INFORMATIONAL MEMORANDUM

TO: Community Investment and Infrastructure Commissioners

FROM: Tiffany Bohee, Executive Director

SUBJECT: To update the Commission on (1) the overall financial performance of the Fillmore Heritage Center at the corner of Fillmore and Eddy Streets, including the recent bankruptcy filing by Yoshi’s San Francisco, and (2) the repayment history of tenant improvement loans associated with several businesses on Fillmore Street.

PURPOSE OF INFORMATION

The purpose of this Informational Memorandum is to update the Commission on (1) the overall financial performance of the Fillmore Heritage Center at the corner of Fillmore and Eddy Streets, including the recent bankruptcy filing by Yoshi’s San Francisco, and (2) the repayment history of tenant improvement loans associated with several businesses on Fillmore Street.

The Fillmore Heritage Center is an $80.5 million public-private partnership that includes 80 condominiums, about 50,000 square feet of commercial space, and a 112-space public parking garage. Of that $80.5 million, about 35% ($28.4 million) was financed using public funds from the City and County of San Francisco (the “City”) and the former San Francisco Redevelopment Agency (the “SFRA”). The public investment of dollars built the public parking garage and the commercial space, which was intended to help revitalize the lower Fillmore Street commercial corridor. The SFRA also contributed the land, and allowed the developer to pay the purchase price for the land over time. Part of the public investment included two tenant improvement loans from the SFRA to the two tenants in the commercial space: (1) Yoshi’s San Francisco, a 28,000-square-foot jazz club and restaurant, and (2) Food for Soul, which operates a 6,300-square-foot restaurant/music lounge known as “1300 on Fillmore.” These two tenant improvement loans total about $10.4 million. The Fillmore Heritage Center is the focus of this memorandum.

In addition, the SFRA approved two other tenant improvement loans to two other businesses on Fillmore Street. One is with Agonafer Shiferaw, who owns a building at 1534-40 Fillmore Street that formerly housed Rasselas Jazz Club, and the other is with Sheba Lounge, which leases space across the street from the Fillmore Heritage Center to operate a restaurant/music lounge. These two tenant improvement loans total about $1.6 million. These loans are discussed in further detail at the end of this memorandum.

DISCUSSION

As mentioned above, the Fillmore Heritage Center can be divided into three components: (1) the residential units, which were entirely privately financed, (2) the commercial space, which was
financed with both private and public funds, and (3) the public parking garage, which was entirely publicly financed. Each of these components is discussed in more detail below.

- **Residential Units.** The Fillmore Heritage Center includes 80 condominiums, including 12 affordable condominiums. The construction of these units was completely privately financed with about $35 million from a pension fund. No public dollars went into the residential component of the Fillmore Heritage Center. All the units have been sold to individual homeowners, and the proceeds were used to pay back the private construction lender and the SFRA for a portion ($3.5 million) of the $6.6 million land value. The condo owners operate a homeowners' association, which manages the residential space, a separate residential garage, and the common areas within the Fillmore Heritage Center (the "HOA"). All the condo owners pay common area maintenance fees to the HOA.

- **Commercial Space.** The Fillmore Heritage Center also includes about 50,000 square feet of commercial space on the ground floor of the building. The City financed the construction of the commercial space. To do this, the City, acting through the Mayor's Office of Housing ("MOH"), borrowed $5.5 million from the U.S. Department of Housing and Urban Development ("HUD") in the form of a securitized Section 108 loan, which is backed by the City's federal Community Development Block Grant ("CDBG") fund allocation (the "HUD Loan"). The City then gave these federal dollars to Fillmore Development Commercial ("FDC"), an affiliate of the developer, Fillmore Development Associates ("FDA"), in the form of a construction loan, so that FDC could build the commercial space (the "FDC Loan"). The SFRA also contributed about $10.4 million in loan funds for the tenant improvements.

OCII owns the commercial space and master leases the entire 50,000 square feet under a ground lease to FDC. The ground lease structure was used as a financing mechanism to allow the developer to pay the $6.6 million purchase price for the land over time instead of in one lump sum upfront (explained in more detail later in this memorandum). FDC, as master tenant, subleases the commercial space to two tenants: (1) Yoshi's San Francisco, and (2) Food for Soul. These subtenants pay rent and common area maintenance fees to FDC, who is supposed to (a) pass the rent through to the City as a debt service payment on the FDC Loan, and (b) pass the common area maintenance payments through to the HOA. This process has not been happening on a regular basis. FDC is about $1.4 million in arrears on the FDC Loan with the City (which is explained more fully below) and about $120,000 behind on its common area maintenance payments to the HOA. A copy of the HOA's July 18, 2013 letter to District 5 Supervisor London Breed is attached as Attachment 1.

FDC is required to pay the common area maintenance charges under its ground lease with OCII, however, OCII is ultimately liable for these charges, as owner of the commercial space, under a separate project document. OCII is paying the outstanding amount to the HOA with reserve balances authorized under OCII's Recognized Obligations Payment Schedule III and 13-14A, both approved by the Oversight Board and the State Department of Finance ("DOF"). Staff has asked for new property tax funds to cover some common area maintenance payments going forward (in the event the space currently occupied by Yoshi's San Francisco doesn't generate enough income to pay
them) on OCII’s Recognized Obligations Payment Schedule 13-14B, which still needs approval from the Oversight Board and DOF.

- Public Parking Garage. The Fillmore Heritage Center also includes a 112-space public parking garage. The SFRA financed the construction of this garage using $5.6 million in tax exempt bond proceeds. The SFRA also used about $860,000 in federal grant funds for site preparation/environmental remediation. OCII still owns the garage and operates it through a garage management agreement with a private garage operator. The garage also pays common area maintenance fees to the HOA. The garage’s performance is very dependent on the performance of the commercial tenants in the Fillmore Heritage Center. Currently, the garage is running a deficit of about $2,000 a month on average, which is a significant improvement from just three years ago, when the average deficit was about $8,000 a month. The improvement can be attributed to better management, lower personnel costs, and improved marketing. Staff has asked for new property tax funds to cover the expected deficit, along with replenishment of the garage’s operating and capital reserve, on OCII’s Recognized Obligations Payment Schedule 13-14B, which still needs approval from the Oversight Board and DOF.

In sum, the public investment went into the land, site preparation, the public parking garage, and the commercial space. The SFRA contributed the land, which was valued at about $6.6 million, and accepted a payback plan on the purchase price of the land over time ($3.5 million has been paid to date). The SFRA contributed an additional $5.6 million in grant funds for garage construction. And about $16 million in SFRA/City loan funds went into building the commercial space. These investments are explained in more detail below.

Investment by the City and County of San Francisco (the “City”)

As mentioned, in an effort to finance the construction of the commercial space, the City borrowed $5.5 million from HUD (the “HUD Loan”) and then loaned that money to FDC to build the commercial space (the “FDC Loan”). The HUD Loan is fully amortized at an interest rate of 5.54% with semi-annual interest payments and annual principal payments due through August 2025. MOH has no ability to alter the terms of the HUD Loan. The FDC Loan is fully amortized at an interest rate of 6.54% with monthly payments due through August 2025. Under this structure, FDC makes its debt service payments to the City using rental income from the commercial space, and then the City uses that money to make its debt service payments to HUD. However, because FDC has missed about $1.4 million in payments to the City since 2005, the City has had to find other money (i.e., CDBG funds used to serve the City’s low- and moderate-income residents) to make its debt service payments to HUD. The City’s loan is secured by a deed of trust on FDC’s leasehold interest in the commercial space, among other things.

Since 2005, City staff has been working with FDC to resolve the arrearage issue. In December 2010, FDC was eight months in arrears, owing the City about $360,000. At that time, instead of foreclosing on the FDC Loan, MOH agreed to amend the loan terms and extend FDC’s repayment of the $360,000 under separate repayment terms. FDC agreed to pay an additional $5,500 per month to the City through August 2013, with the balance of the delinquent $360,000 due as a balloon payment in August 2013. FDC made no payments on this workout loan between January 2011 and April 2013. To date, FDC has made only nine additional $5,500 payments, for a total of $49,500. FDC did not make the balloon payment due August 2013.
Over the last two years, the amount FDC owes under the FDC Loan has skyrocketed because the City’s tax collector has been taking the rental income from the commercial space (rental income that would normally have gone to service the FDC Loan) to pay approximately $570,000 in delinquent property taxes and penalties FDC owed on its leasehold interest in the commercial space. Because that rental income went to the City’s tax collector instead of to MOH, MOH had to service the HUD Loan using other funds (i.e., CDBG program dollars). While the initial $570,000 due to the City’s tax collector has been satisfied, FDC owes the City’s tax collector at least an additional $190,000 in delinquent taxes and penalties for the period July 1, 2012 through June 30, 2014. The FDC Loan is currently about $1.4 million in arrears.

Investment by the former San Francisco Redevelopment Agency (“SFRA”)

The SFRA invested about $6.6 million in land value and about $16 million in public funds in the Fillmore Heritage Center. The SFRA’s total investment took the form of deferred land payments, grants and loans. These are briefly discussed below:

- **Deferred Land Payments ($6.6 million).** The SFRA owned the land on which the Fillmore Heritage Center sits. At the time the property was being developed, it was valued at $6.6 million. The developer did not have $6.6 million to pay the SFRA for the land. Instead, the SFRA agreed to “finance” the land acquisition through a ground lease structure on the commercial space. Under the ground lease, the developer agreed to pay the SFRA the $6.6 million using proceeds from the sale of the condominiums and rental income from the commercial space (after the FDC Loan with the City was paid off). The developer paid the SFRA $3.54 million of the $6.6 million acquisition price using proceeds from the sale of the condominiums. However, the developer still owes OCII $3.1 million under the ground lease, which is supposed to be paid from the rental income from the commercial space (after the FDC Loan with the City is paid off). If and when the developer pays OCII the balance of the $6.6 million acquisition price, the developer will own the commercial space.

- **Grants ($5.6 million).** This money (tax exempt bond proceeds) paid for construction of the public parking garage, which OCII still owns. The state’s environmental protection agency also contributed an additional $860,000 in grant funds to complete environmental remediation at the project site.

- **Loans ($10.4 million).** This money paid to build-out the commercial space. The City’s $5.5 million loan paid for the core and shell, but additional money was needed to finish the space for occupancy. The SFRA loaned Yoshi’s jazz club and restaurant $7.2 million and Food for Soul (doing business as “1300 on Fillmore”) $2.6 million. The SFRA also loaned Food for Soul an additional $624,000 in working capital. These loans are discussed further below.

*Yoshi’s Loan.* In 2004, Yoshi’s tenant improvements were estimated to be $7.4 million. By the time Yoshi’s opened, however, that cost had doubled to $15 million. Yoshi’s financed that cost with $7.8 million in private equity and debt and $7.2 million in loan funds from the SFRA. Repayment of this loan comes from a percentage of the club’s net operating income. No payments have been paid since the loan was first executed in
October 2004 (i.e., no payments have been made in nine years). Further history of the Yoshi’s loan is included in Attachment 2. The recent bankruptcy filing of Yoshi’s San Francisco is discussed later in this memorandum.

**Food for Soul Loans.** As mentioned, Food for Soul has two loans with OCII: (1) a $2.6 million tenant improvement loan, and (2) a $624,000 working capital loan. Repayment of the $2.6 million tenant improvement loan comes from a percentage of the restaurant’s net operating income, and repayment of the $624,000 working capital loan is an amortized quarterly payment. Food for Soul has told OCII staff that the restaurant has not been generating net operating income, and therefore, Food for Soul has not been able to make any payments under the tenant improvement loan that was first executed in October 2004 (i.e., no payments have been made in nine years). OCII staff intends to request audited financial statements, as authorized under the loan agreement, to verify the restaurant’s net operating income and compliance with the existing loan terms.

Food for Soul has been making small payments ($500 a month) on its $624,000 working capital loan since December 2011, which is a small fraction of the amortized quarterly payment due. This loan is currently out of compliance with the existing loan terms and will require some kind of amendment in the future, which will be brought before the Commission and Oversight Board for consideration as soon as possible.

**Bankruptcy Filing of Yoshi’s San Francisco**

In November 2012, Yoshi’s San Francisco filed a petition for Chapter 11 bankruptcy in U.S. Bankruptcy Court, Northern District of California. At the time of filing, the only creditors listed on the petition were Yoshi’s Oakland (owed $1.3 million), a restaurant supply company (owed $2,700), and a refrigeration services company (owed $500). Since that time, representatives of Yoshi’s San Francisco have been in mediation talks (under the supervision of the bankruptcy court) with FDC’s investor group to devise a path forward. All workout agreements proposed to date involve replacing Yoshi’s San Francisco with a new club/restaurant. This transition involves an investment of $1.0 million in new working capital by FDC’s investors at a 12% return. In exchange, FDC’s investor group is asking the City and OCII for a number of changes to existing agreements.

In regards to the City’s FDC Loan, FDC’s investor group is asking the City to (1) invest an additional $216,000 (at a 6% return) into the club/restaurant, (2) give rent reductions to both commercial tenants for a period of about 12 months, (3) allow FDC to repay the $1.4 million in arrears between 2015 and 2027, and (4) waive interest and additional penalties. The source of funds for these payments would be a portion of FDC’s total rental income on the commercial space. These repayments to the City would be after subordinate lenders are repaid.

In regards to OCII’s $7.2 million tenant improvement loan, FDC’s investor group is primarily asking OCII to (1) relinquish its $500,000 loan guarantee from Yoshi’s Oakland, and (2) agree to a considerably longer repayment plan. Under the latest proposal from FDC’s investor group, OCII would not receive a payment until at least 2019, which would be six years after payments were supposed to start under the existing loan agreement and 15 years after the existing loan agreement was executed.
Unless a workout agreement can be reached between the City/OCII and FDC and its investors, the City will likely foreclose and take over as master tenant of the commercial space. Under this scenario, OCII (as owner and landlord) would work with the City (as master tenant) to stabilize and sell the property as soon as possible. If a workout agreement is reached between the City/OCII and FDC and its investors, OCII could possibly transfer this asset to the City for the governmental purposes mandated by the City’s HUD Loan, assuming this transfer was approved by the Oversight Board and DOF. In addition, some kind of loan amendment would likely be required, and this would be brought before the Commission and Oversight Board for consideration as soon as possible.

OCII staff has been working closely with City staff on a response to the latest proposal from FDC’s investor group. Copies of communications between OCII, the City, and FDC’s investors since February 2013 are attached as Attachment 3.

**Other Tenant Improvement Loans on Fillmore Street**

In addition to the tenant improvement loans to Yoshi’s San Francisco and Food for Soul, the SFRA approved two other tenant improvement loans to two other businesses on Fillmore Street. One is with Agonafer Shiferaw, who owns a building at 1534-40 Fillmore Street that formerly housed Rasselas Jazz Club, and the other is with Sheba Lounge, which leases space across the street from the Fillmore Heritage Center to operate a restaurant/music lounge. These two tenant improvement loans total about $1.6 million.

- **Agonafer Shiferaw Loan.** A detailed chronology of Mr. Shiferaw’s $1.26 million tenant improvement loan with the SFRA, and now OCII, is attached as Attachment 4. In sum, Mr. Shiferaw has paid only $100,000 on this loan since it was first executed in December 1997 (i.e., only $100,000 in payments have been made over the last 16 years). In February 2011, Mr. Shiferaw filed a petition for Chapter 11 bankruptcy in U.S. Bankruptcy Court, Northern District of California. He emerged from the bankruptcy process in August 2012. Since then, Mr. Shiferaw has been making monthly payments to OCII of $2,235, pursuant to the bankruptcy plan agreed to in bankruptcy court, which represents a 50% discount to his regular monthly payments. He recently sold his business (Rasselas Jazz Club), but continues to own the building where Rasselas used to be located at 1534-40 Fillmore Street. He will now make his debt service payments to OCII using rental income from the building. OCII’s tenant improvement loan is secured by a fee interest in the building, behind Mr. Shiferaw’s primary lender.

- **Sheba Lounge Loans.** Sheba Lounge has two loans with OCII. One is a $290,000 tenant improvement loan, and the other is a $95,000 loan to cover prevailing wage expenses associated with the tenant improvements at Sheba Lounge’s space at the Fillmore Center. The $95,000 prevailing wage loan is forgiven if Sheba Lounge makes 24 monthly payments of $1,475 each on its $290,000 tenant improvement loan before January 2014. To date, Sheba Lounge has made 20 payments of $740 each (50% of the full payment), and expects to make 24 payments of $740 each before January 2014. The owner of Sheba Lounge has advised OCII staff that her business is not generating enough net income to make the full $1,475 monthly payment. Similar to the Food for Soul tenant improvement loan, OCII staff intends to request audited financial statements, as authorized under the Sheba Lounge loan agreement, to verify the restaurant’s financial
performance and compliance with the existing loan terms. This loan is currently out of compliance with the existing loan terms and will require some kind of amendment in the future, which will be brought before the Commission and Oversight Board for consideration as soon as possible.

(Originated by Tracie Reynolds, Manager, Real Estate and Development Services)

Tiffany Bohee
Executive Director

Attachment 1: July 18, 2013 Letter from HOA to District 5 Supervisor London Breed
Attachment 2: Background on Yoshi’s San Francisco Tenant Improvement Loan
Attachment 3: Recent Communications between OCII/City and FDC’s Investor Group
Attachment 4: Background on Mr. Shiferaw’s Tenant Improvement Loan