Council Meeting of
May 8, 2012

Honorable Mayor and Members
of the City Council
City Hall
Torrance, California

Members of the Council:

SUBJECT: Community Development – Review financial analysis and authorize staff into negotiations for the development of 1640 Cabrillo Avenue.

Expenditure: Not Applicable

RECOMMENDATION

Recommendation of the Community Development Director that City Council authorize staff to enter into an exclusive negotiation period with Meta Housing Corporation for the development of mixed-use workforce housing at 1640 Cabrillo Avenue.

BACKGROUND AND ANALYSIS

A Request for Proposals (RFP) to develop mixed-use workforce housing at 1640 Cabrillo Avenue was circulated in November of 2010. Following an internal review period, staff appeared before the City Council on May 24, 2011 with recommendations to proceed. At that meeting, Your Honorable Body directed staff to contract with an outside consultant to do a more expansive financial analysis on the two highest-rated firms, Meta Housing Corporation (Meta) and Related Companies/ Mar Ventures (Related). The City contracted with Keyser Marston & Associates (KMA) to aid in the review process.

During KMA's review process, redevelopment dissolution bill ABX1-26 was passed by the State of California Supreme Court. Not only did this action temporarily bar former redevelopment agencies from entering into any new agreements, it also effectively froze funding for new projects. Being that the 1640 Cabrillo Avenue RFP was in the proposal review stages, the 20% Low-Moderate Housing Set-Aside funds originally earmarked to fund this project were no longer accessible. With the property still ripe for development, staff sent a memo to Meta and Related on April 19, 2012 detailing the City's financial limitations due to ABX1-26. This letter requested that the firms submit revised proposals to demonstrate their ability to use the land and secure the alternative funding to complete the project.

Revised pro formas were received from each firm and forwarded to KMA for further analysis. Each development team submitted pro formas based on their original

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submittals as requested, as well as an unsolicited alternative development scenario for consideration. Meta's alternative scenario reflected a modified design approach and 44 units over ground floor retail, as opposed to the 45 originally provided for in its RFP submittal. The alternative scenario submitted by Related provided for 45 residential units over ground floor retail, in addition to its original proposal of 39 units. Each scenario was evaluated for financial feasibility. In a memo from KMA dated April 19, 2012, Meta and Related were both sufficiently qualified to secure competitive tax credit financing without any additional subsidy City (Attachment A).

Staff believes that both firms, Meta and Related, are qualified to develop the kind of project envisioned for the 1640 site. All items being equal, staff continues to recommend Meta for the project. Meta's original design for 45 units over commercial and at-grade parking was rated the highest by the internal selection committee due to the compatibility of its design with the character of the surrounding Downtown area. In addition, the revised pro forma identifies their ability to carry out the project. Although alternative development scenarios were provided by each firm, staff felt it best to evaluate the updated pro formas based on what was originally submitted in an effort to remain consistent; however, it should be noted that the revised scenarios still compel staff to recommend Meta's original proposal for the project. This is consistent with staff's previous recommendations to Council.

Community Development staff recommends that the City Council concur with the staff recommendation supported by the KMA analysis and direct staff to enter into a negotiation period for the purpose of developing a Disposition and Development Agreement with Meta Housing Corporation. Upon conclusion of negotiations an Agreement will be forwarded to Your Honorable Body for review.

Respectfully submitted,

Jeffery W. Gibson
Community Development Director

By ______________________
Gregg Lodan
Planning Manager

CONCUR:

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Jeffery W. Gibson
Community Development Director

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LeRoy J. Jackson
City Manager

Attachments:

A) Keyser Marston Associates Memorandum (4/19/2012)
B) Meta Housing Corp. Revised Proposal (3/12/2012) (Limited Distribution)
C) Related/Mar Ventures Revised Proposal (3/12/2012) (Limited Distribution)

ATTACHMENT A

KEYSER MARSTON ASSOCIATES
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

MEMORANDUM

To: Jeffery W. Gibson, Deputy Executive Director
City of Torrance

From: Julie Romey

Date: April 19, 2012

Subject: 1640 Cabrillo RFP – Revised Proposals

At the request of the City of Torrance (City), Keyser Marston Associates, Inc. (KMA) reviewed the revised proposals submitted by the top two developers for the City-owned 0.85-acre site located at 1640 Cabrillo (Site) in the Downtown Redevelopment Project Area. The purpose of the KMA analysis is to review and provide a financial analysis of the two revised proposals as well as a ranking based on the financial proposals. The impacts of the financial issues identified by KMA are calculated in Table 1, which is located at the end of this memorandum.

EXECUTIVE SUMMARY

The two developers, Meta Housing Corporation (Meta) and Related / Mar Ventures, Inc. (Related), proposed the following:

	Meta Proposal		Related Proposal	
	Original Scope	Alternative Scope	Original Scope	Alternative Scope
Number of Units	45	44	39	45
FAR	1.22	1.17	1.03	1.15
Average Affordability	48%	48%	46%	46%
CRL Unit Credit				
Very-Low Income	5	5	38	44
Low Income	9	9	0	0
Moderate Income	30	29	0	0
Financial Proposal	Land Payment	Land Payment	Land Donation	Land Donation
Tie-Breaker Score	29.38%	30.51%	34.85%	32.44%
Deal Terms	Residual Receipts Loan	Residual Receipts Loan	NA	NA

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It should be noted that both developers have added an alternative scope of development from the original proposals. Based on current industry standards and information provided by the City, KMA analyzed the financial assumptions for each proposal. Both developers assume that the proposals will be submitted in the second low income housing tax credit (Tax Credit) round of 2012 and that an approximately 30% tie-breaker would be sufficient to win an allocation. The following summarizes KMA's findings:

1. Meta Proposal:

   a. Financial Issues:

      i. The net operating income (NOI) in both scenarios is overstated due to not including the California Redevelopment Law (CRL) rent restrictions.

      ii. The $1.05 per Tax Credit equity assumption is low in comparison to recent transactions.

      iii. Meta assumed that both scenarios would receive an Affordable Housing Program (AHP) allocation and included developer equity for the commercial component. KMA had requested that these assumptions not be included in the analysis for comparison purposes.

      iv. When these adjustments are taken into account, it is likely that the proposals will need additional financial assistance to be feasible.

   b. Meta proposed that a $2.20 million payment would be made for the Site; however, in turn, Meta requests that the City provide a $2.20 million residual receipts loan to maximize the Tax Credit tie-breaker score. With this strategy, there is potential for the City to receive annual payments on the loan and that the loan would be paid in full in Year 55.

2. Related Proposal:

   a. Financial Issues:

      i. The NOI in both scenarios is understated due to using 2011 rents instead of 2012 rents.

ii. Related assumed that the Tax Credit rate would be fixed at 9.0% when this rate is now a floating rate that is currently approximately 7.5%.

iii. When these adjustments are taken into account, it is likely that the proposals will need additional financial assistance to be feasible.

b. In order to maximize Tax Credit tie-breaker score, Related proposes that the Site be donated to the project without a residual receipts loan structure.

KMA's analysis indicates that the financial proposals are financially competitive. KMA concludes that both developers have the experience and financial capacity to develop the Site with only the land provided as financial assistance by the City. Therefore, it is recommended that the City select a developer based on selection criteria from the RFP other than financial feasibility.

BACKGROUND STATEMENT

The following summarizes the history of this transaction:

1. Late 2010 – The City issued a Request for Proposals (RFP) for the Site with the following intent:

   a. Generate a mixed-use development that provides low and very-low income rental housing units with ground floor commercial space;

   b. A recommended range for the number of units to be 30 to 40 units;

   c. A recommended range for the ground floor commercial space from 3,480 square feet to 8,700 square feet;

   d. 100% of the units are to be restricted to low and very-low income households, as defined by California Redevelopment Law (CRL);

   e. The unit mix should include one-, two- and three-bedroom units;

   f. Affordability covenants are to be in effect for 99 years; and

   g. All projects are to assume prevailing wages will be imposed on the project.

2. January 2011 – Seven developers submitted proposals in response to the RFP.

3. May 2011 – The City recommended Meta as the chosen developer for the Site. However, the RFP evaluation criteria did not include points for the financial feasibility of the proposals. Therefore, the City engaged KMA to analyze the seven proposals in regards to the financial feasibility of the proposals.

4. August 2011 – KMA submitted the analysis of the seven proposals, which ranked Meta and Related as the first and second, respectively, developers. It was recommended that the City request that the top two developers resubmit their pro formas with certain standardized assumptions.

5. October 2011 – City sent a letter to Meta and Related requesting that the developers resubmit their proposals.

6. December 2011 – submitted the analysis of the revised Meta and Related pro formas and recommended Related as the developer for the City to select for the development of the Site. However, also at the end of December, the California State Supreme Court ruled that redevelopment agencies were to be shut down by February 1, 2012.

7. February 1, 2012 - City's Redevelopment Agency (Agency) was shut down and all of the assets were transferred to the Successor Agency, which does not access to low and moderate income set-aside (Set-Aside) funds to assist projects. As such, the City requested that Meta and Related resubmit their proposals with the assumption that the land is the only assistance that the City will be able to provide.

REVISED DEVELOPER PROPOSALS

Meta Proposal – Original Scope

Meta proposes to construct a 45-unit apartment building with 4,480 square feet of ground floor commercial space and 89 at-grade parking spaces. Assuming that the project would apply for 9% low income housing tax credits (Tax Credits) in the second 2012 round, Meta estimates that the $14.36 million project would achieve a 29.38% Tax Credit tie-breaker score.

The proposed funding sources are as follows:

	Funding Sources
Conventional Loan	$2,136,960
Tax Credit Equity	9,173,997
City of Torrance	2,200,000
Affordable Housing Program (AHP)	264,000
Deferred Developer Fee/Costs	433,170
Developer Equity (Commercial)	157,561
Total Funding Sources	$14,365,688

Meta proposes that the City's contribution will be to sell the Site to Meta for $2.20 million, which is the established market rate value as well as provide a $2.20 million loan to the project that will have the following loan terms:

1. A 55-year term;

2. A 0% interest rate; and

3. Repayments made with an undetermined percentage of residual receipts.

Residual receipts are to be defined as the cash available after payment of debt service, an asset management fee, partnership fee and the deferred developer fee.

Meta Proposal – Alternative Scope

In this resubmittal, Meta proposes an alternative development scenario that includes 44 residential units with 2,750 square feet of ground floor commercial space and 75 at-grade parking spaces. Assuming that the project would apply for 9% Tax Credits in the second 2012 round, Meta estimates that the $13.70 million project would achieve a 30.51% Tax Credit tie-breaker score. Thus, the reduction of one residential unit and nearly halving the amount of ground floor commercial space reduces the total development costs by approximately $660,000.

The proposed funding sources are as follows:

	Funding Sources
Conventional Loan	$2,046,441
Tax Credit Equity	8,645,123
City of Torrance	2,200,000
Affordable Housing Program (AHP)	258,000
Deferred Developer Fee/Costs	408,350
Developer Equity (Commercial)	145,091
Total Funding Sources	$13,703,005

Meta proposes that the City's contribution will be to sell the Site to Meta for $2.20 million, which is the established market rate value as well as provide a $2.20 million loan to the project with the same terms as proposed for the Original Scope.

Related / Mar Vista – Original Scope

Related proposes to develop 39 residential units with 2,200 square feet of ground floor commercial space and 71 at-grade parking spaces. Assuming that the project would apply for 9% Tax Credits in the second 2012 round, Related estimates that the project costs will range from $12.06 to $9.81 million, depending upon whether the project pays $2.20 million cash for the Site. If the land is donated to the project, the Tax Credit tie-breaker is calculated at 33.395%, which is more competitive than the 11.147% score if the project pays $2.20 million cash for the Site. The proposed funding sources are as follows:

	Land Payment	Land Donation
Conventional Loan	$1,277,473	$1,277,473
Tax Credit Equity	10,547,404	8,295,263
City of Torrance	0	0
Affordable Housing Program (AHP)	0	0
Deferred Developer Fee/Costs	240,000	240,000
Developer Equity (Commercial)	0	0
Total Funding Sources	$12,064,877	$9,812,735

Related proposes that the City either donate the Site to the project, or Related will pay $2.20 million cash for the Site.

Related / Mar Vista – Alternative Scope

Related also proposes an alternative development scope that includes constructing a 45-unit apartment building with 2,200 square feet of ground floor commercial space and 77 at-grade parking spaces. Assuming that the project would apply for 9% Tax Credits in the second 2012 round, Related estimates that the project costs will range from $13.30 to $11.06 million, depending upon whether the project pays $2.20 million cash for the Site. If the land is donated to the project, the Tax Credit tie-breaker is calculated at 37.732%, which is considerably more competitive than the 11.401% tie-breaker score generated if the project pays $2.20 million cash for the Site.

The proposed funding sources are as follows:

	Land Payment	Land Donation
Conventional Loan	$1,500,707	$1,500,707
Tax Credit Equity	11,523,820	9,277,060
City of Torrance	0	0
Affordable Housing Program (AHP)	0	0
Deferred Developer Fee/Costs	280,000	280,000
Developer Equity (Commercial)	0	0
Total Funding Sources	$13,304,528	$11,057,768

Related proposes that the City either donate the Site to the project, or Related will pay $2.20 million cash for the Site.

KMA ANALYSIS (TABLE 1)

KMA analyzed the four development proposals provided by Meta and Related to determine the financial feasibility of each proposal. It should be noted that given the elimination of redevelopment agencies by the State of California, the level of competitiveness needed to be allocated Tax Credits is in flux. However, it is concluded that future rounds will be less competitive in regards to the needed tie-breaker score as the average level of local financial assistance to projects will be reduced.

Meta Proposal

The following summarizes the KMA analysis of the Meta proposal:

- KMA found that the Meta proposal overestimated the NOI due to incorrect utility allowances and not using the CRL rent restrictions. In addition, Meta included a $7,500 in the operating expenses for the cost of operating the commercial component. KMA had requested that the commercial component not be included in the analysis. When these adjustments were made by KMA, the NOI was reduced by $89,216 for the Original Scope and $86,343 for the Alternative Scope. These reductions in the NOI result in a $1.11 million and $1.16 million reduction in the permanent loan projections for the Original and Alternative Scopes, respectively.
- Meta also assumed that the project would receive an Affordable Housing Program (AHP) loan, which is competitively awarded, as well as developer equity for the commercial component. KMA previously requested that these assumptions not be made for comparison purposes.

- Meta assumed that the Tax Credit equity rate would be $1.05 per Tax Credit. Given recent transactions, KMA found that this rate should be between $1.10 and $1.15.
- The proposal that the City loan the project the $2.20 million purchase price essentially is a request for the land to be donated to the project. However, there is potential for residual receipts payments to the City over the 55-year term and full repayment of the loan in Year 55.

Therefore, KMA concludes that the Meta proposal could have a potential financial gap of $1.10 to $1.16 million.

Related Proposal

The following summarizes the KMA analysis of the Related proposal:

- KMA found that the Related proposal underestimated the NOI due to using the 2011 rents. When the 2012 rents are used, the NOI increases by $16,600 and $16,600 for the Original and Alternative Scopes, respectively. The adjustment to the NOI results in a $207,000 and $240,000increase in the permanent loan proceeds for the Original and Alternative Scopes, respectively.
- However, Related also assumed that the Tax Credit rate would be 9.0% when this rate is no longer set and therefore is a floating rate. The current rate is estimated at 7.5%. This reduction causes a $1.38 million and $1.55 million reduction in Tax Credit equity for the Original and Alternative Scopes, respectively.

To achieve tie-breaker scores above 30%, Related proposes that the land be donated. However, Related does not propose a residual receipts format. As such, the City would not have the potential of receiving residual receipts payment over a 55-year term and full repayment of the value of the land in Year 55.

KMA concludes that the Related proposal could have a financial gap of $1.18 million and $1.31 million for the Original and Alternative Scopes, respectively.

CONCLUSION

KMA's analysis concludes that while both proposals have issues that cause a financial gap over and beyond the need for free land, the proposals are financially competitive. Based on KMA's experience with Meta and Related, KMA also concludes the following:

1. Meta and Related are experienced and well capitalized affordable housing developers that have successfully developed similar projects.

2. This experience also would enable both developers to position an affordable housing project in Torrance to likely be successful in the current Tax Credit competition environment.

3. Based on the developers' experience, the financial issues identified by KMA can be resolved during the negotiations phase of the development process.

Therefore, KMA concludes that either developer has the experience and financial capacity to develop the Site with only the land provided as financial assistance by the City. As such, it is recommended that the City select a developer based on selection criteria from the RFP other than financial feasibility.

TABLE 1

IMPACT OF FINANCIAL ISSUES ON FINANCIAL GAP
CABRILLO AVENUE RFP
TORRANCE, CALIFORNIA

META PROPOSAL	Original Scope			Alternative Scope		
	Developer	**KMA**	**Difference**	**Developer**	**KMA**	**Difference**
Change in Net Operating Income						
Gross Potential Income	$471,336	$369,530	$101,806	$455,554	$356,772	$98,782
(Less) Vacancy Allowance	(23,567)	(18,477)	(5,091)	(22,778)	(17,839)	(4,939)
Effective Gross Income	$447,769	$351,054	$96,716	$432,776	$338,933	$93,843
(Less) Operating Expenses	(282,517)	(275,017)	(7,500)	(281,118)	(273,618)	(7,500)
Net Operating Income	**$165,252**	**$76,037**	**$89,216**	**$151,658**	**$65,315**	**$86,343**
Impact on Convential Loan						
Net Operating Income	$165,252	$76,037	$89,216	$151,658	$65,315	$86,343
Debt Service Coverage Ratio	1.20	1.15		1.15	1.15	
Annual Debt Service	$137,710	$66,119	$71,591	$131,877	$56,796	$75,081
Interest Rate	5.50%	5.50%		5.50%	5.50%	
Amortization	35	35		35	35	
Conventional Loan Amount	**$2,136,962**	**$1,026,019**	**$1,110,942**	**$2,046,446**	**$881,355**	**$1,165,092**
Tax Credit Equity Rate						
Gross Tax Credits	$8,737,137	**$8,737,137**		$8,233,449	**$8,233,449**	
Tax Credit Equity Rate	$1.05	$1.10		$1.05	$1.10	
Tax Credit Equity	**$9,173,997**	**$9,610,851**	**($436,854)**	**$8,645,123**	**$9,056,794**	**($411,671)**
Other Funding Sources						
AHP Loan	$264,000	$0	$264,000	$258,000	$0	$258,000
Commercial Developer Equity	157,561	0	157,561	145,091	0	145,091
Impact on Financial Gap	**$421,561**	**$0**	**$421,561**	**$403,091**	**$0**	**$403,091**
Potential Increase / (Decrease) in Financial Assistance			**$1,096,000**			**$1,157,000**

RELATED PROPOSAL	Original Scope			Alternative Scope		
	Developer	**KMA**	**Difference**	**Developer**	**KMA**	**Difference**
Change in Net Operating Income						
Gross Potential Income	$328,596	$346,128	($17,532)	$379,776	$400,080	($20,304)
(Less) Vacancy Allowance	(16,430)	(17,306)	876	(18,989)	(20,004)	1,015
Effective Gross Income	$312,166	$328,822	($16,656)	$360,787	$380,076	($19,289)
(Less) Operating Expenses	(210,070)	(210,070)	0	(240,850)	(240,850)	0
Net Operating Income	**$102,096**	**$118,752**	**($16,656)**	**$119,937**	**$139,226**	**($19,289)**
Impact on Convential Loan						
Net Operating Income	$102,096	$118,752	($16,656)	$119,937	$139,226	($19,289)
Debt Service Coverage Ratio	1.15	1.15		1.15	1.15	
Annual Debt Service	$88,779	$103,262	($14,483)	$104,293	$121,066	($16,773)
Interest Rate	5.75%	5.75%		5.75%	5.75%	
Amortization	30	30		30	30	
Conventional Loan Amount	**$1,267,751**	**$1,474,568**	**($206,817)**	**$1,489,288**	**$1,728,805**	**($239,516)**
Change in Tax Credit Equity						
Qualified Basis	$8,015,548	$8,015,548	$0	$8,964,240	$8,964,240	$0
Tax Credit Rate	9.0%	7.5%		9.0%	7.5%	
Years	10	10		10	10	
Gross Tax Credits	$7,213,993	$6,011,661	$1,202,332	$8,067,816	$6,723,180	$1,344,636
Tax Credit Equity Rate	1.15	1.15		1.15	1.15	
Tax Credit Equity	**$8,295,263**	**$6,912,719**	**$1,382,544**	**$9,277,060**	**$7,730,883**	**$1,546,177**
Potential Increase in Financial Assistance (Rounded)			**$1,176,000**			**$1,307,000**

Prepared by: Keyser Marston Associates, Inc.
Filename: Cabrillo Ave Proposal Review - 04.19.12; Sheet1; jlr