MEMORANDUM

TO: Oversight Board

FROM: Tiffany Bohee
Executive Director

SUBJECT: Resolution adopting environmental findings pursuant to the California Environmental Quality Act; Authorizing an amendment to an Enforceable Obligation under the Dissolution Law approving a Sixth Amendment to the Hunters Point Shipyard Phase 1 Disposition and Development Agreement between the Successor Agency to the Redevelopment Agency of the City and County of San Francisco and HPS Development Co., LP, and Authorizing Actions Consistent with the Sixth Amendment; Finding that the Sixth Amendment is in the Best Interests of Taxing Entities; Hunters Point Shipyard Redevelopment Project Area.

Resolution adopting environmental findings pursuant to the California Environmental Quality Act; Authorizing an amendment to an Enforceable Obligation under the Dissolution Law approving an amendment to the Disposition and Development Agreement (Candlestick Point and Phase 2 of The Hunters Point Shipyard) between the Successor Agency to the Redevelopment Agency of the City and County of San Francisco and CP Development Co., LP, and Authorizing Actions Consistent with the First Amendment; Finding that the First Amendment is in the Best Interests of Taxing Entities; Hunters Point Shipyard and Bayview Hunters Point Redevelopment Project Areas.

EXECUTIVE SUMMARY

Hunters Point Shipyard ("Shipyard") and Candlestick Point areas are comprised of approximately 750 acres along the southeastern waterfront in San Francisco. Through a public-private partnership with a master developer, these long-abandoned waterfront lands will be transformed into productive areas for jobs, parks, and housing, including affordable housing. The project will deliver 12,100 new homes, up to 3 million square feet of research and development space, and more than 350 acres of new parks in the southeast portion of San Francisco. The project will deliver unprecedented public benefits including more than 11,000 permanent jobs at a wide-spectrum of income levels, over $6 billion of new economic activity to the City, as well as a wealth of additional and improved parks and transit facilities.

The development project will occur in two phases, Phase 1 and Phase 2 (together the "Projects"), each governed by a Disposition and Development Agreement ("Phase 1 DDA" and "Phase 2 DDA" respectively, and together the "DDAs") between the former Redevelopment Agency, now the Successor Agency (the "Agency"), and separate but related developers lead by Lennar Urban (collectively, "Lennar" or the "Developer"). The DDAs generally provide for the transfer of land from the Agency to the master developers, with rights and obligations relating to the
construction of specified improvements, and the financing mechanisms for completing these development projects.

With the Phase 1 project well underway (70-80 percent of the horizontal infrastructure construction is complete), and the Phase 2 entitlements fully in place, Lennar is seeking financing for the development of both phases together, and in the process has identified certain amendments and clarifications to the DDAs that will further facilitate financing for the Projects, and streamline the processes under the DDAs, while preserving the community benefits that were included in these agreements.

In order to facilitate the financing for the development of both phases together, the Agency is proposing a Sixth Amendment to the Phase 1 DDA ("Phase 1 Sixth Amendment") and a First Amendment to the Phase 2 DDA ("Phase 2 First Amendment") (together, the "Amendments") that will enable the Developer to access financing to move the Projects forward. The effect of these amendments is to enhance the feasibility of the project in its early stage, and to ensure that the holders of the enforceable obligations and taxing entities receive benefits as soon as commercially possible (the benefits to the taxing entities are explained later in this memorandum under, "Compliance with Dissolution Laws").

The Amendments will enable the Developer to respond to the current market, to ensure that the Projects can maintain momentum, and to facilitate financing to be obtained for the Projects. The financing Lennar is seeking will, if obtained 1) allow for the completion of horizontal infrastructure and commencement of vertical development on Phase 1, 2) provide for homes to be marketed on a for sale or for rent basis consistent with market demands, 3) accelerate the delivery of affordable housing, and 4) make clarifying changes to the terms of the DDAs.

Both the Phase 1 DDA and the Phase 2 DDA are enforceable obligations under Redevelopment Dissolution Law California Health & Safety Code Section 34171(d) (1) (E) that survived the dissolution of the Redevelopment Agency and that became the obligations of the Successor Agency. The Successor Agency has listed both DDAs on the three Recognized Obligation Payment Schedules that the Department of Finance has approved. A more detailed discussion of the Projects and the DDAs was also attached as Exhibit B-3 to the Oversight Board Resolution No. 5-2012, without Department of Finance objection to the Projects as enforceable obligations. The Oversight Board may approve amendments to enforceable obligations under the Dissolution Laws together with a finding that the amendments are in the best interest of the taxing entities.

Staff recommends that the Oversight Board authorize the Successor Agency to amend an enforceable obligation under the Dissolution Law by approving a Sixth Amendment to the Hunters Point Shipyard Phase 1 Disposition and Development Agreement between the Successor Agency and HPS Development Co., LP; authorize actions consistent with the Sixth Amendment; and find that the Sixth Amendment is in the best interests of the taxing entities.

Staff recommends that the Oversight Board authorize the Successor Agency to amend an enforceable obligation under the Dissolution Law by approving a First Amendment to the Hunters Point Shipyard Phase 2 Disposition and Development Agreement between the Successor
Agency and CP Development Co., LP; authorize actions consistent with the First Amendment; and find that the First Amendment is in the best interests of the taxing entities.

BACKGROUND

In 1997, the Agency adopted the Hunters Point Shipyard Redevelopment Plan and amended it in 2010. On December 2, 2003, the Agency authorized the Phase 1 DDA between the Agency and Lennar - BVHP, LLC, which was succeeded by HPS Development Co., LP ("Phase 1 Developer") in 2008 as the developer and contracting party. The Phase 1 DDA has been amended by the Agency since then, the most recent amendment being the Fifth Amendment authorized on November 3, 2009.

The Phase 1 DDA obligates the Phase 1 Developer to construct the infrastructure necessary to support the development of up to 1,498 homes; a minimum of 27 percent of the homes will be offered at below-market-rates to households earning a mix of up to 50 percent and up to 80 percent of Area Median Income ("AMI"). In addition, the Phase 1 project will construct up to 10,000 square feet of neighborhood-serving retail space, 1.2 acres of community facilities, and approximately 26 acres of new public parks and open spaces.

On June 3, 2010, the Agency approved the Phase 2 DDA between the Agency and CP Development Co., LP ("Phase 2 Developer"). The Phase 2 DDA obligates the Phase 2 Developer to construct the infrastructure necessary to support the development of up to 10,500 homes (of which 32 percent will be offered at below-market-rate, including homes affordable to households earning less than 120 percent of AMI and "Workforce Units" providing below market-rate homes to households making between 120 and 160 percent of AMI). In addition, the Phase 2 project will construct up to 885,000 square feet of regional and neighborhood-serving retail space, approximately 3 million square feet of commercial, light industrial, research and development and office space, up to 105,000 square feet of new replacement space for the Shipyard artists and a new arts center, and approximately 336 acres of additional and improved public parks and open spaces.

The Agency assumed, by operation of law, all of the obligations of the former Redevelopment Agency of the City and County of San Francisco under the DDAs. The Phase 1 development is in the final stages of horizontal infrastructure construction and Phase 2 will commence in 2014 to support the reconstruction of the Alice Griffith public housing development.

DISCUSSION

Need for Amendments

The Phase 1 and Phase 2 projects together represent more than $10 billion of construction over the next 30 years, achieving a wide variety of objectives including the rebuild of Alice Griffith public housing, preservation of historic buildings, the largest parks construction project since Golden Gate Park, a new tier of workforce housing for middle-income earners in San Francisco,
preservation of the largest artist colony on the west coast, reconfiguration of State Parks and new models for streetscape and urban design. As such, the Projects require significant and diverse sources of financing to be completed. The Developer continues to seek additional sources of financing to diversify the interests in the Project and to lower the cost of capital to the Projects. In seeking this financing the Developer has learned that the Phase 1 and Phase 2 Projects together present a more attractive financing opportunity than either one on its own. To better market these opportunities together, several adjustments are required to make the DDAs consistent with each other and with similar agreements in City, to reduce certain barriers to underwriting a loan or partnership, and to clarify technical aspects of the DDAs.

Summary of Amendments

PHASE 1

1-A. Proposed: Permit Phase 1 Developer to obtain loan financing for the infrastructure improvements secured by a customary mortgage and other security instruments on Phase 1 Developer’s interests in the property and the project in a manner that recognizes the interrelationships between Phase 1 and Phase 2 by linking and leveraging mortgages between them.

Current: The current Phase 1 DDA does not allow for mortgaging of the property or project as the developer constructs the project. Without the ability to mortgage the developer’s interest in the property and the project it is difficult, if not impossible, for the developer to obtain loan financing for the improvements on the property.

Analysis: The proposed amendment includes two components: 1) enabling mortgaging of the developer’s interest in the property or the project and 2) allowing any such mortgage to also encumber on security in the Phase 2 project, effectively cross-collateralizing the two projects. When the Phase 1 DDA was originally contemplated it was not envisioned that traditional lending would be a means of financing horizontal development of the project. Enabling mortgaging of the developer’s interest in the property and the project makes available an essential tool for real estate development without limiting an existing or future Mello Roos financing. The proposed change is consistent with other projects in the City, including the Phase 2 Project.

A new provision allowing for cross-collateralization between the Phase 1 and Phase 2 projects would allow lenders to rely upon land values derived from infrastructure completed as part of the Phase 1 project to provide security for the additional funding that will be used for both Projects going forward. By mortgaging both Projects together, the lender would be provided with maximum security, and enable the Projects to continue to proceed as an integrated and inter-related whole. Improving the ability to finance the Projects will help to ensure that affordable and market-rate sites are delivered on schedule, and that tax increment generated by these new properties will then flow to the taxing entities.
1-B. **Proposed:** (i) Permit the required 50 percent AMI Inclusionary Units to be developed in one dedicated affordable housing block (Block 49) on Phase 1 (ii) provide a Developer subsidy to ensure its completion, and (iii) provide an additional $1 million affordable housing subsidy to the Agency to be used for Alice Griffith or other affordable housing in the Projects. Change the inclusionary requirement from 15% to 10.5% (which simply accounts for the placement of the 50% AMI Units on Block 49, but does not change the total number of affordable units), and allow Developer flexibility in designating the percentage of inclusionary units in each residential project (but not less than 5% or more than 20%) so long as the 10.5% inclusionary requirement is met on specified milestone dates.

**Current:** Under the existing Phase 1 DDA, the Phase 1 Developer is obligated to dedicate 15% of the residential units built within the Phase 1 market-rate blocks to households earning up to 80% of AMI. Approximately 30% of such units (approximately 60 units) must be dedicated to households earning up to 50% AMI. Block 49 is currently designated as a market-rate block.

**Analysis:** The proposal would shift the obligation to construct the 50% AMI units within the market-rate blocks to a dedicated affordable housing block, Block 49. So this market rate lot will now become a dedicated affordable housing block. Units restricted to this depth of affordability (i.e., 50% AMI) are less costly to construct and administer in a dedicated stand alone affordable housing project than they are to develop within market-rate blocks. By reducing these costs, and dedicating Block 49 to the 50% AMI units, the Project will build the same total number of 50% AMI units and do so sooner than if they are distributed among many market-rate blocks (that will be built out over the remainder of the Phase 1 Project). To ensure this earlier development, Developer has agreed to pay the specified subsidies (i.e. both the $1 million and the required gap financing) that is not currently required under the Phase 1 DDA. By creating a new dedicated lot for affordable housing, accelerating the delivery of 50% AMI units and providing the additional subsidy that would not have otherwise existed, Agency and Mayor’s Office of Housing (“MOH”) staff concur that the amendment would improve the affordable housing program on the Shipyard. The amendment also reduces barriers to financing market-rate blocks that would have carried the 50% AMI units as inclusionary units, thus improving and potentially accelerating the increase in land values, and hence tax increment that would become available to the taxing entities. By putting all of the 50% AMI Units on Block 49, these units are then removed from the Developer’s market rate inclusionary obligations – resulting in a reduction from 15% inclusionary to 10.5% inclusionary on the market rate residential projects. But there will be no change in the total number of affordable housing units, at either the 80% AMI or the 50% AMI level. Allowing the Developer some flexibility on the number of inclusionary units in each market rate development, so long as it is at least 5% and not more than 20% and meets the required total aggregate 10.5% requirement on 5 specified milestone dates, is consistent with the flexibility provided to the Developer on Phase 2 and other large
development projects, and further enhances the financeability of the Project and the likelihood of a successful development project that is responsive to market forces.

1-C. Proposed: Permit Phase 1 Developer to provide bonds or other security acceptable to the Agency for assuring the satisfactory completion of the infrastructure in an amount equal to 125 percent of the estimated cost to complete the infrastructure and a guaranty for its non-construction financial obligations under the Phase 1 DDA in an amount equal to $5 million.

Current: The Phase 1 DDA requires security in an amount equal to 200 percent of the estimated cost to complete the infrastructure, and no cap or limit on the Developer’s guaranty for its obligations under the Phase 1 DDA.

Analysis: When the Phase 1 DDA was approved, the area surrounding the Shipyard had limited land values and the Agency had a strong desire to ensure that the commitment to advance redevelopment of the Shipyard was realized. At that time, a 200 percent security was demanded to ensure that the Developer would complete the Project. Today, the Phase 1 Developer is substantially complete with infrastructure on the Hilltop portion of the Phase 1 site and the Hillside portion is at least 60% complete. Accordingly, the provision of security in an amount equal to 125 percent of the estimated cost to complete the infrastructure is sufficient to ensure the completion of these improvements. Further the proposed 125 percent security is consistent with other projects in the City, and is in excess of the 100 percent security required by the City’s Department of Public Works for infrastructure projects. The reduced security obligation will enable a less burdensome and more financially efficient infrastructure development program and allows for a more productive use of capital, which can accelerate development and thereby improve the Project’s ability to generate tax increment.

In administering the security requirement, staff will require up-to-date cost estimates and include an allowance for future inflation for the time period over which the infrastructure is expected to be completed. With respect to the limit on Developer’s guaranty, the same principles apply for the same reasons. Furthermore, the reduced guaranty amount is appropriate for the level of completion that Phase 1 has achieved. When the Phase 1 project was approved in 2003, there were many development and market uncertainties for Phase 1 and Phase 2. Since then, many milestones have been achieved, many uncertainties have been removed, and the development program is well defined. With Projects fully entitled and having full environmental clearance, the development risk has been significantly reduced, and the Projects’ have a clear development path forward. Reconciling the security and guaranty requirements between the two Projects is consistent with the proposal to treat them the same for purposes of obtaining the necessary third party financing, and will increase the marketability and financeability of the Projects by providing clarity and consistency for potential investors.
1-D. **Proposed:** Update the Schedule of Performance for the Hillside (Block 48) portion of Phase 1 to require its completion by December 2017.

**Current:** The current Schedule of Performance requires completion of the Hillside by February 2013.

**Analysis:** The extension permits the Phase 1 Developer to focus its efforts on completing the housing units on the Hilltop portion of the Phase 1 Project and better coordinate the Hillside development with the adjacent Phase 2 development which is slated to begin in 2017. When the phasing of Phase 1 blocks was originally developed, the plans and approvals for the Phase 2 project were not in place. Now that the Agency and Developer have prioritized construction on the Alice Griffith public housing development and the remainder of the Shipyard, the delayed delivery of the Hillside is logical and enhances the marketability of home sites sold within the projects. Between Phase 1 and Phase 2 the number and pace of delivery for affordable and market-rate housing units will be the same as it would under the current DDA.

1-E. **Proposed:** Permit both for-sale and for-rent Residential Units to be developed in Phase 1.

**Current:** The Phase 1 DDA requires that all of the Phase 1 units are for-sale, and any rental of units must be reauthorized by the Agency on an annual basis.

**Analysis:** When the Phase 1 DDA was approved, extraordinary increases in rents and home prices in San Francisco lead to a policy concern over preserving the availability of entry-level homeownership opportunities in San Francisco. Through ensuing market cycles it has become clear that allowing for flexibility, especially in a down market, can ensure that vacant lots do not go undeveloped. The proposed amendments (i) lift the restriction to for-sale units within market rate lots, and (ii) allow a vertical developer to request the ability to rent a for-sale unit or sell a for-rent unit based on market conditions, with appropriate tenant and resident restrictions as contemplated by the Affordable Housing Program. The amendment would make the Phase 1 affordable housing requirements more consistent with that of Phase 2 and enable the Developer to respond to market trends and facilitate a more responsive and flexible Phase 1 development. The affordable units would continue to be included in either for-sale or rental developments as is currently required in the Phase 1 DDA.

1-F. **Proposed:** Amend the terms for the Agency’s option to acquire market rate units as defined in Section 3.5(e) of the Affordable Housing Program to be the price offered to the public minus six percent.

**Current:** The Phase 1 DDA provides the Agency the option to purchase up to 15 percent of the Developer’s market-rate units in each Major Phase at the purchase price of the Developer’s costs plus 10 percent.
**Analysis:** The benefit of this Amendment is a positive impact on the established land values since it makes the development a more attractive and marketable land portfolio for potential investors. Assuming the price offered to the public at any point in time is the market price, it is difficult to say how this change might affect the exact amount the Agency could pay for a unit, since it depends on market conditions at the time, as well as land values and construction costs. In an appreciating market the price could be more, but in a depreciating market, it could less than what the Agency would pay under the current formula. Maintaining this favorable option price, without the likely ability to utilize it, would unnecessarily impact the Developer's ability to obtain financing or perhaps make that financing more expensive, which could either lessen the amount or delay the timing of funds for other Project elements.

**Phase 2**

2-A. **Proposed:** Permit the Phase 2 Developer to cross-collateralize the Phase 1 and Phase 2 projects as described above for Phase 1. Clarify the parties' intent that mortgages can encumber both Developers' interest in the Project and the land, including Developer's interest in the DDA, also as described above for Phase 1. Provide for consistent mortgagee protection provisions between the two DDAs.

**Current:** The Phase 2 DDA limits Developer’s rights in mortgaging to the Phase 2 Project only.

**Analysis:** The proposed amendment enables the cross-collateralization provisions described above for Phase 1. The provision would facilitate financing for both Phase 1 and Phase 2 without impacting the availability of Mello Roos and tax increment financing on the property (as contemplated and required under the Phase 2 DDA). Finally, the proposed amendment would clarify the intent of the parties to permit mortgages and related security instruments that encumber both Developer’s interest in the Project and in the applicable land, including Developer’s interests in the DDA.

2-B. **Proposed:** Require the Agency to release its right of reverter (i.e., the right to take back land sold to developer following a default) in a Sub-Phase, or not obtain this right, if Developer provides bonds or other security acceptable to the Agency equal to 125% of the estimated cost of completing all of the horizontal infrastructure in that Sub-Phase.

**Current:** The current terms of the Phase 2 DDA require the Developer to provide a reversionary quitclaim deed to the Agency whenever the Agency transfers land to Developer to ensure completion of the horizontal infrastructure. The Agency may release this reverter after the Developer begins to construct the horizontal improvements if the Developer provides bonds or other security acceptable to the Agency in an amount equal to 150 percent of the estimated cost to complete to ensure completion of infrastructure.
Analysis: The provision of security/bond in an amount equal to 125 percent of the estimated cost to complete the horizontal improvements is sufficient to ensure the timely delivery of the infrastructure, is consistent with other projects in the City, and is in excess of the 100 percent security/bonding required by the City’s Department of Public Works for infrastructure projects. Further, this will enable a more financially efficient infrastructure development and is a more productive use of capital, which in turn should facilitate the flow of tax increment to the taxing entities.

COMPLIANCE WITH DISSOLUTION LAWS

Under AB 26 and AB 1484, the Oversight Board is charged with a fiduciary obligation to both the beneficiaries of the DDAs and the taxing entities, and the changes reflected in both the Sixth Amendment to the Phase 1 DDA and the First Amendment to the Phase 2 DDA assist the Oversight Board in meeting that fiduciary duty.

1. The proposed Amendments are in the best interests of the taxing entities because the Amendments make the Project more attractive to large scale investors, bond buyers, and other lenders who may provide more favorable financing terms, which will reduce the cost of capital, enabling more efficient cost allocation, accelerating development in the early phases of the Projects, and ultimately increasing the land and home values upon which the property tax basis is established.

2. The benefit to the taxing entities is also that the Amendments will ensure that Project winds down sooner rather than on an extended development schedule. Inefficient and or expensive financing reduces the pace of development. Leveraging the Projects together is a more attractive investment profile which will help secure the financing needed to complete the Projects in a timely manner.

STAFF RECOMMENDATION

The proposed Amendments have been reviewed by the Agency’s independent financial real estate consultant (see Exhibit C), who finds that the Amendments strengthen the competitiveness of the project in the context of other real estate investment opportunities in the region and improve the Developer’s ability to attract financing sources to provide the capital necessary to advance the project. The Agency and MOH have reviewed the impacts of the Amendments on the delivery and timing of public benefits including affordable housing, as well as the impact that such Amendments may have on the flow of tax increment to affected taxing entities under the Dissolution Law, as summarized in the above analysis.
Staff has determined that the proposed Amendments will accelerate the delivery of affordable housing and construction job opportunities in the early phases and help increase the City’s tax base which is of significant interest to the taxing entities. No material public benefits would be compromised by the Amendments. Finally, the increased likelihood of project financing mitigates potential risk associated with reducing security requirements, which were imposed before the Developer had completed improvements within the Phase 1 project, and improves the Developer’s ability to deliver early benefits in Phase 2 such as rebuilding of Alice Griffith public housing, Northside community park, certain streetscape improvements in the surrounding neighborhood and the job-generating uses envisioned on the Shipyard.

Despite extensive effort on the part of the Developer to secure financing, the Developer has learned that in order to attract financing sources to provide the capital necessary to undertake this work, the Amendments described above will make the Project competitive with other projects in the City and the region.

CONCLUSION

Redevelopment efforts are long-term undertakings, with work in blighted areas often extending over decades. The work goes forward through changes in economic and real estate cycles, and is often crucial to providing the catalyst for new development and economic growth in otherwise difficult markets. The Successor Agency’s ability to respond to these changes in fulfilling its statutory duty to carry out the obligations in the DDAs is particularly critical to ensure the success of the Projects. The success of the Projects will benefit the taxing entities through an increased and diversified tax base that will produce tax revenues for the taxing entities once the Projects are completed.

Therefore, staff recommends the Oversight Board authorize the Successor Agency to enter into the Sixth Amendment to the Phase 1 DDA and the First Amendment to the Phase 2 DDA in substantially the forms presented to the Oversight Board and to execute all documents, amendments, agreements and instruments reasonably necessary or convenient to implement the Sixth Amendment to the Phase 1 DDA and the First Amendment to the Phase 2 DDA.

Prepared by Thor Kaslofsky and Wells Lawson, Project Managers

Tiffany Bohle
Executive Director
Exhibit A: Sixth Amendment to the Hunters Point Shipyard Phase 1 Disposition and Development Agreement
Exhibit B: First Amendment to the Candlestick Point and Phase 2 of the Hunters Point Shipyard Disposition and Development Agreement
Exhibit C: Independent Consultant’s Analysis Regarding the Proposed Hunters Point Shipyard DDA Amendments, December 6, 2012.