THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Analysis of the Proposed Sale of Tailgate Park

OVERVIEW

The Economic Development Department (EDD) is seeking Council approval of a Development and Disposition Agreement (DDA) and ultimate sale of the property known as Tailgate Park to the Padres Development Team. The Padres Development Team is made up both the Padres Baseball Team as well as the development firm Tishman Speyer. Tailgate Park is a 5.25 acre parcel which was previously owned by the City's Redevelopment Agency, and is subject to state redevelopment dissolution laws.

The DDA and sale of the property would require the Padres Development Team to develop the property into a new housing campus, with 1,800 units of housing, including 10% affordable to households making under 60% of the area median income (AMI) and another 5% affordable to 150% AMI households. The project also includes the development of a park in the northwest corner, 50,000 square feet of retail and/or office space, the provision of 1,200 public above grade parking spaces to satisfy the City's 1,060 space parking requirement, as well as other amenities. This proposal was heard at the Economic Development and Intergovernmental Relations Committee on March 9th, 2022.

Our office received questions from several Councilmembers and the public concerning the proposed DDA and sale of the property, and in particular how recent state changes to the Surplus Lands Act either impact the property, or could impact the property if the DDA is not approved by Council. In this report, we explain:

- How redevelopment dissolution laws affect this property differently than other City owned land,
- How this changes the impact of the Surplus Lands Act, and

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- How the combination of the factors limits the ability of the City in its options for disposition of this property.

Ultimately, we recommend that Council approve the DDA presented by EDD staff, though we provide some additional options for the Council to consider should it seek to ensure City revenues from the DDA are further used to enhance affordable housing options.

BACKGROUND

The development of the proposed DDA and project for Tailgate Park has a long history. To understand the unique circumstances surrounding this property, it is important to understand a brief history of redevelopment dissolution laws, recent changes to the Surplus Lands Act, and the history of the development of the proposed DDA.

Redevelopment Dissolution

Prior to 2011, California law allowed local governments to create redevelopment agencies (RDAs) that assisted in the economic redevelopment of various geographic areas. Upon the formation of a redevelopment project area, the share of property taxes generated from that area that went to schools and other local agencies was frozen, and all growth in property tax receipts then went to the redevelopment agency for that area. RDAs would then use the incremental growth in property tax revenue above that frozen base to invest in various developments and activities designed to spur economic growth and increase affordable housing. This approach is generally known as tax increment financing, and the revenue going to RDAs was referred to as the tax increment. In San Diego, the City had three different such entities, including the Centre City Development Corporation which focused on the Downtown area.

In 2011, the California legislature passed AB 26, which effectively dissolved redevelopment agencies throughout the state. The responsibility to fulfill all obligations the former redevelopment agencies had entered into prior to being dissolved was vested in successor agencies. These successor agencies are responsible for liquidating or disposing all properties owned by the former RDA, as well as fulfilling and paying all obligations of the former RDA (these are considered 'enforceable obligations'). Any property tax increment revenues that are not required for enforceable obligations, or that are the result of the sale or other activities of the former RDA, are distributed to the local taxing entities that would have otherwise received that revenue. These distributions are provided through the Redevelopment Property Tax Trust Fund (RPTTF). In San Diego, the City elected to serve as the former redevelopment agency's successor agency for the purposes of winding down redevelopment obligations, making payments on enforceable obligations, and liquidating the agency's unencumbered assets.

For properties owned by the former RDAs, the City, in accordance with state laws, developed a Long-Range Property Management Plan (LRPMP), which identified all of the non-housing assets owned by the former RDA and determined how these properties would be disposed, with sales proceeds being distributed to local agencies through the RPTTF. This LRPMP was approved by the Oversight Board for the Successor Agency and the California Department of Finance in October 2015. For the most part, properties identified in the LRPMP were either to be liquidated (i.e. sold to the highest bidder without any development conditions) if there were no other lease

encumbrances on the property, or the properties were identified for future development with conditions. For future development projects, the LRPMP is required to identify the type of development that would be sought, and the successor agency must enter into a reimbursement agreement with all affected taxing entities prior to the final disposition of the property. Tailgate Park is identified in the LRPMP as a future development project due to the site's parking requirement.

Surplus Lands Act

The Surplus Lands Act is a state law that provides conditions local governments must meet in order to dispose of surplus land. Surplus land is defined under the law as land owned in fee simple by the City for which the Council takes formal action in a regular public meeting declaring that the land is surplus and not necessary for the City's use.

AB 1486, approved in 2019 and effective January 1, 2020, amended the Surplus Lands Act by changing the process applicable to local agencies' disposition of surplus land and tasked the California Department of Housing and Community Development (HCD) with monitoring local agency compliance with the new law. In general, AB 1486 strengthened the process by which local agencies must offer surplus lands to local housing developers for the development of affordable housing. In general, if a developer is going to use surplus land for development of affordable housing, it must make at least 25 percent of the units affordable to households making at or under 80% of the area median income (AMI).

As it concerns the activities of successor agencies to former RDAs, AB 1486 also expanded the definition of local agencies subject to the Surplus Lands Act to include successor agencies and the properties owned by those agencies. However, AB 1486 *also* allows any properties owned by a successor agency that are covered by an exclusive negotiating agreement or other legally binding agreement that was entered into no later than December 31, 2020, and disposed of no later than December 31, 2022, to be exempted from provisions of AB 1486.

Project History

As part of the formation of the Ballpark District, the former RDA acquired the subject property in the early 2000s for the construction of Tailgate Park, which is a 1,060 space surface parking lot in order to satisfy a portion of the parking required as part of the Ballpark's approval, and as a mitigation measure within the Final Subsequent Environmental Impact Report (FSEIR) for the overall district. Subsequent leases were signed between the former RDA and the Padres that memorialized the requirements to maintain the parking should the former RDA seek to develop the property to a higher and better use. The lease with the Padres currently runs through 2044, as the overall lease is tied to the Joint Use Management Agreement (JUMA) between the City and the Padres for the operation of PETCO Park. Further extensions of the JUMA could also lead to further extensions of the lease.

After dissolution of the RDA, the property was included in the LRPMP as a future development site. The proposed use for the site in the LRPMP is described as "future development as a mixed-use, transit-oriented development consistent with the San Diego Downtown Community Plan

(office, hotel, retail, residential, entertainment, public) intended to maximize the site's value, support the adjacent Ballpark District, and accommodate required Ballpark parking in accordance with the lease as well as the FSEIR."

The City initiated a development process for this property in November 2019 that involved a competitive Request for Proposals (RFP) and bidding process. The RFP also indicated that the goals of the City included, among others, maximizing financial returns, satisfying the parking lease terms, and developing the property in line with the LRPMP. Approximately one year later, in November 2020, the City Council approved the Exclusive Negotiation Agreement (ENA) with the current Development Team, which was selected through the RFP process. The project at that time envisioned a mostly commercial campus with limited housing and other amenities. At this same time - November 2020 - the City agreed to a Compensation Agreement with the affected taxing entities that outlined how proceeds from the site would be distributed, and that and set a goal for maximizing financial return. The ENA was subsequently extended in October 2021 due to delays in the Development Team's ability to conduct due diligence and site investigation activities. These delays were caused by the property's use as a COVID-19 vaccination site in early 2021.Because the project had an ENA prior to December 31, 2020, it appears that the site is exempt from the requirements of the Surplus Lands Act, so long as the transaction closes by December 31, 2022. Our office recommends that any further questions regarding the applicability of AB 1486's exemption should be directed to the City Attorney's Office.

FISCAL AND POLICY DISSCUSSION

The Tailgate Park site and the proposed DDA have a long history, both due to the complicated nature of the transaction as a former redevelopment property as well as the lengthy and thorough solicitation and negotiation process that EDD staff engaged in to prepare and present the current DDA. Several Councilmembers have asked if more affordable housing than what is currently proposed if the property could be provided if instead of approving the current DDA, the City were to allow the site to become subject to additional AB 1486 requirements that would be required if the DDA and subsequent deals do not close before December 31, 2022.

After careful review of the proposed DDA for Tailgate Park, our Office determined that it is unlikely that more units of affordable housing would be developed if the site were subject to all AB 1486 Surplus Lands Act requirements.[1]. Our Office also notes that the current DDA accomplishes *multiple* policy goals in that it both fulfills the requirements of the successor agency to dispose of the site, *and* provides for development of additional affordable housing within the City. In the next section, we explain how the DDA accomplishes these goals. We also provide additional policy options for Council that could further increase affordable housing production with the proceeds from this transaction.

[1] Our office can not say with full certainty that more units of affordable housing could not be developed at the site, however, as will be discussed, requirements and conditions associated with the Tailgate Park site make the development of additional affordable units beyond what is being proposed economically unfeasible absent any additional development subsidy.

Compliance with Redevelopment Dissolution Laws

A primary objective of City staff in negotiating the disposition of this property is compliance with state redevelopment dissolution laws. As previously stated, redevelopment dissolution requires the City to unencumber the former RDA of this property, and as part of that process the City included the subject property within the LRPMP. As such, the City has an obligation to follow the approved LRPMP's objectives for the site, which importantly include the goal to maximize the site's value.

The provision to maximize the site's value is also included in the Compensation Agreement with the relevant taxing entities agreed to at the end of 2020. The Compensation Agreement also included language that stated that the City would "*seek to maximize the net proceeds from the sale of the site, while also requiring the recommended Buyer/Developer to meet site-specific development requirements and an expeditious development schedule*" for this property. The City therefore has an obligation to the other taxing entities to generate a maximum financial return.

The proposed purchase price for the property is $35.1 million, which is above the site's appraised value of $34.0 million. The site's appraisal considers the maximum development of the property, including consideration for the unbuildable land due to fault lines and the parking requirements that must be met per the lease. The $35.1 million figure was derived from a valuation which determined project specific factors, such as income from residential and commercial rent and parking income, project development costs, and site considerations. Given that the agreed upon purchase price of $35.1 million is above the "fair market value" for the property determined by the appraisal, Council's approval of the DDA as presented would fulfill the City's obligations under the LRPMP and Compensation Agreement.

It is important to note that the City is only entitled to 17% of the sale proceeds per the Compensation Agreement, which is in line with the City's share of former redevelopment fund distributions from the RPTTF. Hence, the City's share of the proceeds is just under $6.0 million, with balance due to the other taxing entities.

A significant concern associated with disregarding the site's exemption from AB1486 requirements and proactively seeking to have this property go through the Surplus Lands Act process is that the process is likely to result in a lower sales price. This could lead the other impacted taxing entities to deem that the Council effectively lowered the maximum value of the property, thereby violating the terms of the LRPMP and the Compensation Agreement. This could require the City to pay the other affected taxing entities the difference between their portion of the actual proceeds and what their portion would be if the land were to sell at the current $35.1 million valuation. The City Attorney's office may be able to offer additional context on this potential liability, though we note that if it exists, it may exist in an amount as high as $29.1 million (assuming the price goes down to nothing), and would be avoided by approving the DDA as currently written. We discuss how enhanced affordability requirements may impact the sales price in the next section.

Even if this liability does not exist, the City would still have to secure a minimum amount of proceeds for the property in order to avoid a requirement to subsidize the other taxing entities. The Compensation Agreement guarantees the taxing entities a minimum sales price of $8.4 million for

the property, of which the remaining taxing entities are due approximately $7.0 million (i.e. 83% of the minimum price). Thus, if the City were to create a condition upon the property, or if the property were to require a significant land subsidy due to the amount of affordable housing required on the property, to such an extent that the value of the property were to be taken up by the subsidy, the City would have to pay the taxing entities a minimum of $7.0 million.

Affordable Housing Creation

This project will increase the amount of affordable housing, as well as the overall stock of housing, within the City. The project as proposed includes two levels of housing affordability: 10% of the units will be affordable to households at or below 60% AMI, and 5% of the units will be affordable to households at or below 150% of AMI. This equates to a total of 180 units at the low-income threshold and 90 units at the moderate-income threshold. Based on the construction timeline and the provisions of the DDA, a majority of these units (147 of the 270) will included within Phase I of the project, which is projected to be completed between April 2028 and October 2029, depending on when the project commences.

The low-income affordable units comply with the City's Inclusionary Housing Ordinance, and the moderate-income units were secured by City staff as part of negotiations. Notably, the Development Team is proposing to include the Inclusionary units within the project, as opposed to paying the in-lieu fee. According to City staff, any additional affordable units, or a deeper level of affordability, would have required a reduction of the site's purchase price. Based on the Compensation Agreement with the other affected taxing entities, any decrease in the overall purchase price would likely have to come out of the City's $6.0 million share of the proceeds.

Increasing the number of affordable units proposed would likely require additional development subsidies. Our Office analyzed the potential amount of that subsidy by reviewing the Residual Land Value of the property, which is what the proposed sales price is based upon, if 25% of the project's units were required to be affordable, with 10% affordable to households at 60% AMI to comply with the Inclusionary Ordinance, and 15% affordable to households at 80% AMI based on provisions of the Surplus Lands Act. Our analysis is included as an appendix to this report.

As compared to staff's review, our analysis keeps unchanged as many variables as possible, including the distribution of units between unit size and type, the assumptions on rent levels, and many the other factors, as we are estimating the difference in a developer's income from residential units between the current proposal and one that contains 15% of the units at 80% AMI affordability as opposed to 5% at 150% AMI affordability. We only changed other variables to the extent that reducing market rate units would lower income sources or development costs other than unit rent. Importantly, we also only ran one scenario, and did not seek to run multiple scenarios to see what scenarios, if any, would have resulted in a project that approaches financial feasibility. This analysis was conducted only to get a sense of the magnitude of the subsidy required for the number of affordable units required by AB 1486 and the Surplus Lands Act.

Based on this analysis, we conclude that the project as proposed would most likely no longer be financially feasible, as it would require approximately $97.4 million in development subsidies in order for the project to pencil out as well as for the Residual Land Value to remain above the

appraised value of the site. Thus, in order to meet these higher affordability thresholds, the project would either have to be much smaller and contain significantly fewer total residential units than currently proposed, or would have to secure significant external affordable housing resources in order to make the project financially feasible. Both of these options could be complicated by the conditions and requirements at the site, including the parking requirements, fault lines causing more than 25% of the acreage to be unbuildable, and the environmental remediation required for below-grade development. It is also likely that restarting the disposition process for the site under the full Surplus Lands Act requirements could lead to up to five additional years of development time. Given all of these constraints, we conclude that not approving the DDA as presented would likely result in fewer total housing units being built on the site, fewer affordable units being built on the site, and a longer time period before any units are be developed.

However, if the Council wishes to further increase the number of affordable housing units in the City that result from this transaction, it does have options. The City's share of proceeds from the site's sale would be considered unrestricted General Fund revenue. Council could leverage the project for additional affordable housing by dedicating those proceeds to one of the affordable housing funds that the City and the San Diego Housing Commission oversee. If these proceeds were to be used for an affordable housing program, such as within the Bridge to Home program, these funds could result in the production of up to an additional 120 deeply affordable units beyond those provided by the proposed DDA, per City staff estimates based on projects funded within that program to date.[2]

CONCLUSION

The Tailgate Park site and the proposed DDA have a long history, and the complicated nature of the transaction as a former redevelopment property, as well as the lengthy and thorough solicitation and negotiation process that EDD staff engaged in to prepare and present the current DDA, lead to a number of important considerations. Our Office recognizes Council's goals to maximize the production of affordable housing to help combat the City's housing crisis and the severe and pervasive shortage of affordable housing and housing more generally.

While some have suggested that rejecting the proposed DDA and requiring the Tailgate Park site be disposed of through the AB 1486 Surplus Lands Act Process may result in more affordable housing being built, our Office believes that the proposed DDA largely maximizes the number of affordable housing units at the site that are economically feasible without additional subsidies, and we note that if the City were to dedicate its proceeds from the proposed DDA to additional affordable housing, the potential to support the development of even further affordable housing units exists.

Our Office therefore recommends that the Council approve of the DDA as presented by EDD staff in order to dispose of the property known as Tailgate Park in accordance with state redevelopment laws. Approving the DDA as proposed will keep the City in compliance with state redevelopment dissolution laws and the Surplus Lands Act, and achieve numerous other policy objectives including the production of total 1,800 housing units, including 180 affordable housing units for

[2] We do note that as these proceeds would be unrestricted General Fund revenues, if these funds have already been programed in the Proposed Budget, Council may have to find additional resources to maintain service levels supported by the Proposed Budget.

households at 60% AMI and 90 units for households at 150% AMI. Approval of the DDA will also secure the City almost $6.0 million in unrestricted General Fund revenue that could be dedicated to additional affordable housing if Council so determines. Meanwhile, not approving the DDA could result in increased legal and financial liability to make the affected taxing entities whole while bringing about a project that would most likely not be as advantageous to the City in terms of both the total number of affordable housing units and total housing units developed.

We would like to thank City staff from EDD and the City Attorney's Office from answering our questions in regards to this transaction, and our Office stands ready to assist the Council further.

Jordan More
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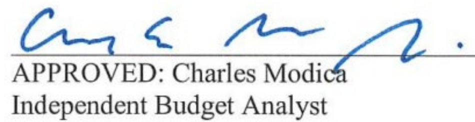

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AFFORDABILE HOUSING FINANCIAL ANALYSIS

As part of our analysis of the potential for this project to absorb additional affordable housing without requiring the City to subsidize the project, we attempted to modify the analysis of the financial affordability of the project. We started with the re-use analysis prepared by KMA, which concluded that the fair re-use value of the Property to be $35.1 million. Below we provide various tables which display the factors in the original analysis compared with factors that we have calculated in order to determine the impact of deeper affordability to a greater number of housing units within the project. To the greatest extent possible, we have only changed variables related to including more affordable housing units within the existing project, to bring them in line with the requirements provided in the Surplus Lands Act and the changes required by AB 1486.

Table 1 displays the differences in Gross Schedule Income (GSI) between the proposed project and a project with deeper affordable housing options, which we refer to as the "affordable scenario". In determining how more affordable units would impact the Residential GSI for the project, we removed the 150% AMI units from the calculation, and replaced them with units at an 80% AMI affordability level. In doing so, we maintained across the scenario the same number of total studios, one-bedroom, and two-bedroom units; our only other change is to moving a sufficient number of units from the market rate category to the 80% AMI category necessary to comply with the Surplus Lands Act and AB 1486 requirements that 25% of total units are considered affordable. The monthly rent is adjusted to meet the 80% AMI affordability level as well. As displayed in the table, the deeper level of affordability results in a loss of approximately $4.5 million to the GSI.

Table 1 - Gross Schedule Income

Proposed Project					**Project with Deeper Affordability**				
Affordable Units		**# of Units**	**Monthly Rent ($)**	**Annual Income ($)**	**Affordable Units**		**# of Units**	**Monthly Rent ($)**	**Annual Income ($)**
Studio	60% AMI	64	$1,195	$918,000	Studio	60% AMI	64	$1,195	$918,000
	150% AMI	30	2,416	870,000		80% AMI	93	1,593	1,778,000
1BR	60% AMI	72	1,362	1,177,000	1BR	60% AMI	72	1,362	1,177,000
	150% AMI	36	2,762	1,193,000		80% AMI	108	1,816	2,353,000
2BR	60% AMI	44	1,508	796,000	2BR	60% AMI	44	1,508	796,000
	150% AMI	24	3,081	887,000		80% AMI	69	2,010	1,664,000
Total		**270**		**$5,841,000**	**Total**		**450**		**$8,686,000**

Market Rate Units		**# of Units**	**Monthly Rent ($)**	**Annual Income**	**Market Rate Units**		**# of Units**	**Monthly Rent ($)**	**Annual Income**
Studio	Market Rate	536	$2,650	$17,045,000	Studio	Market Rate	473	$2,650	$15,041,000
1BR	Market Rate	612	3,425	25,153,000	1BR	Market Rate	540	3,425	22,194,000
2BR	Market Rate	382	4,445	20,376,000	2BR	Market Rate	337	4,445	17,976,000
Total		**1,530**		**$62,574,000**	**Total**		**1,350**		**$55,211,000**

	# of Units		**Annual Income**		**# of Units**		**Annual Income**
Total Gross Schedule Income	**1,800**		**$68,415,000**	**Totals**	**1,800**		**$63,897,000**

In Table 2, we have included the newly calculated GSI and made adjustments to both the Vacancy factor as well as the Other Income and Operating Expenses categories to come up with a new Net Operating Income (NOI) – Residential for the affordable scenario. We have adjusted Vacancy,

calculated as 3.0% of the GSI, accordingly. For Other Income, the variable requiring adjustment is the amount of parking revenue from residents. This is calculated at $150 per market rate unit per month. Since there are fewer market rate units in the affordable scenario, this has also been adjusted. Finally, Operating Expenses were adjusted to account for increased costs for the San Diego Housing Commission Monitoring Fee due to an increase in the number of affordable units in the project. The results to total NOI – Residential are presented at the bottom of the table, resulting in a loss of $4.7 million.

Table 2 - Net Operating Income	**Proposed Project**	**Project with Deeper Affordability**
Gross Schedule Income	$68,415,000	$63,897,000
Vacancy	(2,052,000)	(1,917,000)
Other Income	9,245,000	8,921,000
Effective Gross Income	**75,608,000**	**70,901,000**
Operating Expenses	(24,330,000)	(24,357,000)
Stabilized Annual Net Operating Income	**$51,278,000**	**$46,544,000**

Finally, in Table 3, we have updated the Residential NOI to come up with a new Maximum Supportable Investment. Nothing was changed to the Retail NOI or the Padres Parking Garage NOI. When applying the same Target Return on Investment of 4.5% to the NOI, the affordable scenario's Maximum Supportable Investment is $1.08 billion, which is $104.9 million below the proposed project's Maximum Supportable Investment. To then determine the affordable scenario's Residual Land Value, we adjusted the Development Cost excluding Acquisition to account for a smaller amount of residential parking, since there would only be one parking space built per market rate unit. As displayed in the table, the affordable scenario results in a Residual Land Value of negative $14.3 million, which when adjusted for the costs of the Padres Parking Garage, results in an Adjusted Residual Land Value of negative $62.3 million, which is $97.4 million below the proposed project's Adjusted Residual Land Value of $35.1 million.

Table 3 - Residual Land Value	**Proposed Project**	**Project with Deeper Affordability**
Retail NOI	$1,425,000	$1,425,000
Residential NOI	51,278,000	46,544,000
Parking NOI	835,000	835,000
Total NOI	**53,538,000**	**48,804,000**
Target Return On Investment	4.51%	4.51%
Maximum Supportable Investment	**$1,186,743,000**	**$1,081,807,000**
Less Development Costs	(1,103,643,000)	(1,096,143,000)
Residual Land Value	***$83,100,000***	***($14,336,000)***
Padres Parking Garage	(48,000,000)	(48,000,000)
Adjusted Residual Land Value	***$35,100,000***	***($62,336,000)***

Based on this analysis, we believe the proposed project would require significant subsidies, most likely in the development costs for the affordable units. It is also important to note that we did not run any other scenarios or rerun the project at various sizes to determine what would be a financially feasible project, including an increase in the total number of units, as this would be beyond the scope of this Office's expertise at this time. However, we do believe that this analysis does demonstrate how greater levels of deeper affordability would require subsidies for this project that are beyond the appraised value of the site, at almost three times that cost.