



## Legislation Text

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**File #:** 21-690, **Version:** 1

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Report regarding a resolution approving the third amendment to the Purchase and Sale Agreement and Joint Escrow Instructions for the property located at 432 Baden Avenue and a resolution approving Budget Amendment #22.230 for a \$4,050,000 loan from Commercial Linkage Fee Funds to For the Future Housing, Inc. for the acquisition of 428 and 432 Baden Avenue. (Julie Barnard, Acting Deputy Director of Economic Development and Housing)

### RECOMMENDATION

**Staff recommends that City Council adopt resolutions approving:**

- 1. The third amendment to the Purchase and Sale Agreement and Joint Escrow Instructions for the property located at 432 Baden Avenue, and**
- 2. A \$4,050,000 loan from Commercial Linkage Fee funds to For the Future Housing, Inc. for the acquisition of 428 and 432 Baden Avenue.**

### BACKGROUND

In 1997, the former Redevelopment Agency to the City of South San Francisco (“Redevelopment Agency” or “RDA”) purchased 432 Baden Avenue (the “Property”) for \$270,000 for the development of a public parking lot to serve the 400 block of Grand Avenue. The RDA demolished the residential building that existed on the site and developed a 16-space surface parking lot. Previously, this section of the Downtown had no public parking facilities.

The City of South San Francisco (“City”) is responsible for the disposition of former Redevelopment Agency properties in accordance with the procedures and requirements of the State-approved Long Range Property Management Plan (“LRPMP”). Under the LRPMP, the Property is required to be sold using a negotiated Purchase and Sale Agreement. The City is required to select a buyer that proposes the highest value to the taxing agencies. Before entering into a Purchase and Sale Agreement, the City typically seeks review and approval of the sale price by the San Mateo County Countywide Oversight Board (“Oversight Board”)

In September 2018, Baden Development, LLC (then Sierra Investment Group) (“Baden Development”) purchased 428 Baden Avenue, for development of a small multi-family housing project. During the entitlement process for 428 Baden Avenue, Baden Development approached the City with a proposal to purchase the Property, 432 Baden, to assemble land for a larger housing project.

Typically, the City would undergo a competitive bid process for the sale of former RDA properties. However, because the adjacent property owner made an offer on the Property with the intent to develop a project that was determined to be the highest and best use of the assembled properties, the City considered the proposal exclusively to determine whether or not a better offer might be made on the open market. In this case, this sole offer with the site assembly would provide a housing project with more housing units (rather than being developed individually).

By assembling 428 and 432 Baden Avenue, Baden Development was able to pursue a project with better design and more housing units and offer a higher price for 432 Baden Avenue than the City might expect to receive on

the open market. The proposed development also included 10% Below Market Rate (“BMR”) units at the Very Low Income (“VLI”) level.

On October 9, 2019, the City Council considered a Letter of Intent (“LOI”) provided by Baden Development and agreed that the site had a far greater value if assembled with 428 Baden Avenue than disposing of it as a stand-alone site. The City Council accepted the offer price of \$1,100,000 (which was \$80,000 more than the November 2019 appraised value of \$1,020,000) and directed staff to negotiate the Purchase and Sale Agreement and Joint Escrow Instructions (the “PSA”) with Baden Development. The purchase price was confirmed by the Oversight Board on February 10, 2020. The PSA was executed on February 19, 2020.

Baden Development then proceeded with entitling the larger development project. At its August 6, 2020 meeting, the Planning Commission approved the entitlements for 36 rental residential units, including three BMR units affordable to households earning 50% or less of the Area Median Income (“AMI”) (otherwise known as VLI). Attachment 1 indicates the San Mateo County AMI levels for 2021.

Due to the impacts of the COVID-19 Pandemic and the Shelter in Place (“SIP”) orders, Baden Development initially experienced some delays to their due diligence contingency period, and further required additional time to investigate some small issues relating to their Density Bonus concessions and waivers. The PSA allows for administrative extensions at the City Manager’s discretion, for six months at a time. Staff executed the First Amendment to the PSA, extending the due diligence period administratively by six months, to October 18, 2020, and the Close of Escrow from August 17, 2020 to February 16, 2021. The Second Amendment provided further extensions to the Close of Escrow and was considered and approved by Council on January 21, 2021.

Baden Development is also afforded two paid extensions to the schedule of performance in the Second Amendment to the PSA. Baden Development have utilized one of these two 90-day extensions by paying \$15,000, moving the Close of Escrow date to August 16, 2021. The second extension was also utilized and the City waived the \$15,000 extension fee, which is City practice for affordable housing developers. Under the current schedule, escrow will close before November 16, 2021.

## **DISCUSSION**

There are two key components for Council’s consideration in this report:

1. The amendments to the PSA replacing Baden Development with a new, affordable developer; and
2. The approval of a \$4,050,000 City loan for acquisition of 428 and 432 Baden Avenue for a fully affordable housing development.

## **PSA Amendments**

Presently, the developer is requesting the following amendments to the PSA:

1. Change the development team from Baden Development to For the Future Housing, Inc.;
2. Amend the scope from market rate (with a 10% affordable component) to a fully affordable housing development; and
3. Extend the Close of Escrow.

## ***Development Team Substitution***

While Baden Development were working through the building permit stages, they obtained several bids from general contractors. The bids they received were considerably higher than originally projected in their proforma. Construction costs (which include material costs and labor) were increasingly more expensive and were projected to rise further in the coming months. Further, the Pandemic had also softened the potential rental rates the development was likely to receive. These reasons made the advancing of the project more difficult to

secure financing with lenders.

Baden Development was approached by an affordable housing developer, For the Future Housing, Inc. (“FTF Housing”), which made an unsolicited offer to purchase the entitled property and convert it to a 100% affordable housing development. The proximity to Downtown amenities and available transportation options, means that the development is best suited to an affordable housing project and that this would be considered favorably by the City of South San Francisco. Baden Development agreed to enter into an Assignment Agreement with FTF Housing to assign Baden Development’s interest under the PSA to FTF Housing. The Assignment Agreement between the two developers assigns all obligations that Baden Development had with the City to FTF Housing.

FTF Housing’s mission is to deliver affordable, high-quality, and safe housing. The company is a developer as well as a general contractor and has significant experience in the bay area, including entitling 78 units in Calistoga, 177 units across two developments in Downtown Santa Cruz, and they are a partner in a 65-unit development on El Camino Real in Santa Clara.

### ***Delivery of Affordable Housing***

Under the new arrangement, FTF Housing would be delivering 35 BMR units and one manager’s unit to the housing market for a total of 36 units. The final AMI limits for the project have not yet been determined, as they will be driven by the final funding sources. FTF Housing have indicated that the average across units will not exceed 50% AMI, with the highest AMI limit being 60% AMI. The attachment shows the existing AMI limits for San Mateo County for 2021.

### ***Close of Escrow***

FTF Housing have made a request to close escrow on 432 Baden when they must acquire the neighboring, privately-owned parcel, 428 Baden Avenue. Typically, the City will close escrow and convey a site once all project financing has been secured. This is because the City prefers to retain site control until the project is ‘shovel-ready’. However, this project is unique as it is entitled as one project over two independently owned properties. Any financiers providing acquisition financing to FTF Housing to buy the Project require both parcels as collateral (regardless of property ownership) so that the Project, as entitled, can be developed.

In this case, staff recommends deviating from the City’s preferred approach of conveying the property before construction financing has been secured because of the City loan that is proposed and discussed below.

### **Project Financing and Acquisition Loan**

Cities typically need to provide a financial contribution to affordable housing developers for them to leverage other funding sources, like County funds and tax credits. In some cases, the City can donate the land which is considered a financial contribution to the development by other lenders. Since the Property was acquired by the former Redevelopment Agency, the City presently holds title to 432 Baden; however, the sale proceeds must be distributed to the taxing entities, including the School District and County. As mentioned earlier, the Oversight Board has already approved the purchase price of \$1,100,000 and the taxing entities are anticipating their shares of the proceeds when the property is sold.

At the August 25, 2021 City Council meeting, Council considered a request from Baden Development and FTF Housing to substitute development teams and to reduce the purchase price to \$1 to enable the delivery of a fully -affordable housing development. At that time, Council directed staff to provide FTF Housing with an acquisition loan for the property since it was unlikely that the Oversight Board would approve a land sale price reduction from \$1,100,000 to \$1. Council also expressed concern about how long it would take to deliver these

affordable units, given the need to assemble several funding sources.

Since then, FTF Housing have made significant progress in securing financing for the project. FTF Housing was awarded \$6 million in funding through the San Mateo County Department of Housing Affordable Housing Fund 9.0 (Measure K). The Measure K funding that was secured is contingent upon FTF Housing securing their tax credit financing with their first attempt. They will be applying for the competitive Federal 9% tax credit funding in the first quarter of 2022 with outcomes being determined in late Summer.

As mentioned above, the Federal 9% tax credits are competitive. Applications for developments that are shown to have substantial local (City and County) funding are awarded more tie-breaker points, thereby making them more competitive and increasing the likelihood that the project might secure tax credit financing. Given this, FTF Housing requested a permanent financing loan of \$4,050,000 from the City.

While a \$4.05 million permanent financing loan is a substantial increase from the original ask to reduce the purchase price from \$1.1 million to \$1, staff has negotiated for half of this loan to be a short-term acquisition loan and half to be permanent financing. Providing this level of financing in this staff-negotiated configuration will help accelerate the financing and construction of these affordable units, secure the City's investment with real collateral (the property and its entitlements and plans), and ensure half of the funds are repaid within just a few years. The intricacies of this proposed loan are discussed below.

#### ***Loan terms***

Recently, the City provided other fully-affordable housing developers with housing financing up to \$55,000 per unit. For a 36-unit project, like FTF Housing's project, that amounts to \$1,980,000. Staff considered the request for the full acquisition loan of \$4,050,000 and could only support a long-term loan of approximately \$2,000,000. This amount is \$900,000 more than the tentatively agreed upon amount at the August 25, 2021 City Council meeting (loaning \$1.1 million to FTF Housing to buy the Property), but is in keeping with financing provided in other City funding affordable housing developments.

FTF Housing has requested a \$4.05 million loan because it is sufficient to cover the acquisition of 428 Baden, 432 Baden, plus all entitlements, construction documents, and building permit plan revisions to date - everything needed to build this project. Below is a discussion of why staff recommends a \$4.05 million loan (half of which is repayable within a few years and the other half is a long-term loan) as to opposed to a smaller loan amount.

If the City were to provide an acquisition loan of under \$2,050,000, the City would end up in second lien position. This means that if FTF Housing fell into default, the primary lender with first lien position would be repaid first and has first rights to any collateral that secures the loan and the City, in second lien position, would have little site control and be repaid after the first lender has been repaid. The collateral, in this case, includes both properties (428 and 432 Baden Avenue), the entitlements and all construction drawings and permits completed at the time of default.

If the City were to provide a loan between \$2,050,000 and \$4,050,000 and thereby secure first lien position, FTF Housing would have trouble securing financing for the remaining funding, since very few other lenders would be willing to accept second lien position. The City providing the full acquisition loan streamlines the likelihood and timeline for this project's delivery.

To mitigate any risk to the City, staff propose to provide all \$4,050,000 in one loan with the following loan terms:

1. A short-term, acquisition component of the loan totaling \$2,000,000 with the following conditions:
  - a) to be repaid when the project secures construction financing;
  - b) an initial term of 24 months; and
  - c) if FTF Housing does not secure construction financing, the City may take the collateral and resell the property at its discretion.
2. A long-term permanent financing component of the loan of \$2,050,000 with the following conditions:
  - a) to be due and payable 55-years from the date of project completion; and
  - b) paying annual residual receipts payments to the City.
3. Both components of the loan would become due and payable if FTF Housing has not made best efforts to secure construction financing is not secured within 24 months. If FTF Housing make best efforts to secure financing (including a minimum of two tax credit applications), one 24-month extension may be granted at the City Manager's discretion.
4. The loan is secured with a Note, Deed of Trust encumbering both properties, and an Affordable Housing Regulatory Agreement.

All parties benefit from this solution.

- The benefits to the City include:
  - Securing first lien position and all collateral, which would leave the City with site control if the developer defaults.
  - Demonstrating the City's commitment to accelerating affordable housing production. The project is more competitive for other sources of funding, such as the 9% Federal tax credits with this level of local financial support.
  - Two million dollars is returned to the City very quickly, allowing another development in the City to be financed.
- The benefits to the Developer include:
  - Project financing costs are reduced by \$600,000 to \$900,000, which is the additional cost of having to place two acquisition loans.
  - The project is more likely to be fully financed sooner because it will be more competitive for 9% Federal tax credits.

### FISCAL IMPACT

Baden Development has paid a cost recovery deposit for City Attorney and staff time and additionally has paid \$30,000 in fees for the time extensions permitted under the PSA. At the time the Third Amendment to the PSA becomes effective, City Attorney and staff time will be recovered through cost recovery of the sale proceeds. There is no impact to the general fund.

The City will disburse \$4,050,000 from the Commercial Linkage Fee into escrow with \$1,100,000 returning to the City as sale proceeds for 432 Baden Avenue. As a member of the taxing entities, the City will receive a 16% share of those 432 Baden sale proceeds, or \$176,000, for the General Fund.

Staff recommends utilizing \$4,050,000 from the Commercial Linkage Fee Fund with \$2,000,000 being repaid within 24 months. The \$2,050,000 long-term loan will receive a small amount of residual receipts payments over the 55-year term. At the end of the 55-year term, the developer could either repay the outstanding amount on the loan, or request to extend the Affordable Housing Regulatory Agreement for another 55-years.

### RELATIONSHIP TO STRATEGIC PLAN

The development meets the City's Strategic Plan Objective #2 - Quality of Life by providing a full range of

housing options.

**CONCLUSION**

Staff recommends City Council adopt a resolution approving the third amendment to the PSA:

1. Approving assignment of the rights and obligations of Baden Development LLC to For the Future Housing, Inc.,
2. Modifying the project scope from market rate to a fully affordable housing product with 36 BMR units, and
3. Extending the Close of Escrow.

Additionally, staff recommends City Council adopt a resolution approving a \$4,050,000 loan agreement for the acquisition of 428 and 432 Baden Avenue, of which:

1. \$2,000,000 will be repaid upon the earlier date of 24 months, or when construction financing is secured, and
2. \$2,050,000 is a long-term loan from which the City will receive repayments through residual receipts.

Attachment:

1. San Mateo County Area Median Income Limits (2021)