TO: Mayor and City Council

FROM: Jennifer Hall, Executive Director Ann Arbor Housing Commission

CC: Milton Dohoney Jr., Interim City Administrator
Kevin McDonald, Interim City Attorney
Marti Praschan, Chief Financial Officer

SUBJECT: Affordable Housing Units and/or Payment-In-Lieu at 350 S 5th Ave

DATE: March 23, 2022

The Mayor and City Council requested that staff provide a trade-off analysis related to allowing a payment-in-lieu of affordable housing option for some of the affordable units at 350 S 5th or requiring all the affordable units to be provided on site. I apologize for the length of this memo, but it is a complex site with multiple variables that drive the trade-off analysis, that do not apply to market-rate developments by private developers on privately-owned property.

BACKGROUND

The City has owned 350 S 5th on and off since 2004 and has so far not been able to develop the property as affordable housing to replace the 100 Single Room Occupancy (SRO) units that were previously on the site.[1] Private developers are very aware of the challenging development history of this site and the challenges of developing in the City of Ann Arbor.. That is why staff have approached this development process with the intent of mitigating zoning, legal and financial risk to ensure that affordable housing actually gets built on this site.

The 350 S. 5th project is large and complicated and a new model that neither the City of Arbor nor the Ann Arbor Housing Commission have developed before. The site has four components: required affordable tower, required driveway and bus parking for the Ann Arbor Area Transit Authority (AAATA), activated ground floor space, and a 2nd tower than is flexible related to the uses (could include market-rate owner or rental housing, affordable owner or rental housing, cooperative housing, office, retail or other commercial spaces allowed in the supplemental regulations). The new model is to: partially pre-entitle the site with the proposed PUD and Supplemental Regulations, then issue an RFP for a co-developer, then apply for site plan approval and secure financing in order to build affordable housing.

Staff are committed to including as much affordable housing as is financially feasible on the site. The project will be in partnership with a private developer who has the capacity to develop a complicated site with multiple public purposes and multiple funding sources. Although we have talked to many developers at the local, state and national level about the site to try and understand how to structure

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[1] See Appendix A for history of 350 S 5th

the project so that it is financially feasible and worth investing in, we will not know what response from developers will be until we issue a Request for Proposal (RFP).

The PUD and Supplemental Regulations are intended to provide structure as well as flexibility. The structure includes the maximum height, set-backs, etc. of the buildings as well as the public purpose goals of affordable housing, A2Zero goals, and accommodation of the AAATA. However, the PUD does not include a site plan because we need flexibility in the RFP to ensure that we attract the best development partner to help us develop the best mix of uses and secure financing. A project this large and complicated has significant risk. The development process is a 3-5 year process and the market is constantly changing related to development costs and scoring and underwriting criteria for funding applications such as Low Income Housing Tax Credits. And every public purpose requirement makes the project more difficult to build.

PUD & SUPPLEMENTAL REGULATION PRESENTED ON MARCH 7, 2022

The staff team and consultants have run the numbers under multiple development scenarios, and the March 7th PUD Zoning and Supplemental Regulations were designed to provide the best opportunity to add sustainable affordable housing, expand the AAATA & pay off the City's bond debt. The Supplemental Regulations required the development to include:

1. In the Affordable Phase, 100% of dwelling units shall be Affordable Housing Dwelling Units as defined by the Unified Development Code.
2. In the Mixed-Income Phase, 20% of dwelling units shall be Affordable Housing Dwelling Units as defined by the Unified Development Code. This requirement for Mixed-Income Phase only, may be satisfied by payment in lieu[2], based on the most recently adopted formula by the City at the time of payment.
3. The entire PUD District shall provide a minimum of 100 Affordable Dwelling Units and a minimum of 40% of the total number of dwelling units as Affordable Dwelling Units as defined by the Unified Development Code in combination of the Phased options above.

Research has shown that the most successful mixed-income projects have a close range of incomes. I.e. homeless to low, low to moderate, or moderate to high. We could not find any project that successfully included homeless households in market-rate projects where the market is as high as Ann Arbor. 350 S. 5th is a site that should include housing for people experiencing homelessness, which is why we proposed a 2-tower project. One tower was 100% affordable for households up to 60% AMI, including a portion set aside for homeless households, and the 2nd tower was flexible.

REVISED PUD & SUPPLEMENTAL REGULATIONS FOR APRIL 4, 2022 – MAXIMIZE AFFORDABLE HOUSING AS HIGHEST PUBLIC POLICY

Based on the City Council discussion on March 7th and feedback from the community, staff are revising the PUD & Supplemental Regulations to require all of the affordable units to be built on site instead of allowing the units in the 2nd tower to pay payment-in-lieu of units. This change will ensure that the greatest number of affordable units will be built on-site, however, the consequence is that the value of the property will decrease[3] and iwe believe that it will be unlikely that a market rate developer will

[2] See Appendix B related to zoning regulations and the City's payment-in-lieu formula
[3] See Appendix C related to property value

respond to the RFP with a sales offer that is high enough to pay off the bond debt[4]. Even with the payment-in-lieu option, it is unclear whether there is enough value in the property to pay off the bond debt.

However, if City Council and the community value affordable units on-site as the highest policy goal, the risks can be mitigated by the City agreeing to sell the property to the Ann Arbor Housing Commission using Affordable Housing Millage funds in the amount owed on the bond. This removes a significant zoning and financial driver of the project. The bond will be paid back and the financial pressure to maximize the value of the market-rate component is removed. The secondary consequence is that this decision may lead to a smaller project with 2 affordable towers, which will provide more affordable units on the site, but greatly reduces ongoing tax revenue. Below are the revised Supplemental Regulations related to Affordable Housing:

1. In the Affordable Phase, 100% of dwelling units shall be Affordable Housing Dwelling Units as defined by the Unified Development Code.
2. In the Mixed-Income Phase, a minimum of 20% of dwelling units shall be Affordable Housing Dwelling Units as defined by the Unified Development Code.
3. The entire PUD District shall provide a minimum of 100 Affordable Dwelling Units and a minimum of 40% of the total number of dwelling units as Affordable Dwelling Units as defined by the Unified Development Code in combination of the two towers above.

The chart below shows the trade-offs of including affordable housing on-site or payment-in-lieu of affordable housing for a private development of market rate housing.

350 S 5th	**Payment-in-Lieu Option for 2nd Tower Only**	**No Payment-in-Lieu Option**
Maximize Affordable Housing on Site	No	Yes
Pay off Bond Debt Through Sales Proceeds	Unknown, but more attractive to private developer of market-rate housing	Unknown, but will likely necessitate a sale to the AAHC with millage funds
Increase Tax Base	Highest potential	Lowest potential
Long-term Public Ownership	No, if property sold to private developer to pay back bonds	Yes, if AAHC ownership
Deed Restriction Affordable Units	Yes	Yes
Affordable Units Built at Same Time as Market Rate	No	Yes
Affordable Units are all 60% AMI or less	Yes	Yes
Affordable Units are Permanent Supportive Housing with On-Site Services	Yes in Affordable Phase, and yes on another site if required through RFP process to allocate the	Yes in Affordable Phase and potentially also in “Mixed-Income” Phase if both towers are primarily affordable units

[4] See Appendix D related to bond debt

	Payment-in-lieu from the Affordable Housing Fund	
Affordable Housing is located at scattered sites	Yes	No
Projection of Number of Affordable Units Physically Built at 350 S 5th	~100 - 145	~145 - 200
Ongoing Lease Revenue	If City does ground lease to private developer instead of sale, revenue to general fund	If AAHC acquires and does ground lease to private developer, revenue for tenant services or could share revenue with general fund
Activate Ground Floor	Yes	Yes
Expand Transit	Yes	Yes
Meet Sustainability Goals	Yes	Yes

APPENDIX A: 350 S. 5TH HISTORY

In 1959, the YMCA moved its operations from S 4th Ave and built a new recreational building at 350 S 5th and included 50 Single Room Occupancy (SRO) units. The SRO's were managed like a hotel and could be rented by the day or by the week as low-cost, furnished, 8 x 10 living spaces with communal bathrooms and without cooking facilities in the room.

- 1986: 17 units were converted to childcare facilities, reducing the number of SRO's to 37
- 1991: The 37 SRO's were renovated and an additional 63 units were added for a total of 100 SRO units with the intent of providing low-cost housing for service workers and minimum wage earners. The Downtown Development Authority (DDA) and the City of Ann Arbor both contributed funds to add 63 SRO's but the primary source of funds was a private bank loan.
- 1995: The YMCA was struggling to make its monthly debt payments on the bank loan. The City agreed to refinance the debt, added restrictions to the incomes and rents charged for some units and added a right of first refusal to purchase the property if the YMCA ever decided to sell. Over time, the SRO's became long-term housing for extremely low-income households, who were priced out of the rental housing market.
- 2000: The YMCA decided to sell the property and the AAATA expressed an interest in acquiring the YMCA property to combine with the AAATA's adjacent transit center property and construct a new transit center with buses off of 4th Ave. and a development above, potentially to include an affordable housing element.
- 2000: After a series of negotiations and feasibility analyses by the City, DDA and the AAATA, City Council exercised its option to purchase the property, with many conditions, in order to ensure that the 100 units of affordable housing were preserved and to collaborate with AAATA to expand its transit operations on the combined site.
- 2003: Negotiations appear to have broken down between the parties and the AAATA entered into a purchase agreement with the YMCA and then the City exercised its option of first refusal to acquire the property in order to preserve the 100 units of affordable housing, which prevented the AAATA from acquiring the property. City takes on a 5-year loan to acquire the property for $3.5 million.
- 2004: The City issued a Request for Proposal to redevelop the site to include a minimum of 100 units of housing affordable to 60% AMI households and to include a significant portion of those units affordable to 30% AMI households
- 2005 (Sept): YMCA moves into its new building on W. Washington
- 2005 (Sept): City selects HDC (in partnership with the AAATA) as the developer through the RFP process
- 2005 (October): Pipes burst in the building and the building was condemned by the City. 80+ residents were relocated by the City Community Development Department to hotels and eventually to apartments for about 3 years
- 2006: City approved the site plan by HDC for "William Street Station", which included a mix of market-rate and affordable housing, expanded space for the AAATA, first floor retail, and underground parking.
- 2007: City Council did not approve an extension of the purchase option with HDC after the developer failed to meet the project milestones and William Street Station was not built.

- 2008: The City requested assistance from and the DDA approved funding to demolish the building and refinance the City's 5-year acquisition bank loan which was due
- 2008: Housing and Human Services Advisory Board studied the site to determine if 100 units should be replaced on the site and recommended that City Council issue a new RFP for a developer to develop the site with a minimum of 100 Permanent Supportive Housing units.
- 2008: Council working session to discuss replacing 100 affordable units at alternative downtown sites, including the city-owned site at 121 E. Catherine
- 2011: The City asked the DDA to conduct the "Connecting William" study and 2-year study was conducted that included the former "Klines" lot on Ashley/William, 353 S. Main (next to Palio), the 4th/William parking structure, 350 S 5th and the lot adjacent to the library.
- 2013: City Council approved the sale of 350 S 5th through a broker to pay off the $3.5 million balloon note. The City received 5 offers, 3 of which partnered with the AAATA. City sold the property to Dahlmann for $5.25 million with conditions, including the right of first refusal for the City to repurchase the site for $4.2 million if it was not developed by 2018.
- 2018: The site was not developed and the City exercised its right of first refusal to repurchase the property for $4.2 million.
- 2018: City Council voted to sell bonds and use the sales proceeds from selling the Library Lane lot to Core Spaces to retire the bond debt.
- 2018: The City settled litigation with Dahlman by agreeing to repurchase the lot for $5.2 million, and the City sold a 15-year bond for $5.35 million to pay for the purchase and associated fees.
- 2018: City Council directed the AAHC to work with the City Administrator to conduct a financial feasibility analysis to determine if the site can and should be redeveloped as affordable housing. Staff recommended developing conceptual plans to conduct community engagement around development of the site and bring back recommendations to City Council.
- 2019: City Council hires SmithGroup to conduct Community Engagement.
- 2019: City Council adopted multiple additional resolutions directing the AAHC to conduct a financial feasibility analysis of a total of 13 City-owned sites to determine if they are feasible to develop as affordable housing
- 2020 & 2021: The SmithGroup developed concept plans for 350 S 5th and other City-owned site and conducted community engagement and staff reported the results back to City Council
- 2020: Affordable Housing Millage approved
- 2022: The AAHC worked with staff from the City, DDA, AAATA and the SmithGroup to submit PUD and Supplemental Regulations based on the community engagement process.

APPENDIX B: ZONING REGULATIONS

The City's Uniform Development Code includes several incentives to developers of residential projects to provide affordable housing as a public purpose. Requiring market-rate residential developments to include affordable housing units is widely known as inclusionary zoning. The State of Michigan Planning and Zoning regulations do not expressly allow inclusionary zoning and therefore the City of Ann Arbor utilizes Planned Unit Development and Residential Premiums in its zoning ordinances to encourage the development of affordable housing on-site or off-site in exchange for zoning benefits.

When a developer commits to affordable housing, the developer can either provide affordable housing dwelling units on-site in perpetuity or the developer can make a payment in lieu of affordable housing for up to 50% of the affordable units. The payment in-lieu funds are then deposited into the Affordable Housing Fund and are available for an affordable housing developer to use the funds to help subsidize the development of affordable housing on a different site.

The express purpose is to ensure that some affordable housing gets built when market-rate developments are built. The definition of affordable housing is determined by the local community and typically includes an income target by Area Median Income. The affordable housing units can be rental or owner-occupied. The City of Ann Arbor defines an affordable housing dwelling unit as: Housing units reserved for households with income levels that are less than 60% of Area median income as defined by the United States Department of Housing and Urban Development (HUD) where the occupant is paying no more than the current HUD Fair Market Rents for Ann Arbor, including taxes and utilities.

2021 Area Median Income & Fair Market Rents (2022 not published yet)

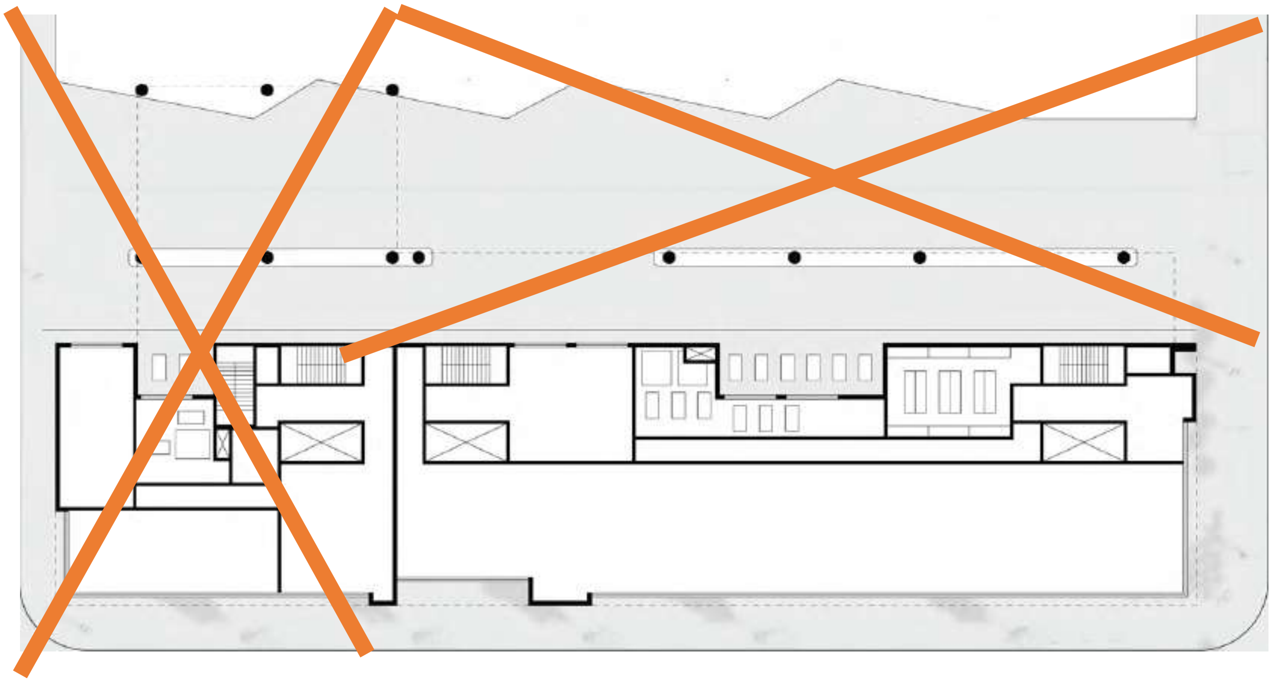
	1 Person/Studio	2 person/1 bdr	3 person/2bdr
60% AMI Income	$44,760	$51,120	$57,540
Fair Market Rent	$1,119	$1,198	$1,438

City Council adopts a resolution periodically to determine the payment-in-lieu formula. The most recent formula was adopted on August 19, 2019 (R-19-378). Based on the 2019 formula, a payment-in-lieu payment is $126/SF for each unit the developer is paying payment-in-lieu of. If the developer would otherwise provide a 700 SF unit on-site, the Payment-in-lieu payment is $88,200/unit ($126 x 700). A 500 SF unit payment-in-lieu payment is $63,000/unit.

The payment-in-lieu payment is not intended to pay 100% of the development cost of an affordable unit at another location, it is intended to provide enough subsidy that a developer of affordable housing can leverage other funds with the payment-in-lieu payment to develop an affordable unit at another location. The Housing and Human Services Advisory Board (HHSAB) issues a Request for Proposal (RFP) to makes recommendations to City Council to allocate payment-in-lieu payments from the Affordable Housing Fund. Historically, only non-profit developers have received funding from the City's Affordable Housing Fund. Non-profit developers are mission driven and purposefully choose to serve low-income, special needs and homeless households that are not being served in the market-place. The payment-in-lieu option is a conduit for market-rate developers to subsidize affordable housing developed by mission-driven non-profits.

APPENDIX C: PROPERTY VALUE

The property was appraised for $11 million in 2019 based on the assumption that it is an unencumbered property that will be developed at the highest return on the investment. The proposed PUD and Supplemental Regulations greatly reduce the market value of the property because over 60% of the site is dedicated to a bus lane, bus parking, a service alley, sidewalks and affordable housing. Only the remainder of the site has any value, and only if it is developed as market rate housing and commercial space.



If the PUD and Supplemental Regulations require income and rent-restricted affordable units to be included on-site, in the second tower of the development, it further reduces the value of the property because there will be a deed restriction on those units. It is not necessarily a deal-killer, but it is narrowing the potential feasible development options because the City needs to pay off the bond debt. After the Supplemental Regulations are adopted, the AAHC can update the appraisal to help evaluate the responses to the RFP from developers.

APPENDIX D: BOND DEBT

This city-owned site is the only property under consideration for affordable housing, with debt that needs to be repaid, which further complicates the site. The City sold bonds to finance the purchase of this site in 2018 for $5,350.000. The annual debt payment increases from $147,125 to $572,175 starting in 2023 when the City must start paying principal in addition to interest. The 15-year total principal and interest is $6,812,626. There are 3 options to pay off the debt.

1) Sell the property to the highest responsible bidder (with all of the restrictions adopted in the PUD Supplemental Regulations) at a price reflecting the value of the property with the restrictions adopted by the PUD Supplemental Regulations.
2) The City maintains ownership of the property and ground leases the improvements (physical structures) to the highest responsible bidder (with all of the restrictions in the PUD Supplemental Regulations) and uses the ground lease payments to pay off the debt over the life of the bond, approximately $570,000/year for the 11 remaining years. After the bond is paid off, the ground lease payments would provide revenue for the City's general fund. Until an RFP is issued, it is unknown whether a developer will offer at least $570,000/year as a ground lease payment to the City.
3) Sell the property to the AAHC using Affordable Housing Millage in the amount needed to retire the debt. Depending on what is built, the AAHC ground leases the tax generating component to the development partner and ground lease payments can be used as a long-term source of tenant services funding for existing AAHC properties, once the County Mental Health Millage expires in FY27. The FY23 County Mental Health Millage budget includes $605,480 for tenant mental health, eviction prevention and youth and family services at 17 AAHC properties and for the tenant-based voucher program. Again, until an RFP is issued, it is unknown what a developer will offer as a ground lease payment, but the bond will be paid off in full.

TIMELINE RELATED TO 3 BOND PAYMENT OPTIONS

After the PUD Zoning and Supplemental Regulations are approved, the next step is for the AAHC to issue a Request for Proposal for a private developer to co-develop the site. The intent is to pay the developer a fee for service (like an architect) for the affordable tower and AAATA component. The developer will be responsible for securing financing for the second tower. The developer will need to determine how to ensure that all components of the site are financially feasible.

1) City sells to developer: The developer would typically raise equity from itself and investors to acquire property (because financial institutions don't typically provide acquisition loans) and the developer and investors would be paid back over time from project revenue as a return on their investment. If the property is sold to a private developer, the purchase would typically occur after site plan approval and after all finances are committed. For a complicated affordable housing, mixed-use project with multiple funding sources, it can take 1-3+ years to secure financing. The value of the land is not eligible for Low Income Housing Tax Credits and must be paid for with an alternative funding source.
2) City Ground lease to developer: If the project is ground-leased by the City to a private developer, the ground lease might start at the time of closing on a construction loan but is more likely to start after construction completion, once revenue can be generated to pay the ground lease. The advantage of a ground lease is that it enables a developer to use the value of the land

as equity, and pay for that equity over time as a ground lease payment. The disadvantage to the developer, is the developer will not own the land outright and will be subject to the terms of the ground lease. The purchase option favors larger developers with deeper pockets and access to investors and the ground lease favors smaller developers and non-profit developers. The ground lease also has political risks if the lessor is the City. Several years will pass between approval of the zoning and supplemental regulations and execution of the ground lease.

3) City sells to AAHC and AAHC ground lease to developer: This option mitigates the risk for the City and the developer if the AAHC purchases the property from the City using Affordable Housing Millage and/or ARPA funds in order to pay-off the bond debt in full, and the AAHC ground leases the property to the developer. Regardless of how the development is structured, the AAHC will be a co-developer, co-owner of the improvements, and a co-property manager of the property with the private developer. The AAHC can act as a risk-buffer between the developer and the City because the AAHC can pay off the bond debt, generate revenue through a ground lease, and still have accountability with the public because the AAHC's board is appointed by the Mayor and City Council. From a timing perspective, the AAHC can acquire the property as soon as the City determines the affordable housing deed restrictions will be placed on the property as a condition of the acquisition.