont Street, subject to approval by the Board of Supervisors in its capacity as legislative body for OCII, and authorizing the acceptance of a future payment of \$13.85 million to OCII for use in fulfilling its affordable housing obligations in the Project Area.

BACKGROUND

Transbay Affordable Housing Obligation

Assembly Bill 812, enacted by the California Legislature in 2003 and codified at California Public Resources Code §5027.1, mandates that a total of 25% of the residential units in the Project Area be available to low income households, and an additional 10% be available to moderate income households (the “Transbay Affordable Housing Obligation”), for a total of 35% affordable housing units. This Transbay Affordable Housing Obligation is expected to generate approximately 1,200 affordable units through a combination of units within market rate buildings, or inclusionary units, and stand-alone 100% affordable projects to be built on publicly owned properties.

In order to comply with the Transbay Affordable Housing Obligation, the Redevelopment Plan, at Section 4.9.3, and the San Francisco Planning Code, at Section 249.28(b)(6), require that all housing developments within the Project Area contain a minimum of 15% on-site affordable housing (the “On-Site Requirement”). Neither the Redevelopment Plan nor the Planning Code authorizes off-site affordable housing construction or an “in-lieu” fee payment as an alternative to the On-Site Requirement in the Project Area.

Variation Requirements

The Redevelopment Plan provides a procedure and standards by which certain of its requirements, including the On-Site Requirement, may be waived or modified. Section 3.5.5 of the Redevelopment Plan gives the Commission the ability to grant a variation from the Redevelopment Plan, the Development Controls and Design Guidelines, or the Planning Code where enforcement would otherwise result in practical difficulties for development creating undue hardship for the property owner and constitute an unreasonable limitation beyond the intent of the Plan, the Design for Development or the Development Controls and Design Guidelines. Section 3.5.5 also states that variations can only be granted by the Commission because of unique physical constraints or other extraordinary circumstances applicable to the property, and that the Commission shall condition the variation as necessary to secure the goals of the Redevelopment Plan, the Design for Development and the Development Controls and Design Guidelines.

181 Fremont Mixed-Use Project

On December 6, 2012, the Planning Commission issued approvals for the Project at 181 Fremont Street in Zone 2 of the Project Area. The Project is a 52-story (approximately 700 feet tall), containing approximately 404,000 square feet of office uses, approximately 74 for-sale units on the highest 15 floors of the tower, approximately 2,000 square feet of retail space, and approximately 68,000 square feet of subterranean area with off-street parking. In compliance with the On-Site Requirement of the Redevelopment Plan and Planning Code, the Project approvals require that 11 of the 74 units be available to moderate income households earning 100% of area median income. The Project’s developer estimates that the homeowners association fees for the residential units will exceed \$2,000 per month.

DISCUSSION

Variation Request

The Developer of the Project has requested a variation from the On-Site Requirement that would allow for the conversion of the 11 on-site affordable units to market-rate units (see Exhibit A, the "Variation Request"). In the Variation Request, the Developer explained that the Project was unique in that (1) it is the only approved or proposed mixed-use office and housing development within the Project Area, (2) it has the smallest number of residential units of any high rise development in the Project Area, and (3) its 74 residential units are located on the upper 15 floors of an approximately 52-story tower. The Variation Request concludes that the application of the On-Site Requirement to the Project creates "practical difficulties for maintaining the affordability of the units because homeowners association ("HOA") fees, already high in such developments, will likely increase such that the original residents would not be able to afford the payments" and thus "creates an undue hardship for both the Project Sponsor and the owners of the inclusionary housing units." Finally, the Variation Request proposes that OCII grant a variation on the condition that the Developer contributes \$13.85 million toward the development of affordable housing in the Project Area, in order to ensure that the conversion of the 11 inclusionary units to market-rate units does not adversely affect OCII's compliance with the Transbay Affordable Housing Obligation.

Analysis of the Variation Request

As noted above, the Commission can authorize a variation from the On-Site Requirement if the following findings can be made: (1) enforcement of the Off-Site Requirement would result in practical difficulties for development creating undue hardship for the property owner; (2) enforcement of the Off-Site Requirement would constitute an unreasonable limitation beyond the intent of the Plan, the Design for Development or the Development Controls and Design Guidelines; and (3) there are unique physical constraints or other extraordinary circumstances applicable to the property.

Practical Difficulties/Undue Hardship

Given the unique nature of the Project, in particular the affordable units at the top of a high-rise tower, the On-Site Requirement creates practical difficulties for the Project, as well as undue hardships for the future owners of the inclusionary below-market-rate units ("BMR Owners") and the Mayor's Office of Housing and Community Development ("MOHCD"), as the housing successor responsible for enforcing the long-term affordability restrictions on the units, as follows:

- 1) HOA fees pay for the costs of operating and maintaining the common areas and facilities of a condominium project and, per state law, generally must be allocated equally among all of the units subject to the assessment (Cal. Code Reg., title 10, § 2792.16 (a)). HOA fees may not be adjusted based on the below-market-rate ("BMR") status of the unit or the income level of the homeowner. If HOA fees increase, BMR owners will generally be required to pay the same amount of increases as other owners;

- 2) OCII's Limited Equity Homeownership Program ("LEHP") ensures that income-eligible households are able to afford, at initial occupancy, all of the housing costs, but does not cover increases in HOA dues that occur over time. Initially, the LEHP will decrease the cost of the BMR unit itself to ensure that income-eligible applicants are able to meet all of the monthly costs, including HOA fees. Neither OCII nor MOHCD has a program, however, for assisting owners in BMR units when increases in regular monthly HOA fees occur;
- 3) HOA members may approve increases in HOA fees without the support of the BMR Owners because BMR owners, particularly in a development with inclusionary units, typically constitute a small minority of the total HOA membership. Increases less than 20% of the regular assessment may occur without a vote of the HOA; increases exceeding 20% require a majority vote of members in favor. (Cal. Civil Code § 1366 (b)) To date, state legislation to provide protections to low- and moderate-income households in inclusionary BMR units of a market-rate building when HOA fees increase has been unsuccessful; and
- 4) When HOA fees increase or special assessments are imposed, BMR owners whose incomes have not increased comparably may have difficulty making the higher monthly payments for HOA fees. The result is that housing costs may become unaffordable and some BMR owners will face the hardship of having to sell their unit at the reduced prices required under the limited equity programs of OCII and/or MOHCD. If a BMR owner is forced to sell the inclusionary unit because of the high HOA fees, the cost of the restricted affordable unit, which will now include the high HOA fees, will be assumed by either the subsequent income-eligible buyer or by MOHCD. In either case, the high HOA dues will have caused an additional hardship.

Unreasonable Limitation

The hardship imposed by the On-Site Requirement, as described above, constitutes an unreasonable limitation beyond the intent of the Redevelopment Plan to create affordable housing for the longest feasible time, as required under the Community Redevelopment Law, Cal. Health & Safety Code § 33334.3 (f) (1).

Extraordinary Circumstances

There are several extraordinary circumstances applicable to the Project. The Project is unique in that it is a mixed-use, high-rise development with a very small number of for-sale, on-site inclusionary affordable housing units at the top of the tower. Of high-rise development recently approved or proposed in the Project Area, the Project is the only mixed-use development with commercial office and residential uses and has the smallest number of residential units. As previously noted, the construction of affordable housing units at the top of a high-rise creates practical difficulties for maintaining the affordability of the units.

Additionally, the Developer has offered to contribute \$13.85 million toward the development of affordable housing in the Project Area, which constitutes approximately 2.5 times the amount of the affordable housing fee that would be permitted under the City's Inclusionary Affordable Housing Program if this Project were located outside of the Project Area, which is approximately

\$5.5 million. The amount of the affordable housing fee was determined based on a market analysis by a real estate economics firm retained by OCII, The Concord Group (“TCG”). TCG calculated the net additional revenue that would accrue to the Developer if the 11 on-site affordable housing units were converted to market-rate units and concluded that the Developer would accrue an additional \$13.85 million (see Exhibit B). The analysis took into consideration the exact location of the 11 on-site affordable units within the Project in order to determine a value consistent with other comparable high-rise sales prices. Staff estimates that OCII could provide the local share of subsidy for approximately 55 stand-alone affordable housing units on publicly-owned parcels in the Project Area with the \$13.85 million based on projected construction and subsidy costs.

Compliance with the Transbay Affordable Housing Obligation

As previously mentioned, the Transbay Affordable Housing Obligation is an enforceable obligation under Redevelopment Dissolution Law and requires that 35% (approximately 1,200 units) of the residential units in the Project Area shall be developed for low and moderate income households. OCII is on track to meet the Transbay Affordable Housing Obligation (which has been finally and conclusively determined to be an enforceable obligation by the State Department of Finance) through a combination of stand-alone and inclusionary housing on the OCII assisted parcels in Zone One of the Project Area as well as inclusionary units on privately developed projects in Zone Two. To date in Zone 1, OCII has completed 120 very-low income units on Block 11 and provided funding for 70 affordable units currently under construction on Block 6. OCII has provided predevelopment funding for 85 affordable units on Block 7, and construction will commence in 2015. Another 286 affordable units are currently in predevelopment in Blocks 8 and 9. Over the next several years, OCII will facilitate the development of approximately 600 additional units of affordable housing in Zone 1 on Blocks 1, 2, 4, and 12. In Zone 2, there are an additional 49 affordable inclusionary units currently approved in at 41 Tehama Street. Cumulatively, the affordable units in these projects total approximately 1,200 units, which will achieve the 35% Transbay Affordable Housing Obligation. Please see Exhibit C for a map of the Transbay Project Area for further reference.

The payment of \$13.85 million as a condition of granting the Variation Request ensures that the variation will not be materially detrimental to the public welfare. OCII will use the payment to fulfill the Transbay Affordable Housing Obligation. Specifically, OCII will use the \$13.85 million payment to not only fund the 11 units that would have otherwise been provided in the Project on an OCII assisted site, but also to fund an additional 44 units on future OCII assisted Transbay projects. Staff is currently programming the majority of the \$13.85 million payment for Transbay Block 8, a mixed-income project that will include approximately 177 affordable units.

NEXT STEPS

As required by Board of Supervisors Ordinance No. 215-12, the Commission’s approval of the Variation Request would be subject to approval by the Board of Supervisors, in its capacity as legislative body for OCII, because it constitutes a material change to OCII’s affordable housing program. Additionally, the Planning Commission and Board of Supervisors will consider approving a development agreement with the developer that would be consistent with this action,

would provide relief from the on-site affordable housing requirement in Section 249.28 of the Planning Code, and would require the developer to pay an affordable housing fee of \$13.85 million to OCII for its use in fulfilling the Transbay Affordable Housing Obligation.

CALIFORNIA ENVIRONMENTAL QUALITY ACT

Approval of the Variation Request does not compel any changes in the Project that the Planning Commission previously approved. Rather, approval of the Variation Request merely authorizes the Planning Commission and Board of Supervisors to consider a future action that would remove the On-Site Requirement from the Project. Thus, OCII's approval of the Variation Request is statutorily exempt from the California Environmental Quality Act ("CEQA") as a feasibility and planning study under CEQA Guidelines Section 16262.

Approval of the Variation Request will not result in a physical change to the Project that was approved by the Planning Commission on December 6, 2012. In approving the Project, the Planning Commission found that because the Project was consistent with the adopted zoning controls in the Transit Center District Plan and was encompassed within the analysis contained in the Transit Center District Plan Final EIR, it did not require further environmental review under Section 15183 of the CEQA Guidelines and Public Resources Code Section 21083.3.

Finally, the payment of \$13.85 million as a condition of granting the Variation Request will be used by OCII to fund the 55 units that would have otherwise been in the Project Area and that were previously analyzed in the Environmental Impact Statement/Environmental Impact Report for the Transbay Terminal/Caltrain Downtown Extension/Redevelopment Project, which was certified in 2004. Any development project on the OCII assisted Transbay projects would require its own CEQA determination prior to project approval. Authorizing the future acceptance of \$13.85 million for the Transbay Affordable Housing Obligation thus does not constitute a project under CEQA Guidelines Section 15378(b)(4) because it merely creates a government funding mechanism that does not involve any commitment to a specific project.

STAFF RECOMMENDATION

Staff recommends conditionally approving a variation to the Redevelopment Plan's On-Site Requirement as it applies to the mixed-use project at 181 Fremont Street, subject to approval by the Board of Supervisors in its capacity as legislative body for OCII, and authorizing the acceptance of a future payment of \$13.85 million to OCII for use in fulfilling the Transbay Affordable Housing Obligation.

*(Originated by Christine Maher, Senior Development Specialist, and
Courtney Pash, Acting Transbay Project Manager)*


Tiffany Bohee
Executive Director

- Exhibit A: Variation Request
- Exhibit B: Market Analysis by The Concord Group
- Exhibit C: Map of the Transbay Redevelopment Project Area



June 5, 2014

Office of Community Investment and Infrastructure
Attn: Mike Grisso, Office of Community Investment and Infrastructure
1 South Van Ness Avenue, 5th Floor
San Francisco, CA 94103

Re: Request for Variation 181 Fremont Street
San Francisco, CA Block 3719/Lots 10 & 11
Case No. 2007.0456EBKXV

Dear Mr. Grisso:

Pursuant to section 3.5.5 of the Redevelopment Plan for the Transbay Redevelopment Project Area (the “Plan”), 181 Fremont Street LLC, (the “Project Sponsor”) hereby requests a variation from the requirements of section 4.9.3 of the Plan and section 415.6 of the San Francisco Planning Code in exchange for the payment of \$13.85 million dollars to the Office of Community Investment and Infrastructure (“OCII) for the provision of affordable housing within the Transbay Redevelopment Project Area (the “Project Area”).

181 Fremont is a unique mixed-use high-rise development project (the “Project”). The Project contains office space and for-sale residential units, including 11 inclusionary affordable ownership units at the top of the tower. The construction of for-sale, on-site affordable housing units at the top of a high-rise creates practical difficulties for maintaining the affordability of the units because homeowners association (“HOA”) fees, already high in such developments, will likely increase such that the original residents would not be able to afford the payments.

The burden placed on the Project Sponsor to maintain the affordability of the units creates an undue hardship for both the Project Sponsor and the owners of the inclusionary housing units. A variation allowing the Project Sponsor to pay an affordable housing fee to OCII will increase OCII’s ability to delivery affordable housing units within the Project Area, a primary goal of the Plan, create deeper affordable levels, produce more net affordable units, and maintain land values necessary for the Transbay Joint Powers Authority’s financing assumptions.

The Plan and Planning Code

Pursuant to section 3.5.5 of the Plan, OCII, in its sole discretion, may grant a variation from the Plan, the Development Controls and Design Guidelines, or the Planning Code, if enforcement would result in practical difficulties for development creating an undue hardship for the property owner and constitute an

unreasonable limitation beyond the intent of the Plan. OCII may grant variations only if there are unique physical constraints or other extraordinary circumstances applicable to the property. Any variation granted must be in harmony with the Plan and not materially detrimental to the public welfare or neighboring property or improvements.

Section 2.1G of the Plan states that it is both the purpose of California Redevelopment Law and a major objective of the Plan to strengthen the community by supplying affordable housing with the deepest affordability levels economically feasible. The Plan requires that 35% of all new housing units in the Project Area be affordable. Both Planning Code section 415.6 and section 4.9.3 of the Plan require that at least 15% of all new housing development units must be on-site, affordable housing units. To achieve this requirement, the Redevelopment Plan must utilize both inclusionary units and stand-alone affordable housing developments. The Plan's 2005 report set a goal of 388 inclusionary units and approximately 795 stand-alone affordable housing units.

The Project and the Project Area

The Project is currently the only approved or proposed mixed-use office and housing development within the Plan Area. The Project's tower contains 54 floors comprised of approximately 400,000 sq. sf. of office and retail space, and 74 residential units, the smallest number of residential units of any high-rise development in the Project Area. Office and retail uses occupy the lower 38 floors and residential units, including 11 inclusionary units, occupy the upper 15 floors.

The Plan Area covers 40 acres and includes blocks programmed for: (i) stand-alone affordable housing developments; (ii) all or a majority of office space; and (iii) a combination of market and affordable housing. The Transbay Joint Powers Authority ("TJPA") established specific land value goals for each block in its funding plan for the Transbay Transit Center ("TTC"). There are a limited number of publicly-owned blocks remaining upon which affordable housing may be built to meet the Plan's 35% affordability requirement.

Affordability Challenges

Due to the unique nature of the Property, maintaining the affordability of the affordable units in harmony with the Plan is problematic. The residential units within the Project are for-sale and include high HOA fees, in excess of \$2,000 per month. Although the initial price of the affordable for-sale units would be adjusted to reflect the cost of the HOA fees, after completion of the project the HOA may raise fees at any time regardless of the effect on the affordable units. Because the HOA, in its sole discretion, may increase HOA fees, once affordable units may quickly become unaffordable. The potential increase in turn-over of the units will de-stabilize the affordable community within the Project and create an undue hardship for both the Project owner and future owners of the affordable units. The granting of a variation will increase the number of affordable units with the Project Area and allow the production of units with deeper affordability levels.

Affordable Housing Fee

The Project Sponsor proposes to pay an affordable fee in the amount of \$13.85 million dollars to OCII to subsidize the equivalent an estimated 55 stand-alone affordable housing units on publicly owned parcels in the Project Area.

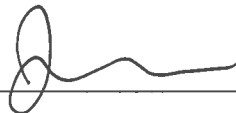
The fee is above and beyond that required pursuant to section 415.5 of the Planning Code. The amount of the fee was determined by The Concord Group (“TCG”), a real estate economics firm engaged by OCII. TCG calculated the net additional revenue that would accrue to the Project Sponsor if the 11 on-site affordable units were converted to market-rate units.

In summary, a variation from the on-site affordable housing requirements under the Plan and Planning Code would (i) result in the payment of \$13.85 million dollars to OCII in consideration of the elimination of the on-site requirement; (ii) provide OCII the ability to subsidize up to approximately 55 affordably housing units, with a net gain of 22 affordable units; (iii) prevent undue hardship to the Project Sponsor and future affordable housing unit owners; (iv) maintain of land values necessary for the TJPA’s financing assumptions; and (v) remain in harmony with the intent of the Plan to produce affordable housing at the deepest affordability levels.

The Project Sponsor is prepared to enter into an agreement with OCII confirming such obligation to make the affordable housing fee payment in exchange for the requested variation. Please contact me at the e-mail or telephone number shown above if you have any questions.

Best regards,

181 FREMONT STREET LLC, a
Delaware limited liability company

By:  _____

Name: Jay Paul

Its: President

From: Benjamin, Maria (MYR)
Sent: Tuesday, September 23, 2014 2:33 PM
To: White, Jeffrey (CII)
Cc: Hartley, Kate (MYR)
Subject: RE: 181 Fremont, proposal re: inclusionary BMRs
Attachments: 181 Fremont MOHCD BMR Pricing Baseline and with proposed HOAs.pdf

Hi Jeff. Thanks for sharing the discussion that the OCII Commission is having about 181 Fremont offering onsite inclusionary units. As you know, while many developers opt for the in lieu fee, MOHCD policy historically has allowed developers citywide to provide inclusionary BMR obligation off-site. We have found that the off-site units avoid affordability obstacles that occur when they are included a luxury building. In today's market, accepting the 181 Fremont in-lieu fee isn't unusual or an isolated circumstance.

MOHCD supports accepting \$13.85 million in lieu of 11 units at 181 Fremont as is consistent with MOHCD policy and practice:

- HOA fees at \$2,000 per month (wow!) would be a disproportionately large portion of a homebuyer's monthly housing cost at approximately 84% of total housing cost. This severely limits the size of a mortgage the homebuyer could carry, and limits the mortgage interest tax deduction, which is a significant benefit of homeownership.
- Unit sales prices would be well below \$100,000 artificially low/distorted due to extremely high HOA dues. This would result in a small first mortgage for the initial BMR homebuyer. A very low first mortgage on the BMR unit, severely limits the homebuyer's future ability to recoup at sale the money paid down on a mortgage over time – instead the majority will have been paid toward HOA dues. In a typical case, an owner will purchase a unit for \$300,000 and pay a monthly \$400 HOA fee. If the unit resells for, say, \$320,000 the owner recoups the money paid down on the mortgage minus interest. If an owner buys a unit for \$60,000 and sells the unit for \$65,000 in 5 years, the owner has no chance of recouping the bulk of the payments that have been made over time, therefore losing one of the main benefits of ownership. A BMR buyer in this situation resembles a renter not an owner.
- BMR units at 181 Fremont would start in MOHCD's portfolio, not OCII-Limited Equity Program. MOHCD calculates the initial sales price with the HOA dues in. However, upon resale the HOA dues are not calculated in. This way, the seller can sell the unit based on increases in AMI without taking into consideration the HOA dues. Great for the seller however, the new buyer now has to pay the affordable sales price plus the monthly HOA dues. It makes it harder for the new buyer to be able to afford the AMI priced home without down payment assistance. Thanks to the Housing Trust Fund and a state grant, we have been able to provide downpayment assistance so that our new buyers can still afford our BMR's. While we acknowledge that this is a band-aid approach because we cannot indefinitely rely on DALP to cover rising HOA dues, we have been able to ensure that new buyer of resale units are able to afford their units. Having said that, we've never had HOA dues in excess of \$1000. I'm not sure that even our DALP could bridge an affordability gap that large.
- With HOAs as a disproportionately large amount of their housing costs, a BMR homeowner is at increased risk because HOAs have historically increased more than inflation. Wealthier market-rate homebuyers, assuming they carry a mortgage, are impacted proportionally less by increasing HOAs and may have less incentive to control higher HOAs. For example, if \$500 HOA monthly dues increase 10% = \$50, but if \$2,000 HOA monthly dues increase 10% = \$200, making it more difficult for the BMR homeowner to absorb increases.
- MOHCD's stewardship obligation is both to the buyer and to the unit. An artificially low first mortgage will surely attract predatory lenders who see an opportunity to offer high interest second mortgages and lines of credit to our unassuming first time homebuyers leaving them vulnerable to foreclosure.

Instead of adding 11 BMR units at 181 Fremont, the \$13.85 million in-lieu fee would leverage other funds and could create approximately 55 affordable units elsewhere in Transbay. A net increase of 44 affordable units. Great deal!!

Attached is a spreadsheet comparing "baseline" BMR pricing to pricing with the high HOAs at 181 Fremont.

Maria Benjamin
Director of Homeownership & Below Market Rate Programs
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415-701-5500
415-701-5511 direct

MOHCD is experiencing a high volume of applications for all DALP programs. Please allow 20 days review and process time of all loan packages.