CITY OF OAKLAND
AGENCY AGENDA REPORT

OFFICE OF THE CITY CLERK

2005 DEC -1 PM 7:28

TO: Office of the Agency Administrator
ATTN: Deborah Edgerly, Agency Administrator
FROM: Community and Economic Development Agency
DATE: December 13, 2005

RE: A REPORT FOR DISCUSSION AND DIRECTION REGARDING AUTHORIZING A GRANT MACARTHUR PARK DEVELOPMENT ASSOCIATES, LLC, TO COVER ADDITIONAL COSTS FOR THE DEVELOPMENT OF THE PALM VILLAS PROJECT ON MACARTHUR BOULEVARD BETWEEN 90TH AND 94TH AVENUES

SUMMARY

A request for a $1,400,000 closeout subsidy for the Palm Villas Housing Development Project was heard at the July 12, 2005 Community and Economic Development Committee meeting. At this meeting staff was directed to bring back a report to the Committee with the following:

1. Provide the number of requests for assistance the developer has made to the City Council
2. Provide an analysis of project costs and delays
3. Conduct an audit of the development expenditures
4. Provide a fund source analysis
5. Make recommendation for City Council consideration

FISCAL IMPACT

The City's HOME funds can not be used for this grant because of the income restrictions tied to these funds. Nor can the Agency's Low and Moderate Income Housing Funds be used for this grant, as it would require retroactively imposing additional affordability restrictions on homes that have already been sold. There are only two sources of funds that would be suitable: non-housing redevelopment tax increment funds from the Central District or Central City East District or land sale proceeds from Oak Knoll.

It is proposed that up to $1,230,000 be allocated from future Oak Knoll land sale proceeds to fully fund this grant. Because the Oak Knoll close of escrow will not occur for another six months to a year, land sale proceeds will not be available until that time. Therefore, temporary funding will need to come from Central City East affordable housing fund (voluntary five percent) and Central District ending fund balance. The resolution authorizes an appropriation of up to $1,230,000 from the Oak Knoll Operations Fund (9546) to provide the permanent funding for the grant.

Beginning in 2001, the Agency voluntarily increased its contribution to the Low and Moderate Income Housing Fund from the 20 percent required by State law to 25 percent. The voluntary five percent additional contribution can be withdrawn from the Low and Moderate Income Housing Fund and returned to regular redevelopment funds in the Central City East Project Area. It is proposed that $808,185 be transferred out of the Central City East Project Area's voluntary five percent contribution to the housing fund. This includes a surplus of $313,483 in Central City East

Project Area's voluntary five percent contribution that exceeded the FY 04-05 budgeted amount for the voluntary five percent contribution. This surplus will need to be appropriated before it can be expended. The $808,185 would be transferred out from the Low and Moderate Income Housing Fund (9580), Housing Development Organization (88929), Housing Development Program Project (P209310), Central City East Program (SC18) to the Central City East Operations Fund (9540). Because these funds have not been budgeted to specific affordable housing projects or programs pending review and recommendations by the Central City East Project Area Committee (PAC), this transfer will not impact the Agency's ability to meet any of its current affordable housing goals.

A recommendation from the Central City East PAC was not available at the time this report was prepared. The PAC will consider this item at its December 5, 2005 meeting and a recommendation will be provided in an oral report.

Because the land sale proceeds will not be available for 6 to 12 months, it is recommended that, if additional funding is provided, the Agency temporarily provide the balance of the grant amount, or $421,815, from the Central District ending fund balance (9510). Once the sale of the Agency's Oak Knoll property is completed, the Central District ending fund balance (9510) would be fully reimbursed and the Central City East Operating Fund (9540) would be reimbursed to the extent that sufficient funding is available from the land sale proceeds. The amount paid back to the Central District would be in addition to the $2,000,000 already advanced from the Central District Operating Fund for the Oak Knoll settlement regarding the homeless.

BACKGROUND

The Agency committed $6,084,000 to Oakland Community Housing, Inc (OCHI) for predevelopment, site acquisition, demolition and gap financing to develop an affordable housing project at the site located at Macarthur Boulevard between 90th and 94th Avenue. OCHI expended $2,831,000 to acquire the site, demolish existing buildings and entitle the land from 1992 - 1997.

Because of uncertainty regarding additional funds needed by OCHI to complete the project, the Agency requested proposals from OCHI and other developers. The MacArthur Park Development Associates LLC (MPDA) proposal was one of four proposals considered for the development of this project. MPDA's proposal was selected in an effort to build local capacity and because of their assurance that they could complete a 78 unit affordable housing project on the site for the remaining balance of $3,253,596 in unspent funds. MPDA is a joint-venture between Em Johnson Interest, Inc. and Baines & Robertson Development, LLC (BRD). This was the first project for this partnership. The general contractor, Baines & Robertson, Inc. (BRI), is an affiliate of Baines & Robertson Development, LLC. The principals of BRI are the same as for BRD.

KEY ISSUES AND IMPACTS

The $1.4 million request is the fourth time this project has come back to the Agency requesting loan term modifications and/or additional subsidy. Project costs have escalated from $14.5 million to $23.8 million over the last five years. The Agency has provided the land, a $2.8 million value, three additional grants in the amount of $5.35 million, and relinquished the requirement that 25% of the excess sale proceeds derived from homes selling above $160,000 be converted into silent second mortgages to the homebuyers (with the Agency as the beneficiary). The additional $1.4 million request would bring the Agency's assistance to $9.55 million or 40% of the total project cost. If the #1 alternative recommendation is directed by the Council for $1.23 million of additional funding, this would bring the Agency's assistance to $9.03 million or 37.9% of the total project cost.

The developer's original proposal contemplated a two phase project and a 21 month construction period. The developer's sources of funds were to come from a $3.25 million Agency loan, a $10.6 million Bank of America (B of A) loan and an unsecured, third party developer loan in the amount of $300,000 (developer's equity). Since the project's commencement (August 2000), there have been over 125 change orders and 11 loan modifications due to cost overruns, loan financing and timely completion of the 78 homes. The cost overruns are due to a number of factors including under-estimated project costs, subcontractor performance, available developer capital and weather.

The amount of capital available to the developer was also a major factor in project delays. The developer's capital was tied to progress performance and completion of units. The developer experienced significant cost overruns within six months of construction. With very little developer equity, contingency funds were quickly exhausted. As project costs increased, the developer had few resources to assign to the completion of the project.

A. Project Analysis and Chronology

On July 13, 1999 the Agency approved site transfer and a reservation of development funds in the amount of $3,253,000, contingent on MPDA successfully securing commitments for full project funding. Bank of America (B of A) agreed to provide a $10,600,000 construction loan, but only under very conservative terms.

On November 8, 1999 the Agency and MPDA executed an agreement for a $3,253,000 forgivable loan with no interest. Upon the initial sale of each unit to an eligible home buyer, a portion of the loan, represented by the difference between the construction cost of the project unit and $160,000, was to be converted to a grant and forgiven. If the average sale price for the project units exceeded $160,000, 25% of the excess sale proceeds were to be converted into silent second mortgages to the homebuyers (with the Agency as the beneficiary) to increase participation of lower income households. Any surplus was to be developer profit.

The Agency's loan was to be utilized for site work. B of A's loan was to be utilized to construct the homes. B of A required that the project consist of three phases and the release of their funds was tied to completed homes and sale proceeds. The developer's equity was to bridge the gap between the Agency's loan and the B of A loan.

The developer was not able to secure a bond for the home construction portion of the project. In an effort to build local capacity, the Agency agreed to only require a performance and completion bond from the developer on the site work portion of the project and in turn, the developer would require their subcontractors to obtain the necessary bonds for the work they were to complete in constructing the 78 homes. However, as the developer received bids to complete the various stages of construction, several low bidders were not able to obtain the required bonds. In order to keep the project on budget and to provide local contractors with an opportunity to participate in this project, an exception was made to the bonding requirement and the project was authorized to proceed.

Construction commenced in August 2000 and within six months of site work, the developer experienced cost overruns due to unanticipated site conditions and sewer work. This necessitated the first of nine loan modifications with Bank of America to provide funds to complete the site work. As construction commenced with the building of the actual homes, two of the developer's primary subcontractors, the framer and concrete contractors went bankrupt. The developer received new bids to complete the work at significantly greater costs than budgeted. At this point, the developer determined self-performing the framing and concrete work would keep the project on budget.

By April 2002, the developer had completed 26 of the 78 homes and was experiencing severe cash flow problems due to cost overruns, weather delays and the replacement of subcontractors. MPDA had already expended the Agency's $3.25 million loan and $6.6 million of its $10.6 million Bank of America loan on site work and development of the first 26 homes. Bank of America was unwilling to release any additional construction funds without further financial assurances that the project could be completed. It was at this time that the developer requested the initial Agency loan of $3,253,000 be forgiven and an additional $1 million loan be provided by the Agency to complete the project.

Without the protection of performance and completion bonds, the Agency was faced with two alternatives: bring in another developer at a higher cost to complete the project, or allow B of A to foreclose on the property and sell the remaining units at market value, thus eliminating the affordability restrictions on the remaining 52 of the 78 homes still in construction. Based on the developer's proforma and other assurances made, staff recommended the $1 million in assistance to complete the project be approved by the Agency. The Agency provided a $1 million bridge loan that was to be repaid from sale proceeds.

By April 2003, the developer had completed 49 of the 78 homes and continued to experience cash flow problems. The developer requested that the $1 million bridge loan be forgiven so that the sale proceeds could be used to complete the project. The Agency approved the request.

By March 2004, the developer had completed 62 of the 78 homes and ran out of money and nearly shut down the project. The developer requested an additional $1.1 million grant from the Agency to complete the project. The Agency met with the developer and bankers to discuss this proposal. As part of the developer's proposal, the remaining balance of the developer's construction loan with B of A was paid off and a new loan with Silicon Valley Bank (SVB) was secured. The

Agency conditioned the release of any additional assistance on the completion of 12 of the remaining 16 units. A revised budget of $22,192,000 was submitted by the developer which contemplated a $1.1 million grant from the Agency to complete the project. The Agency, SVB and developer agreed that the revised budget would provide the necessary funds to complete the project. The Agency approved this request in April 2004.

By February 2005, the last of the 78 homes was completed and sold to a buyer. In May 2005, the Agency received a request for an additional $1.4 million grant to pay for outstanding costs associated with the project. The remaining unpaid costs include amounts due the Carpenter's Union (Local 713), the IRS, local sub-contractors, and local suppliers. See Attachment A for a partial list of the sub-contractors and suppliers on this project.

It is not clear when the $1.4 million in additional costs occurred on this project. There were 125 change orders due to cost overruns. Additionally, there were a total of eleven loan modifications between the two lenders. These change orders and loan modifications occurred throughout the project and, as a result, contributed to the significant short fall in funds from those originally budgeted.

B. Audit

At the July 12, 2005 Community & Economic Development Committee Meeting, staff was directed to conduct an audit of the project and bring back a report on costs and expenditures. Community and Economic Development Agency staff worked with the City Auditor's office to examine costs associated with the project. The Auditor was asked to look at a number of project costs that created some of the most significant budget increases in expenditures including, but not limited to, retaining walls, general requirements, supervision, and Baines & Robertson, Inc. (BRI) overhead, as submitted by the developer on May 2005. Housing staff held several meetings with Auditor staff to discuss the Auditor's findings. The final Auditor's report was not available at the time this report was prepared.

The chart below displays some of the larger cost increases from the developer's cost certification submitted May 2005:

Uses	Original Budget	Costs per Audit
Hard Costs BRI Overhead	$109,230	$379,855
Super Structure BRI Overhead	$430,284	$1,366,486
Hard Cost General Requirements	$68,800	$150,915
Super Structure General Requirements	$267,200	$807,014
Hard Costs Supervision	$93,600	$75,287
Super Structure Supervision	$374,400	$697,044
Hard Cost Retaining Walls	$236,787	$2,048,084

The Auditor's office tested a number of the expenditures in these categories and others and determined that the costs presented in the third party cost certification were expended on the Palm Villas project.

The general contractor, BRI, had other projects under construction while completing the Palm Villas project from September 2000 through February 2005. Housing and Auditor staff looked closely at how contractor overhead was applied to these projects. BRI chose to assign contractor overhead to the different projects based on project revenue. Auditor staff indicated this is an acceptable accounting practice. To that end, approximately 80% of BRI's overhead for the past four plus years has been charged to the Palm Villas Project.

Housing staff looked at a number of costs associated with the overhead and general conditions charges by the general contractor and concluded that several items should be excluded from the $1.4 million consideration: the difference between luxury auto expenses and standard automobile expenses, a vacation timeshare owned by BRI and three months of the contractor's on-site general staffing costs in 2004, during which work completed on the project was negligible. Staff estimates these costs at $169,320.

The total variance in project costs from the budget approved on April 2004 is a negative $1,723,574. The developer, MPDA, does not have any assets to pay outstanding costs. The general contractor, BRI, does not have any assets to pay outstanding costs. As of July 31, 2005, BRI had a <u>negative</u> net worth of $1,377,748. In addition, there is currently $259,433 in mechanics liens recorded against the properties. Neither staff nor BRI have been able to verify whether these liens are valid or whether settlements will result from current lawsuits regarding these liens. To assure that no valid liens remain against the project, or against the individual units, grant payments will be made directly to lien holders to ensure all valid liens are paid off and lien releases are recorded. Staff recommends that any additional grant authorized to cover liens be made available to cover only valid liens or settlements (Verification of the final amount was not available at the time this report was prepared. Staff will provide an update as part of its oral report).

<u>C. Fund Source Analysis</u>

MacArthur Park Development Associates has requested $1.4 million to pay for costs associated with completion of the entire 78 unit project. The Palm Villas project allows for homes to be sold to families earning up to 120% of area medium income (AMI). Federal HOME funds can only assist families earning less than 80% of AMI. Additionally, 64 of the 78 homes have 15 year affordability terms (the required affordability term before 2002 under California redevelopment law) and the remaining 14 homes have 45 year affordability terms (the required term after 2002). To use Low and Moderate Income Housing Set Aside Funds for this grant, the developer would have to record 45-year affordability restrictions on all 78 homes. It would be impossible to get the homeowners with 15-year affordability requirements to agree to new 45-year affordability requirements. Therefore, use of Low and Moderate Income Housing Set-Aside funds is ruled out.

As stated in the fiscal impact section of the report, neither the City nor the Agency has funds in its affordable housing budget for this grant request. The two sources of funds identified as viable sources are non-housing redevelopment funds from the Central City East and Central District Project Areas and land sale proceeds from Oak Knoll. Although these are viable sources, there are a few problems with using Central City East and Central District tax increment funds and the Oak Knoll land sale funds.

There are insufficient tax increment funds available in the Central City East Project Area or any other project area, with the exception of the Central District Project Area, to permanently fund the requested grant amount. Additionally, while Oak Knoll land sale proceeds is a viable source for this grant, the sale of the property is not anticipated to be completed for another six months to a year. Therefore, interim funding is needed.

If the Agency approves additional funding staff recommends the additional funding be allocated from future Oak Knoll land sale proceeds to fully fund this grant. However, because the land sale proceeds will not be available for six to 12 months, staff recommends that a portion be allocated from the Central City East Project Area voluntary 5% contribution to the Low and Moderate Income Housing Fund, equal to the amount available and the balance be allocated from the Central District ending fund balance.

When the sale of the Agency's Oak Knoll property is complete, land sale proceeds will be used to fully reimburse the Central District ending fund balance and the Central City East Operating Fund. The amount paid back to the Central District would be in addition to the $2,000,000 already advanced for the Oak Knoll settlement regarding the homeless.

The majority of funds identified come from the Central City East Project Area because Palm Villas is located in the Central City East Project Area and this use would not impact the various Central City East non-housing projects currently planned and underway. Oak Knoll land proceeds were identified as a permanent source to reimburse the temporary funding sources and will not affect Central City East affordable housing implementation.

SUSTAINABLE OPPORTUNITIES

There are no new sustainable opportunities as a result of additional funding. All environmental opportunities regarding this project were discussed in the agenda report for Resolution No. 99-36 C.M.S. which was approved in July 1999. Throughout the development of this project, now completed, the contractor has hired local construction workers and laborers and worked with the union. The project has served as a catalyst for redevelopment in the area and provided 78 ownership units affordable to moderate income households.

DISABILITY AND SENIOR CITIZEN ACCESS

There are no new issues regarding disability and senior citizen access as a result of additional funding. The issues regarding disability and senior access were discussed in the agenda report for Resolution No. 99-36 C.M.S.

ALTERNATIVE RECOMMENDATION(S)

There are five alternative recommendations for consideration and direction:

1) The first alternative is approving an additional grant not to exceed $1,230,000, to MacArthur Park Development Associates, LLC to cover additional costs for the Palm Villas Homeownership Development. As discussed in the Audit section of the report, housing staff reviewed a number of costs associated with the overhead and general conditions charges by the developer and concluded several items should be excluded from the $1.4 million consideration: The difference between luxury auto expenses and standard automobile expenses, a vacation timeshare owned by BRI and three months of the general contractor's on-site general staffing costs in 2004 (when a minimal amount of work was completed on the project). Staff estimates these costs at $169,320.

   As stated above, the total variance in project costs from the budget approved on April 2004 is a negative $1,723,574. The developer does not have any assets to pay outstanding costs. BRI does not have any assets to pay outstanding costs. As of July 31, 2005, BRI has a <u>negative</u> net worth of $1,377,748. The general contractor, BRI, has indicated that if this request isn't substantially funded, it could result in bankruptcy for BRI because of the contractual obligations and guarantees that remain largely within this company and its two principals.

   The developer, MPDA, was selected, in part, to build local capacity and to provide local contractors participation in a publicly assisted project. On prior occasions, the Agency approved additional assistance and loan term modifications. The project is substantially complete. A number of local businesses and the Carpenter's Union (Local 713) will suffer significant hardship if the funds are not provided.

   The project has made a significant and positive impact to ongoing revitalization efforts underway within this community.

2) The Agency could provide the full amount of MPDA's request, $1,400,000, as a closeout subsidy for the project. If this alternative is approved, the resolution would need to be revised to increase the total amount to $1,400,000 and the portion that is temporarily coming from the Central District Operating Fund increased to an amount not to exceed $591,815. The permanent funding for this option would also be provided from Oak Knoll land sale proceeds as described above.

3) There are currently $259,433 in recorded liens against the properties which are many months past due. Lawsuits having been filed to foreclose on some of the liens. It is not clear at this time how many of these liens are valid. The Agency could provide funding, in an amount not to exceed $259,433, to pay off valid liens so current homeowners are not negatively impacted. Payment of these liens or settlements from the lawsuits would be contingent on staff's verification of the liens' validity. The funding for this option would be provided from Oak Knoll land sale proceeds.

4) The Agency could opt to fund the grant using $808,185 from Central City East's 5% voluntary contribution to the affordable housing funds and the balance from the Central District ending fund balance as permanent sources. Under this scenario, the Oak Knoll land sale proceeds would be available for other redevelopment activities.

5) The Agency could direct that no additional funding be provided.

ACTION REQUESTED OF THE REDEVELOPMENT AGENCY

Provide direction on additional funding. If necessary, a supplemental report will be prepared for the City Council with the appropriate resolution based on direction received.

Respectfully submitted,

DANIEL VANDERPRIEM
Director of Redevelopment, Economic Development and Housing

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APPROVED AND FORWARDED TO THE
COMMUNITY AND ECONOMIC DEVELOPMENT COMMITTEE:

OFFICE OF THE AGENCY ADMINISTRATOR