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 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)

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