



REPORT

DATE: For the Agenda of June 28, 2002

ITEM 103

REPORT NO: HCR02-063

SUBJECT: Approval of Purchase and Sale Agreement for the Housing Commission's Proposed Office Development (District 2)

SUMMARY

Issue: Should the Housing Commission recommend that the Housing Authority authorize the CEO to proceed with the Housing Commission's proposed office development to be located at 12th Avenue and "C" Street in downtown San Diego?

Recommendation No 1: That the Housing Commission recommend that the Housing Authority approve the Purchase and Sale Agreement (PSA) with Lankford & Associates, Inc., or a Limited Liability Company of which Lankford & Associates, Inc. is the managing member owning not less than 51% of the company, provided that the composition of the Limited Liability Company is approved by the Commission's Chief Executive Officer, or designee and General Counsel; and authorize the Chief Executive Officer to execute a Purchase and Sale Agreement as approved by General Counsel and to expend funds.

Fiscal Impact No 1: Approval of Recommendation No. 1 will result in the expenditure of up to \$21,778,130, to be funded with bond proceeds. The amount of the bond proceeds will be offset by sale proceeds from the Housing Commission's existing Newton Avenue Office. Should these monies not become available, the PSA would terminate with no penalty to the Commission.

Recommendation No. 2: That the Housing Commission recommend that the Housing Authority and City Council take the initial steps to issue tax-exempt and taxable bonds to finance the Housing Commission's construction of a new office facility and related parking, including:

1. Housing Authority approve a bond inducement resolution for up to \$31.1M in tax-exempt and taxable bonds; and



2. City Council hold a public hearing (known as a TEFRA hearing – Tax Equity and Fiscal Responsibility Act) and adopt a resolution approving the issuance of bonds by the Housing Authority.

Fiscal Impact No. 2: Approval of the bond inducement resolution does not commit the Housing Authority to issue bonds. Issuance of bonds does not affect the ability to bond-finance housing or other municipal facilities.

Recommendation No. 3: That the Housing Commission approve CSG Advisors, Inc. as financial advisor and Orrick, Herrington & Sutcliffe, LLP as bond counsel to begin work on the proposed bond issuance.

Fiscal Impact No. 3: This action will result in the expenditure of approximately \$95,000 that will be funded with bond proceeds.

Environmental Review: Prior to the issuance of building permits, Lankford & Associates, Inc. will ensure compliance with all applicable environmental regulations and compliance with the California Environmental Quality Act (CEQA) and the National Environmental Policy Act (NEPA), to the extent applicable. The development of the project generically has been previously reviewed by CCDC, and environmental reports concerning that review are on file in the offices of CCDC and/or the Redevelopment Agency. Neither the construction of the office building nor the close of the Purchase and Sale Agreement may be consummated unless and until all applicable environmental clearances have been obtained.

Previous Related Action(s): On September 21, 2001 and November 27, 2001, the Housing Commission and Housing Authority, respectively, authorized the Chief Executive Officer to execute an Exclusive Negotiating Agreement (ENA) with Lankford & Associates, Inc. for potential development of the Housing Commission Headquarters Facility at 12th Avenue and "C" Street in San Diego (Report HCR01-105 and HCR01-105 Supplemental, **Attachment 2**).

On June 7, 2002, the Housing Commission authorized the Chief Executive Officer to execute up to two (2) 30-day extensions to the ENA with Lankford & Associates, Inc. (Report HCR02-053, **Attachment 3**).

Future Related Action(s): Specific authorization to issue bonds for the project will be sought from the Housing Authority at a future date.

BACKGROUND

In 1984, the Housing Commission relocated its main office from the leased space in the Spreckles Building in the downtown area to its current location, a retrofitted warehouse facility located at 1625 Newton Avenue. Since 1984, the Commission has experienced significant

growth in budget, from nearly \$21,500,000 to approximately \$135,000,000, and a corresponding increase in staff size, from 110 in 1984 to nearly 250 today, enabling it to provide housing assistance to about 75,000 San Diegans annually.

The 18-plus years of operation at Newton Avenue have not been without challenge. Proximity to public transportation, air circulation, temperature control and access to natural light have remained issues since 1984, augmented more recently by the issues of overcrowding, lack of private space in which to hold confidential meetings with clients, and inadequate parking for clients and staff. Major improvements are needed now and in the near future to address normal systems repair and replacement requirements, changing client and staff needs and to comply with changing federal regulations.

In July 2000, the Housing Commission established an ad hoc subcommittee comprised of Chairman Neal Arthur and Commissioner David Dick to work with staff and Keyser Marston Associates (KMA) to investigate office space options. Options available to the Commission, including "Do Nothing" (Actual Base Cost), "Renovation," "Lease New," and "Build New," were reviewed and the subcommittee determined that it was in the best interest of the Housing Commission to pursue the alternative of building a new office facility (**Attachment 4**).

In September 2000, the Commission issued a Request For Qualifications (RFQ), inviting responses from developers interested in providing a headquarters facility for the Housing Commission. At that same time, a Request For Proposal (RFP) was issued by Centre City Development Corporation (CCDC), related to development of a site located on the southwest corner of 12th Avenue and "C" Street.

Lankford & Associates, Inc.'s responses to both of the above-mentioned solicitations proved successful and on November 27, 2001, the Housing Commission entered into an Exclusive Negotiating Agreement (ENA) (**Attachment 5**) with that firm.

Staff has been involved in negotiations with Lankford & Associates, Inc. since the execution of the ENA, and the proposed Purchase and Sale Agreement (PSA) before you today represents the results of that effort.

DISCUSSION

Development Concept

The Commission is proposing to enter into an agreement with Lankford & Associates, Inc. (the "Developer") where the Developer would agree to construct a 5-story office building with ground floor retail space and parking garage (collectively the "Project") for the Commission for a guaranteed maximum price of \$21,778,130 (**Attachment 6**). Any savings achieved during the approximate three-year development process will be shared by the Commission and the Developer in accordance with the terms and conditions of the PSA. In addition to the

Project's components, the Developer also proposes to build, on the same site, a separate building containing private office and retail, and private residential condominium units (the "Developer Portion"). The Housing Commission has no direct involvement with the residential building.

The site would also contain an MTDB trolley station. The trolley station and its related components would be financed and developed by MTDB.

The entire site, including the Project, the Developer Portion and the MTDB trolley station sit within air-rights parcels atop the underground parking garage.

The proposed development site is currently owned by CCDC who proposes to enter into a Development and Disposition Agreement with Lankford & Associates, Inc. to facilitate the entire development.

Ownership Structure

Permanent Ownership

The final ownership of the components of the development would be as follows:

The Commission would own the components of the Project except for a portion (approximately 40%) of the garage, which would be owned by the condominium association with the spaces in that portion dedicated to condominium owners (**Attachment 7**).

The Developer would retain ownership of its private retail and office components and would sell the residential condominiums to individual owners, collectively comprising a homeowners association. The homeowners association would also own the portion of the garage dedicated to parking spaces for the condominium owners.

MTDB would retain ownership of the portion of the site dedicated to the MTDB trolley and station.

Ownership During Construction

The Developer has proposed that the Commission commence ownership of the Project as of the start of construction. However, alternative structures include the Developer owning the Project, as well as other components of the Development, until the completion of the Project, whereupon the Commission uses its financing (both taxable and tax-exempt) to purchase the completed improvements comprising the Project.

SELECTION OF THE FINANCING TEAM MEMBERS

Staff recommends assigning CSG Advisors, Inc. as financial advisor and Orrick, Herrington & Sutcliffe, LLP as bond counsel to begin work on the project. The proposed financing team members have been selected in accordance with the existing policy for the issuance of bonds. Financial advisors and bond counsels are designated on a rotating basis from the firms selected under the program through a competitive RFP process.

FINANCING STRUCTURE

It is anticipated that the bond-financed loan of up to \$31.1M will be underwritten utilizing AMBAC credit enhancement resulting in an AAA rating of the bonds. The \$9.3M difference between the \$31.1M is in the bond proceeds and the \$21.8M in the cost of the project is composed of that portion of the garage the developer will reimburse the Housing Commission upon completion of the project (\$5.5M), a debt service reserve of \$1.75M and costs of issuance of approximately \$2M. The outstanding bond amount will be reduced by proceeds from the sale of the existing Housing Commission office building as well as the \$5.5M reimbursement from the developer for the garage associated with the other building.

In the future, should the Housing Authority, under a separate action, authorize the issuance of bonds for the project, the bonds would be the sole responsibility of the Housing Authority and would not constitute a debt or liability of the City of San Diego, nor would it negatively impact the ability of the Housing Commission to issue bonds for housing projects (**Attachment 8**). Neither the faith and credit nor the taxing power of the City would be pledged to the payment of the bonds.

The Developer has proposed that the Commission issue approximately \$31.1M in tax-exempt and taxable governmental purpose bonds to finance the project. The office building and a portion of the retail and parking garage are eligible uses for tax-exempt bonds with the remainder of the development to be funded with the taxable bond proceeds. Any proceeds from the sale of the existing Housing Commission office building will be used to reduce the bonded indebtedness. The Developer proposes that the Commission finance the construction of the entire garage, and receive a payment at completion for the portion to be dedicated to spaces for condominium owners. This payment will retire a like amount of bonded indebtedness.

The Developer, in association with Newman and Associates – the underwriter proposed by the Developer – proposes that the bonds would be publicly sold as long-term, fixed-rate, rated bonds. The rating on the bonds would reflect the rating of a provider of bond insurance – AMBAC. AMBAC would provide the insurance on the basis of a minimum investment-grade “shadow” rating of the San Diego Housing Commission from Moody's. Moody's is currently evaluating eligibility of the Commission for a rating.

Newman and Associates estimates that the all-in interest rate, including the base bond rate and the cost of bond insurance, would be approximately 6% for the tax-exempt debt and approximately 7.5% for the taxable debt, given the proposed credit structure.

The bonds would be issued at the start of construction – even if the proceeds are not used to directly fund construction – to avoid interest risk associated with selling bonds at project completion for the purpose of purchasing the improvements related to the Project.

The Developer would obtain other financing for the Developer Portion, including other private sources as well as its own equity.

The Developer has negotiated an arrangement with CCDC where the land for the Commission's project would be provided at no cost subject to a profit participation upon sale of the Development or portions thereof.

BUDGET ANALYSIS

The cost of the proposed new office facility is reasonable for the type of structure envisioned. It is also appropriate to analyze the budget implications to the Housing Commission of a new facility. While initial costs are slightly higher (by about \$50,000 per year, primarily in order to capitalize a reserve account) than that of renovating the existing building, this differential is reduced over time.

The Housing Commission's FY03 Budget includes an appropriation of \$841,582 for the offices at Newton Avenue, Gateway Center and Ridgehaven Court, all of which would be moved to the proposed new 12th Avenue and "C" Street development. First year costs at the new office would be \$1,160,000. If the current facility were renovated, the first year occupancy cost would be expected to total \$1,109,000. In the longer term, the 12th Avenue and "C" Street facility would actually cost less because the rental income from leased office space and parking grows and the building debt payment remains constant. In addition, the value of the building would appreciate, providing future opportunities to leverage the equity.

During the recent deliberations concerning the Housing Commission's FY03 Budget, staff also produced estimates of five-year budget projections. This proposal is within the projected budget increase for office expenses. No funds currently used for rental housing production (HOME, Housing Trust Fund or housing bond proceeds) would be used for office expenses.

RISKS AND MITIGATIONS

Approval of the bond inducement resolution does not commit the Housing Authority to issue bonds. The recommended actions do not represent any commitment by the Housing Authority to proceed with the tax-exempt or taxable financing of the project. When eventually

issued, the financing risks associated with the project would be minimal since a third party would guarantee repayment of the bonds.

There is some risk involved with the rental income included in the pro forma:

- One of the floors of office space will be available for lease to other organizations. One of the conditions for the tax-exempt bond financing is that available space must be leased to government or non-profit organizations. Although it is not possible to obtain firm commitments from potential lessees at this time, several non-profit organizations have expressed interest in leasing the available space;
- The ground floor in the proposed office facility will be available for lease to retail establishments with taxable financing being utilized; the site is adjacent to one of the busiest trolley stops in the City, making the retail space very desirable for businesses;
- The rental income derived from the parking garage is an important part of making the proposal affordable to the Housing Commission. Keyser Marston has concluded that there is currently a shortage of parking in the area, which will be exacerbated by the planned development of several surface parking lots, thereby increasing the likelihood of full utilization of the parking garage.

CONCLUSION

Staff, KMA, and the ad hoc building subcommittee have analyzed the Commission's long-range office needs, performed the necessary "due diligence" to ensure reasonable costs within industry standards (**Attachment 9**), negotiated in good faith with the Developer, and are presenting a proposed development plan that represents the best available option. The resulting cost of occupancy (\$1.52 per square foot) and is well below market value for similar space (**Attachment 10**).

Approval of this proposed action will improve access for clients, resolve overcrowding and physical condition issues at the Commission's current facility, accommodate possible future growth, assure long-term occupancy at a less than market rate, and allow for long-term capital appreciation. SEIU Local 535 leadership (which represents most of the Housing Commission employees) has been consulted regarding this matter and is supportive of going forward with this development opportunity.

ALTERNATIVE

Alternative No. 1: Direct staff to proceed with the renovation of the Newton Avenue building. This alternative is not recommended due to the cost of the rehabilitation and the significant disruption to staff and clients during the construction phase. In addition, this alternative does

not address the problems of inadequate parking and access to public transportation, nor is there an opportunity to offset costs with rental income, nor to leverage building equity for housing in the future.

Alternative No. 2: Direct staff to pursue new construction or acquisition opportunities outside of the downtown area. This alternative is not recommended due to loss of opportunities to acquire the site from CCDC at no cost. Also, it is unlikely that the rental revenue income derived could be duplicated outside of the downtown area.

Alternative No. 3: Direct staff to lease other office space. This is not recommended, as it is the most expensive alternative currently and in the future.

Respectfully submitted,

Approved by,

Signature on File with Original Document

Steve Snyder
Asset Manager

Elizabeth C. Morris
Chief Executive Officer

- Attachments:
1. Purchase and Sale Agreement and Escrow Instructions
 2. Report HCR01-105 and HCR01-105 Supplemental
 3. Report HCR02-053
 4. Review of Alternatives Considered
 5. Exclusive Negotiating Agreement with Lankford & Associates, Inc.
 6. Project Budget
 7. Development of 12th Avenue & "C" Street
 8. 11/21/01 City of San Diego Memo from Patricia T. Frazier
 9. Cost Reasonableness
 10. Occupancy Cost Comparison
 11. Statement for Public Disclosure