The
Long Beach Housing Development Company

M E M O R A N D U M

DATE: September 15, 2010

TO: Board of Directors
The Long Beach Housing Development Company

FROM: Ellie Tolentino, Vice President

PREPARED BY: Meggan Sorensen, Development Project Manager

SUBJECT: **Loan Agreement with Lyon Capital Ventures, LLC for the Redevelopment of City Hall East (CD 2)**

RECOMMENDATIONS

1) Approve a loan of up to $1,841,000 to Lyon Capital Ventures, LLC to provide gap financing for the redevelopment of an office building located at 100 Long Beach Boulevard into a 99-unit residential rental project that includes ten units restricted for low-income households;

2) Authorize the President or designee to negotiate and enter into a Loan Agreement with Lyon Capital Ventures, LLC; and

3) Authorize the President or designee to execute any and all documents necessary to implement the Loan Agreement.

BACKGROUND

The City of Long Beach acquired the property located at 100 Long Beach Boulevard, known as City Hall East (CHE), from Southern California Edison in June 2000. The site consists of a ten-story, 149,160 square foot office building with a 149-space parking structure (Site Map). The building was originally constructed in 1959 and is within the Downtown Redevelopment Project Area. In 2002, the first three floors of the building were renovated and occupied by the Long Beach Police Department as a temporary replacement facility while the City's existing Public Safety Building was being renovated. Since completion of the Public Safety Building improvements in June 2005, CHE has been vacant and the City intends to declare it as surplus property.

MAKING AFFORDABLE HOUSING HAPPEN

AGENDA ITEM NO. 2

Mailing Address:
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After two rounds of Requests for Proposals (RFP) and several unsolicited offers to purchase CHE, Lyon Capital Ventures, LLC (Lyon) has made the highest and best use offer to purchase the property in accordance with the requirements of the latest RFP. Lyon proposes to redevelop the existing office building into 99 one-bedroom apartment units and 10,000 square feet of ground floor retail space. Lyon has agreed to pay $4,000,000 for the property, comprised of $2,650,000 cash at closing plus a $1,350,000 loan from the City. Lyon has also proposed to restrict ten of the units to low-income households subject to receiving a $1,841,000 loan from The Long Beach Housing Development Company (LBHDC). Note however that the terms and conditions of the proposed sale are not contingent upon either the LBHDC agreement to provide financial assistance or Lyon's provision of ten low-income units.

AFFORDABILITY GAP

Staff requested that Keyser Marston Associates, Inc. (KMA) review the request from Lyon for financial assistance to restrict ten residential units to low-income households. KMA assumed that Lyon's pro forma is reasonable due to the previous review and approval by the City. Therefore, to estimate the financial impact to the project as a result of the restricted units, KMA estimated the loss of supportable private investment based on the estimated net operating income for the 10% low-income scenario versus the 100% market rate scenario. The analysis resulted in an affordability gap of $1,903,300. Hence, Lyon's request for $1,841,000, or $184,100 per affordable unit, is determined to be reasonable. The KMA analysis is attached as Attachment B for further detail.

CONCLUSION

Staff recommends approval of a loan of up to $1,841,000 in exchange for a 55-year covenant on the ten low-income units. No funds will be disbursed until after the close of escrow for the property.

Attachments:
- A – Site Map
- B – September 9, 2010 KMA Analysis

ET:PU:MS

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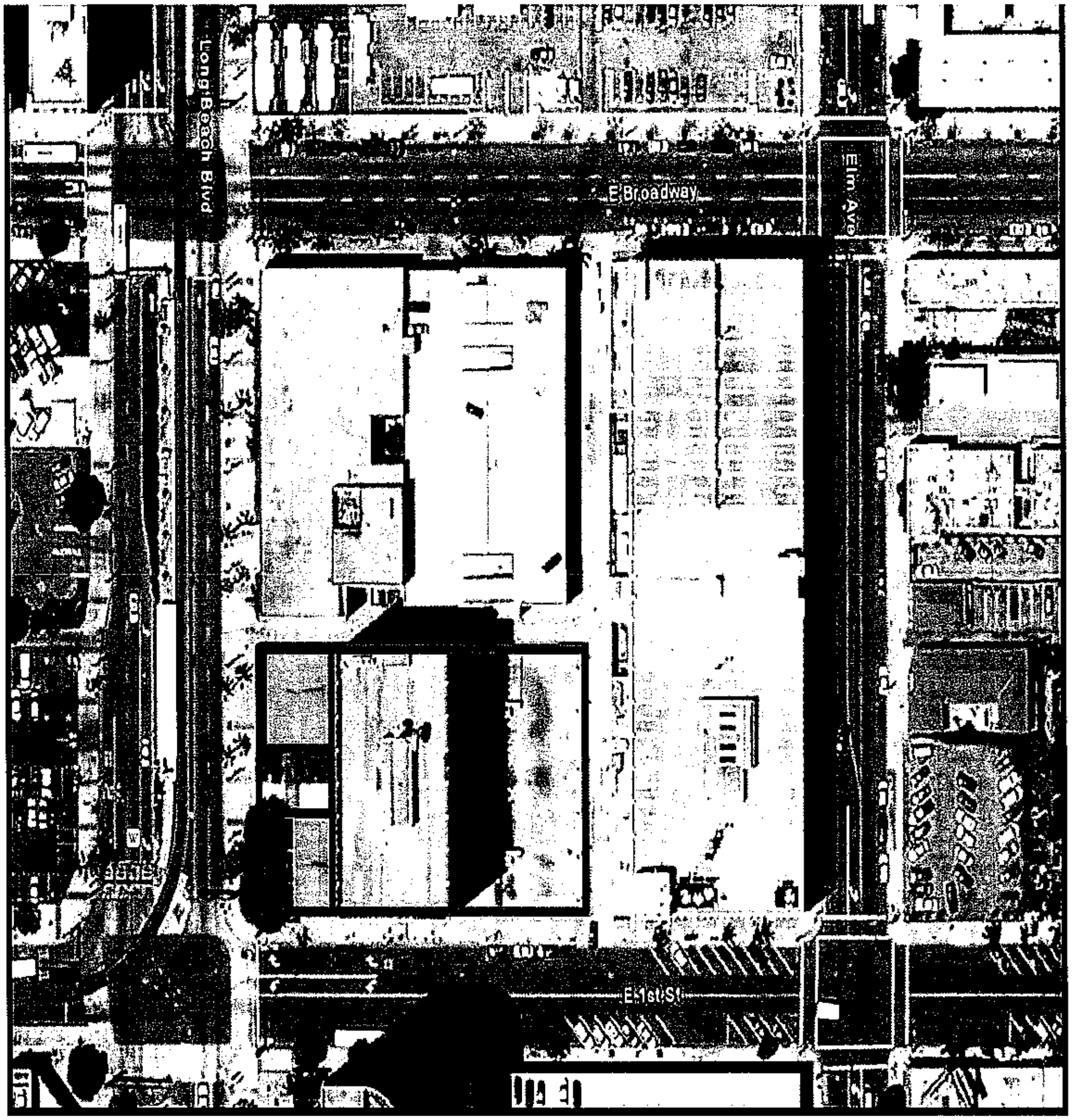
Attachment A

City Hall East
100 Long Beach Blvd
Site Map



KEYSER MARSTON ASSOCIATES.
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

MEMORANDUM

ADVISORS IN:
REAL ESTATE
REDEVELOPMENT
AFFORDABLE HOUSING
ECONOMIC DEVELOPMENT

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To: Ellie Tolentino, Housing Services Bureau Manager
City of Long Beach

From: Julie Romey

Date: September 9, 2010

Subject: City Hall East – Affordability Gap Analysis

At your request, Keyser Marston Associates, Inc. (KMA) reviewed the request from Lyon Capital Ventures, LLC (Developer) for financial assistance from the Long Beach Housing Development Company (LBHDC) to restrict 10 residential units to low income households at the proposed City Hall East project (Project). The purpose of this analysis is to estimate the affordability gap associated with the proposed income and rent restrictions.

EXECUTIVE SUMMARY

The Developer has agreed to pay $4.00 million for the property located at 100 Long Beach Boulevard (Property), comprised of $2.65 million in cash at closing plus a $1.35 million loan from the City of Long Beach (City). The proposed Project entails redeveloping the 10-story office building into a mixed-use project including 99 rental units and 10,000 square feet of ground floor retail space. The Developer has also proposed to restrict 10 of the units to low income households subject to receiving $1.84 million from LBHDC.

The deal terms between the City and the Developer are not contingent upon the LBHDC agreement to provide financial assistance and the Developer providing 10 low income units. However, LBHDC staff has indicated that low and moderate income housing set-aside (Set-Aside) funds will likely be used as a funding source if the Developer's request is approved by the LBHDC Board.

The KMA analysis concludes the following:

1. The Developer's request of $1.84 million in financial assistance from the Agency is warranted given that the affordability gap is estimated at $1.90 million.

2. KMA recommends that the affordability covenants be in place for a minimum of 55-years and be unsubordinated to financing as well as in accordance with California Redevelopment Law (CRL).

3. For CRL proportionality requirements, 100% of the $1.84 million of financial assistance would be applied to the low income expenditure category.

BACKGROUND STATEMENT

In June 2000, the City purchased the 10-story, 149,160 square foot office building with a 149 space parking structure from Southern California Edison. The Property was originally constructed in 1959 and the City utilized the building as a temporary replacement for the Long Beach Police Department through June 2005. The Property is currently vacant and the City intends to declare it as surplus property.

After two Requests for Proposals (RFP) rounds and several unsolicited offers to purchase the Property, the Developer has made the highest and best offer to purchase the Property in accordance with the requirements of the latest RFP. The Developer proposes to redevelop the Property into a 99 one-bedroom unit apartment project with 10,000 square feet of ground floor retail space. The Developer has agreed to pay $4.00 million for the Property, comprised of $2.65 million in cash at closing plus a $1.35 million loan from the City. The Developer has also proposed to restrict 10 of the units to low income households subject to receiving $1.84 million from LBHDC.

The deal terms between the City and the Developer are not contingent upon the LBHDC agreement to provide financial assistance and the Developer providing 10 low income units. However, LBHDC staff has indicated that low and moderate income housing set-aside (Set-Aside) funds will likely be used as a funding source if the Developer's request is approved by the LBHDC Board.

KMA performed a pro forma analysis to assist in the evaluation of the Developer's request. The analysis is organized as follows:

Table 1:	Stabilized Net Operating Income – 100% Market Rate Scenario
Table 2:	Stabilized Net Operating Income – 10% Low Income Scenario
Table 3:	Affordability Gap Analysis

AFFORDABILITY GAP ANALYSIS

To estimate the financial impact to the Project as a result of the restriction of 10 units to low income households, KMA assumed that the Developer's August 25, 2010 pro forma is reasonable due to the previous review and approval of the proposal by the City. As such, KMA estimated the loss of supportable private investment based on the estimated stabilized net operating income for the residential component in 2010 dollars for the following scenarios:

1. 100% Market Rate Scenario; and

2. 10% Low Income Scenario.

Stabilized Net Operating Income (Tables 1 and 2)

Market Rate Rents

Based on the Developer's August 25, 2010 pro forma, the current market rents are estimated at $2.55 per square foot. With an average unit size of 872 square feet, the estimated rents for the one-bedroom units equates to approximately $2,219 per month.

Low Income Rents

If approved, the LBHDC plans to fill the affordability gap with Set-Aside funds, which requires the Project to impose income and affordability restrictions in accordance with the California Redevelopment Law. To that end, the Project's income and affordability standards must comport with the following income and affordability standards:[1]

	Number of Units	Income Restrictions[2]	Rent Restrictions[3]
1-Bedroom Units	10	H&SC Section 50079	H&SC Section 50053

Based on 2010 income information published by the California Housing and Community Development Department (HCD), one-bedroom units restricted to low income households in Los Angeles County have a maximum monthly rent of $714, which is net of the $42 month utility allowance.

[1] "H&SC" stands for Health and Safety Code and "Median" refers to the Los Angeles County area median income as published by the Housing and Urban Development department (HUD).
[2] The tenants' income cannot exceed the CRL income limits.
[3] The rents applied to the restricted units must reflect the CRL rents.

Stabilized Net Operating Income (NOI)

In addition to rental revenue, the Developer assumes that the residential units will also generate $17 per month in other income. At stabilization, the Developer projects the following vacancy and collection assumptions:

1. Loss to Lease – 2.00% of gross scheduled income;
2. Vacancy – 5.00% of gross potential income; and
3. Concessions and Collection Loss – 2.00% of gross potential income.

The following summarizes the effective gross income (EGI) estimates for the two scenarios:

	100% Market Rate Scenario	10% Low Income Scenario	Difference
Gross Scheduled Income	$2,636,700	$2,456,100	$180,600
(Less) Loss to Lease	(52,700)	(49,100)	(3,600)
Gross Potential Income	$2,584,000	$2,407,000	$177,000
(Less) Vacancy	(129,200)	(120,400)	(8,800)
(Less) Concessions & Collections	(51,700)	(48,100)	(3,600)
Add: Other Income	20,200	20,200	0
Effective Gross Income	$2,423,300	$2,258,700	$164,600

Therefore, the imposition of 10 low income affordability covenants is projected to result in a loss of $164,600 of effective gross income (EGI).

The operating expenses are estimated as follows:

1. The general operating expenses are estimated at approximately $5,088 per unit per year.
2. The management fee is estimated at 4% of EGI.
3. The Developer has indicated that the property tax rate is 1.115% of value for the Project. A 6.0% capitalization rate was assumed to estimate the value of the Project.
4. The annual capital replacement reserve deposit is estimated at $236 per unit.

	100% Market Rate Scenario	10% Low Income Scenario	Difference
General Operating Expenses	$503,700	$503,700	$0
Management Fee	96,900	90,300	6,600
Property Taxes	282,000	257,200	24,800
Replacement Reserves	23,300	23,300	0
Effective Gross Income	$905,900	$874,500	$31,400

Therefore, the projected stabilized NOI for the two scenarios are as follows:

	100% Market Rate Scenario	10% Low Income Scenario	Difference
Effective Gross Income	$2,423,300	$2,258,700	$164,600
(Less) Operating Expenses	(905,900)	(874,500)	(31,400)
Stabilized Net Operating Income	$1,517,400	$1,384,200	$133,200

In summary, the inclusion of 10 units restricted to low income households results in a $133,200 decrease in NOI.

Affordability Gap Calculation (Table 3)

To calculate the affordability gap as a result of the affordability covenants, the amount of private investment supported by the stabilized NOI in each scenario assuming a 7.00% return on investment are compared as follows:

	100% Market Rate Scenario	10% Low Income Scenario	Difference
Stabilized Net Operating Income	$1,517,400	$1,384,200	$133,200
Return on Investment	7.00%	7.00%	
Supportable Private Investment	$21,677,000	$19,774,000	$1,903,000

KMA concludes that the affordability gap associated with the proposed affordability restrictions is as follows:

	Affordability Gap
Supportable Investment – 100% Market Rate	$21,677,000
(Less) Supportable Investment – 10% Low Income	(19,774,000)
Affordability Gap	$1,903,000
Per Affordable Unit	$190,300

Therefore, the Developer's $1.84 million, or $184,100 per affordable unit, request of assistance is determined to be reasonable.

Redevelopment Obligations

State law also imposes proportionality restrictions on the use of the Set-Aside funds, which are to be met by 2014.[4] The following provides the proportionality breakdown of the Set-Aside funds in relation to this Project:

	Proportionality	Set-Aside Expenditure
Very-Low Income	0%	$0
Low Income	100%	1,841,000
Moderate Income	0%	0
Total Set-Aside Funds	100%	$1,841,000

CONCLUSIONS AND RECOMMENDATIONS

The following are the conclusions and recommendations derived from the KMA analysis:

1. The Developer's request of $1.84 million in financial assistance from the Agency is warranted as it is lower than the $1.90 million affordability gap.

2. KMA recommends that the affordability covenants be in place for a minimum of 55-years and be unsubordinated to financing as well as in accordance with CRL.

3. If the LBHDC Board approves the Developer's $1.84 million request for assistance and it is filled with Set-Aside funds, the entire amount can be applied to the low income expenditure category.

Attachment

[4] The income proportionality requirements are defined in Section 33334.4(a) of the California Health and Safety Code.

TABLE 1

STABLIZED NET OPERATING INCOME - 100% MARKET RATE (2010 DOLLARS)
CITY HALL EAST
LONG BEACH, CALIFORNIA

I.	Residential Component [1]				
	A. Rental Income				
	Market Rate Units [2]	99 Units	$2,219 /Month	$2,636,700	
	Affordable Units [3]	0 Units	$714 /Month	0	
	Gross Scheduled Income			$2,636,700	
	(Less) Loss to Lease	2.00% GSI		(52,700)	
	Gross Potential Income			$2,584,000	
	(Less) Vacancy Allowance	5.00% GPI		(129,200)	
	(Less) Concessions & Collection Allowance	2.00% GPI		(51,700)	
	Add: Other Income	99 Units	$17 /Month	20,200	
	Effective Gross Income				**$2,423,300**
	B. Operating Expenses				
	General Operating Expenses	99 Units	$5,088 /Year	$503,700	
	Property Management Fee	4.0% of EGI		96,900	
	Property Taxes	1.115% Tax Rate	6.00% Cap Rate	282,000	
	Capital Expenditures Reserve	99 Units	$236 /Year	23,300	
	Total Operating Expenses				**$905,900**
	Residential Net Operating Income				**$1,517,400**

1 Based on the Developer's August 25, 2010 pro forma assumptions.

2 The market rents equate to $2.55 per square foot per month for the one-bedroom units.

3 Based on LA County 2010 incomes distributed by HUD/HCD. The rents are based on Section 50053 of the California Health and Safety Code for low income units. The utility allowance is $42 per month for the one-bedroom units.

Prepared by: Keyser Marston Associates, Inc.
Filename: City Hall East - 09.03.10; 100% Mkt Rate; jlr

TABLE 2

STABLIZED NET OPERATING INCOME - 10% LOW INCOME (2010 DOLLARS)
CITY HALL EAST
LONG BEACH, CALIFORNIA

I. Residential Component				
A. Rental Income				
Market Rate Units	89 Units	$2,219 /Month	$2,370,400	
Affordable Units	10 Units	$714 /Month	85,700	
Gross Scheduled Income			$2,456,100	
(Less) Loss to Lease	2.00% GSI		(49,100)	
Gross Potential Income			$2,407,000	
(Less) Vacancy Allowance	5.00% GPI		(120,400)	
(Less) Concessions & Collection Allowance	2.00% GPI		(48,100)	
Add: Other Income	99 Units	$17 /Month	20,200	
Effective Gross Income				**$2,258,700**
B. Operating Expenses				
General Operating Expenses	99 Units	$5,088 /Year	$503,700	
Property Management Fee	4.0% of EGI		90,300	
Property Taxes	1.115% Tax Rate	6.00% Cap Rate	257,200	
Capital Expenditures Reserve	99 Units	$236 /Year	23,300	
Total Operating Expenses				**$874,500**
Residential Net Operating Income				**$1,384,200**

1 Based on the Developer's August 25, 2010 pro forma assumptions.
2 The market rents equate to $2.55 per square foot per month for the one-bedroom units.
3 Based on LA County 2010 incomes distributed by HUD/HCD. The rents are based on Section 50053 of the California Health and Safety Code for low income units. The utility allowance is $42 per month for the one-bedroom units.

Prepared by: Keyser Marston Associates, Inc.
Filename: City Hall East - 09.03.10; 10% Low Inc; jlr

TABLE 3

AFFORDABILITY GAP ANALYSIS (2010 DOLLARS)
CITY HALL EAST
LONG BEACH, CALIFORNIA

I.	**Supportable Investment - 100% Market Rate Scenario**			
	Stabilized Net Operating Income (See Table 1)		$1,517,400	
	Required Return on Investment		7.00%	
	Supportable Investment - 100% Market Rate Scenario			**$21,677,000**
II.	**Supportable Investment - 10 Low Income Units Scenario**			
	Stabilized Net Operating Income (See Table 2)		$1,384,200	
	Required Return on Investment		7.00%	
	Supportable Investment - 100% Market Rate Scenario			**$19,774,000**
III.	**Affordability Gap**			
	Supportable Investment - 100% Market Rate		$21,677,000	
	(Less) Supportabel Investment - 10 Low Income Units		(19,774,000)	
	Affordability Gap	**10 Aff Units**	**$190,300 /Unit**	**$1,903,000**

Prepared by: Keyser Marston Associates, Inc.
Filename: City Hall East - 09.03.10; Aff Gap; jlr