MEMORANDUM

August 5, 2017

TO: MEMBERS, PORT COMMISSION
Hon. Willie Adams, President
Hon. Kimberly Brandon, Vice President
Hon. Leslie Katz
Hon. Doreen Woo Ho

FROM: Elaine Forbes
Executive Director

SUBJECT: Informational presentation regarding the Financing Plan for the Mission Rock Development Project at Seawall Lot 337 and Pier 48, bounded by China Basin Channel, Third Street, Mission Rock Street and San Francisco Bay (AB 8719/Lot 002; AB 9900/Lots 048, 048H, & 62)

DIRECTOR'S RECOMMENDATION: Information Only; No Action Required

EXECUTIVE SUMMARY

Port and City staff have been working with Seawall Lot 337 Associates, LLC ("Developer") to develop proposed amendments to the Planning Code to add a Mission Rock Special Use District ("SUD") that will allow for the development of the Mission Rock mixed-use project at Seawall Lot ("SWL") 337 and Pier 48 (the "Project). The Project includes construction of up to 1,600 units of new rental housing and 1.4 million square feet of new commercial and office space, as well as space for small-scale manufacturing, retail, and neighborhood services, waterfront parks, public infrastructure and the rehabilitation of historic Pier 48 ("Project").

At the June 13, 2017 Port Commission meeting, Port staff and the Developer provided an overview of the proposed Mission Rock Design Controls, the design standards and guidelines for the Project subject to future Port and Planning Commission approval. City staff will utilize the approved design standards to guide development of the Project.

On July 11, 2017, Port and Developer staff presented descriptions of three transaction documents that will guide development of the site and integration of the Project into the surrounding neighborhood and City: the Transportation Plan; the Infrastructure Plan; and the Sustainability Strategy. These plans were prepared in consultation with City staff from multiple departments in accordance with adopted City policies.

THIS PRINT COVERS CALENDAR ITEM NO. 11C

This staff report describes the financing framework between the City, acting through the Port, and Developer to guide development of the Project. Port and City staff is currently negotiating the financing plan ("Financing Plan") with the Developer that will be an exhibit to the Development and Disposition Agreement ("DDA"). The plan will outline options to finance the new neighborhood at Mission Rock, including new streets, parks and infrastructure, in accordance with adopted City policies and each Party's financial objectives.

STRATEGIC OBJECTIVES

Subject to Port Commission and Board of Supervisors approval, the Financing Plan will realize several objectives of the Port's 2016-2021 Strategic Plan including:

Livability – The Financing Plan will guide capital investment in a new neighborhood supporting affordable housing and public amenities such as parks, bicycle routes, and infrastructure specifically designed to complement and enhance the adjacent working maritime waterfront at Piers 48 and 50.

Stability – The Financing Plan will guide capital investment in Port assets that will improve projected financial performance without risking either the City's General Fund or the Port's Harbor Fund. Investments at Mission Rock will generate new ongoing funding streams for future Port facility renewals and enhancements.

Climate Change – The project includes initial improvements to protect the project from projected sea level rise and the Financing Plan will establish a "Shoreline tax" to fund capital investments to address the threats of sea level rise to the Port's shoreline.

OVERVIEW OF FINANCING PLAN MAJOR GOALS

The DDA between the Port and Developer will include a Financing Plan to establish the framework for financing new publicly-owned infrastructure, streets, and parks ("Horizontal Development") in the Project as well as significant new public benefits. The Financing Plan's primary goals include:

1. Construct horizontal improvements in coordination with vertical improvements to minimize financing costs;

2. Use public financing sources to maximize Port's land value, and reduce Project risk

3. Provide the Developer with an opportunity to achieve a market-rate return on its capital investment ("Developer Capital") in horizontal development costs;

4. Provide the Port with an opportunity, but not the obligation, to invest Port capital in the Project and, if the Port elects to do so, to achieve a market-rate return on its capital investments in horizontal development costs;

5. Meet or exceed affordable housing goals established by San Francisco voters;

6. Provide the Port with fair market value for the development parcels at Mission Rock consistent with Senate Bill 815 and repay the Port's investment in infrastructure with interest in compliance with Assembly Bill 2797;

7. Use lower cost debt to the extent available to reduce reliance on Developer Capital and the associated return

8. Provide a funding source for the Project's ongoing maintenance costs;

9. Provide a funding source to assist the Port in adapting to rising sea levels after full build-out of the Project; and

10. Implement sound and prudent municipal fiscal policies that protect the City's and Port's funding streams, respective financial standings, and fiduciary obligations.

SOURCES OF FUNDING FOR THE PROJECT

It will be costly to build the infrastructure to support a new neighborhood at Mission Rock. Due to other competing capital needs, neither the Port nor the City has the capacity in their respective 10-Year Capital Plans to finance these costs. Building on the City's practice in recent master-planned developments, the Financing Plan describes how the Developer will supply Developer Capital and be repaid from Project-generated sources to develop the new public infrastructure and provide public benefits to support the new neighborhood at Mission Rock.

Table 1: Primary Funding Sources Detailed in the Financing Plan

FUNDING SOURCE	DESCRIPTION
Community Facilities District ("CFD")	An area the City will establish in accordance with the City's CFD ordinance within which special taxes are levied to fund capital improvements and provide services
Infrastructure Financing District ("IFD")	An area the City will establish in accordance with state IFD law that permits the City to capture growth in City property tax revenue ("tax increment") to pay for public improvements and historic rehabilitation
Developer Capital	Funds advanced to the Project by the Developer (18% annual return)
Port Capital	Funds advanced to the Project by the Port from the Harbor Fund (10% annual return)
Land Proceeds	Revenues generated from the lease of Port land

The Project relies on Developer equity that may only be paid back from Project revenues, thus protecting the City's General Fund and the Port Harbor Fund. Because the Developer's capital is at the greatest risk and Developer is obligated to fund all horizontal improvements if no other sources are available, Developer Capital will earn a market rate, risk-adjusted return of 18 percent annually ("Developer Return").[1]

MAJOR GOAL DETAILS

The details of each Financing Plan goal are provided below.

1. Construct Horizontal Improvements in Coordination with Vertical Development – The Financing Plan will guide the flow and distribution of funds for the construction of an estimated $187 million in horizontal improvements over four phases. The horizontal development must be closely coordinated with vertical development to minimize the financing cost of horizontal development and maximize the flow of revenues from the Project.

2. Use Public Financing Sources When Possible – Because annual ground rent increases after the Developer's investment/equity has been re-paid (and Developer shares in annual ground rent on a tiered, threshold basis), it is in both Parties' interests to limit the amount of private equity by substituting lower-cost public financing sources when feasible. As further described below, these public financing sources include infrastructure financing district ("IFD") and community facilities district ("CFD") bond proceeds and ongoing tax revenues. Both of these sources are designed to protect the City's General Fund and the Port's Harbor Fund. In the event that there is a failure to pay debt service on bonds issued to finance the Project using these public financing sources, bondholders will have recourse to a leasehold interest in land or public financing revenues from the Project, but no recourse to the General Fund or the Harbor Fund.

The primary public financing sources utilized within the Financing Plan include:

- **Mello-Roos Special Taxes and Bond Proceeds.** The state Mello-Roos Act authorizes a form of financing that can be used by cities, counties, and special districts in California by establishing CFDs. If approved by 2/3 of land owners in a CFD without registered voters (in this case, the Port), special taxes may be levied to fund capital improvements and/or provide services. The City has adopted a local CFD ordinance largely mirroring the Mello-Roos Act but providing for flexibility to address local concerns.

  Mello Roos bonds are an attractive credit in the municipal debt market because the bonds are secured by both a pledge of special taxes and by a lien against the

[1] Port staff and consultants researched market rate returns for risk capital in master planned projects of this type, both in San Francisco and outside of San Francisco and determined that an 18% is a market rate return.

property that is taxed in the district. In this case, the lien will be against the leasehold interest, not the Port's fee interest.

If the Port Commission and the Board of Supervisors approve the DDA, including the Financing Plan, the City will concurrently[2] establish one or more CFDs over the Project site and approve related documents setting the rates and methods for levying special taxes. Under a proposed MOU regarding the allocation of taxes ("Tax Allocation MOU"), the City would levy special taxes and allocate the revenue to development of infrastructure and other public facilities. Under the proposed Financing Plan, the Port may ask the City to issue Mello-Roos bonds that will be secured and payable by a pledge of special taxes as well as IFD tax increment generated from the Project Site, enabling the Project to capture special taxes in advance of completion of the vertical development. This approach will allow bonds to be sold early in each phase of the Project as agreed under a phase budget and significantly reduce the need for Developer equity, in turn reducing the overall cost of the project and increasing revenue share returns between the Developer and the Port.

- **Project Tax Increment.** State law authorizes the City to form an IFD over Mission Rock to pay for public improvements and historic rehabilitation funded by the City's share of property tax revenue growth ("tax increment"). In 2016, the Board of Supervisors formed an IFD project area covering all Port property and approved a portwide infrastructure financing plan ("IFP"). At the same time, the Board of Supervisors approved a sub-project area within the Pier 70 project area for the Orton Development Inc. leasehold, the first Port IFD. If the Port Commission and the Board of Supervisors approve the DDA and Financing Plan, the City will concurrently establish a new sub-project area in the Seawall Lot 337 project area and approve a Project-specific appendix to the IFP. Under the proposed Tax Allocation MOU, the City would allocate the City's share of tax increment to finance public improvements at the Project.

  Under a typical Mello Roos financing approach, property owners pay both underlying property taxes and special taxes. These additive special taxes decrease land value by increasing the carrying cost of the land.

  Under the Financing Plan, Port and City staff and the Developer have developed a proposed approach that combines the benefits of Mello Roos bonds (attractive, secure credit), but largely avoids the negative impacts on land value of an additive special tax.

[2] References to City agreements for the Project Site in this staff report are conceptual and conditioned on the City's completion of review of the environmental impacts of proposed development at the Project Site, certification of a final environmental impact report, and adoption of special findings and a mitigation, monitoring, and reporting program.

Under this approach, the Port would use IFD tax increment revenue from improved property values at the Project (in lieu of special taxes) to pay debt service on Mello-Roos bonds issued to fund horizontal improvements. Using tax increment to service debt on Mello-Roos bonds would lower the rates at which special taxes would be levied and mitigate the negative impact that special taxes otherwise would have on Port land values.

<u>3. Provide Developer with the Opportunity to Achieve a Market-Rate Return for Developer Investments on Horizontal Development and Entitlement Costs</u> – The Developer has used and will use Developer Capital to pay for costs related to project approval, entitlement and horizontal development. Under the Financing Plan, Developer Capital will generally not be used when land proceeds, public financing sources, and Port capital are available to ensure the lowest cost of capital. Under the DDA, the Developer is entitled to a market-rate return on its investments of equity equal to the greater of: (1)18 percent return and (2) 1.5 multiple on equity (e.g., invest $100, get back $150). The Developer achieves this by bringing forward a phase with revenue projected to both provide the 18 percent return and meet the agreed-upon Project Reserve Rent (annual ground rent) to the Port. The Port's obligation to provide the Developer's 18 percent return on costs is limited to financing sources the Project generates, including the lease of parcels improved by the Developer.

<u>4. Provide the Port with the Opportunity to Achieve a Market-Rate Return for Port Capital Investments on Horizontal Development Costs</u> – The Port Commission has the right (but not the obligation) at its sole discretion to invest Port Capital in the Project, and improve Project performance by substituting lower cost money for higher cost money. Port investment will earn a 10 percent return. These funds may be used to pay any outstanding Developer balance or to directly invest in horizontal improvements. Under the Financing Plan, the Port could commit to capital advances to fund specific horizontal improvements for a project phase through Port Commission approval of a phase budget.

<u>5. Meet Affordable Housing Goals Established By San Francisco Voters</u> – The Project is proposed to include 40% inclusionary affordable housing. The Financing Plan supports the Developer's Affordable Housing Plan, which outlines how the Developer intends to meet its obligations to:

- Provide affordable housing in amounts and at the income levels described below:
  2% @ at 45% of the Average Median Income ("AMI")
  10% @ at 55% AMI
  4% @ at 90% AMI
  17% @ at 120% AMI
  7% @ at 150% AMI

- Deliver affordable housing in each residential parcels in every phase of the Project;

- Pay project-specific jobs-housing linkage impact fees, which will be allocated to subsidize and implement the Affordable Housing Plan, in lieu of fees under the Jobs/Housing Linkage Program.

6. Provide the Port with Fair Market Values on Parcels and Repay Port's Investment in Infrastructure. – The DDA will require that the Port receive fair market value for the long term leasing of its property. The Project provides significant financial benefits to the Port by creating new ongoing revenue streams to support future operations and capital investments. The Port maximizes these benefits by capturing fair market value on all parcels in compliance with SB 815 and AB2797.[3] The DDA and its Financing Plan articulate the process for acquiring horizontal improvements from the Developer that ensures that horizontal development costs will be commercially reasonable and represent a fair market price for the horizontal improvements.

7. Use Tax-Exempt Debt to The Extent Reasonably Feasible – Tax-exempt debt reduces the costs of the Project by exempting the bondholders' interest income from federal, state, and local taxes. Reducing the cost of debt benefits the Port and the Developer by creating higher land proceeds for revenue-sharing between parties. The Port will work with bond counsel to secure tax-exempt debt when reasonably feasible.

8. Provide a Funding Source for Ongoing Maintenance Costs – If Port Commission and the Board of Supervisors approve the DDA and its Financing Plan, the Project would establish a CFD to levy special taxes in perpetuity to fund ongoing maintenance of public facilities within the CFD. The special tax would cover expenses ranging from the maintenance and repair of streets and parks to security and janitorial services. Port staff and the Developer will establish maintenance expense assumptions to document the basis for establishing special tax rates to be levied on contributing parcels.

9. Provide a Mechanism to Adapt to Rising Sea Levels – The Project itself will be constructed to accommodate an estimated 66 inches of sea level rise. In addition, the CFD formation documents will establish a special tax that would be levied on new development at Mission Rock to finance shoreline improvements ("Shoreline Special Tax"). Initially, all of the Shoreline Special Taxes from Phase 1 will be reinvested in the Project for site improvements to protect the Project site from sea level rise.

In addition to the improvements outlined in the Infrastructure Plan which will raise the central portion of the Project, the Shoreline Special Tax will help the Port address sea level rise impacts along the entire extent of its 7½ miles of waterfront in coming decades.

10. Implement Sound and Prudent Municipal Fiscal Policies – The Financing Plan will protect the City's and Port's funding streams, respective financial standings, and fiduciary obligations as described below.

[3] State legislation applicable to Seawall Lot 337 authorizing non-trust uses to generate higher land value to be used for specific trust purposes.

- **Limitation on Sources. The** Developer bears the risk of loss if the Project does not perform as well as projected. The Financing Plan will explicitly limit access to City and Port funds and requires Developer to acknowledge that the City's General Fund and the Port Harbor Fund are not Project sources. The Port's financial commitment in terms of repayment to the Developer is limited to: Land Proceeds from the project, Port Capital committed to the project in a phase budget, and a potential loan to the project from a portion of Lot A parking lot lease revenues, only available in a case where revenues from Phase 1 are insufficient to support Phase 1 costs (described further below, in "Budget Controls").

- **Special Fund Accounts & Trustee.** Except for Port land proceeds disbursed from escrow, each public source of funds identified in the Financing Plan will be placed in a unique account held by a corporate or indenture trustee who will be responsible for holding, administering and disbursing each source. The Port will enter into a trust administration agreement with the special fund trustee and a bond indenture agreement with each bond trustee (usually a qualified bank) to manage the flow of funds between accounts and distributed to parties, ensuring that funds are managed in accordance with the Financing Plan.

- **Budget Controls**. The Financing Plan will require all horizontal development costs to be commercially reasonable. The Developer will establish commercial reasonableness by entering into guaranteed maximum price contracts secured by competitive bidding or subjected to cost validation. Before the Developer is authorized to begin construction in any phase, the Port Commission will review the proposed phase budget for consistency with documents previously approved by the Port such as the Design Controls, Infrastructure Plan, and Master Utility Plans among others. This will include the construction cost estimates associated with the level of detail in the phase submittal, the anticipated dates on which the Developer will incur horizontal development costs, the projected amount and timing of any public financing sources, and Port staff's recommendation on any Port capital advance. During construction, the Developer will submit quarterly spending reports to Port staff, which will have the right to review change orders requiring major cost increases consistent with processes outlined in the DDA.

  Due to its high costs, the Parties have negotiated additional controls specifically for Phase 1. These include:
    - Reduction of return on all project costs from 20 percent to 18 percent, in exchange for participation in rent in project future revenue stream;
    - Stopping return on Developer's entitlement costs through assignment of a portion of Lot A lease revenues (equal to concept of Lead Parcel transfer in the Term Sheet);
    - Port's ability to delay Phase 1 approval until Developer has all leases in the phase valued and reasonably assured;
    - If, during Phase 1, costs increase due to unforeseen conditions and revenues in the Phase are insufficient to repay Developer equity and

return, annual 18 percent return reduces significantly to avoid “drowning” subsequent phases in compounding Developer return.

- **Payment Controls**. The Acquisition Agreement (an exhibit to the Financing Plan) provides specific provisions for Port review of all documents supporting each payment request. In addition, a Port consultant specializing in public finance (usually a certified public accounting firm or engineering firm with public finance expertise) will conduct an audit-level review of the Developer’s payment requests before land proceeds are disbursed from escrow, an indenture trustee disburses bond proceeds, or the special fund trustee disburses public financing sources to satisfy a Port-approved payment request.

OTHER CONSIDERATIONS

District Parking – City and Port staff and the Developer continue to negotiate the approach to financing a parking garage on Parcel D1. The Financing Plan will describe provisions related to financing a garage.

NEXT STEPS & ANTICIPATED PROJECT SCHEDULE

Port staff recommends the following schedule of Port Commission informational hearings leading up to Port Commission consideration of the Mission Rock transaction documents.

September 26, 2017	Presentation regarding Staff Analysis of the Mission Rock Project transaction and related matters
October 5, 2017	San Francisco Planning Commission, certification of the Seawall Lot 337 and Pier 48 Mixed-Use District Project Final EIR and consideration of proposed CEQA findings, a Mitigation, Monitoring, and Reporting Program, recommendations regarding General Plan and Planning Code amendments and related matters
October 10, 2017	San Francisco Port Commission consideration of proposed CEQA findings, a Mitigation, Monitoring, and Reporting Program, and approval of the Mission Rock Project transaction documents and related matters
Nov/Dec 2017	Board of Supervisors consideration of proposed CEQA findings, General Plan and Planning Code Amendments for the Mission Rock Project transaction documents and related matters

Port staff welcomes and appreciates comments, input and feedback from the Port Commission and the public.

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