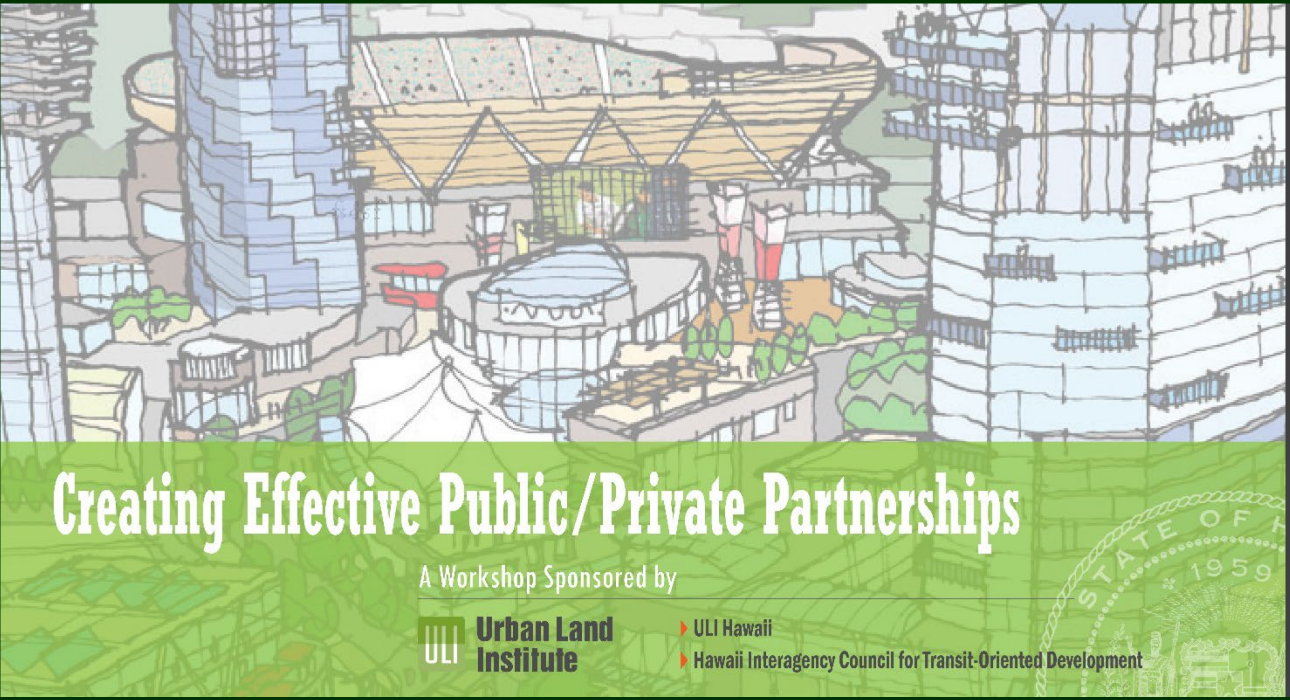

ULI Public/Private Partnerships Workshop

Tuesday, May 7, 2019
8:30 am – 3:30 pm

HCDA 1st Floor Community Room
547 Queen Street, Honolulu

Public Private Partnerships: Tools for TOD, Affordable Housing, Revitalization

Charles A. Long
Junction Properties, LLC

Honolulu, HI

May 7, 2019

Urban Land Institute
PPP Workshop

Outline for today

I. Introductions / Objectives

II. The development process and real estate finance

III. Public Private Partnerships: why are they now a critical tool for community vitality?

IV. The tools of public private partnerships

V. Doing a deal!

Charles A. Long
Junction Properties, LLC
775-742-9166
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- Developer specializing mixed use development in California
- Consultant on redevelopment, capital finance and economic development
- Instructor for ULI Real Estate School on development process, public-private partnerships and sustainable development
- Former city manager of Fairfield and interim manager in Mammoth Lakes, Hercules and Pinole, CA
- Author of “Finance for Real Estate Development “ published April 2011. Winner of 2012 Silver Award, NAREE
- Served on 18 ULI advisory panels, chairing panels in Salem OR, Boise, ID, Dallas, TX, Buffalo, NY, Pasco County, FL, San Bernardino, CA
- Masters in Public Policy, UC Berkeley; platoon sergeant, US Army

Under construction-Two Uptown Oakland Projects

471 26th Street (97 residential apartments)

570 21st Street (78 residential apartments)

Finance for Real Estate Development

published by ULI

April 2011

Winner NAREE

Silver Award 2012

Panel

PPP in Hawaii: Opportunities & Challenges

Stanford Carr

President
Stanford Carr Development LLC

Chris Kinimaka

Public Works Manager
State Dept of Accounting & General Services

Harrison Rue

Community Building & TOD Administrator
City Dept of Planning & Permitting

Jon Wallenstrom

Principal
Alaka'i Development

Creating Effective Public/Private Partnerships

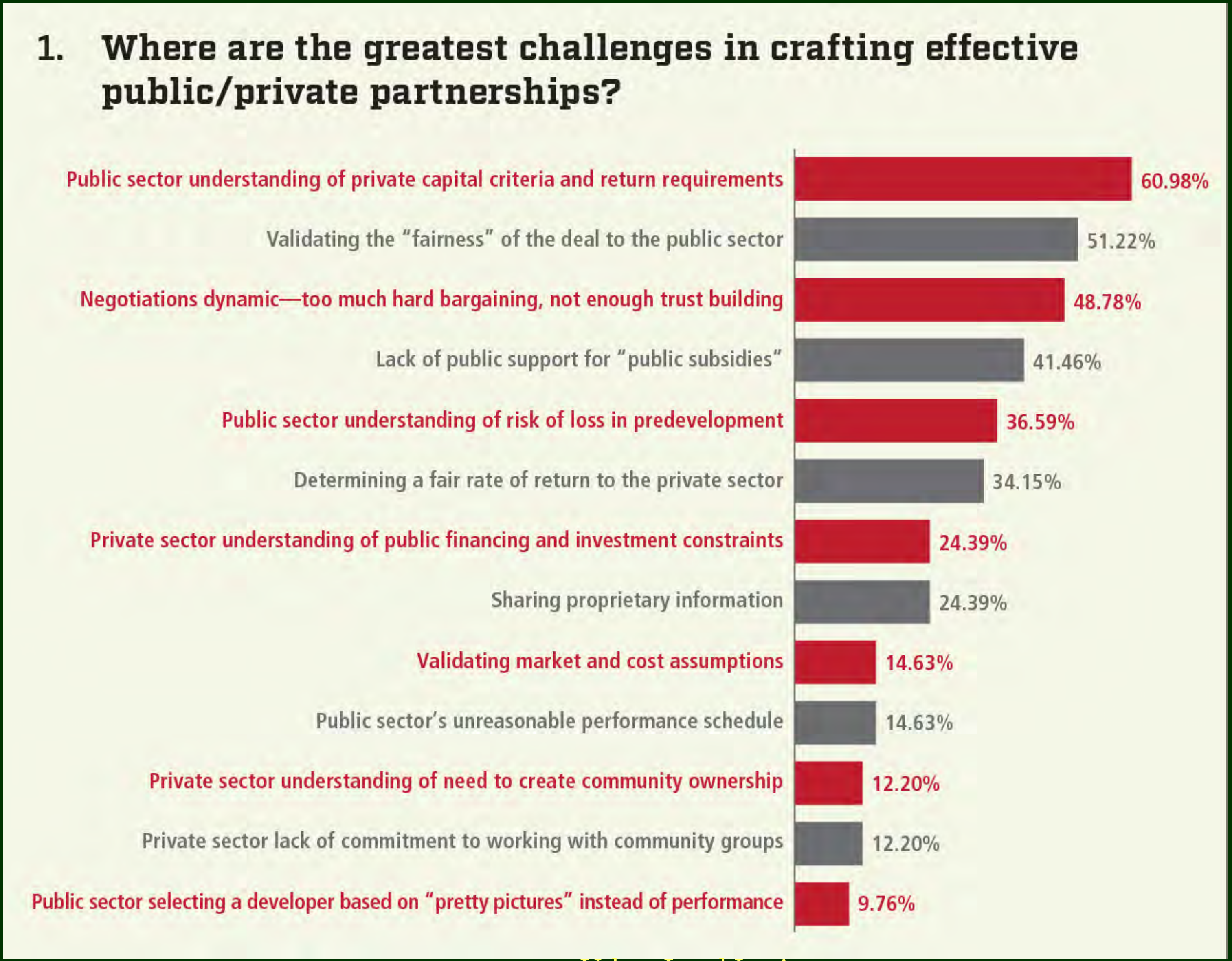
A Workshop Sponsored by

Urban Land Institute

- ULI Hawaii
- Hawaii Interagency Council for Transit-Oriented Development

STATE OF HAWAII 1959

The Challenges to successful Public Private Partnerships

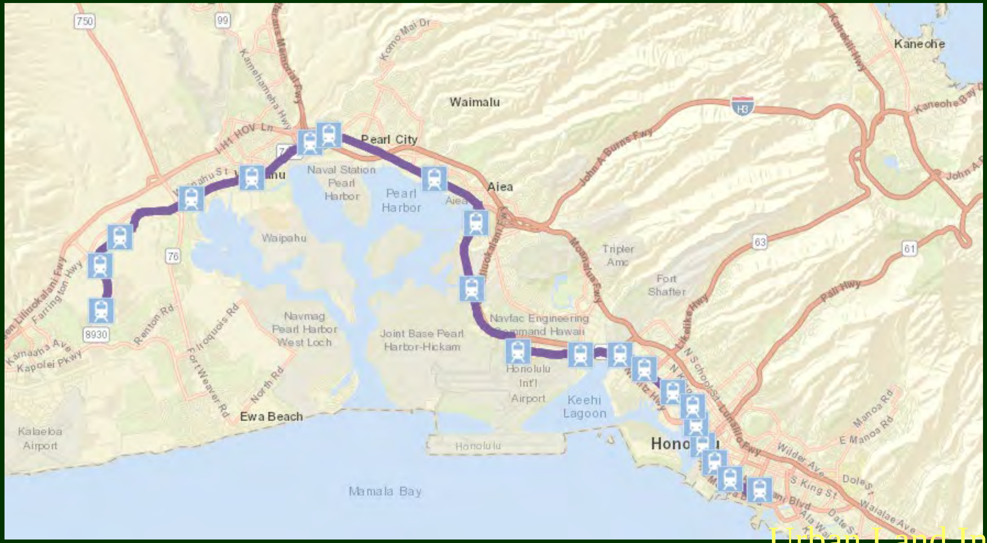


Public Private Partnerships pending on Oahu

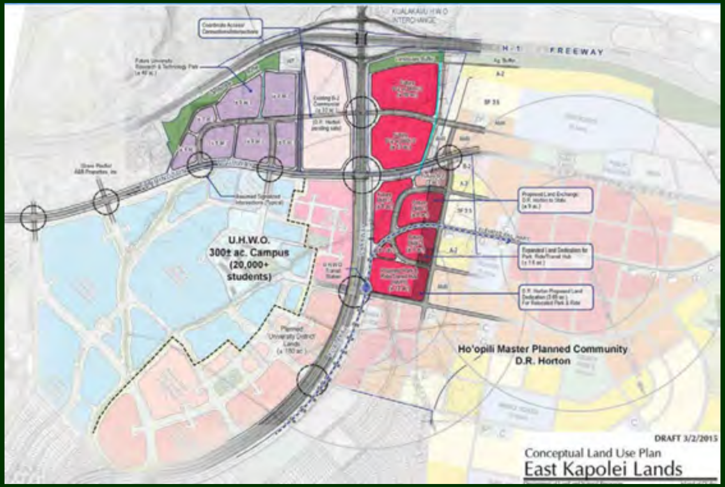
Aloha Stadium Redevelopment

Mayor Wright Homes Redevelopment

HART: 21 Transit Stations



East Kapolei Master Development Plan



Key Issues

1. Connection to transit
2. Financing and delivery
3. Housing Renewal
4. Affordable Housing
5. Placemaking
6. Anti-Displacement
7. Community acceptance

Learning Objectives:
For you to understand:

1. The basics of real estate finance to be able to conduct an open and transparent negotiation process.

2. The work flow to successful partnerships.

3. Who you need to have on your team.

4. The 8 tools of public private partnerships and the resources needed to effectively deploy these tools.

5. How to craft a fair and validated deal that is supported by the community.

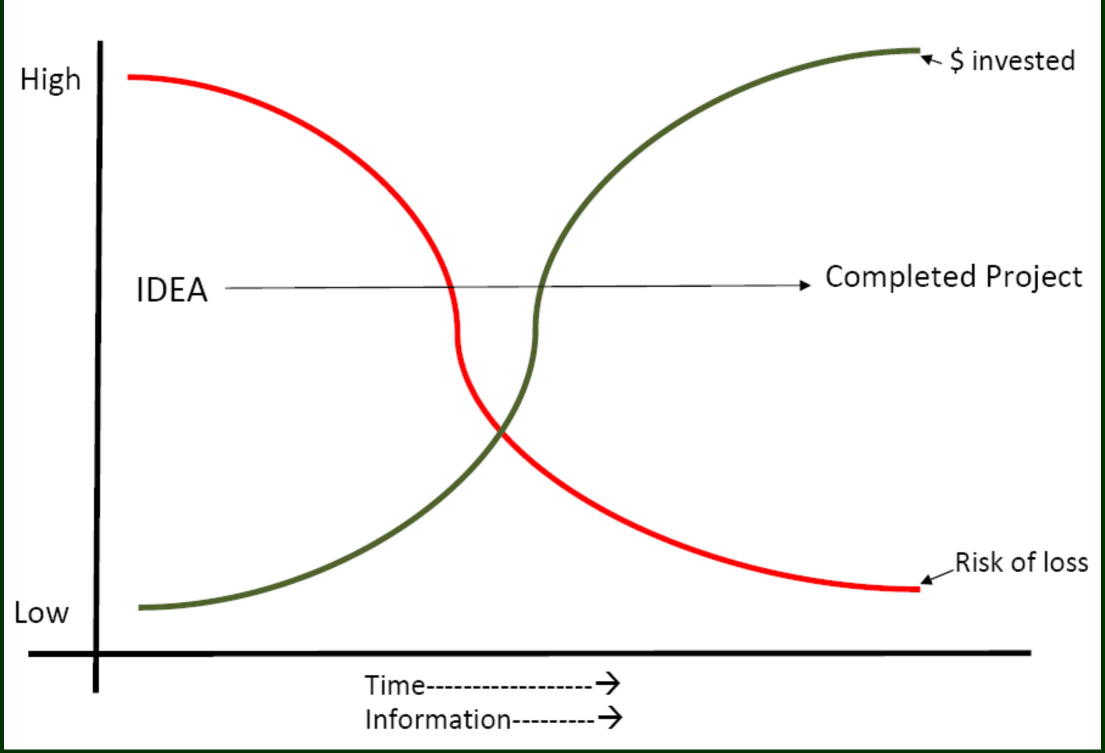
Introductions

- Your objectives from this course

II. The Development Process and Real Estate Finance

Development is…

a <u>separate self financing</u> enterprise that goes from small to large.



The Development Process has three phases

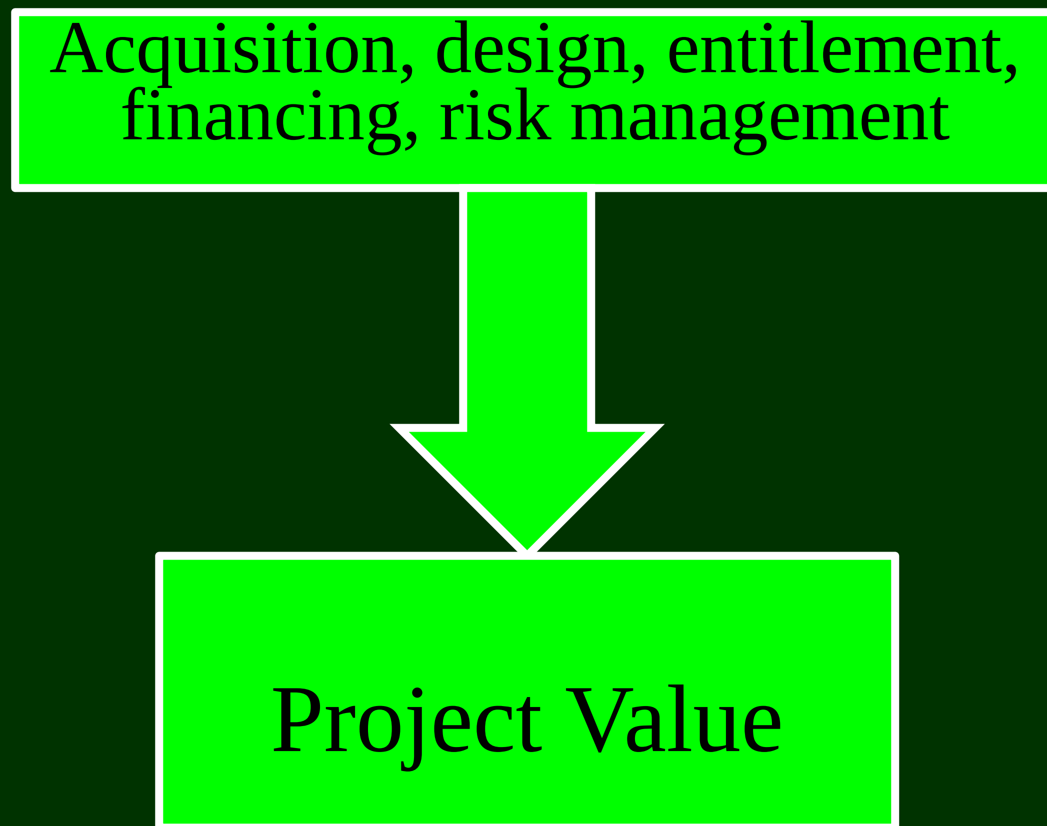
Stages	Pre-Development	Development	Close-out
% of total project budget	5%-15%	80%-90%	5%-8%
TASKS	*Site selection*	*Close on land purchase*	
	Negotiate terms of land aquistion and execute purchase constract		
	Due Diligence on land		
	Market Analysis	*Continue to monitor market conditions and financial viability*	*Leasing or selling*
	Pre-leasing and pre-sales planning	*Initiate marketing and lease-up/sale*	
	Site Analysis	***Construction:*** *Implement construction management strategies*	*Construction close-out, punch list and tenant move in*
	Design Development		
	Project Design		
	Pre-construction planning		
	Financing Analysis	*Comply with financing source requirements*	*Provide return to financing sources*
	Financing Commitments		
	Entitlement	*Set up property management*	***Ongoing project management***

Six areas of focus

- Site acquisition, conditions and cost
- Market Dynamics
- Community (Entitlement, time, costs, stakeholders)
- Design and Configuration
- Construction cost and management
- Financing/ Capital Stack

Success in PPP requires work in these six dimensions

80% to 90% of project value is created in the pre-development phase



Pre-development Risk

Entitlement—Site Assembly—Cleanup

Funding for pre-development comes primarily from developer capital.

Developers avoid opportunities with high pre-development risk and cost.

Questions

1. Why do developers have the highest risk of losing money before construction starts?
2. What implications does this risk profile have for the public sector for creating a public private partnership?
3. What are the six areas of focus to effectively manage a real estate project?

Real Estate Investment is based on an adequate return.

Value - Costs = Return

How much return is needed for a project to be financially viable?

A viable project has a value sufficient to:

1. attract debt and equity to fund all project costs (including cost of capital) and
2. compensate the developer for skill and time

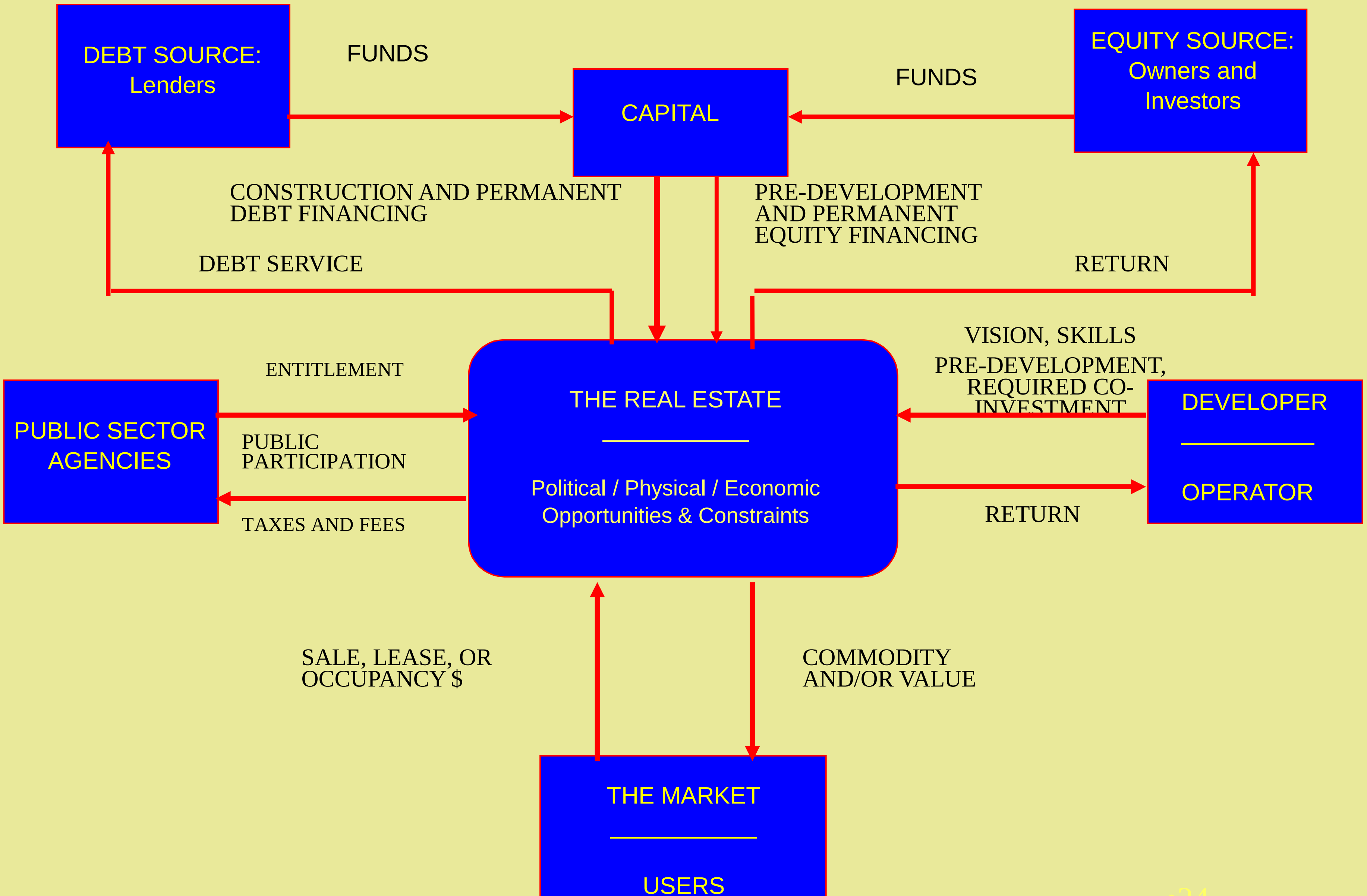
Value – Cost =Return
which pays:

- Cost of debt: interest on a construction loan (variable rate 4% to 6.5%)
- Return on equity: return to investors (15% to 20%)
- Developer profit: based on project performance after paying costs of capital.

Return depends on:

- Market conditions
  - Pricing of existing product
  - Rents, cycle, etc.
  - Investor underwriting criteria
- Distribution of costs over the project
- Time to start and to construct
- Leverage—debt costs less than equity

Basic Financing Structure Involving Debt and Equity



Capital funding categories

Equity

- Return from project performance
- Paid in tiers (the waterfall)
- Much higher return than debt
- Funds <u>before</u> debt

Mezzanine or performing debt

- The value-add play
- Return from interest rate and from performance

Debt

- Pays an interest rate
- Costs less than equity
- Secured by a lien on the property
- Amount based on LTV, LTC or DCR
- Lender can foreclose if not paid
- Construction and permanent loans

Real Estate Development is Capital Intensive

Cost of Capital
10% to 35%

Land
5% to 15%

Construction and Fees
60% to 80%

Equity
30% to 40%

Debt
60% to 70%

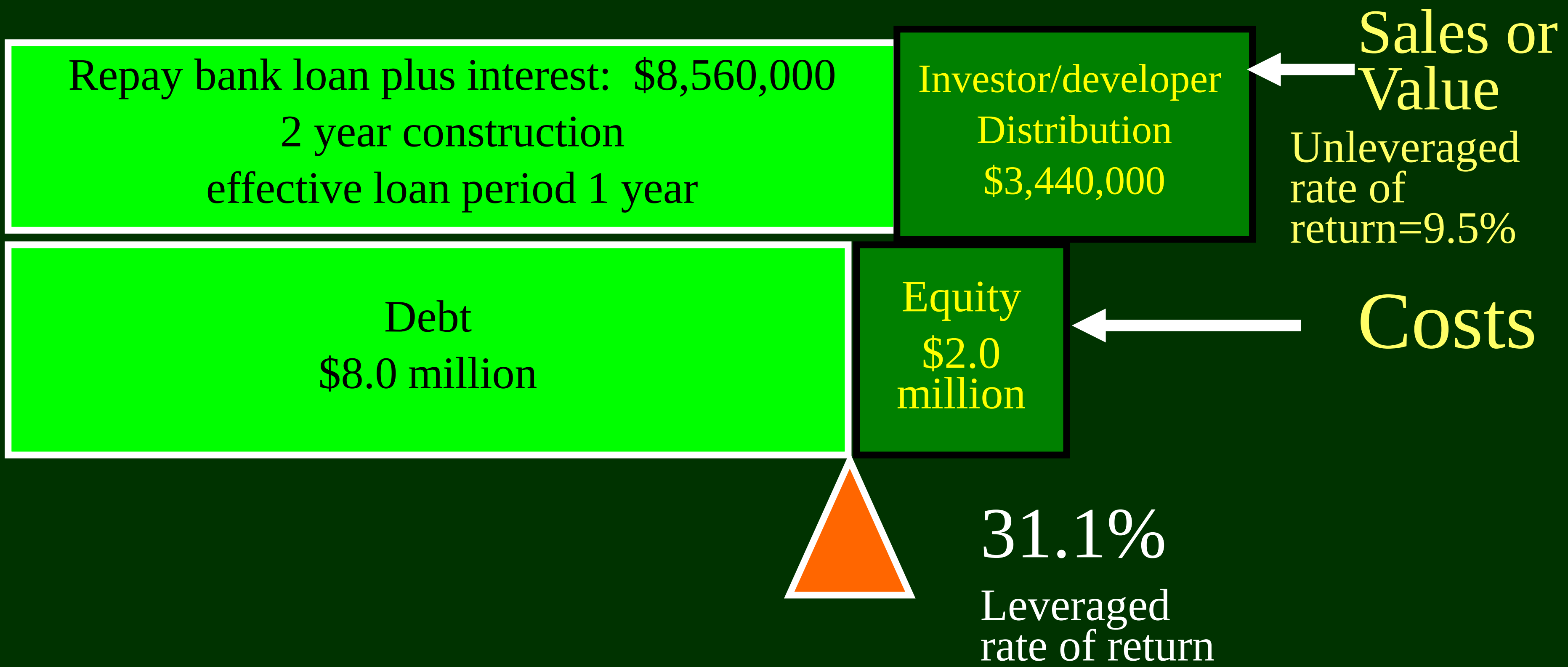
<u>Example</u>

- Apartment project takes 24 months to complete
- 60% leverage—debt at 5%, equity at 20%
- Cost of capital = 20% of other projects costs

Higher % Debt (higher leverage) reduces cost of capital and increases return to Equity.

80% Leverage

80% leverage on a project that costs $10 million and produces $12 million in valuation after 2 year construction



60% Leverage

60% leverage on a project that costs $10 million and produces $12 million in valuation after 2 year construction

Repay bank loan plus interest: $6,420,000
2 year construction
effective loan period 1 year

Investor/developer
Distribution
$5,580,000

Sales or Value

Unleveraged rate of return=9.54%

Debt
$6.0 million

Equity
$4.0 million

Costs

18.11%

Leveraged rate of return

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Project return is expressed many different ways

- Pre-tax Internal Rate of Return(IRR)
  - Leveraged
  - Unleveraged
- Net Present Value
  - Present Value of cash flow (if equal to investment=IRR)

- Net operating income/Total cash cost (the "Development Cap")
- Return on Cost

Use Return on Cost for project feasibility evaluation.

The return on cost measures whether a project is viable

First, what is the blended cost of capital?

Example

Cost of equity: 20% per year (30% of costs) = 6%

Cost of debt: 5% per year (70% of costs) = 3.5%

TOTAL ANNUAL COST OF CAPITAL = 9.5%

If a project takes 2 years to construct, the cost of capital is: 9.5% per year or a total of about 20%.

The minimum required cash-on-cash return is the "hurdle rate" based on blended cost of capital and duration of development period

1-year: about 10%

2-years: about 20%

3-years: about 30%

Valuing a real estate project

For Sale Project

(primarily residential)

Net Sales

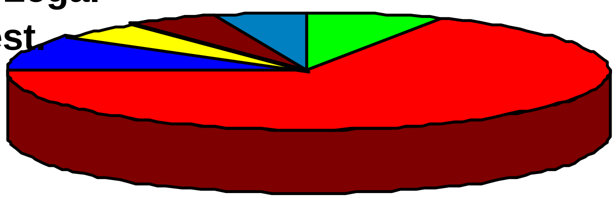
Income projects

(retail, office, apartments, etc.)

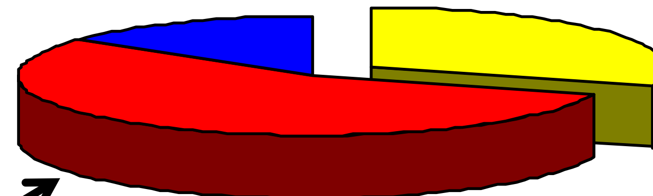
Net Operating Income divided by a “cap rate”

Economics of **Income** Property Development and Ownership

DEVELOPMENT COSTS



FINANCING



Private debt based on
Debt Service Coverage Ratio
OR Loan-to-Value
OR Loan-to-Cost Ratio

OPERATIONS

GROSS INCOME - **OPERATING EXPENSES** = **NET OPERATING INCOME (NOI)** - **DEBT SERVICE** → **OPERATING CASH FLOW (OPCF)**

= Rent
+ Other Income
- Vacancy

= (Maintenance, Management, Taxes, Insurance)
+ Utilities
+ Replacement Reserves

= Periodic Return to Investors

Value of an "income" project.

e. g. apartments, offices, retail stores, industrial buildings, hotels, business parks…; i.e. real estate with a Net Operating Income.

$$\text{Project Value} = \frac{\text{NOI}}{\text{Capitalization Rate}}$$

OR:

$$\text{Capitalization Rate} = \frac{\text{NOI}}{\text{Project Value}}$$

Value an income stream based on two parameters:

- <u>Net Operating Income </u>(NOI): The stabilized annual income resulting from Gross Rental income and maintenance charges (Gross Operating Income) <u>less</u> maintenance, taxes and insurance.

- <u>Capitalization Rate or Cap Rate</u>: A real estate "term of art", expressed as a percentage, indicating current market conditions for valuing a project.

The cap rate indicates how the market values a stream of income (NOI)

Or, the same NOI with a different

- property condition
- sector
- Regional and local market
- capital market conditions

has a different value, and that difference is reflected by the “all in” market indicator called a “cap rate”.

Oahu: wide variation in cap rates

Property Type	Class AA	Class A	Class B	Class C
Multifamily Metro Mid & High Rise	4.55	4.88	5.26	6.10
Multifamily Suburban		5.35	5.68	6.25
Retail Metro (CBD)	5.15	5.36	5.76	6.16
Retail Suburban		5.87	5.96	6.28
Office Metro	5.18	5.64	5.87	6.27
Office Suburban				
All Self-Storage		5.67	6.58	7.92
All Industrial		6.12	6.36	7.00
Hotel Metro (Luxury)(CBD)	6.30	6.90	7.10	7.38
Hotel Suburban	6.70	7.20	7.50	7.86
Hotel Economy			7.86	8.20

Source: Apartment Loan Store, April 29, 2019

What is the project value?

NOI	Cap Rate
$3,000,000	5%
$3,000,000	6%
$2,000,000	4%
$2,000,000	5%

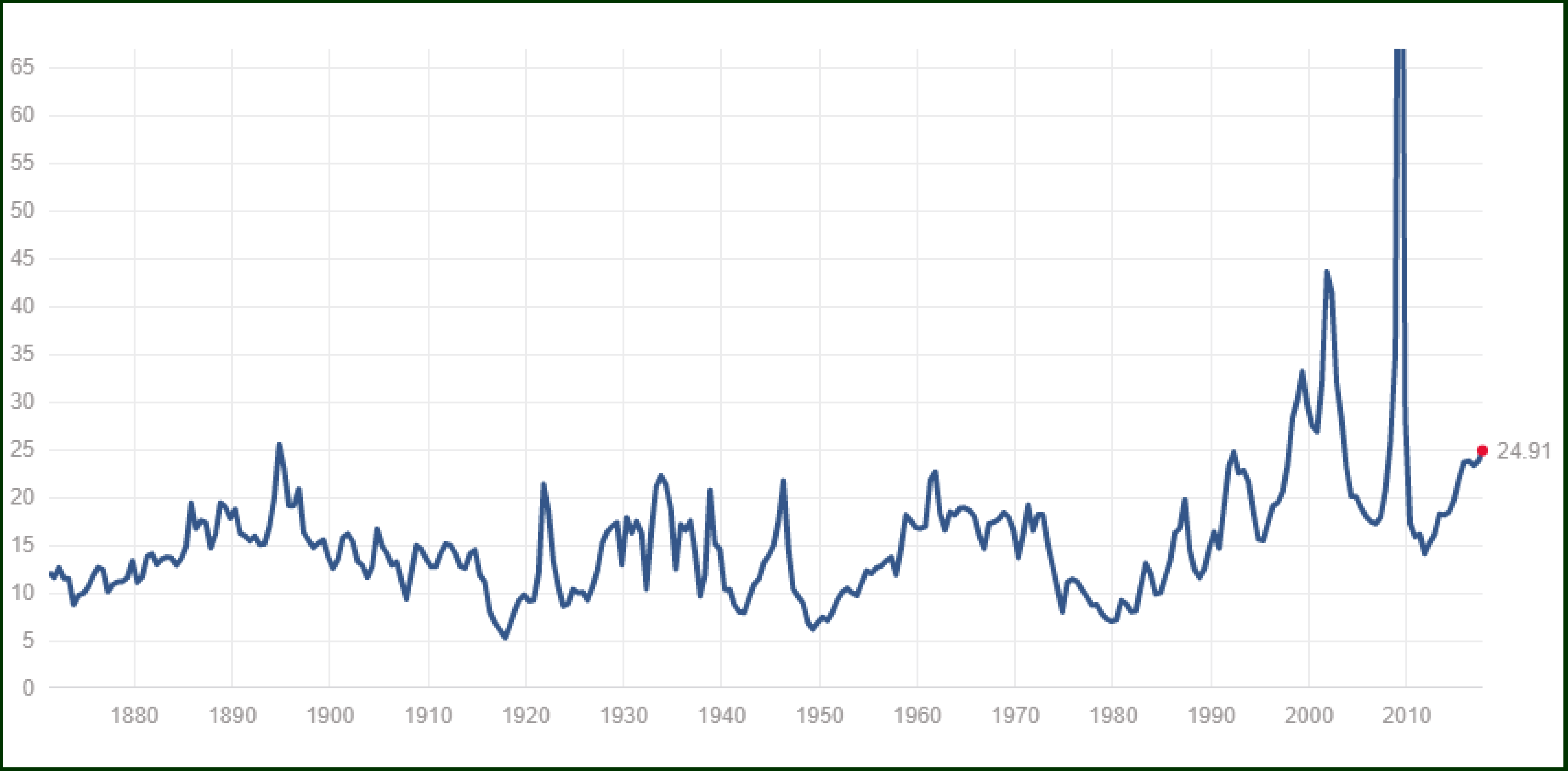
How is the difference in value reflected in the percentage increase between the low and high cap rate?

Cap rate is the inverse of the P/E ratio used in the stock market

Cap rate	P/E Ratio
2%	50
3%	33
4%	25
5%	20
6%	16.7

And, is the same type of market indicator—i.e. an indicator of investor preferences.

S&P 500 PE ratio is up from its historical average of 15.67



Source: multpl web site

Other stock P/E ratios

General Electric	15.87
Microsoft	22.42
Starbucks	26.70
Amazon	273.99

What does a high P/E (or low cap rate) signal about investor expectations on income?

Source: NASDAQ web site

Tesla

$61 billion market value
$7 billion annual sales

P/E Ratio: current (47.05)
Projected 2019 79.59
Cap rate of 1.26%

General Motors

$57.4 billion market value
$166 billion annual sales

P/E Ratio: 6.39
Cap rate of 15.65%

Web sites where you can track cap rates by region, sector and investor type

- CBRE https://www.cbre.com/research-and-reports
- Real Estate Research Council www.rerc.com
- Real Capital Analytics http://global.rcanalytics.com/
- National Council of Real Estate Investment Fiduciaries (NCREIF) http://www.ncreif.com
- Reis: http://www.reis.com/index.cfm

“Hurdle rate” can be used to determine the “Feasible Project Costs ”

$$\text{Feasible Project Costs} = \frac{\text{Project Value}}{1 + \text{hurdle rate}}$$

Pop quiz
What is the Feasible Project Cost?

Project Value	Hurdle Rate
$36,000,000	20%
$39,000,000	30%
$50,000,000	25%
$60,000,000	25%

How much is land is worth?
What you can use it for.

<u>Residual Land Value is:</u>

The price that the project can afford.

THE DEVELOPMENT VALUE.

<u>BASED ON</u>:

A realistic cost pro-forma and project valuation.

Residual land value is the land component of feasible project costs.

$$\frac{\text{Project Value}}{1 + \text{hurdle rate}}$$

Feasible Project Costs

MINUS

Costs without land

=Residual land value

A realistic pro-forma includes:

1. A realistic estimate of PROJECT VALUE
2. A realistic estimate of PROJECT COSTS
   a) *Land (at what the project can afford)*
   b) Hard costs
   c) Fees and Allowances
   d) Architecture and Design
   e) Other “soft costs”
   f) Contingency: (10-15% in early stages)

Return below the “hurdle” is the “funding gap”

The Simple Pro-Forma

Land Area=696,960		Unit Mix 80% Market, 20% Affordable			
APARTMENT MIX	**# of Units**	**Net Square Feet**	**$/SF/Mo.**	**Rent/Month**	**Total Annual**
Apartments--market rate	1,600	800	$3.50	$2,800	$53,760,000
Affordable apartments	400	800	$2.00	$1,600	$7,680,000
Totals:	**2000 Units**	**1,600,000 SF**			**$61,440,000**
Averages:		**800 SF**	**$3.20**	**$2,560**	
COMMERCIAL SPACE		**Net Square Feet**	**NNN Rent**		**Total Annual**
	Retail&commercial	70,000	$24.00		$1,680,000
	Total commercial	**70,000**	**$24.00**		**$1,680,000**
PARKING			GROSS INCOME		**$63,120,000**
Residenital	2,000		Plus: Other income		$6,312,000
Commercial	240		LESS: Vacancy, Operations, Taxes and Reserves		($20,829,600)
Total Parking	2,240		**Net Operating Income**		**$48,602,400**

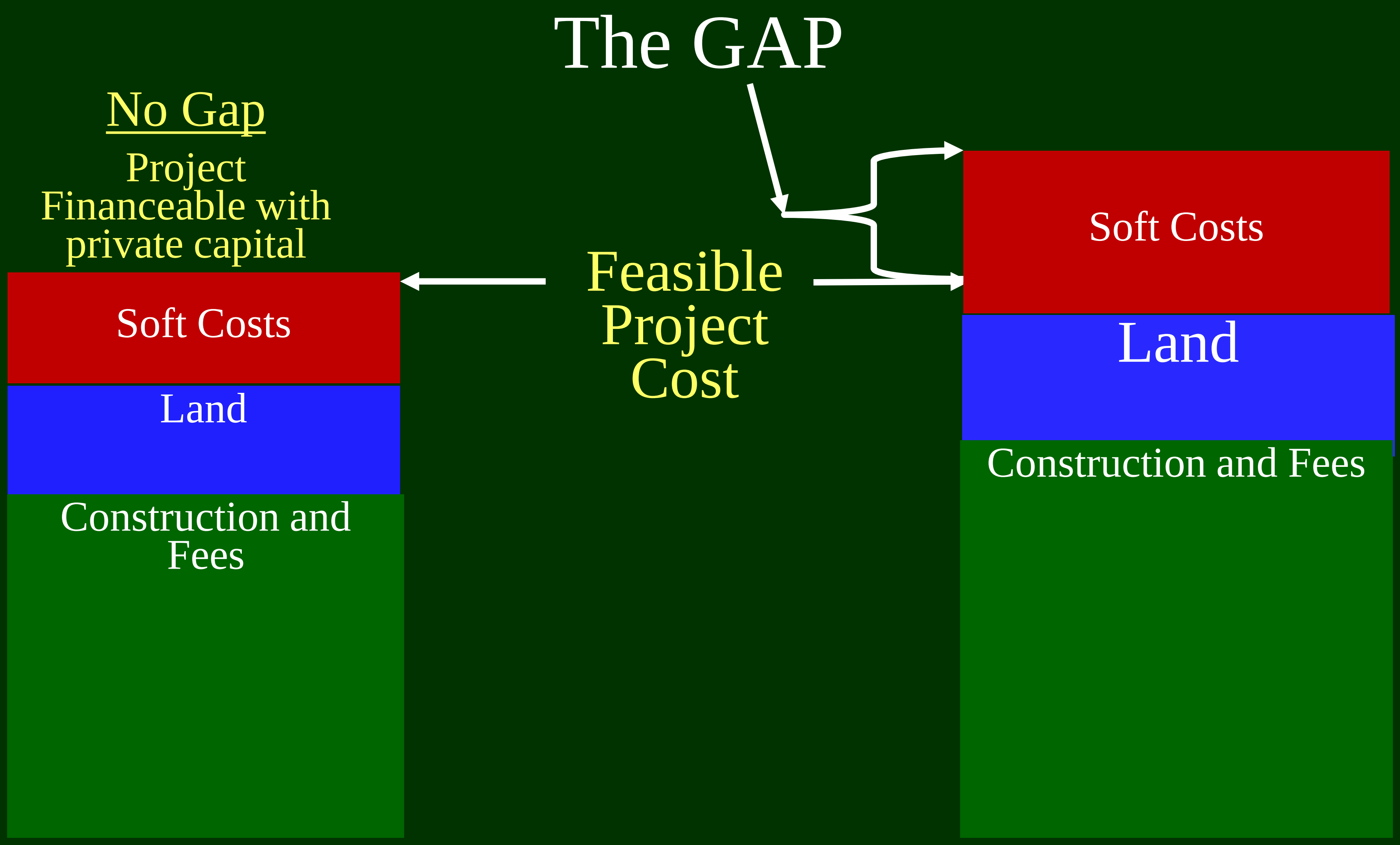
PROJECT COSTS				
	BASIS	Budget	Per Unit	$/total rentable sf
Construction Cost Estimate	$300 per SF net leasable	$501,000,000	$250,500	$300
Parking stalls	$20,000 per stall	$44,800,000	$22,400	$27
Hard Cost Contingency	10% of GMP costs	$50,100,000	$25,050	$30
LAND	Estimate of residual value	$30,000,000	$15,000	$18
Community Benefit Improvements	Estimate	$10,000,000	$5,000	$6
Design/Engineering	5% of total hard costs	$29,795,000	$14,898	$18
Soft Costs	10% of total hard costs	$59,590,000	$29,795	$36
Construction Interest and originaition	7.50% of loan amount	$35,250,000	$17,625	$21
Additional Contingency	Estimate	$25,000,000	$12,500	$15
Total Cost		**$785,535,000**	**$393,000**	$470

Net Operating Income	$48,602,400
Project Value and ROC	
Total Value at 6% Cap Rate	$883,680,000
Feasible Project Cost at 20% Hurdle	$736,400,000
Total Development Cost at $470 per sf	$785,535,000
Gap at $470 per sf	($49,135,000)

If Feasible Project Costs are less than Actual Costs, there is a gap.

Feasible Project Costs	minus	Actual Costs	<	0

The gap is the deficit between actual costs and the Feasible Project Cost


The GAP
No Gap
Project Financeable with private capital
Feasible Project Cost
Soft Costs
Land
Construction and Fees
Soft Costs
Land
Construction and Fees

Closing the "Gap"
How Much?

Project value=$120 million

Feasible Project Cost=$100 million

Total Development Costs= $110 million

The "Gap"=$10 million

Assistance from:
- Tax increment financing
- Tax credits
- Land "write-down"
- Lower city requirements for infrastructure or fees

City "Upside":
- Profit Sharing, "net" revenue
- Often difficult to monitor

Questions

1. How is the value of a project estimated?
2. How does the value of the project determine the “feasible project costs”?
3. What is the difference between actual costs and feasible project costs called?

II. Why are Public Private Partnerships so critical for community vitality

Public Private Partnerships are critical for contemporary development. But they are hard to do.

Airport redevelopment

Dead shopping malls

Community revitalization

Transit Oriented Development

Stapleton Airport Redevelopment
Denver, CO

- New Airport Approved 1988 and opened in 1995.
- Stapleton Redevelopment Foundation formed 1990 funded by $3M philanthropic contributions
- Planning 1989-1995: 5 Principles
  - Environmental Responsibility
  - Social Equity
  - Economic Opportunity
  - Physical Design
  - Implementation

- **12,000 Homes and Apartments**
- **10 Million SF Office**
- **3 Million SF Retail**
- **Over 1,100 acres of regional parks and open space**
- **$620 million of infrastructure financed with PPP**

Silver Spring, MD

1. Catalyzing Value Creation
   - American Film Institute
   - Discovery Channel
2. Costs
   - Parking
   - Re-do of streets/utilities
3. Site Assembly
   - Acquisition w threat of condemnation
4. Entitlement
   - Streamlined approval based on specific plan

Silver Spring Town Center
"I will revitalize Silver Springs or die trying"
County Manager, Montgomery County, MD

Del Mar Station, Pasadena, CA

- Joint project of Urban Partners, Archstone, and LA Metro
- 1,200 space underground parking for all uses.
- Restoration of historic train depot.
- 11,000 sf of retail
- 347 units residential
- Construction of all components took place simultaneously.

An old Rouse Shopping Mall revitalized

Metropolitan (Charlotte, NC)

Mixed use redevelopment

Pappas Properties

Cost

- $240 million private

Size

- 163,000 sf office
- 231,000 sf retail
- 205 residential units
- 2,000 parking spaces

Public participation enhanced value and “closed the gap”

- $8.9 million in infrastructure
- $8.0 million in greenway/land acquisition
- $17 million from property tax rebates

Mission Bay, San Francisco, CA

- 303 Acres-old rail yard
- 11,000 new residents
- 31,000 new jobs
- Biotech research labs
- Public transit links and open space
- Site cleanup and $400 million of infrastructure (Financed with “land secured” and TIF bonds)

UCSF campus land donation required by Mayor Willie Brown

Catalyzing value

Part of Jerry Brown's 10,000 initiative

Uptown, Oakland, CA

- 665 rental units; 25 percent affordable
- New, one half acre park
- $160 million private cost
- $50 million public investment

Fundamental change in Downtown Oakland

Nashville Metro Development and Housing Authority

Seattle Housing Authority

The Redevelopment of Yesler Terrace

Replaced 561 units of affordable housing with:

- 5,000 residential units
- 1,800 affordable
- 65,000 sf for neighborhood services
- 1.8 acre park
- Green street loop
- Community garden
- 88,000 sf of retail
- 900,000 sf of retail
- 5,100 parking spaces.

It takes time and community support

Pleasant Hill BART station

- 1983 Specific Plan, 1984 Redevelopment Plan
- Six day planning charrette in 2001—project started construction in 2004
- Lease of BART surface parking to developer for 100 years. Revenues estimated at up to $1 billion: 75% to County, 25% to BART.
- Redevelopment financing for parking replacement ($45 million), parks, plazas and streets ($12 million)
- $125 million of housing revenue bonds

Entitlement process frequently delays investment

- More public involvement
- More review steps
- Skepticism about density.
- Development impacts must be funded
- Pre-development risk results in missed opportunities.

Alameda NAS, Alameda, CA

Three developers dropped out!

After 20, years "We took a different approach. We were able to streamline the public, community process."

Jennifer Ott, Chief Operating Officer, Alameda Point

Lack of stakeholder consensus

A FIGHT OVER FREMONT

The city has plans for thousands of new homes. Residents are having second thoughts

CAN DEVELOPERS AFFORD S.F.'S AFFORDABILITY REQUIREMENTS?

San Francisco's new deal over affordable housing requirements is raising concerns that housing

backed by the region's largest business group.

"There's reason to be concerned as it creeps higher, especially as we enter into an economic slowdown," he said. "You produce not only a greater supply of housing, but more affordable units if you have the right percentage."

The city will re-examine the affordable housing rate

CAN FREMONT FIND THE WAY FORWARD?

'EVERYONE'S ANGRY'

Labor unions take aim at housing in Oakland hills

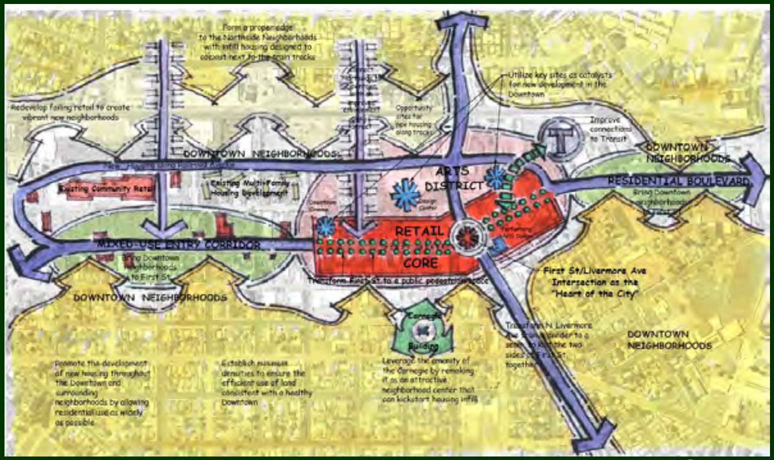
Massive Oak Knoll project becomes target of fight over prevailing wage

tin Group, Wood Partners and Holland Partner Group

The EBRRD issued a "Stop SunCal!" petition on its website to persuade the Oakland City Council to reject Oak Knoll. As master developer, SunCal does

San Francisco Business Times, May 26, 2017

Streamline the entitlement process.



Livermore, CA downtown specific plan

Walnut Creek, CA downtown plan

- Incorporate the vision into the regulatory framework
  - Comprehensive plan
  - Zoning
  - Development conditions
  - Environmental review
- Eliminate the project-by-project gauntlet—projects that meet the standards proceed to design and permit.
- Base the plan on the market
- Imbed flexibility (e. g. form based code)

Co-investment creates development value for public and private sectors

Examples:

- Transit
- Theater
- Golf course
- Park
- Interchanges
- Streetscape
- Stadiums
- Trails

Union City, CA

- Intermodal TOD site
- Community Theater
- Brownfield site cleaned up by redevelopment agency

Atlanta, GA

45 mile beltline trail on old transit r.o.w. links 45 neighborhoods

Rancho Solano and Paradise Valley Golf Courses, Fairfield, CA

- Developer donates land to the city (180 acres for each golf course)
- City uses lease revenue financing for building golf courses
- Developer captures increased value of homes build around course.

Converting Northland Shopping Mall into a Town Center Plan

Northland Shopping Mall, built 1954
Closed 2015

The Master Plan

City is still working on market analysis, gap funding estimates and developer selection

Newark, CA
150 acres
Industrial site
conversion to TOD

–4 property owners: concerned about to distribute cleanup costs and the connection of costs to value.

–Cleanup will increase land value by up to $130 million

–Agency to use TIF and land secured bonds to equalize costs and fund infrastructure for access and circulation.

Economic Assistance based on evaluating the Risk Profile and Project Economics

- Lower project risks
- Increase project value
- Lower the cost of capital
- Reduce project costs—Fund the gap

- Important layer in the capital stack
- Private capital sources rely on public to meet underwriting criteria
- MAKE A FAIR DEAL

Avoid using the Old Paradigm

CLOROX Distribution facility

University Park, Illinois

- Pure pay-as-you go (90% of property tax increment)
- Client has ready access to capital
- Self-financed
- Old structure works and is the best fit for this Fortune 100 client

Courtesy of Richard Klawiter, DLA Piper, Chicago

Old Paradigm rarely evaluated whether the incentives made sense economically

– Naked pledge of tax-based, usually incremental, revenue source

– Limited "valuing" of the revenue stream by underwriters.

– Justified as an “inducement” for private investment.

– Public agency doesn’t share in the upside.

Old Paradigm undermines public trust

New York Finally Called Amazon's Bluff

Huge incentive packages are a bad deal for taxpayers. Other cities should follow New York's lead.

These kinds of economic incentive deals are typically struck with little public oversight and get support from voters who seem satisfied that their leaders have at least tried to create jobs. But New York's rage at Amazon's sweetheart deal may finally signal a sea change in how the public reacts to these billion-dollar boondoggles.

Source: New York Times, Bryce Covert 2/14/19

Northern Virginia Is Keeping Amazon's 25,000 Jobs, and Wants You to Know It

From the beginning, Virginia officials said, their preparations differed sharply from those of other cities that applied to Amazon. Residents and others were generally welcoming, in contrast to the steady drumbeat of protests in New York.

For years, the region had planned and made improvements to roads, subways, trains and bike lanes to accommodate a major corporation like Amazon, Ms. Backmon said.

A bipartisan state board of legislative leaders that reviews major incentive deals had many hours of discussions on Amazon before an agreement was reached for the new campus, said Stephen Moret, who runs the Virginia Economic Development Partnership.

"The fact that that group exists and was so heavily engaged periodically throughout the 14 months was a major contributor for how well things have rolled out at the state level," Mr. Moret said in a recent interview. He said Arlington and Alexandria officials had been briefed about Amazon in closed sessions multiple times as well.

Late last month, the Virginia legislature overwhelmingly passed a $750 million incentive package for Amazon, which the governor signed into law. It provides Amazon with $550 million in grants for the first 25,000 jobs it creates, and $200 million more for creating 12,850 additional jobs in subsequent years.

Source: New York Times, Cecilia Kang 2/15/19

Amazon's Tax Breaks and Incentives Were Big. Hudson Yards' Are Bigger.

At Hudson Yards, the expansive real estate development that is about to open in Manhattan, seven floors of retail are occupied by Fendi, Dior, Neiman Marcus and other high-end shops. Major corporations, including WarnerMedia and L'Oreal USA, will have their headquarters there. In the luxury residential buildings, one-bedroom apartments will rent for at least $5,200 a month — or you can buy a two-floor penthouse condo for $32 million.

All thanks to the help of taxpayers.

New York was riveted for weeks by a debate over whether Amazonshould receive $3 billion in tax breaks and other incentives in return for setting up a headquarters in Queens and creating 25,000 jobs. But with far less public attention, the city government has for more than a decade been funneling even more aid to Hudson Yards, a 28-acre complex of gleaming office buildings and luxury residential towers that is one of the nation's biggest real estate projects in recent years.

In all, the tax breaks and other government assistance for Hudson Yards have reached nearly $6 billion, according to public records and a recent analysis by the New School.

Source: New York Times, Matthew Haag 3/09/19

The New Paradigm of Pubic Private Partnerships

Lakeside Steel Plant site conversion, Chicago, IL

TIF BOND ISSUANCE CLOSING CONDITIONS:

RETAIL PRE-LEASE
1 TOWER PAD SALE
SECURE PRIVATE EQUITY AND FINANCING COMMITMENT

Bonds supported by TIF	
City GO Bonds	$55M
Second lien bonds	$41M
Total TIF bonds	$96M
Private EQUITY	$75M
Private DEBT	$226M

- Total capitalization $400 million
- 25% from municipal bonds

- 35 million square feet
- Dwelling units maximum 13,575
- Commercial Area approximately 17.5 million square feet

Source: Jeffrey Owen, DLA Piper, Chicago

The New Paradigm

1. Public financing achieves FINANCIAL VIABILITY using multiple revenue sources where the private sector cannot do so alone.
2. Public sector assembles and cleans up the site with reconveyance at "residual land value" (FINANCING THE GAP)
3. Public investment receives a FAIR RETURN if overall returns exceed benchmarks needed for private investment.
4. Public benefits go beyond beating other jurisdictions—they achieve a COMMUNITY VISION

Public Private Partnerships are about achieving Community Benefits

- Revitalization
- Jobs/Economic Vitality
- Anti-Displacement
- Affordable Housing
- Placemaking
- Parks/Open Space
- Transit Oriented Development
- Creative Arts Activities Preservation

What benefits are you trying to achieve through PPP?

And yet, neither sector fully understands the other

- Public:
  - Weak understanding of the private real estate process and economics
  - Unrealistic, irresponsible or constraint-driven deal making
  - Inconsistent and unreliable performance on commitments.
- Private sector:
  - Uncertain about how to craft a partnership with a public entity.
  - Frustration with process and constraints
  - Failure to capture opportunities

Key elements of successful PPP

- Need an entity to provide leadership for creating the community-based vision.
- Streamline the entitlement
- Foster cooperation and coordination among all stakeholders.
- Enhance value through co-investment.
- Look for catalytic opportunities.
- Create housing renewal and mixed income opportunities.

Build trust and transparency with the public and your partners

MOST IMPORTANT:
Be Trustworthy

- A relationship-based business.
- Be Value Driven
- Seek valid information as basis of deciding.
- Do what you say you will do.
- Change your mind if the information changes.
- Explain why.

PPP Knowledge and Skills

- Negotiation
- Building Trust
- Real Estate Finance and market dynamics
- Legal
- Political
- Community participation

Questions

1. Why are the key parameters of success for a PPP?

2. What challenges do you face in your community for achieving good partnerships?

3. What skills do you want to achieve to be effective?

Panel

PPP in Hawaii: Opportunities & Challenges

Stanford Carr

President
Stanford Carr Development LLC

Chris Kinimaka

Public Works Manager
State Dept of Accounting & General Services

Harrison Rue

Community Building & TOD Administrator
City Dept of Planning & Permitting

Jon Wallenstrom

Principal
Alaka'i Development

Creating Effective Public/Private Partnerships

A Workshop Sponsored by

Urban Land Institute

- ULI Hawaii
- Hawaii Interagency Council for Transit-Oriented Development

Halekauwila

Keauhou Lane


Keauhou Lane

Keauhou Lane


Made in Hawaii
Hale Kewalo

Panel

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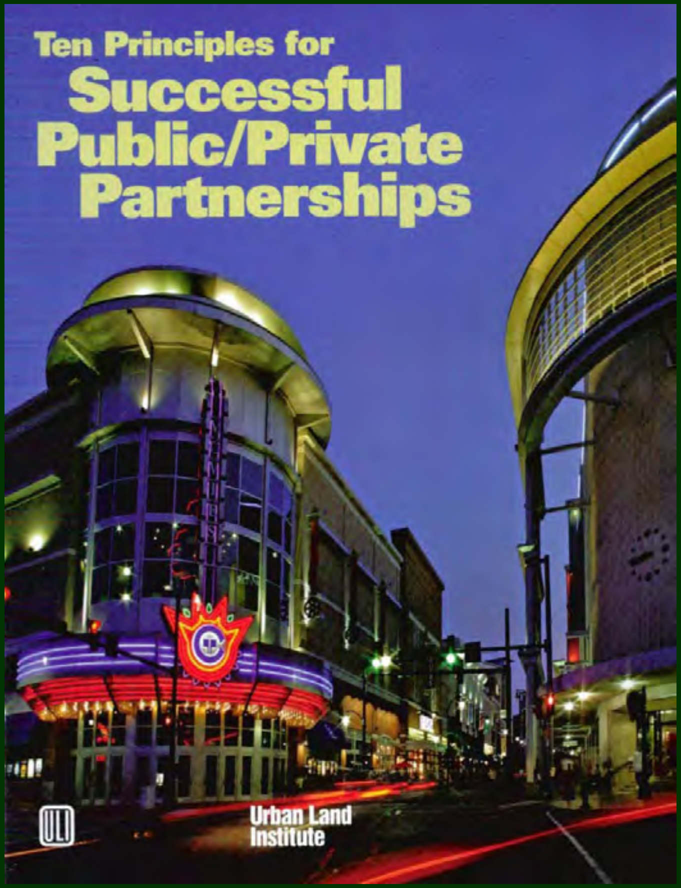
IV. The tools of public private partnerships

Numerous tools—Lots to learn

- Tax Increment bonds
- Land secured bonds
- Business improvement districts
- Lease revenue bonds
- GO bonds
- Tax abatements
- Sales tax sharing
- PILOTS
- Tax credits
- EB-5
- Federal and state grants

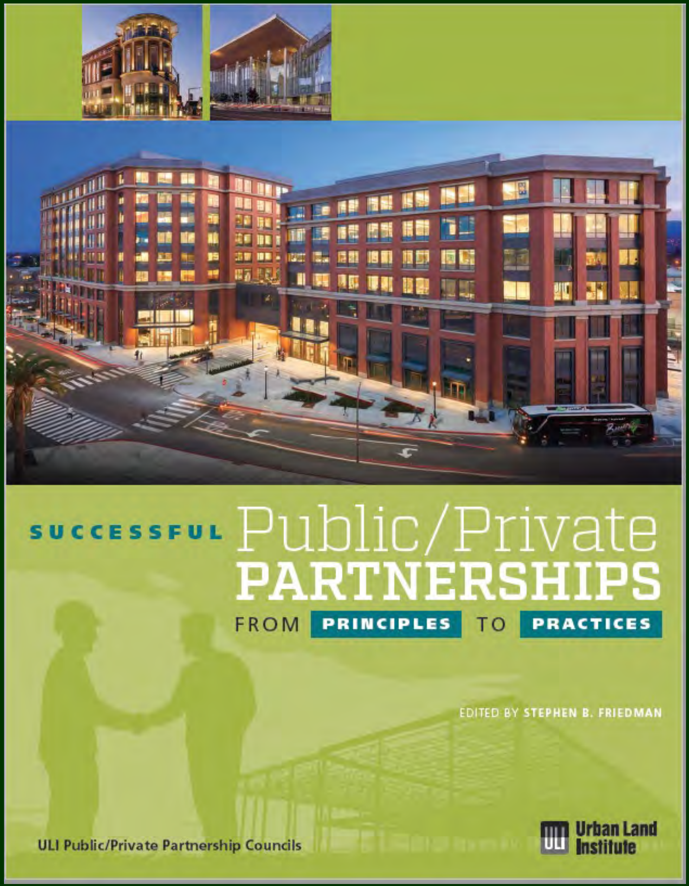
Resources



1. Proactive Predevelopment
2. Create a shared vision
3. Assemble a Development Team
4. Be clear on the risks and rewards for all parties
5. Document a clear and rational decision-making process
6. All parties must do their homework
7. Secure consistent and coordinated leadership
8. Communicate early and often
9. Negotiate a fair deal structure
10. Build trust as a core value

Urban Land Institute
PPP Workshop

Resources


SUCCESSFUL Public/Private
PARTNERSHIPS
FROM PRINCIPLES TO PRACTICES
EDITED BY STEPHEN B. FRIEDMAN
ULI Public/Private Partnership Councils
ULI Urban Land Institute

The Development Team

- Architects
- Urban Designers
- Engineers
- Land Planners
- Landscape Architects

- Designers

- Attorneys
- Development Advisors
- Market Researchers
- Finance feasibility consultant
- Contractors
- Environmental Consultants
- Transportation Consultants

- Expertise/Support

The Lead Entity?

Department of Business, Economic Development & Tourism
Hawaii Housing Finance & Development Corporation

State of Hawaii
Department of Public Safety

State of Hawaii
Office of Planning

CITY AND COUNTY OF
HONOLULU

Department of Business, Economic Development & Tourism
Hawai'i Community Development Authority

Making Hawai`i a Great Place to Live!
Department of Land and Natural Resources

- Leadership
- Memorandum of Agreement for alignment.
- Authority to act
- Financial capacity

The flow

Designate the Lead Entity and Assemble the Team → Create the Vision and Conduct a Market Valuation → Evaluate gap financing needs

12 to 18 months—simultaneous tasks

Select a development partner → Entitle the project → Negotiate and validate the deal → Implement and monitor

6 months

6 to 12 months—simultaneous tasks

Involve the Community—make the process open and transparent

The toolkit checklist

1. Lower project risk
2. Increase project value
3. Lower the cost of capital
4. Reduce project costs-Fund the gap
5. Negotiate and monitor within an environment of trust
6. Select the developer based on qualifications
7. Create alignment
8. Create a Fair, Validated Deal

#1 Lower Project Risks

Before the developer is involved (if possible):

- Entitlement based on a community vision.
  - Market Analysis
- Assembly and cleanup
  - Land / Eminent Domain
- Relocation
- Demolition

Bellevue, WA

Bellevue was named number 1 in CNN Money's list of the best places to live and launch businesses. It has a top-down and highly integrated land use and transportation planning process.

Make the plan real!

- Is it focused on public benefits?
- Does it reflect a community consensus?
- Is it connected to a valid means for accomplishment?
- Does it recognize market realities?

"The reason that everybody likes planning is that nobody has to do anything."

Governor Jerry Brown

Chapter 201H process streamlines entitlement for affordable housing projects

At least 51% affordable—with additional mixed uses allowed.

Program instituted through HFDC and recently adopted by City and County of Honolulu.

Requires processing of application and public hearing.

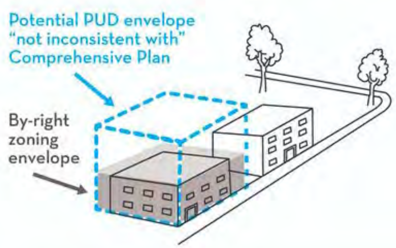
#2 Increase Project Value

- Zoning Bonus
  - Community Facilities
  - Transit
  - Plaza
  - Affordable Housing
    - On Site
    - Off Site
- Co-investment
- Value catalyzation
- Tax Abatements

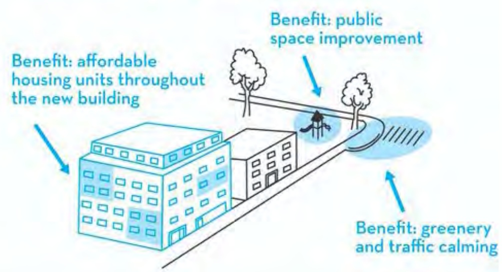
Zoning Bonuses

How is Affordable Housing Produced in DC's Planned Unit Developments (PUDs)?

By-Right Zoning Potential



PUD Potential



Delays are impacting affordable housing:

1000 affordable housing units produced through PUDs since 2015

2000 affordable housing units are currently held up in lawsuits and appeals

28 ↘ 3 PUD applications from 2015 to 2018

planning.dc.gov

District of Columbia Office of Planning

GOVERNMENT OF THE DISTRICT OF COLUMBIA
MURIEL BOWSER, MAYOR

Tax Abatements—Be careful!

- …(tax) abatement practices go largely unmonitored …and …municipal governments have little incentive to comprehensively assess whether an abatement is necessary to attract development, whether the type of development is needed in the first place or whether the abatement ultimately achieves its desired economic development goals.

(New Jersey State Controller)

#3 Lowering cost of capital

1. Municipal bonds
   a) Land secured bonds
   b) Tax increment bonds
   c) GO, lease revenue bonds
2. Backup guarantee from public agency
3. Tax Credits

Municipal Bonds

- A municipal security the interest on which is excluded from:
  - gross income for federal income tax purposes.
  - state income for tax purposes and

Current rate of 4% for 40 year muni bond financing compared to 5.5% Prime Rate for 20 year term

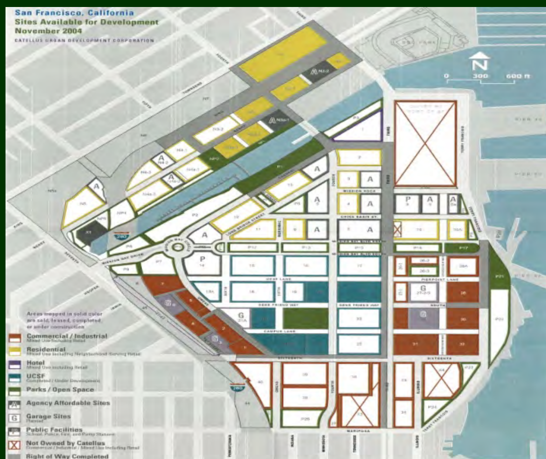
Tax exempt financing lowers cost and increases leverage

Berkeley Reparatory Theater

Lease revenue bond with the Berkeley General Fund as guarantor of debt service.

- Public financing takes many forms
  - Land secured financing for infrastructure/cleanup
  - Housing revenue bonds
  - Lease revenue financing for facilities
  - Revenue and general obligation bonds
  - Tax Increment Financing
- Federal regulations limit use to public purpose and require compliance with IRS regulations for use of funds.

Land Secured Bonds: assessment bonds are the primary means of financing infrastructure and cleanup



Mission Bay

Hunters Point

- Financing provided by tax exempt bonds with lower interest rate and longer amortization period.
- Assessment or annual tax levy repays the bonds and is passed on to users
- Delinquencies result in tax lien and foreclosure
- BE CAREFUL! ESTABLISH FINANCING STANDARDS.
- Private financing subordinates to public financing.

Tax Credits provide equity in return for tax benefits to the tax credit purchaser

Low-Income Tax Credits

- Affordable rent-restricted housing
- $9 billion annual market – awarded at the state level to specific projects
- Rigorous compliance requirements

New Market Tax Credits

- Low-income communities
- $3 billion to $4 billion annually awarded by Treasury Dept.
- Rigorous compliance requirements

Historic Tax Credits

- Historic preservation
- Administered by U.S. Park Service and state preservation offices
- Rigorous compliance requirements

Courtesy of Leslie Eckstein, Wells Fargo Bank

Tax Credit Examples

Market Creek Plaza-San Diego

77,482 sf retail shopping center

New Market Tax Credits

Argonaut Hotel, San Francisco

Rent income supports historic ships

Historic Tax Credits

Museum of African American Art - Harlem, NY

3 story museum and 20 story residential

$19 million of

Historic Tax Credits

#4. Reduce Project Costs (Closing the "Gap")

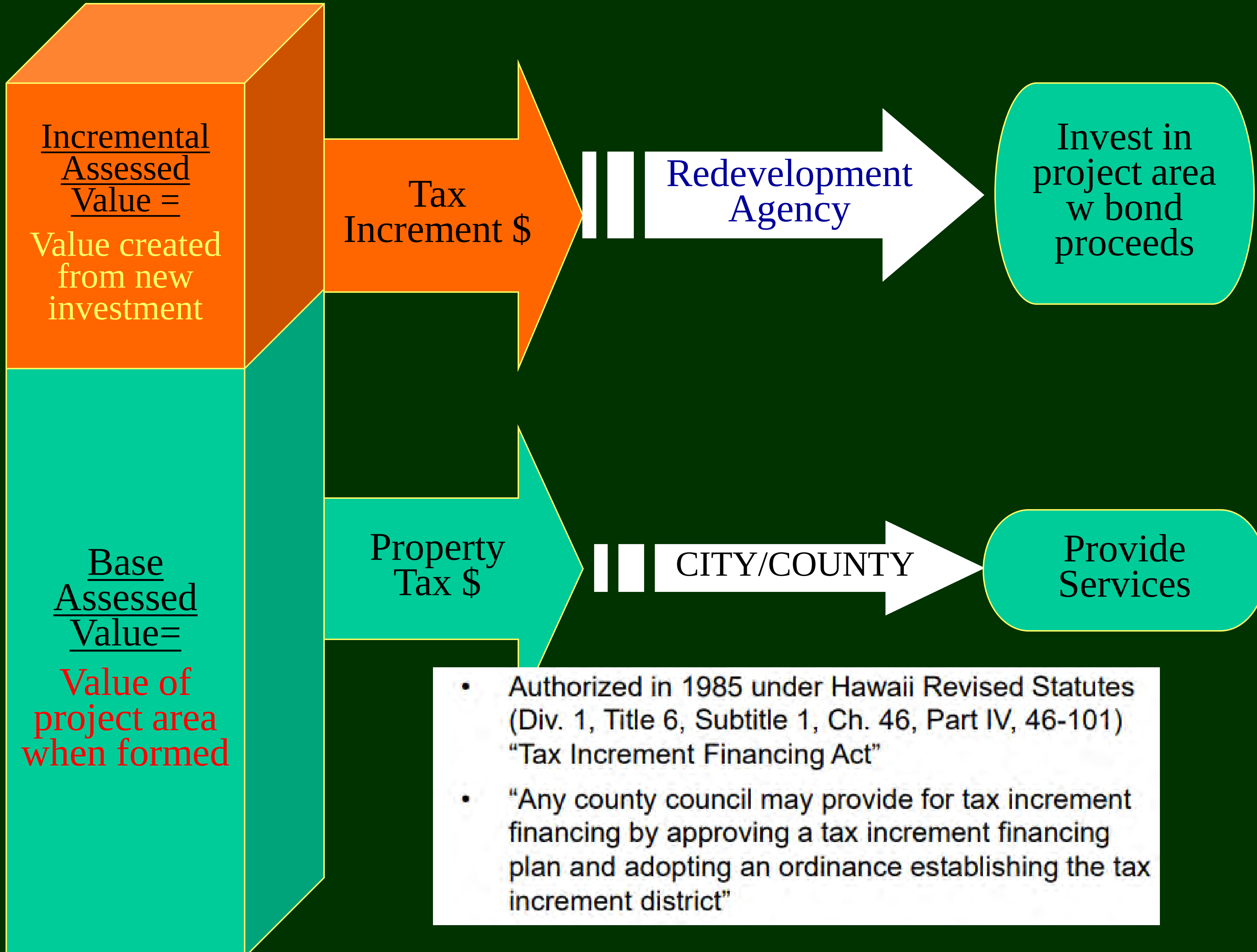
"Gap" - The shortfall between actual project cost and it Feasible Project Cost. (the "but for")

Because of:

- Market conditions
- Density limits
- Project costs:
  - Site acquisition/preparation/conditions
  - Required infrastructure

Gap Funding options

- Tax Increment subsidies
- Value capture PILOTS
- Land write-down
- Lower city infrastructure or fee requirements



- Authorized in 1985 under Hawaii Revised Statutes (Div. 1, Title 6, Subtitle 1, Ch. 46, Part IV, 46-101) "Tax Increment Financing Act"
- "Any county council may provide for tax increment financing by approving a tax increment financing plan and adopting an ordinance establishing the tax increment district"

Value Capture on Tax Exempt properties

– Payments in lieu of taxes (PILOTS) levied on tax exempt properties.
– Negotiated as part of the project financial analysis with tax exempt landowners.
– Subject to annual appropriates process.

Land Writedown
Buy at appraised value (usually high)
Sell at development value (usually lower)

Possible 45 Acre site including OCCC

Land Assembly would enhance the development program

But: Assembly costs may increase the funding gap

City credits on fees or infrastructure

Bayfront project
Hercules, CA

Site is old munitions factory.

Ferry terminal, train and bus station (Intermodal Transit Center-ITC)

•http://www.herculesbayfront.com/

Project "gap" was $22 million in 2012

Developer owned site of ITC. Normally would have been required to dedicate site.

City granted a reduction in development impact fees to acquire site of ITC. <u>Only for development within first 5 years.</u>

#5 Negotiate and Monitor the deal

- Negotiate a fair disposition and development agreement
  - Terms: sale or lease price
  - Performance
  - Amount of assistance
  - Profit-sharing
  - Doomsday scenarios
- Present a public third party analysis evaluating the fairness of the deal.
- Monitor performance responsibilities and financial results

Pinole Valley Shopping Center

Renovation of a 70,000 square foot neighborhood shopping center built in the 1960's.

Pinole Valley Shopping Center
Pinole, CA

Renovation of a 70,000 square foot neighborhood shopping center built in the 1960's.

- Agency purchased site from foreclosure along with two gas stations for $7.3 million in 2004.
- Ground leased site to developer for 80% of net cash flow (NOI after debt service)
- Developer obtained financing to renovate the center based on the Agency land value serving as the equity.
- With sale, Agency receives 80% of net proceeds ($10 million) in 2012 after paying off permanent loan. Monitoring the deal was essential!

Negotiation is about problem-solving

- Don’t treat the process as a hard bargaining situation
- Know your project economics and don’t make concessions you can’t afford.
- Build the relationship of trust
- Build community ownership

Sharing Proprietary information

- Understand the local public information laws.
- Disclose to an outside 3d party consultant
- Recognize that the final deal must meet the open book requirement.
- Don’t be ashamed about return requirements

#6: Developer Selection

- Select the developer with RFQ not RFP- once selected execute an Exclusive Negotiating Agreement (ENA)
- "Who" you partner with is just as important as the development plan.
- Build trust during the negotiation process.
- Provide for joint decision-making to insure alignment of interest.
- The Developer <u>must</u> co-invest in the project

Developer Selection Process

1» DEFINE DEVELOPMENT GOALS

- Develop a community-supported vision with all stakeholders
- Prepare site development program
- Address development readiness of site
- Understand resources
- Create a "believable fiction"

2» ESTABLISH DEVELOPER RELATIONSHIP

SOLICIT DEVELOPER FOR PUBLIC LAND

- Prepare request for qualifications
- Review qualifications and determine short list
- Solicit proposals from short list
- Evaluate proposals
- Conduct interviews/community reviews
- Select developer

OR

RESPOND TO DEVELOPER SEEKING LAND/ASSISTANCE

- Identify land sales processes
  - Negotiated sales
  - Modified bidding
  - Alternative bids
- Identify entitlements
- Review assistance application
  - Project plan and costs
  - Market analysis
  - Financial benefits/tax increment
  - Pro forma/gap
  - Community benefits
  - Eligible costs
  - Basic structure/capital stack

3» FINALIZE AND IMPLEMENT PROJECT

- Negotiate term sheet/ redevelopment agreement
- Obtain zoning/planned development approval
- Identify financing structure/sources
- Identify public structure
  - Pay-as-you-go
  - Notes
  - Bonds
- Obtain simultaneous approvals
- Coordinate and oversee project

SUCCESSFUL DEVELOPMENT

#7: Alignment

Ropy

Wide

Sharp

Flappy

Tubular

Wrinkly

Who?

1. City Departments—Economic development, Planning, Public Works, Building, Fire
2. Community groups.
3. Adjacent cities/ the County
4. State housing
5. State transportation department.
6. State toxic substance department
7. Federal transportation/transit

#8: Make a Fair Deal

1. Public Sector must analyze the “Cost of Public Incentives” and compare to the ”Benefit value of the project”
2. VALIDATE the deal publicly with an outside 3d party.
3. Public agency must SHARE IN RETURN in excess of that needed to attract private capital.
4. It’s not about beating other jurisdictions—it’s about achieving COMMUNITY VISION

Ultimately, this is about governance

- Have a shared vision for the future---build a community consensus.
- Set clear, predictable and high development standards.
- Develop the competence to understand constraints and opportunities in real estate economics.
- Build partnerships with the private sector based on fiduciary principles that protect the public interest.
- Have strong leaders and committed citizens

Public Private Partnerships require:

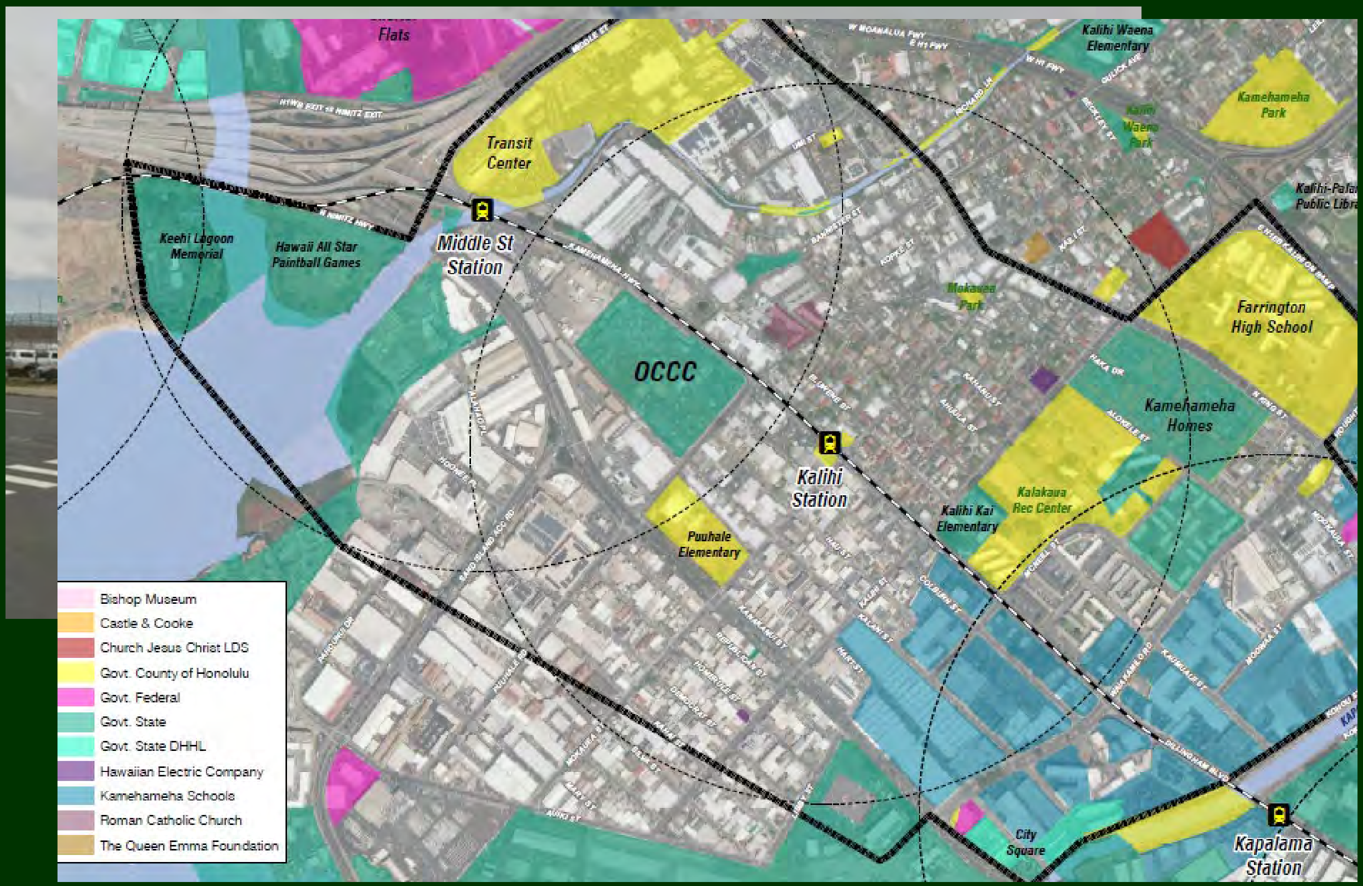
1. **Make deals based on the real estate, not wishful thinking:** Validate the deal based on the real estate economics and on what the markets will actually support.
2. **Build trust and ownership:** Who is involved in the partnership is as critical as what the project is. Developers and communities need to take the time to use the "open book" and to develop relationships of consistency and trust.
3. **Do the hard work competently:** Public private partnerships are complicated and require resilience and persistence to accomplish. They require a competent team on both sides of the table who take the time and effort to craft complex deals.

Questions

1. What are the leadership challenges for PPP in Hawaii?

2. What public benefits are critical for PPP in Hawaii?

V. Preparation: OCCC-a catalyst to renewal in Kalihi



16 Acres

In 2017, the State Office of Planning planning process resulting in the "21st Century Kalihi Transformation Initiative"

- *"economic development and housing for the support and betterment of Kalihi's current and future generations. The Initiative supports innovation and capacity building and takes a balanced approach in creating jobs and providing housing so the people who live in the area can continue to live and work in Kalihi and enhance the quality of life for future generations. Mixed-income and mixed-housing types would be provided including affordable, workforce, low income and kupuna housing as well as market rate and larger 2-3 bedroom units to support families and multiple generations.*

ECONOMIC DEVELOPMENT

- Use the OCCC site to its highest and best use
  - Bargain with investors and developers to relocate the jail
- Balanced approach
  - Consider economic future of Kalihi; develop jobs/tax base so you can elevate people that live in the area
- Support innovation
  - Housing / co-working / living; draw population in so they can learn skills they can do in place
- Preserve Kalihi's industrial uses
- Establish City facilities
  - Coordinate future transit services with existing transit services to provide convenient access and greater mobility

All market Rate

Land Area=696,960			Unit Mix 100% Market		
APARTMENT MIX	**# of Units**	**Net Square Feet**	**$/SF/Mo.**	**Rent/Month**	**Total Annual**
Apartments--market rate	2,000	800	$3.50	$2,800	$67,200,000
Affordable apartments	0	800	$2.00	$1,600	$0
Totals:	**2000 Units**	**1,600,000 SF**			**$67,200,000**
Averages:		**800 SF**	**$3.50**	**$2,800**	
COMMERCIAL SPACE		**Net Square Feet**	**NNN Rent**		**Total Annual**
	Retail&commercial	70,000	$24.00		$1,680,000
	Total commercial	**70,000**	**$24.00**		**$1,680,000**
PARKING			GROSS INCOME		**$68,880,000**
Residenital	2,000		Plus: Other income		$6,888,000
Commercial	240		LESS: Vacancy, Operations, Taxes and Reserves		($22,730,400)
Total Parking	2,240		**Net Operating Income**		**$53,037,600**

PROJECT COSTS				
	BASIS	**Budget**	**Per Unit**	**$/total rentable sf**
Construction Estimate	$300 per SF net leasable	$501,000,000	$250,500	$300
Parking stalls	$20,000 per stall	$44,800,000	$22,400	$27
Hard Cost Contingency	10% of GMP costs	$50,100,000	$25,050	$30
LAND	Estimate of residual value	**$30,000,000**	$15,000	$18
Community Benefit Improvements	Estimate	**$10,000,000**	$5,000	$6
Design/Engineering	5% of total hard costs	$29,795,000	$14,898	$18
Soft Costs	10% of total hard costs	$59,590,000	$29,795	$36
Construction Interest and originaition	7.50% of loan amount	$35,250,000	$17,625	$21
Additional Contingency	Estimate	**$25,000,000**	$12,500	$15
Total Cost		**$785,535,000**	**$393,000**	$470

Return-All Market Rate

Project Value and ROC-100% Market	
Total Value at 6% Cap Rate	$964,320,000
Feasible Project Cost at 20% Hurdle	$803,600,000
Total Development Cost at $470 per sf	$785,535,000
Gap at $470 per sf	$18,065,000
Yield on cost	6.8%
Minimum Required Value at ROC of 20%	$942,642,000

20% Affordable Rate

Land Area=696,960	Unit Mix 80% Market, 20% Affordable				
APARTMENT MIX	**# of Units**	**Net Square Feet**	**$/SF/Mo.**	**Rent/Month**	**Total Annual**
Apartments--market rate	1,600	800	$3.50	$2,800	$53,760,000
Affordable apartments	400	800	$2.00	$1,600	$7,680,000
Totals:	**2000 Units**	**1,600,000 SF**			**$61,440,000**
Averages:		**800 SF**	**$3.20**	**$2,560**	
COMMERCIAL SPACE		**Net Square Feet**	**NNN Rent**		**Total Annual**
	Retail&commercial	70,000	$24.00		$1,680,000
	Total commercial	**70,000**	**$24.00**		**$1,680,000**
PARKING			GROSS INCOME		**$63,120,000**
Residenital	2,000		Plus: Other income		$6,312,000
Commercial	240		LESS: Vacancy, Operations, Taxes and Reserves		($20,829,600)
Total Parking	2,240		**Net Operating Income**		**$48,602,400**
			Project Value and ROC		
			Total Value at 6% Cap Rate		**$883,680,000**
			Feasible Project Cost at 20% Hurdle		**$736,400,000**
			Total Development Cost at $470 per sf		**$785,535,000**
			Gap at $470 per sf		**($49,135,000)**

Questions

1. How should the State work with the community to determine a viable development program? What factors should determine which agency should lead the planning and development process?

2. How should a developer be engaged to partner with and address the final design, risks and financial issues in the project?

3. What are the risks that this development opportunity presents and how can the community mitigate those risks?

4. What options exist for increasing project value to the State and developer?

5. What options could lower the cost of capital and address the gap funding required for the mixed income project requiring higher levels of affordable housing?

6. How should the size of the gap be validated and sources explored that could be used to fund it?

7. How should the community be involved in addressing these questions?

Summing up

1. What have you found useful about today's discussion in terms of how you approach fostering high quality development?

2. What approaches to PPP do you think Oahu should consider?

3. What would you suggest ULI do to enhance the ability of jurisdictions to do PPP?

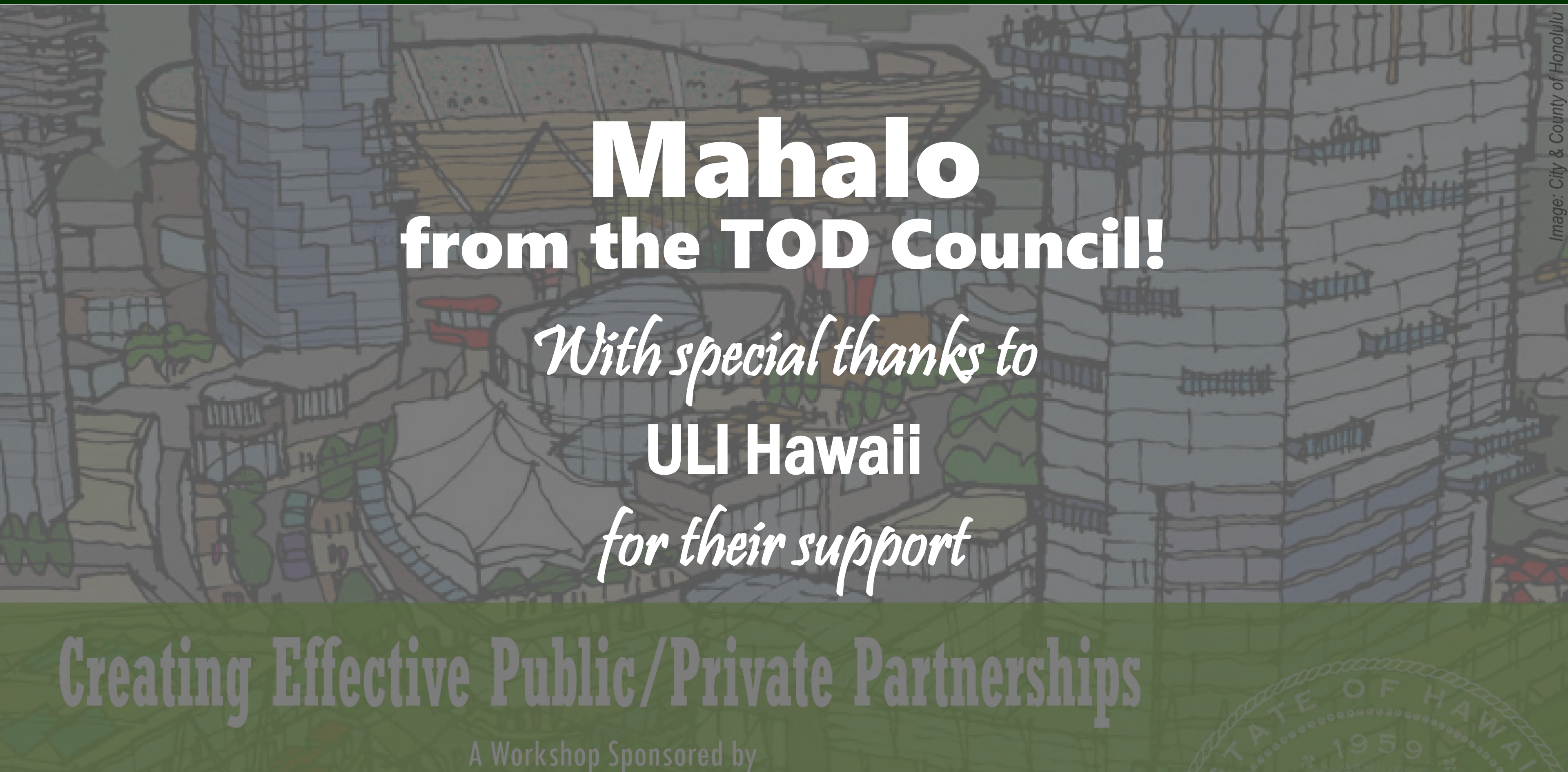


Image: City & County of Honolulu

Mahalo
from the TOD Council!

With special thanks to

ULI Hawaii

for their support

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