

# Agenda Report

March 5, 2018

**TO:** Honorable Mayor and City Council

**FROM:** Office of the City Manager

**SUBJECT:** APPROVAL OF TERMS OF SECURITY AGREEMENT WITH HHP-LOG, LLC FOR DEVELOPMENT OF INCLUSIONARY OFF-SITE HOUSING PROJECT AT 745-759 N. ORANGE GROVE BOULEVARD

## **RECOMMENDATION:**

It is recommended that the City Council:

- 1) Find that the action proposed herein is exempt from CEQA review pursuant to State CEQA Guidelines Section 15061(b)(3), the "general rule" that CEQA applies only to projects which have the potential for causing a significant effect on the environment;
- 2) Approve the terms of a Security Agreement between the City and HHP-LOG, LLC in connection with the proposed development of a 25-unit affordable housing project located at 745-759 N. Orange Grove Blvd (the "Development"); and
- 3) Authorize the City Manager to approve, and the City Clerk to attest, the Security Agreement along with any and all documents required to secure HHP's obligation to complete the Development.

## **BACKGROUND:**

### ***AMLi's Inclusionary Housing Obligation***

AMLi Residential is the developer of the 394 unit rental housing development associated with the Lincoln Properties project at 100 West Walnut Street. Under the City's Inclusionary Housing Requirements (Chapter 17.42 of the Zoning Code), any new residential development of ten or more units is required to provide 15% of the units in the development as affordable housing. Accordingly, AMLi would be required to provide 39.4 Low income units and 19.7 Moderate income units or 52.5 Low income units on site.

As an alternative to developing units on site, developers may satisfy the City's

requirements through one of three options:

- 1) Paying to the City an Inclusionary In-Lieu Fee. In this case AMLI would pay the City an inclusionary fee of \$10.21 million if paid in full at building permit issuance, or an inclusionary fee of \$11.34 million if paid in equal installments at building permit and certificate of occupancy issuance.
- 2) Providing Inclusionary units at another location within the City, or
- 3) Donating land to the City.

If a Developer wishes to take advantage of one of these three options, they are required to submit an Inclusionary Housing Plan which is subject to City Manager approval.

***HHP proposes to assume AMLI's Inclusionary Housing Obligation***

AMLI has indicated it wishes to pursue Option 2, off-site units. However, rather than construct the off-site units itself, AMLI proposes to assign its obligation to a single purpose entity, HHP-LOG, LLC, which is fully-controlled by Heritage Housing Partners ("HHP"), a local developer with a successful record of constructing affordable home-ownership projects in Pasadena and other cities. Pursuant to this arrangement, AMLI would pay \$9,531,556 directly to HHP-LOG. The payment by AMLI would be conditioned upon a release of any further obligations to the City with respect to the proposed inclusionary housing project and HHP-LOG would be solely responsible for the completion of the off-site project. AMLI has stated that if the off-site transaction is not approved, they would choose to defer payment of the full In-Lieu Fee to Certificate of Occupancy for their project at 100 W. Walnut Street, through a letter of Credit, as provided under the City's Inclusionary Housing Regulations.

The following table summarizes how HHP's proposed Lincoln-Orange Grove off-site project, located at 745-759 N. Orange Grove Boulevard, is similar or different from other Inclusionary off-site projects that HHP has developed.

	Haskett Court	Evanston Court	Summit Grove	Lincoln-Orange Grove
1. City was a direct lender	No	No	Yes	No
2. Source developer paid partial In-Lieu fee to City	Yes	Yes	No	No
3. Source developer transferred partial Inclusionary units obligation to HHP off-site project	Yes	Yes	No	No
4. Source developer had a direct role in assembling the off-site property	Yes	No	No	No
5. Off-site project eliminates blight/nuisance	No	No	Yes	Yes
6. City released source developer from Inclusionary obligations prior to construction of HHP off-site project	Yes	Yes	Yes	Proposed

Because of the high dollar value of the proposed transaction and the fact that the source developer is not otherwise involved with the City or the Development in any respect, staff is presenting the Security Agreement to the City Council for consideration, as discussed later in this report.

***The Proposed Inclusionary Housing Project Would Remove Blight***

AMLI has submitted an Inclusionary Housing Plan that would provide for the construction of off-site low-income home-ownership units to be located at 745-759 N. Orange Grove Boulevard. On January 8<sup>th</sup> the City Council approved amendments to the Inclusionary Housing Regulations that qualify this property, which in part houses an abandoned gas station and automotive repair shop (at 745 N. Orange Grove Boulevard), for such a project. Previously, the regulations required that an off-site project in northwest Pasadena was permissible provided among other things, it eliminated a nuisance and legal non-conforming use. By way of the Council's action on January 8<sup>th</sup> nuisance only, *i.e.*, not non-conforming, properties would become eligible provided the City Council were to make a finding that the property represents a blight of long-standing duration. As part of its action in January, the Council made such a finding as to this specific property.

Staff has been working closely with HHP to refine the proposed project and consider its appropriateness based on the existing Inclusionary Housing regulations. Below is a brief discussion of how the project seeks to meet the requirements of the regulations. In considering the project, another overarching consideration has been the extent to which it will effectively address a long-standing nuisance property which has been a blight on the surrounding neighborhood. This important factor is in keeping with the policy direction of the City Council which recognized that with the loss of Redevelopment as a tool to address blight, the City's Housing program could be used in a strategic fashion. For example, a similar approach was employed to replace a nuisance liquor store at Orange Grove Avenue and Summit Avenue, the site of the HHP Summit Grove affordable home-ownership project mentioned above.

***Comparability of Projects in Consideration of Unique Opportunity To Remove Blight.***

The proposed project meets the City's Inclusionary Housing regulations as it relates to: zoning, infrastructure, title, lack of over concentration and neighborhood character. However, the Inclusionary Housing regulations also require that off-site projects be of comparable size and number of units as would otherwise exist in the source project. The following table provides a comparison between an on-site affordable AMLI project and the project proposed by HHP:

	On-site AMLI project	Off-site HHP project
Number of Low-income units	52.5	25
Total square footage	43,731	31,500

It is important to keep in mind that this comparison is only theoretical because AMLI has indicated that in the event HHP's off-site project is not approved, it would pay the in-lieu fee to the City rather than construct Inclusionary units on-site. Moreover, any AMLI project would be rental and the proposal by HHP is for home-ownership, which is recognized as having additional benefits related to building and maintaining stable neighborhoods. Consequently, staff also considered HHP's proposal as compared to an AMLI project based on the number of bedrooms that would be provided and the likely number of persons to be housed:

	On-site AMLI project	Off-site HHP project
Bedroom count	69	70
Number of persons housed	104	105

When compared this way, the two projects appear much more comparable. There is precedence for considering bedroom count. In HHP's Summit Grove project (currently under construction), the source project at the Ambassador site had an inclusionary obligation of 13 units, which had a total area of 15,347 sq. ft. and 22 bedrooms. The off-site Summit Grove project provides 12 inclusionary units with a total area of 16,174 sq. ft. and 36 bedrooms. Given that the proposed project is home-ownership and provides essentially the same number of bedrooms, staff has determined that it satisfies the intent of the Regulations. Furthermore, it is important to note that four (4) existing occupied and likely "naturally occurring affordable" rental units will be eliminated by the proposed project. Each of the displaced households will receive relocations payments by the property Seller in the amount of \$7,124 as specified by the City's Tenant Protection Ordinance.

### ***Environmental Conditions of the Project Site.***

Another important consideration relates to environmental conditions. The Inclusionary Housing regulations state that an off-site location must be free of characteristics that would make it difficult or impossible to develop including but not limited to soil or other contamination. As mentioned above, this site previously housed a gas station and automotive repair shop. A Phase 1 environmental report on the site was prepared in November, 2015. Also, HHP's environmental consultant Ambient Environmental, Inc. conducted a limited subsurface investigation in October, 2017.

Because the project site will be the location of an affordable housing project, and due to staff concerns regarding the adequacy of the prior analyses with respect to identification and remediation of negative site conditions, the City engaged its own experts to independently review the studies performed to date. This resulted in requiring HHP/Ambient to perform additional soil testing and examinations which were performed during the week of February 18, 2018.

The results of the recent testing and examination indicate the lack of any toxic constituents in the soil observed, monitored or tested, and with no impact to the subsurface soils, it appears that ground water and the public health would not be adversely affected. Furthermore, the analysis concludes that the site can be developed



for residential use, and any additional investigations, studies or remediation relating to soil can take place during the course of site preparation for construction. Based on this, the location has been determined by staff to meet the environmental site suitability criteria set forth in section IV.B.3.a(iii) of the Inclusionary Housing Regulations, which is, "The parcel shall be free of characteristics that would make it difficult or impossible to develop (i.e., irregular shape, excessive sloping, land-locked or otherwise inaccessible, soil or other contamination, adjacent to incompatible land use). The Developer shall submit a Phase I environmental evaluation report before any parcel can be considered."

Based on the recommendations of the City's environmental consultant, Alta Environmental, HHP will be required to meet the following requirements for project entitlement: additional site-wide soil vapor testing, completion of a Health Risk Assessment conducted by a California Board-certified toxicologist and tailored to future residential use, cooperating with a qualified third-party acting on behalf of the City to provide oversight and review of future environmental activities, completion of a separate Closure Report as to the Underground Storage Tanks and associated piping and dispensers, and obtaining appropriate environmental insurance to cover the potential discovery of previously unknown environmental impacts. With respect to this last item, HHP has agreed to procure a pollution liability policy in the amount of \$2 million to provide a source of funds for remediation should yet undetected hazards be discovered during construction; the City would be named as an additional insured.

***The Proposed Security Agreement is Designed to Limit City Risk.***

As discussed above, AMLI is seeking to be released of its obligations upon payment to HHP. As envisioned by the Inclusionary Housing regulations, a developer constructing off-site units would not receive a certificate of occupancy on its source project until the off-site units are constructed and also receive a certificate of occupancy. Alternately, developer would be judged to have fulfilled their obligations upon payment of the In-Lieu inclusionary fee. Under the City's regulations AMLI could choose to pay a total of \$10.21 million if paid in full at building permit issuance, or a total of \$11.34 million if paid in equal installments at building permit and certificate of occupancy issuance. The proposed arrangement with HHP represents somewhat of a hybrid-approach.

Staff's main concern with this, and the reason for seeking direction from the Council, is ensuring the City's financial interests are adequately protected in the event HHP should not be able to perform its obligations to complete the project.

To mitigate this risk, HHP has proposed a Security Agreement. The Agreement would include terms which have been part of prior agreements with HHP when the City has funded other projects in whole or in part. These terms include:

- 1) City will review and approve project pro forma prior to start of project.
- 2) City will review and approve all requested funding disbursements, including disbursements made from the AMLI funds, the conventional construction loan, and (if applicable) the New Market Tax Credits (NMTC) loan.

- 3) In case of an uncured default by HHP, HHP will agree to transfer title to the property and improvements to the City, provided that City assumes the project's conventional construction loan and (if applicable), the NMTC loan.

Beyond those terms which the City has agreed to previously, HHP is proposing the following additional terms and conditions:

- 4) All AMLI funds not used for purchase of the Property will be placed in an account requiring approval by both the City and HHP for any disbursements (the "Controlled Account"). The City will have the right to review and approve all requested fund draws from the Controlled Account.
- 5) Disbursements will be made on a proportional basis between the AMLI funds, the conventional construction loan, and (if applicable) the NMTC loan. For example, if the AMLI funds represent 60% of construction period costs, construction period disbursements will be made on a 60/40 basis. This will insure that some portion of the AMLI funds will be available to be "recaptured" (see item #6, below) throughout the construction period (vs. disbursing 100% of the AMLI funding prior to commencing disbursement of the construction loan).
- 6) City will be given direct access to any unspent AMLI funds in case of an uncured default by HHP. By virtue of the City assuming the conventional construction loan pursuant to item #3 above, the City will have access to remaining AMLI funds held in the Controlled Account to complete construction. Furthermore, the final installment of AMLI funds (to the extent not already paid and put into the Controlled Account) which are a source of funds to complete construction will be payable to the City (instead of HHP) upon City acquiring title to the Property.
- 7) In case of an uncured default by HHP, City will have access (in conjunction with the construction lender) to HHP's portion of the Holdback account.
- 8) To address the City's concerns about the environmental condition of the site, HHP will obtain a pollution liability policy with coverage in the amount of \$2 million, naming the City as an additional insured. This policy will be in place for three (3) years from the date of HHP acquiring title to the Property.

The proposed Security Agreement will mitigate but cannot eliminate all potential risks associated with the proposal such as rising interest rates and construction costs. As such, there is some inherent risk by providing a release to AMLI and agreeing to HHP's proposal. In the alternative AMLI would pay the in-lieu fee to the City and the City would use those funds towards developing affordable housing potentially at the Lincoln-Orange Grove location or elsewhere in the City. However, the City does not control the Lincoln-Orange Grove site and locating other suitable locations and bringing a project(s) forward would likely take considerably longer than the proposed HHP project.

Given the unique nature of the proposed arrangement, while staff believes the project to have merit in terms of providing affordable ownership units and simultaneously

eliminating a blighted nuisance property, it is appropriate for the City Council to make the final determination as to whether to proceed by considering approval of the proposed security agreement.

**COUNCIL POLICY CONSIDERATION:**

The proposed action is consistent with the City's General Plan - Housing Element and the Five-Year Consolidated Plan. It also supports and promotes the quality of life and the local economy -- a goal of the City Council's Strategic Objectives.

**ENVIRONMENTAL ANALYSIS:**

The action proposed herein seeks to assign the affordable housing obligations of the Lincoln Properties project from AMLI to HHP. The action does not approve the actual development of the affordable housing, does not irrevocably commit the City to that project, nor does it constitute public funding of that project since it is AMLI's funds that are being transferred to HHP. Rather, the action ensures the City's interest in enforcing the affordable housing obligations imposed on the Lincoln Properties project are adequately protected in the event HHP should not be able to perform the assigned obligations. An environmental review of the proposed affordable housing project pursuant to California Environmental Quality Act will be undertaken after HHP submits a project application to the City for entitlements. Accordingly, the action proposed herein is exempt from CEQA review pursuant to State CEQA Guidelines Section 15061(b)(3), the "general rule" that CEQA applies only to projects which have the potential for causing a significant effect on the environment.

**FISCAL IMPACT:**

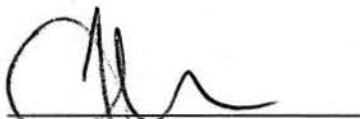
Approval of the subject recommendation will have no direct fiscal impact on the City.

Respectfully submitted,




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