MEMORANDUM

TO: Kathy Kleinbaum & Sandy Council - City of San Mateo
FROM: Mollie Naber & Nevada Merriman - MidPen Housing
RE: Downtown San Mateo Opportunity Sites Project Update
DATE: November 12, 2019

The purpose of this Memorandum is to summarize major Downtown San Mateo (DTSM) Opportunity Sites project updates following City Council selection of MidPen Housing as developer on April 16, 2018. It is our understanding that the contents of this Memorandum will serve as the basis for a November 18, 2019 City Council Study Session.

<u>Section I: Current Project Status</u>

DTSM will be a community of 164 family homes in downtown San Mateo with an adjacent approximately 700 stall parking garage that will also contain an approximately 1,200 square foot community-serving space. The residential and garage improvements will be constructed on neighboring parcels at 480 East 4th Avenue and 400 East 5th Avenue. The two parcels have a combined area of 2.41 acres. The DTSM homes will form an innovative mixed income community serving both low and moderate income households. The DTSM garage will provide up to 535 public parking spaces, 164 resident parking spaces, and on the ground floor, operating space for the Worker Resource Center and other community groups. The residential and garage improvements will be connected by a pedestrian bridge over 5th Avenue.

Figure 1: Architect Rendering of DTSM Opportunity Sites

MidPen submitted a CEQA/NEPA application in February 2019 and a Mitigated Negative Declaration/Finding of No Significant Impact decision is anticipated by February 2020. The

NEPA-required Explosives and Flammables Survey identified the need to mitigate the risk of thermal radiation (heat emissivity) in case of a transformer accident at the PG&E Beresford Substation by fully enclosing access to the resident courtyard from 5th Avenue. The design team is revising the project plans accordingly. CEQA-required due diligence, including the Traffic Impact Analysis, is ongoing.

MidPen submitted a formal entitlement application in July 2019 in anticipation of a Planning Commission Meeting in March 2020 and City Council Meeting in June 2020. City Building, Fire, Parks & Recreation, Planning, Police and Public Works staff provided two rounds of comments; MidPen formally responded to the second round comments November 8, 2019. Design considerations associated with the City's long-term ownership of the DTSM garage have been a focus of the entitlement review process. Prior to submitting the formal entitlement application, City Planning, Public Works, and Management staff joined MidPen on a tour of parking garages with a similar design to that planned for the DTSM garage.

The City and MidPen began negotiating a Disposition and Land Development Agreement (DDLA) in January 2019 in anticipation of a City Council Meeting in June 2020. Noteworthy discussion terms include the project ownership structure, garage operating terms, and the housing affordability mix. The proposed project ownership structure is that the City continues to own both parcels of land, the City owns the garage improvements, and a MidPen-affiliated Limited Partnership (LP) owns the residential improvements. The City will provide an exclusive easement to the LP for the residential parking spaces in the City garage.

Consistent with MidPen's original RFP response, all homes will be affordable rental units with a City of San Mateo live/work preference applied to all units to the extent permitted by law and other project funding sources. In response to the City's desire for a portion of the units to also target public employees, MidPen and the City worked collaboratively to explore the legal ramifications of applying an additional preference for public employees to a portion of the moderate income units. Due to a recent IRS decision, multiple third-party legal reviews of existing legislation regarding employer housing, and a City-initiated disparate impact study, the project team is optimistic that project funding sources, including the California Tax Credit Allocation Committee (TCAC), will allow a preference for public employees[1], to apply to affordable units that generate tax credit equity. If the affordable units do not generate tax credit equity, TCAC approval of the public employee preference is not necessary.

[1] Working definition of public employees is as follows:
City of San Mateo employee, County of San Mateo Employee, or employee of the 10 other RDA successor agencies: San Mateo Community College District, San Mateo Union High School District, San Mateo-Foster City School District, Estero Muni Improvement District, Bay Area Air Quality Management District, County Harbor District, San Mateo County Mosquito and Vector Control District, Peninsula Hospital District, Sequoia Hospital District, County Education Tax District [Note: definition may ultimately also include State employees].

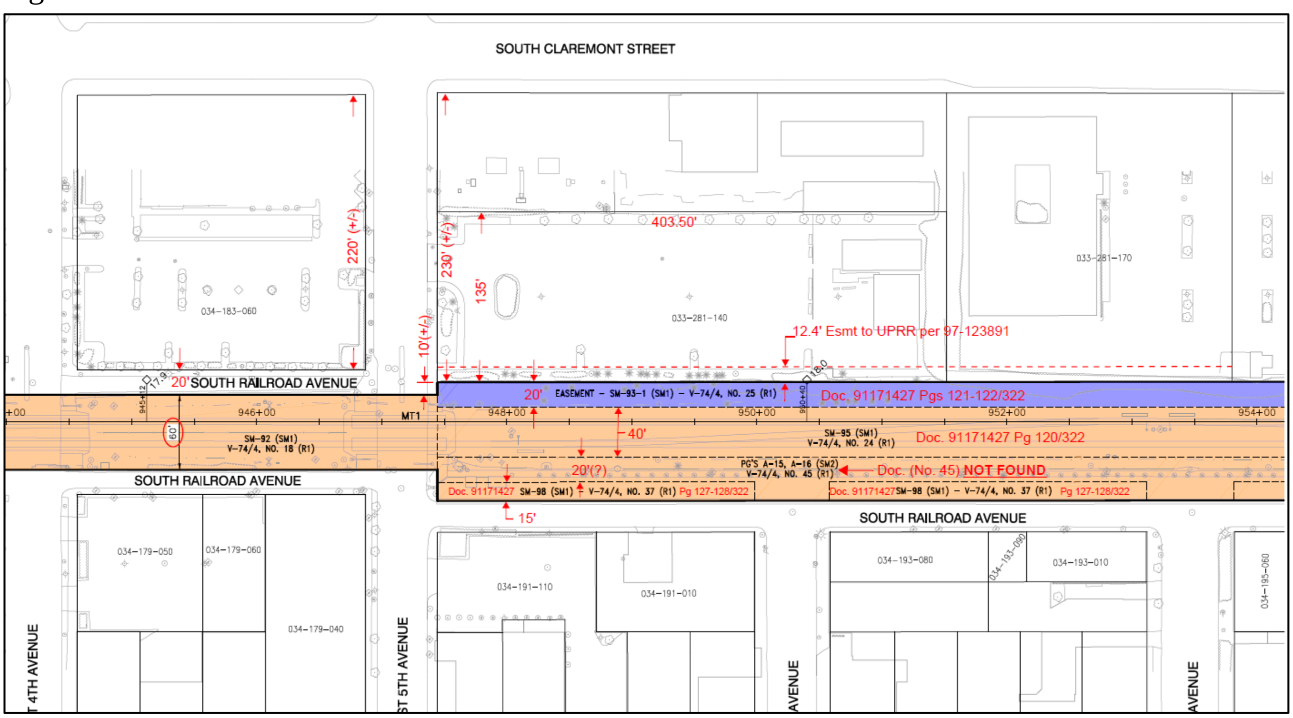
Section II: Design and Construction Updates

In addition to the due diligence and design work required for the CEQA/NEPA review, application for entitlement, and DDLA drafting, MidPen and the City have achieved key project milestones as dictated by the ENA. These milestones include identifying title issues and completing in-depth environmental analyses. In parallel, both MidPen and the City have raised the bar in terms of their respective sustainability targets, including through the City's adoption of the updated Reach Codes for 2019 Building Code. The title issues, environmental analyses, and revised sustainability targets have had design and construction implications for the project, which are outlined in Section II.

Title Issues

Union Pacific Railroad holds a 12.4 foot easement along the southern side of the 400 East 5th Avenue parcel, adjacent to the railroad tracks. The easement was not disclosed in the RFP. Union Pacific Railroad is a separate entity from the Peninsula Corridor Joint Powers Board, which owns and operates Caltrain. Under the terms of the easement, Union Pacific "*[has] the right to own, construct, reconstruct, maintain, operate, use and/or remove existing and/or future railroad, rail and railroad-related equipment, facilities, transportation systems, pipelines, communication systems, lines and facilities of every kind and nature*" over and through the easement area. Union Pacific has rejected requests to construct limited improvements in the easement area, including a paved pedestrian emergency exit path, a fence and landscaping designed to control stormwater run-off.

Figure 2: Easement

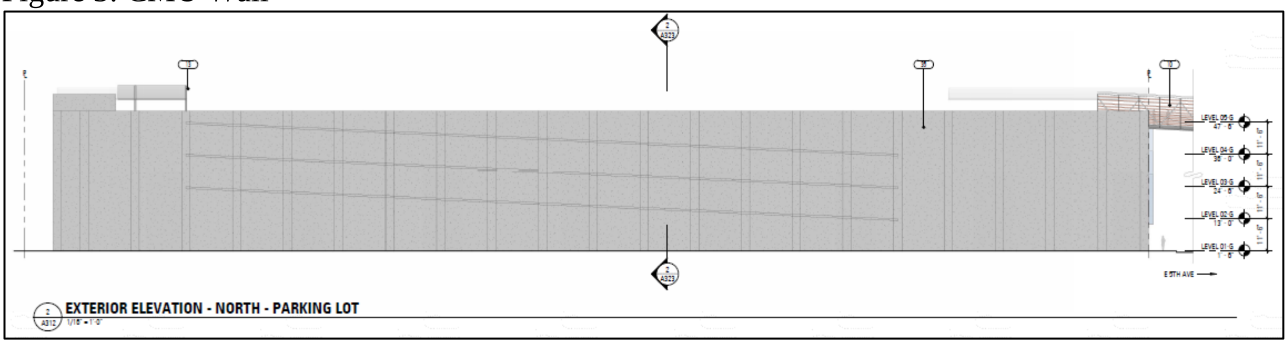


Union Pacific railroad easement is indicated by red dashed line "Easement to UPRR"

The easement necessitated significant modifications to the garage design. The design team shifted the garage ten feet to the north, in the direction of South Claremont Street, and reduced the overall width of the garage by approximately four feet. To mitigate resulting fire hazard risk due to the garage's proximity to neighboring structures, the entire north elevation of the garage is now designed as an enclosed, fire-rated concrete masonry unit (CMU) wall instead of open bays. The emergency exit path from the back stairwell in the garage also had to be moved from the planned outdoor location in the easement area; an interior rated emergency exit corridor is now proposed on the ground floor of the garage. The added construction costs for the CMU wall and the interior rated corridor are approximately **$1,555,000** (hard cost only).

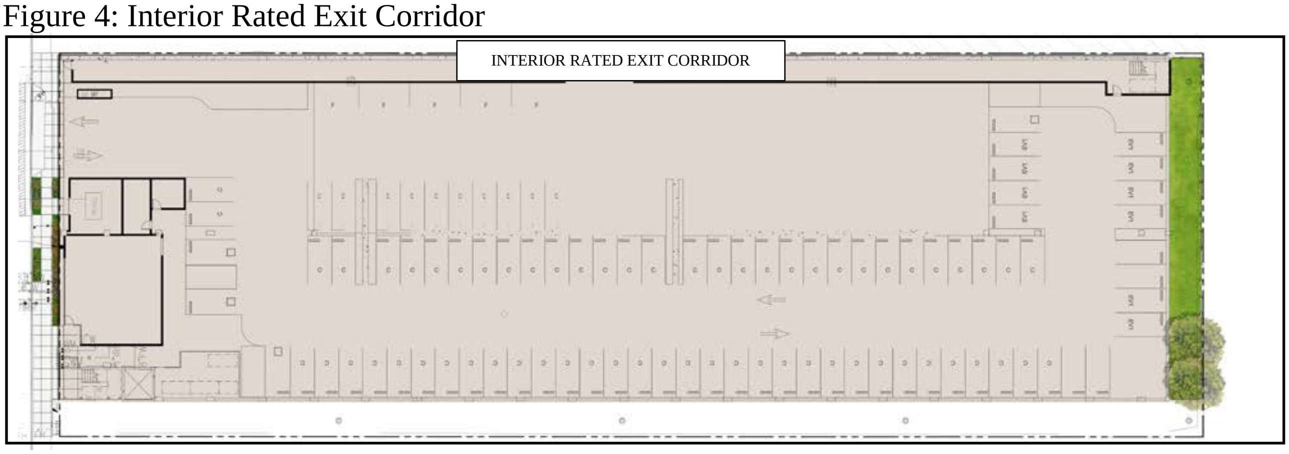
The reduced width of the garage also forced the team to adjust the turning radii, significantly increase the number of compact stalls, add a series of parallel parking stalls, and extend the height of the ramp on the top level of the garage, thereby increasing the available parking surface area. Currently, the number of public parking stalls is aligned with the City's target of 535. However, there is the potential that some public stalls may be lost as the garage design is fine-tuned.

Figure 3: CMU Wall



CMU wall on north elevation, adjacent to warehouses and PG&E substation.

Figure 4: Interior Rated Exit Corridor



Interior rated exit corridor on ground floor of garage is labeled at the top of above image.

Environmental Issues

Initial Phase I and II studies completed in July and November 2018 respectively reported that no remediation was needed for either site, only the need to procure change of use approval for the residential parcel from the San Mateo County Health Services Agency (SMCHSA) via a Soil Management Plan per the terms of a 2002 SMCHSA case closure letter. However, the Regional Water Quality Control Board (Water Board) adjusted Environmental Screening Levels (ESLs) in early 2019. As a result of this update, the 480 East 4th Avenue parcel now has soil gas and lead levels above the acceptable thresholds. The added cost for hazardous soil offhaul and a vapor mitigation system for soil gas at the residential site is approximately **$1,300,000**. MidPen is currently preparing an application to the Water Board to assess the case; while it is not confirmed that the vapor mitigation system will be required, it is anticipated.

Sustainability Targets

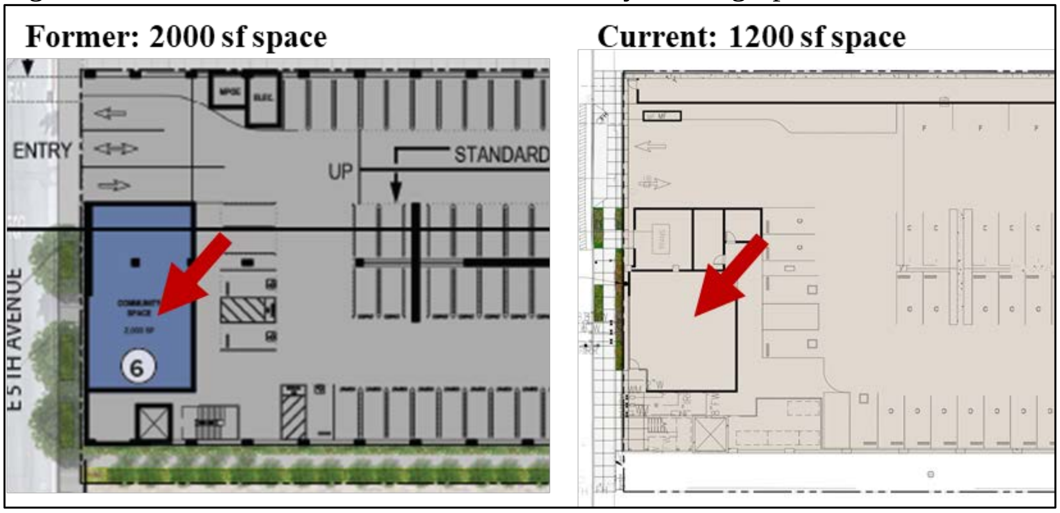
The City of San Mateo is in the process of updating the 2019 Energy Code Reach Codes for new construction. As a result of the proposed updates, 15% of parking spaces at the DTSM garage will need to be electrical vehicle (EV) capable, a five percentage point increase from the original requirement of 10%. The actual EV capable stall count has increased from 70 to 106, of which 25 will now be required to have EV charging infrastructure installed. In order to power the additional EV stalls, the size of the transformer for the garage structure increased to a 1600 A, 480v, 3 phase pad mounted model. A transformer room was added in the garage structure in lieu of an underground transformer in the sidewalk. The added cost of the transformer room plus wiring and hardware for additional EV capable and EV charging infrastructure installed is approximately **$540,000** (hard cost only).

MidPen is also exploring the possibility that the DTSM project be all-electric. This is an elective effort in response to environmental concerns, public interest in electrification and MidPen's success developing our first all-electric affordable housing community in Sunnyvale. An electric hot water heating system would replace the standard gas-powered boiler system at the residential site, clearing the way for an all-electric development (appliances are already all-electric). Given safety and extended-hour accessibility needs, electricity is a major ongoing operational cost for large shared parking garages. The current garage plans include an optional solar carport array on the top floor of the parking garage, designed to offset the majority of garage lighting costs. The optional solar carport array at the garage and any increased design and construction costs due to an optional residential electric hot water heating system are currently not carried in the project budget.

Community Serving Space

The addition of a transformer room adjacent to the community serving space, and required relocation of the mechanical / electrical room to meet PG&E transformer requirements, resulted in a reduction of the community serving space from approximately 2,000 sf to approximately 1,200 sf. The estimated cost of the warm shell community serving space is $500,000 (hard cost only), and currently carried in the project budget. The community serving space will be owned by the City and include a basic kitchenette, a bathroom, and office space. A detailed scope for the space will be negotiated prior to Design Development, which is an intensive architectural and engineering drafting process that will begin shortly after the project is entitled.

Figure 5: Former and Current Size of Community Serving Space



Section III: Community Outreach Developments

MidPen met with seven community stakeholder groups in fall 2018, hosted a voluntary project Open House in October 2018 and hosted a required Community Meeting in March 2019. Community feedback was generally positive: participants appreciated the design direction, emphasis on workforce housing, and improved public amenities including public art and efficient downtown parking. Community members did have mixed reactions to the construction staging plan, in which the garage is built first followed by the housing. Some stakeholders expressed concerns that taking all of the existing parking offline at once would disrupt downtown business operations. Other community members worried that building the garage first delays delivery of much needed workforce housing.

In addition, MidPen and the City teamed to discuss the project with public education stakeholders, including securing their and other public employees' participation in a Public Employee Survey conducted in October 2019. In parallel, MidPen engaged an outside firm to conduct a quantitative analysis of public employee and local demand for the moderate income units the project is proposing. The public employee survey and market study results, however, raised new questions about the proposed income mix.

Construction Phasing

Community engagement conducted in 2018-2019 included one-on-one meetings with nearby neighborhood groups, business associations, and homeowner associations as well as voluntary and required public meetings. In one-on-one meetings, business associations expressed concerns that the loss of all or a portion of the existing 235 public parking spaces at the DTSM parcels during construction would be detrimental for their operations due to impacts to employee and customer parking. In public meetings, housing advocates expressed concerns that public parking was prioritized over affordable housing, as constructing the garage before the residential structure would delay delivery of the housing units by nearly a year. If the garage is built first, the total construction period is approximately 31 months. If the garage and residential structure are built concurrently, the total construction period is approximately 21 months. The additional cost of construction loan interest and contractor general conditions due to building the garage first is more than $2,000,000, an amount that does not consider the costs of an additional year of City inspections, traffic control and third party construction monitoring.

Public Employee Survey & Moderate Income Market Study

Under the proposed income mix for DTSM, half of the units (81) will be affordable to households earning up to 60% of area median income (AMI) and half of the units (81) will target moderate income households earning between 60% and 120% of AMI. An estimated 41 of the moderate income units (a quarter of all units) will have a preference for public employees, in addition to the City of San Mateo live/work preference applicable to all units, to the extent permitted by law and other project funding sources.

We originally conceived that the 41 moderate income units with a public employee preference would target households earning 80% AMI to 120% AMI, which is above the income threshold allowed for tax credit financed units. The rates for these units would be set at approximately 15% below market rate rents for Class A/B properties in San Mateo (such as Metropolitan and Mode).

Figure 6: Proposed Base Case Unit Mix and Rents

AMI Category		Studio		1 BR		2 BR		3 BR	
		Units	Net Rent	Units	Net Rent	Units	Net Rent	Units	Net Rent
Low Income, Tax Credit	≤ 30%	5	$671	7	$717	3	$848	5	$962
	≤ 50%	0	$0	14	$1,267	7	$1,508	13	$1,724
	≤ 60%	0	$0	16	$1,542	5	$1,838	6	$2,105
	≤ 80%	4	$1,954	18	$2,092	7	$2,498	11	$2,868
Moderate Income, Non-Tax Credit	≤ 120%	0	$0	24	$2,505	9	$2,993	8	$3,592
	Mgr Unit	0		0		2		0	
	Total Units	9		79		33		43	

In collaboration with the City, County, and Elementary and High School Districts, we conducted a public employee rental survey in October 2019 to assess the target population's willingness to pay the "Moderate Income, Non-Tax Credit" rents shown in Figure 5. Survey questions included:

> *What is the maximum additional monthly rent you would be willing to pay to reduce your daily commute by 30-60min?*
> - *$100/month*
> - *$200/month*
> - *$300/month*
> - *$400/month*
> - *I would not pay additional rent to reduce my daily commute*

If you left your current living situation, would you be willing to pay $2,500/month to rent a new 1 bedroom apartment with on-site amenities in walking distance to Caltrain in downtown San Mateo?				
Extremely likely	*Somewhat likely*	*Neither likely nor unlikely*	*Somewhat unlikely*	*Extremely unlikely*

Approximately 800 public employees from the City of San Mateo, San Mateo County Health Department, San Mateo County – Other Departments (Superior Court, Coroner, Education, Libraries, etc.), San Mateo-Foster City School District, San Mateo Union High School District and San Mateo Consolidated Fire Department participated in the electronic survey. 82% of respondents work exclusively in the City of San Mateo or in the City of San Mateo plus a selection of neighboring municipalities. Half of all respondents work for the County; 25% work for the City. The majority of respondents live in San Mateo County (62% in the County, 28% in the City of San Mateo), although certainly not all: public employees live as far away as Richmond, Aptos, and Stockton. The proportion of respondents that reported they would not pay more to commute less (58%) is not surprising given so many already live within 20 miles of the City of San Mateo. This data, combined with a general preference for a lower rent, older unit in suburban San Mateo versus a slightly higher rent, newer unit in downtown San Mateo, suggests respondents may prioritize rent over location.

The purpose of the Public Employee Survey was to assess demand among public employees earning 80% to 120% of AMI for the 41 employee preference units at the Proposed Base Unit Mix and Rents (see Figure 6). We analyzed the data by splitting the respondents into two groups based on reported household income:

1. **Lower Moderate Income:** households earning less than 80% of AMI for a family of two in San Mateo County

2. **Higher Moderate Income:** households earning greater than 80% of AMI for a family of two in San Mateo County.

422 respondents (53%) reported a gross household income of $105,000 or less and were thus categorized in the **Lower Moderate Income** group. This group is nearly all renters (90%), and dominated by County employees (57% or 242 respondents) followed by City employees (20% or 81 respondents). The majority of the Lower Moderate Income group (+50%) reported earning less than $80,000, which is below 60% of AMI for a family of two in San Mateo County. The average monthly rent including utilities that renters in the Lower Moderate Income group report paying is $2,050, which is about $900 per month less than the maximum TCAC rent for a two-bedroom unit in San Mateo County restricted to households earning less than or equal to 80% AMI ($2,902). Household sizes in this group tend to be smaller (60% had 1-2 persons in their home). Because the rent levels featured in the Public Employee Survey targeted higher income households, it is not surprising that only 41% of the Lower Moderate Income group stated they were extremely or somewhat likely to move to the proposed units at the proposed rents. The 194 written comments provided by this group further illustrated the data indicating their preference for an affordable San Mateo residence, but need for a lower rent then proposed. For example: *"most of us would not be able to afford $2,500 or $2,000 a month for rent"* and *"$2,500 is still a lot of money to ask a public*

school teacher to pay to live; there needs to be something more reasonable" and *"rental housing in San Mateo is expensive and most of us spend the majority of our incomes on rent."*

377 respondents (47%) reported a gross household income of +$105,000 to $155,000 or more and were thus included in the **Higher Moderate Income** group. The majority of this group (47%) reported earning $155,000 or more, which indicates their incomes are greater than 120% of AMI for a family of two in San Mateo County (but less than 120% of AMI for a family of four). More respondents in the Higher Moderate Income group own their own home (31% homeowner). The City employee portion of this group was also larger: 33% (133 respondents) of the Higher Moderate Income group works for the City, not including the 6% (25 respondents) employed by the San Mateo City Fire Department. The average monthly rent including utilities that renters in the Higher Moderate Income group report paying is $2,880, which is nearly equal to the maximum TCAC rent for a two-bedroom unit in San Mateo County restricted to households earning less than or equal to 80% AMI ($2,902). This group included proportionally more large households (47% had 3 or more persons in their home). Because studio, one-bedroom and two-bedroom rents featured in the Public Employee Survey are less than or equal to 30% of the total reported income of the lowest income band in this group ($105,000), it is surprising that only 47% of Higher Moderate Income respondents stated they were extremely or somewhat likely to move at the proposed rents. This suggests that although the proposed rents may be more affordable to this group, the group may also have different preferences than the Lower Moderate Income group. The 174 written comments from respondents in this income group focused more on amenities and ownership inquiries. For example: *"survey did not mention bathrooms – I prefer 2 bed 2 bath for $3000"* and *"consider family units with a designated child care center at the complex and I would move"* and *"affordable housing to buy."*

Also in October 2019, The Concord Group (TCG) conducted a market analysis of demand for the proposed units targeting income households earning between 60% and 120% of AMI, including the 41 moderate income units with a public employee preference. TCG's analysis substantiated a takeaway of the Public Employee Survey: many public employees would income qualify for tax credit units. The analysis also provides an important caveat that the DTSM development will only capture a limited portion of income qualified public employee households (estimated capture rate of 2%) and future income qualified public employee households (estimated capture rate of 67%); and to ensure full occupancy of public employee preference units, it is prudent to target lower moderate income public employees to ensure adequate demand.

Figure 7: California Tax Credit Allocation Committee Maximum Income Levels for Projects Placed in Service on or after 4/24/19 – San Mateo County

% of Area Median Income	Number of Household Members					
	1	2	3	4	5	6
120%	$135,480	$154,800	$174,120	$193,440	$208,920	$224,400
100%	$112,900	$129,000	$145,100	$161,200	$174,100	$187,000
80%	$90,320	$103,200	$116,080	$128,960	$139,280	$149,600
70%	$79,030	$90,300	$101,570	$112,840	$121,870	$130,900
60%	$67,740	$77,400	$87,060	$96,720	$104,460	$112,200
50%	$56,450	$64,500	$72,550	$80,600	$87,050	$93,500
40%	$45,160	$51,600	$58,040	$64,480	$69,640	$74,800
30%	$33,870	$38,700	$43,530	$48,360	$52,230	$56,100

Section IV: Financing Update & Options

The project currently has an approximately **$8,000,000** financing gap. The additional costs resulting from the title issues, environmental issues, and increased EV-ready and EV-capable stall count, which total approximately **$3,400,000** in hard costs only, are included the current "base case" financing model. The base case assumes 41 moderate income units with a public employee preference targeting households earning 80% to 120% of AMI and a 31 month construction period. Conservative financing assumptions typical for projects at this stage of predevelopment, namely a $1.02 tax credit equity pay in rate and an approximately 3% spread plus cushion applied to current interest rates, are assumed in the base case. The tax credit equity pay in rate and interest rates will not be confirmed until investor and lender commitments are executed at construction finance closing in 2021; however, these financing rates fluctuate based on market conditions and can significantly impact the project financing gap.

Figure 8: Base Case Sources of Funds

Permanent Loan – Tranche A (anticipated)	$35.3 M
Permanent Loan – Tranche B (anticipated)	$17 M
California Department of Housing and Community Development IIG (anticipated)	$5 M
County of San Mateo AHF Loan (partially committed)	$8.8 M
City of San Mateo Parking and Housing Funds (committed)	$9.5 M
Subordinate Surplus Cash Loan (anticipated)	$6.7 M
Tax Credit Investor Proceeds (anticipated)	$35.4 M
General Partner Equity (committed)	$12.3 M
Gap	$8 M
Total Development Cost	**$138 M**

While it is typical for a project of this size to have a financing gap at this stage of predevelopment, the team is proactively exploring options to mitigate the gap. There are several options for reducing the financing gap, including (1) capping affordability levels at 80% of AMI to ensure all residential units generate tax credit equity, (2) allowing the garage and residential structures to be built concurrently, (3) requesting greater City subsidy, and (4) increasing the number of County Project Based Voucher units. These options are presented individually, but could be layered to further reduce the gap.

Option 1: 100% Tax Credit Units

The rent and income levels for the moderate income units not only have demand implications, as outlined in Section III above, but also significant financing implications. Moderate income units targeting households earning greater than 80% of AMI are not eligible for tax credit equity, an affordable housing funding source that does not need to be repaid. Furthermore, the +80% of AMI units help support a subordinate surplus cash loan that would be repaid through residual receipts over 15 years. However, any increase in vacancy above the standard assumption of 5% vacancy for the +80% AMI units would significantly extend the period within which this loan is repaid, and subsequently, the date the City and County begin to receive installments on their outstanding loans. Although the public employee preference is a preference not a set-aside, if public employees are not interested in the available units the project would be competing with the broader market, but offering units with unique requirements such as annual income re-certifications.

Based on current (2019) maximum income levels published by TCAC for San Mateo County, setting the income cap at 80% of AMI would imply the maximum income of a qualifying two person household would be $103,200; the maximum income of a qualifying four person household would be $128,960. By contrast, if the project continued to contain moderate income units targeting households earning up to 120% of AMI, an income level that does not leverage tax credit equity, the maximum income of a qualifying two person household would be $154,800; the maximum income of a qualifying four person household would be $193,440.[2]

If all residential units are tax credit units, with a maximum income of 80% AMI, the project's financing gap would decrease by $5,500,000 to $2,500,000, holding all other base case assumptions constant, including the proportion of low and moderate income units (81 units targeting households earning 30 to 60% of AMI; 81 units targeting households earning +60% of AMI) and the number of public employee preference units (41), pending TCAC approval.

Option 2: Concurrent Construction

Shortening the construction schedule by allowing the garage and housing to be built concurrently reduces the project's financing gap by $2,000,000 to $6,000,000. This is a conservative cost estimate, based on reduced construction loan interest and contractor general conditions. If construction occurs concurrently, however, zero rather than half of the existing public parking stalls would be available during most if not all of construction.

Option 3: More City Subsidy

An additional City contribution of $1,500,000 to $2,000,000, amounts that are approximately equal to the environmental remediation costs anticipated at the residential site or the additional garage construction costs incurred due to modifications to accommodate the railroad easement and Reach Code updates, would reduce the project gap by the amount of the additional contribution.

[2] It is worth noting that TCAC Income Limits for San Mateo County have increased more than 20% since MidPen initially responded to City RFP in 2017.

Option 4: More County Project Based Vouchers

MidPen anticipates requesting 48 Section 8 Project Based Vouchers through the County of San Mateo. Project Based Vouchers are beneficial to project financing in that they supplement the rent of the extremely- and very low income households occupying the Section 8 designated units. The number of Project Based Vouchers that a development is awarded, however, does have implications for overall income targeting and preferences. The more Project Based Vouchers a development is awarded, the higher the number of homeless-disabled designated units the development must provide. Also, Section 8 designated units cannot carry a City of San Mateo live/work preference and/or public employee preference. If the County awarded 65 instead of 48 Project Based Vouchers, the financing gap would fall by $3,000,000 to $5,000,000, holding all other base case assumptions constant.

Figure 9: Summary of Financing Scenarios

Scenario	Gap Reduction	Gap Remaining
Base Case	$0	$8 M
Option 1: 100% Tax Credit Units	$5.5 M	$2.5 M
Option 2: Concurrent Construction	$2 M	$6 M
Option 3: More City Subsidy	$1.5 – 2 M	$6.5 – $6 M
Option 4: More County Project Based Vouchers	$3 M	$5 M

Section V: Conclusion

The DTSM Opportunity Sites project will provide high quality workforce housing and public parking at the gateway to downtown San Mateo. The project is progressing on schedule toward entitlement in June 2020. In anticipation of reaching this project milestone, and the critical design and underwriting work that will follow in preparation for a 2021 finance closing and construction start, MidPen appreciates the opportunity to communicate updated project information to City Council.