CITY COUNCIL TRANSMITTAL

Date Received: November 8, 2018
Date sent to Council: November 9, 2018

TO: Salt Lake City Council
   Erin Mendenhall, Chair

FROM: Mike Reberg, Director Department of Community & Neighborhoods

DATE: 

SUBJECT: Below market seller-financing terms and reduced purchase price related to the City's disposition of real properties located at approximately 320 East 400 South and 338 East 400 South. Study pursuant to Utah Code section 10-8-2.

STAFF CONTACT: Randy Hillier, Sr. Policy and Budget Analyst (801) 535-6606, Melissa Jensen (801) 535-6035 or Megan DePaulis, City Attorney (801) 535-7685

DOCUMENT TYPE: Public Benefits Analysis and Recommendation

RECOMMENDATION: The Administration recommends that a public hearing be held on the matter of the Public Benefits Analysis of the below market seller-financing terms related to the City's disposition of the properties located at approximately 320 East 400 South and 338 East 400 South

BUDGET IMPACT: None

BACKGROUND/DISCUSSION: In order to facilitate the disposition of the City-owned properties located at approximately 320 East and 400 South and 338 East and 400 South, and the ultimate development of the site, the Administration is recommending the City provide below-market rate seller financing terms. The buyer, an entity comprised of a partnership between Domain Companies and Giv Development, was chosen by the Mayor after a unanimous recommendation by the Selection Committee and has agreed to the construction of a mixed-use development known as the Exchange. This development will include:
- Micro-unit Apartments
- Mixed-income Housing
- Business Incubator
- Active Commercial Space
- Urban Design Solutions

The appraised value of the City Property is $5,460,000 with an original purchase price of $5,527,000. The purchase price considering the public benefit is proposed at $4,802,000 ("Purchase Price"). Under the purchase and sale agreement, the purchase price will be paid to the City through a seller note over time ("Seller Note"). The Seller Note is proposed to be at below-market terms for in the purchase price, reduced by $725,000, to expedite and ensure the delivery of the affordable housing, aid in the acquisition of an additional parcel of property adjacent to the site, as well as creation of business and food incubator concepts on the City Property.

Utah Code 10-8-2 (1) (a) (v) states that after first holding a public hearing, a municipal legislative body may authorize municipal services or other nonmonetary assistance to be provided to or waive fees required to be paid by a nonprofit entity, whether or not the municipality receives consideration in return.

The attached memo to Patrick Leary, the Mayor’s Chief of Staff, more thoroughly outlines the financing details, as well as the public benefits identified by the Administration that the City will realize from this development, and the below-market rate financing that will help facilitate its construction.

PUBLIC PROCESS: A Public Hearing is Recommended to be held

EXHIBITS:

A. Resolution
B. Memo and Recommendation that SLC Corp Provide Below-Market Seller-Financing Terms and a Reduced Purchase Price
C. Community Benefit Review from The National Development Council
RESOLUTION NO. _____ OF 2018

(Authorizing Below-Market Seller-Financing Loan Terms and a Reduced Purchase Price to Downtown Partners, LLC, for Development of Affordable Housing)

WHEREAS, Salt Lake City desires to dispose of certain real property located at approximately 320 East 400 South and 338 East 400 South ("City Property"); and

WHEREAS, Salt Lake City desires to sell the City Property through seller-financing, for a reduced price with below-market terms (collectively, the “Below-Market Loan Terms”) to expedite and ensure the development of low and mixed-income housing, mixed use development and innovative building development incorporating tenants of the City’s adopted master plans: Plan Salt Lake and Growing SLC: A Five-Year Housing Plan. The development will include commercial space for underserved populations such as refugees, micro-housing that serves 40% AMI and below, co-working space, and does so outside of the traditional 9% tax credit methodologies; and

WHEREAS, Utah Code Section 10-8-2(1)(a)(i) allows public entities to “appropriate money for corporate purposes only”; and

WHEREAS, Utah Code Section 10-8-2(3) provides that “a corporate purpose” is the appropriation of money for any purpose that “in the judgment of the municipal legislative body, provides for the safety, health, prosperity, moral well-being, peace, order, comfort, or convenience of the inhabitants of the municipality” so long as the procedures set forth under Utah Code Section 10-8-2 are followed; and

WHEREAS, Utah Code Section 10-8-2(3)(d) requires “the municipal legislative body making any decision to appropriate any funds for a corporate purpose under this section,” to hold a public hearing after notice of at least 14 days; and
WHEREAS, Utah Code Section 10-8-2(3)(e) requires a study "demonstrating the purpose for the appropriation" to be performed, taking into consideration the following factors: “(i) what identified benefit the municipality will receive in return for any money or resources appropriated; (ii) the municipality’s purpose for the appropriation, including an analysis of the way the appropriation will be used to enhance the safety, health, prosperity, moral well-being, peace, order, comfort, or convenience of the inhabitants of the municipality; and (iii) whether the appropriation is necessary and appropriate to accomplish the reasonable goals and objectives of the municipality in the area of economic development, job creation, affordable housing, blight elimination, job preservation, the preservation of historic structures and property, and any other public purpose" ("Study"); and

WHEREAS, the City Council has, following the giving of not less than fourteen (14) days public notice and posting of the Study, conducted a public hearing relating to the foregoing, in satisfaction of the requirements of Utah Code Section 10-8-2; and

WHEREAS, the Council has reviewed the Study, and has fully considered the conclusions set forth therein, and all comments made during the public hearing.

THEREFORE, BE IT RESOLVED by the City Council of Salt Lake City, Utah, as follows:

1. The City Council hereby adopts the conclusions set forth in the Study, and hereby finds and determines that, for all the reasons set forth in the Study, the Below-Market Loan Terms are appropriate under these circumstances.

Passed by the City Council of Salt Lake City, Utah, this _____ day of ________, 2018.

SALT LAKE CITY COUNCIL

By: ____________________________
   CHAIRPERSON
MEMORANDUM

TO: David Litvack
   Deputy Chief of Staff

FROM: Randy Hillier, Policy & Budget Analyst
   Melissa Jensen, Director, Housing and Neighborhood Development
   Megan DePaulis, Senior City Attorney

DATE: November 7, 2018

SUBJECT: Below market seller-financing terms and reduced purchase price related to the City’s disposition of real properties located at approximately 320 East 400 South and 338 East 400 South. Study pursuant to Utah Code section 10-8-2.

1. INTRODUCTION

   It is recommended that Salt Lake City Corporation provide below-market seller-financing terms and a reduced purchase price as part of its disposition of the parcels that make up the 4th South TOD, located at 320 East 400 South and 338 East 400 South (“City Property”), to Downtown SLC Partners, LLC, a New York limited liability company (“Buyer”). In 2017, the Housing and Neighborhoods Division of the Department (“HAND”) of Community and Neighborhoods worked with other City departments and to develop a request for proposals (“RFP”) for the disposition and development of the City Property. This process included a collaboration of internal stakeholders in addition to meeting with the Central City Neighborhood Council to solicit input on the RFP, and participation of community representatives on the RFP Selection Committee. The Buyer, an entity comprised of a partnership between Domain Companies and Giv Development, was chosen by the Mayor after a unanimous recommendation by the Selection Committee. The mixed-use development, known as The Exchange, includes:

   - Micro-unit Apartments
   - Mixed-income Housing
   - Business Incubator
   - Active Commercial Space
   - Urban Design Solutions

   The appraised value of the City Property is $5,460,000 with an original purchase price of $5,527,000. The purchase price considering the public benefit is proposed at $4,802,000 (“Purchase Price”). Under the purchase and sale agreement, the purchase price will be paid to the City through a seller note over time (“Seller Note”). The Seller Note is proposed to be at below-market terms for in the purchase price, reduced by $725,000, to expedite and ensure the delivery of the affordable housing, aid in the acquisition of an additional parcel of property adjacent to the site, as well as creation of business and food incubator concepts on the City Property. The acquisition of the additional parcel was deemed a critical piece to development of the units and the ability to deliver on the affordable units. Because seller financing is by its nature done on a
case-by-case basis, there is not a typical “market rate” for this financing. For the purposes of this study, the Seller Note is defined as having below-market terms based on: (1) the .79% blended interest rate for a term of 35 years; and (2) the payment structure whereby repayment comes from surplus cash. A typical interest rate can range between 1% - 3% from the City’s Housing Trust Fund to 5% - 7% for conventional bank financing. With surplus cash repayments, there is not a specific cost attributable to the structure of the payments, but it is called out as a risk to the City as the availability of sufficient surplus cash is not guaranteed. The payment will be based on the borrower’s ability to first pay all debt and operating costs to other creditors with the remaining surplus cash going toward the Seller Note. The current projections and underwriting determined that surplus cash is sufficient to adhere to the repayment terms of the Seller Note. Both terms were requested to ensure the development could proceed, maximize other financing, and will operate with a sustainable financing model.

II. LEGAL FRAMEWORK

Utah Code section 10-8-2 states municipalities may appropriate funds for “corporate purposes only.” Utah Code §10-8-2(1)(a)(i). Those purposes are, in the judgment of the municipal legislative body, any purpose that “provides for the safety, health, prosperity, moral well-being, peace, order, comfort, or convenience of the inhabitants of the city.” Utah Code §10-8-2(3). Although this section of Utah Code does not explicitly state that a municipality must receive consideration for any disposition of real property, it permits municipalities to sell or lease property only “for the benefit of the municipality . . . if the action is in the public interest and complies with other law.” Utah Code §10-8-(1)(a)(iii). As courts have interpreted the statute, the power to dispose of real property must be “in good faith and for adequate consideration” because “public property is held in trust for the public.” Price Dev. Co., L.P. v. Orem City, 2000 UT 26, ¶26 (internal quotations and citations omitted). “Adequate consideration” means the municipality “must show that there is a clear present benefit that reflects . . . fair market value” for whatever is given by the municipality. Id.

A municipal legislative body must make a determination that the “net value received for any money appropriated” is “measured on a project-by-project basis over the life of the project.” Utah Code § 10-8-2(3)(a). The municipal legislative branch “may consider intangible benefits received by the municipality in determining net value received.” Utah Code § 10-8-2(3)(c). Moreover, and “determination of value received, made by the municipality’s legislative body, shall be presumed valid unless it can be shown that the determination was arbitrary, capricious, or illegal.” Utah Code § 10-8-2(3)(b).

Prior to the municipal legislative body making a decision to appropriate any funds for a corporate purpose, a public hearing must be held. If the entity receiving the benefit from the City is a for-profit entity, then a study (“Study”) that demonstrates the purpose for the appropriation must be undertaken and posted for review by the public at least 14 days before a public hearing on the issue. Utah Code § 10-8-2(3)(e). The factors to be considered in the Study are set forth under Utah Code as:

(i) what identified benefit the municipality will receive in return for any money or resources appropriated;
(ii) the municipality’s purpose for the appropriation, including an analysis of the way the appropriation will be used to enhance the safety, health, prosperity, moral well-being, peace, order, comfort, or convenience of the inhabitants of the municipality; and

(iii) whether the appropriation is necessary and appropriate to accomplish the reasonable goals and objectives of the municipality in the area of economic development, job creation, affordable housing, blight elimination, job preservation, the preservation of historic structures and property, and any other public purpose.

Utah Code § 10-8-2(3)(e)(i)-(iii). This Study examines each of these factors below.

III. ANALYSIS

A. Background of City Property and Request for Proposal Process.

The City Property is comprised of two parcels located at 320 East 400 South (“Property One”) and 340 East 400 South (“Property Two”). Together, the approximately 2.24 acres of property includes many smaller parcels that have been acquired by the City over a long period of time. Prior to releasing the RFP, the City updated the existing subdivision plat to consolidate several parcels into three lots that include Property One, Property Two, and the lot for the new Public Safety Building (“PSB”). The new plat also identified Blair Street, the north to south mid-block connection between 400 and 500 South, as well as Peoples Way, the street connecting 300 East to Blair Street.

Property One consists of 1.4 acres and includes a 5-story structure previously known as the Barnes Bank Building, a two-story building that was the formerly the Salt Lake Roasting Company and a secondary entrance to the PSB. None of the existing structures is considered historic and, with the exception of the entrance to the PSB, all structures will be demolished and replaced by the new development. The PSB entrance will be incorporated into the new development and include an easement for the occupants of the PSB to access this entrance. Property One is unique as the parcel fronts four streets. The RFP encouraged developers to activate at least three of the four street fronts.

Property Two consists of 0.87 acres and includes a two-story office building previously known as the Celtic Bank Building. The parcel also includes vacant land currently used for parking. The City previously identified this parcel for development of micro-unit housing. This innovative design study encouraged developers to create minimal living space to determine if the smaller units could be affordable simply based on the size. This became a part of the RFP for development.

The City identified Properties One and Two as opportunities to collaborate with a private sector developer to build a project that will contribute to city-wide livability goals and support the surrounding urban neighborhood by providing new housing opportunities, space for small and local business and new neighborhood amenities. The City will achieve these objectives by requiring that the development including the following elements:
• Innovative Micro-Unit Housing
• Neighborhood Oriented Businesses and Services
• Mixed-Income Housing
• Business and Food Incubator
• High Density Urban Design Solutions

Through the RFP process, the City identified the Buyer and its development team’s proposal as the development plan that best met the RFP requirements. At this point, the City has entered into a Purchase and Sale Agreement with the Buyer but has not yet conveyed the City Property to the Buyer. The development team consists of a partnership between Domain Companies and Giv Development (the “Development Team”).

A summary of the Development Team’s proposal to develop the previously described two properties is as follows:

**Residential Housing:**
Total housing units: 412 total units (138 income restricted, 274 market rate)
- Building A on Property One: 286 total units (20% units income restricted at 50% of Area Median Income “AMI”)
- Building B on Property Two: 126 total units (63% units income restricted at 40% and 80% of AMI)

**Commercial Space:**
- Building A on Property One: 15,000 square feet of ground floor commercial space fronting three sides of the building
- Building B on Property Two: 2,700 square feet of ground floor retail along 400 South and 30,000 square feet of a Business Incubator operation.

The Development Team has been awarded 4% tax credits for both properties. The development will still provide deep AMI targets – 50% of AMI in Building A and 40% AMI in Building B – without the use of the competitive 9% tax credits.

**Terms of the Assistance.**

The terms of the Seller Note are similar to the City’s Housing Trust Fund loan program, which provides below-market rate financing for affordable housing developments. The Purchase Price is structured in the form of a Seller Note to expedite delivery of deeply-targeted affordable housing and in recognition of the limited nature of the City’s funds for affordable housing. Deeply targeted housing, which is rental housing targeting those making less than 50% of area median income requires higher subsidies because the rents are extremely below market level and thus do not cover the cost of building or maintaining that unit. Without the option to pay the Purchase Price back to the City over time and at below-market terms, the Buyer would not be able to meet the City’s goals for the property in terms of affordability, urban design and business incubation or would require additional subsidies from other sources to be financially feasible.
The Seller Note is structured to meet the City’s repayment objectives while enabling the development phases to maximize available financing options.

- **Loan Amount:** $5,527,000
- **Term:** 35 years (with deferred payments during construction)
- **Interest Rate:** 0.79%
- **Payments:** From surplus cash flow (cash flow available after operating expenses and payments to senior lenders)

The Seller Note is secured by a deed of trust recorded against Property One and Property Two.

**B. Benefits and Enhancements of the City’s Health, Safety, Prosperity, Order, and Convenience of Its Inhabitants the City Will Receive in Return for Assistance.**

The City Property is a good fit for the proposed use for several reasons outlined below. Primarily, there is an urgent need for affordable housing in Salt Lake City. The proposed disposition of the City Property and below-market terms for the related Seller Note will expedite the development, which will expand the stock of long-term deed-restricted affordable housing for an array of income levels in the Central City neighborhood. “Deed-restricted” means that the affordability restrictions are recorded on the property, and provide a legal remedy to the City if the restrictions are not met. Both buildings will be mixed-use and mixed-income. Further, the City Property is currently unused, deteriorating and requires City resources for continued maintenance. The construction of the development will activate this important site and provide high-quality urban design. The following is a discussion of the many public benefits that development of the City Property according to the City’s required development plans will bring to the City:

(i) **Innovative Housing Types – Micro Units**

The project’s Building B will be providing 126 micro-unit apartments, 40 of which will be restricted at 40% of AMI and 40 of which will be restricted at 80% of AMI. The remaining 46 units will be rented at 80% AMI rents but not deed-restricted. One of the goals of Growing SLC is to lead in the development of new affordable housing types that incorporate innovative solutions. Micro-units are an example of this type of innovation. Per the RFP, these units are required to consist of studio or one-bedroom units between 250-500 square feet, because smaller units tend to have lower rents and meet housing needs that are currently being under-provided for the downtown workforce. Additionally, a large percentage of these units are deeply targeted, meaning the income levels served target very-low income renters as defined as 50% of AMI and below. The proposed development will help meet housing needs of the downtown workforce because of its location, the types of units available, and the range of targeted income/rent levels.

(ii) **Affordable Housing**

In addition to the micro-units provided at Property One, the proposed development will also provide an additional 20% affordable housing at Property Two. Property One will include
58 affordable units at 50% of AMI with market rate housing in a high-quality mixed-income development. These units will range from studios to three-bedrooms.

(iii) Market Rate Housing

Property One will also be providing a total of up to 228 market rate units ranging from studios to three-bedrooms.

(iv) Business Incubator and Active Ground Floor Commercial Uses

Property Two includes a 30,000 sf location of “The Shop,” The Domain Companies’ incubator, accelerator and co-working platform. Property Two will also include approximately 2,700 sf of ground floor retail. Property One includes about 15,000 sf of ground floor retail.

The Exchange development is a unique opportunity that will create a community that houses a broad spectrum of households. The development will provide a range of affordability from extremely low income to market rate and unit types from micro-units to three-bedrooms. It will also create an active and vibrant public realm through its ground floor uses and economic opportunity through its incubator space. The development concept is rooted in the great diversity of the Central City community – its people, places, businesses and experiences – and will positively impact the quality of life for the Central City community.

C. Necessity of the Assistance to Accomplish the City’s Economic Development, and Affordable Housing Goals.

a. Economic Development and Job Creation.

Property One includes approximately 15,000 square feet of ground floor, street exposed commercial space along its street frontages and Building B includes approximately 2,700 square feet at the corner of 400 South and Blair. Additionally, Property Two will provide 30,000 square feet of incubator/accelerator/co-working space. These spaces will be designed to enliven the street frontages and will create highly-visible opportunities for businesses to start up or grow in the downtown market.

The Buyer estimates the following jobs will be created as a direct result of the project:
- 250 short-term construction jobs
- 55 permanent retail jobs
- 275 shop jobs (as a result of the co-working space)
- 22 property management positions

In addition to the new commercial space, the development will have other positive economic impacts including: (1) systemic cost savings seen by providing affordable housing for extremely low income households; (2) expanded opportunities for workforce housing downtown which is a major driver of businesses labor force recruitment and retention; and (3) increased customer base for downtown businesses.

b. Accomplishing the City’s Housing Goals.
Growing SLC: A Five Year Housing Plan envisions Salt Lake City as a place for a growing, diverse population to find housing opportunities that are safe, secure, and enrich lives and communities, recognizes the changing nature of the city, and provides the foundation for creating goals and strategies to manage the housing needs of tomorrow. The City’s housing policies must address issues of affordability at the root cause, creating long-term solutions for increasing the housing supply, expanding housing opportunities throughout the city, addressing systemic failures in the rental market, and preserving our existing units.

One of the tools identified in the Housing Plan and by the Affordable Housing Finance Working Group was an expansion of what the City has already been doing — viewing City land as a resource to finance affordable housing. The Seller Note discussed in this memorandum provides financing that enables the development to proceed expeditiously. It is structured with sustainability in mind, balancing the interest in seeing the development proceed and operate successfully and the City’s payment for the property.

Salt Lake City is in the beginning stages of a systemic housing crisis that highlights the shortcomings of the multi-year economic rally. While many factors have contributed to the housing crisis, at its root is the demand for housing in Salt Lake City driving up home prices and rental rates at a faster pace than wage increases. Between 2011 and 2014, rental rates increased two times faster than the wage increase for most renters. Additionally, home sale prices increased four times faster than the wages of most homeowners. Unabated, this trend will impact greater numbers of low and middle-income residents of the City every year pushing out those that make the City economically diverse and culturally dynamic.

The growing disparity between wages and rental rates will create greater instability in the lives of low-income households as they are forced into homelessness or become more cost-burdened by housing, resulting in difficult tradeoffs with more limited financial resources. In Salt Lake City, there is currently a 7,567 affordable unit deficit for the 12,624 residents living in poverty and making $20,000 per year or less. Very little of the new housing being built will serve this population because it is extremely difficult to finance these units. Without these units, people are forced to live in unclean, crowded and unsafe conditions or are forced into homelessness. These residents require a rental rate of $500 per month or less or the burden of housing becomes overwhelming. Today, 49% of renters and 22% of homeowners in Salt Lake City spend more than 30% of their income on housing. Additionally, 24% of renters are severely cost-burdened, spending more than 50% of their income on housing. For those already living in poverty, being cost-burdened by their housing can result in having as little as $500 remaining each month to cover all other costs including basic necessities such as food, medicine, and healthcare.

The housing crisis is also impacting middle-income households. The historically low vacancy rate of 2% for multifamily rental in Salt Lake City has driven prices up in every neighborhood. In many cases, middle-income households are forced to make the decision take on a greater housing-cost burden, or move to another community with lower rents and housing.

1 2016 BBC Housing Market Study Update
2 Growing SLC: A Five Year Plan (Adopted December 2017)
prices, often outside of Salt Lake City. In August 2016, Salt Lake City conducted the Salt Lake Live Work Survey, which included approximately 172 (or 12%) of respondents who identified themselves as being people that commuted into the City for work. Among these commuters, 52% indicated that they would consider living in Salt Lake City if housing were more affordable. Salt Lake City’s population grows by 60% every day from in-commuters, which creates significant stress on our transportation network and the environment. Providing more affordable options could greatly reduce these impacts, which are shared by all residents.

The systemic affordable housing crises has implications for every Salt Lake City resident and business. Resolving this crisis will require a community-wide effort, one development at a time, to fulfill the City’s Housing Plan. The Exchange development meets the City’s objective of affordable housing and a diversity of housing options in areas with strong access and amenities.

IV. CONCLUSION

When complete, The Exchange will provide housing for a diverse array of incomes and household types, from extremely low-income housing to market-rate housing and from micro units to three bedrooms. The benefits of The Exchange include affordable housing, economic development impacts, and job creation ground level street activation, as well as systemic cost savings from the provision of deeply targeted affordable housing and positive impacts from an increased downtown resident base. The costs to the City of providing below-market terms and a reduced price for the Seller Note are outweighed by both the tangible and intangible benefits to the City. It is recommended that the City provide the Seller Note in the amount of the reduced Purchase Price of $4,802,000 for the in exchange for the tangible and intangible benefits to the entire City for the public purpose of accomplishing the City’s goals and objectives in the area of economic development, job creation, affordable housing, and job preservation.

REFERENCES
This analysis has been available in the City Recorder’s Office, Room 415, City & County Building, 451 South State Street since __________, 2018. The City Council will hold a public hearing on whether to adopt a resolution approving the proposed study. The public hearing will be held ______________.
October 29, 2018

To: Melissa Jensen, Director, Housing and Neighborhood Development

From: Chuck Depew, Senior Director

Subject: Community Benefit Review
City Property Disposition – Exchange Buildings

Salt Lake City’s Housing and Neighborhood Development Department (HAND) is looking to sell property at 320 East 400 South and 338 East 400 South to a development team proposing a mixed use project – called The Exchange. You have asked NDC to look at the transaction to determine whether proposed terms are appropriate for the benefits provided by the project.

The National Development Council ("NDC") has been engaged in economic and community development across the nation since 1969. Since that time, NDC has evolved into one of the most respected and comprehensive providers of financing, development expertise, technical assistance and training for development finance and community revitalization. Since its founding, NDC has provided technical assistance to thousands of communities in addition to Salt Lake City, UT. NDC’S core expertise is in assisting its client cities in strategic use of public resources and incentives in order to leverage private investment in economic and community development efforts.

Development Summary

Residential Housing:
- Total housing units: 412 total units (138 income restricted, 274 market rate)
  - Building A on Property One: 286 total units (20% units income restricted at 50% of Area Median Income “AMI”)
  - Building B on Property Two: 126 total units (63% units income restricted at 40% and 80% of AMI)

The Development Team has been awarded 4% Low-Income Housing Tax Credits (LIHTC) for both properties but will provide lower affordability for some units than would be required.

Commercial Space:
- Building A on Property One: 15,000 square feet of ground floor commercial space fronting three sides of the building
- Building B on Property Two: 2,700 square feet of ground floor retail along 400 South and 30,000 square feet of a Business Incubator operation.
The range of uses proposed for the project fulfill many of the City's policy goals for mixed-income housing, innovative micro-unit housing, neighborhood-oriented businesses and services as well as a business and food incubator. The mix of uses complicate financing with the range of housing affordability and commercial uses.

Disposition Proposal

The City is proposing some flexibility in its sale of the property to the development in order to accomplish these community development objectives. Primary terms include:

- Adjust the purchase price for the site from an appraised value of $5,527,000 to $4,802,000. The $725,000 difference represents a 12% reduction in price; and
- The property will be sold using a seller note from the City with payments over 35 years; and
- The interest rate charged on the City's seller note is .79%; and
- Payments are made from residual receipts from the project with cash flow after expenses, senior lenders and investors are paid.

In determining whether the revised business terms are appropriate we would want to confirm potential increased project costs to the project in order to meet public objectives and whether terms are consistent in the industry.

The mixed use project provides significant public objectives that would not be typically be done in the private project. They include:

- The mix of uses require a more complicated design and development process, which limits basic development efficiencies. This is likely to lead to higher than normal development costs. Many of the public uses such as affordable housing and incubator space could also lower revenue potential and ultimately the value for the project.
- Provision of affordable housing. While the project will benefit with some financial equity provided through the provision of low-income tax credits, the project is using the 4% program as opposed to using the 9% program while still targeting lower levels of affordability. The lower rents reduce the project's cash flow further and the 4% program significantly reduces the housing subsidy provided to build those units.
- Directing commercial space to neighborhood-serving business and services also limits revenue available to the project. Regional businesses and chains generally lease larger amounts of space at higher rents with stronger financial strength.
- The provision of a business and food incubator also limit revenue potential to the project. Unless proven brands such as WeWorks are included, incubator space can take a longer time to lease-up with unproven revenues putting pressure on rents. The inclusion of food facilities increases the development costs with uncertain revenues as well.
The above point to a project that could have higher development costs than a normal project with some level of unproven revenues that could affect the project’s underlying financing success. Those financial limitations would naturally lead to a diminished value for the underlying property and warrant a discount. Over the term of the 35 year seller financing, the developers would pay $5,515,254 for the property. This exceeds its current value but the City electing to be paid over time is a reasonable accommodation.

There is a separate question of the whether the terms provided by the City’s financing are appropriate to the project and/or consistent with the industry. The alternative would have been the developer suggesting a much lower purchase price.

The essence of the City’s business terms are to reduce the initial project capital costs by using a seller note for the land acquisition and then easing the impact of this debt by providing a below-market interest rate and allowing payments to be made from residual receipts. Residual receipts refer the cash flow remaining from project after expenses are paid.

Given the challenging project economics, it is typical of a government to provide favorable terms to encourage public objectives. Choosing to use seller financing of the site reduces the project’s overall costs making it easier to secure need equity and debt. The 35-year term is actually less than typical ground lease, which is another option. The 35-year term, though, should allow for long-term debt financing which is essential for the project. A lender typically prefers any lease or property liability to be 1 ½ times is financing term.

The use of residual receipts is typical of any project with rent-restricted affordable housing. If the repayment were required from direct revenues, the effect would lower the funds available for debt service, which, in turn, reduces the debt financing available to the project. The below-market interest rate is also typical of a project with affordable housing. The rate is lower than normal but has been set in order to ensure it can be paid without affecting operating requirements of the project.

It is in the City’s interests to ensure that the project’s developers can secure needed private equity, housing tax credit equity, and debt needed to build The Exchange. The project includes significant elements that support City and community goals. They do affect the costs and revenues of the project, which could limit basic feasibility. Rather than exclude those important elements and try to negotiate a lower or maybe full contribution of the property, the City is proposing flexible but typical terms for selling the property. Being patient with repayments, being paid from residual cash flow and using a lower rate are prudent adjustments to the transaction. While favorable to the developer, they assist the provision of needed debt and private equity rather than overly advance the developer’s financial returns. They are a thoughtful approach to move the project to construction.

If you have any questions or clarifications, please don’t hesitate to contact me at (206) 419-3904 or at cdepew@ndconline.org. Good luck with the project. I look forward to seeing the positive impacts from its development.