



ATTACHMENT 1

CITY OF MILPITAS AGENDA REPORT (AR)

Item Title:	Receive a report on the proposed project proposal for moderate income housing at Turing Apartments through a California Statewide Communities Development Authority program and provide direction to staff on next steps, if any.
Category:	Leadership and Support Services
Meeting Date:	9/21/2021
Staff Contact:	Ashwini Kantak, Assistant City Manager, 408-586-3053 Sharon Goei, Building Safety and Housing Director, 408-586-3260
Recommendations:	<ol style="list-style-type: none">1. Receive a report on the proposed project proposal for moderate income housing at Turing Apartments through a California Statewide Communities Development Authority program.2. If Council wishes to pursue the proposed project, (a) provide input to staff on the preliminary recommendations; (b) direct staff to bring back a framework and goals for this type of a moderate income housing program for Council consideration based on staff recommendations and Council input, and (c) direct staff to bring back for Council consideration along with a revised project proposal consistent with the framework and goals for a moderate income housing program.

Executive Summary

In June 2021, Council directed staff to analyze a proposal to join the Community Improvement Authority (Authority), an affiliate of the California Statewide Communities Development Authority (CSCDA), and to support the purchase of the Turing Apartments for the purpose of converting the 371-unit market rate project to moderate income housing.

This program is premised on providing potential benefits that include: creating moderate income housing; providing management and oversight of the project without City resources; and providing a valuable asset to the City at the end of the bond term. However, it is important for the Council to look at the assumptions of the project as well as consider implications of no City oversight, control, or assurance of affordability, for a project that will be indirectly associated with the City and could be a City asset in the future.

The consultant and staff note four key areas for Council consideration and discussion:

1. Level of affordability;
2. Financial projections and assumptions;
3. Level of capital investment; and
4. Transparency and oversight.

As an example with Level of Affordability, the proposed discounts to current rents at the Turing Apartments would still place the rents higher than the market rents. Furthermore, if the rate of rent increases is adjusted to be in line with past historical trends, the value of the asset at the end of the bond term becomes significantly lower than projected by the project team. Also, since the City will be receiving the asset in “as-is” condition after the bonds are paid off, it is important to ensure that the asset will be maintained in good condition; the

planned dollars for capital investment are not based on a project condition report for the term of the bond. Lastly, since the City does not have a role in oversight and management of the project, it will be important to require adequate transparency, reporting, and oversight on how the affordability covenants are implemented and enforced and how the property is managed.

Another area of consideration for Council is the impact to the General Fund. Over a 30-year period, it is estimated that the City would forego a total of \$15.4 million (\$9.7 million in 2021 dollars) of property tax revenue, comprised of \$12.4 million of ad valorem property tax revenue and \$3 million of property tax in-lieu of vehicle license fee revenues from the state that are linked to taxable assessed property values. Other taxing entities would forego a total of approximately \$77.5 million in property tax revenue. Thus, including all taxing agencies, foregone tax revenues would approximate \$92.9 million over a 30-year period. The City would not be responsible for repaying the revenues forgone by the other taxing entities. Staff also notes that the analysis of the proposed project required a significant amount of staff resources. If Council directs additional work on this project or other similar moderate income housing programs, staff will need to bring back information on costs for additional resources and impacts on other workplan items for Council direction.

If Council wishes to pursue this specific project, staff recommends follow up on the preliminary recommendations as a next step. Additionally, staff recommends developing a framework and goals for a moderate income program, based on staff recommendations and Council input, and bringing back a revised proposal for Council consideration, consistent with the framework and goals for a moderate income housing program.

Background:

The greater Bay Area is experiencing a housing crisis of unaffordability. As home prices and rents continue to increase, the result has disproportionately affected long term, lower income residents in Milpitas who do not have the financial resources to remain in the area. The City Council has taken measures to minimize the impact of the overall housing crisis by providing direct aid to Milpitas residents and families and adopting policies to increase affordable housing.

For example, in late 2019, the Milpitas Rent Relief Program began as a pilot program to aid renters experiencing emergency housing assistance needs. Its prescient formation was instrumental in delivering immediate aid to those most affected by COVID-19, as other jurisdictions were in the process of creating similar programs. To date, the program has provided assistance to over 100 families with over 300 Milpitas residents.

Other similar programs adopted by the Council are intended to ensure that Milpitas residents avoid displacement and are protected from the rising cost of housing. Some examples include the Rent Review and Just Cause Eviction Protection Urgency Ordinances, housing services funded by Community Development Block Grants, and a new Mortgage Relief Program and expanded Rent Relief Program eligibility to be created with the American Rescue Plan Act funding.

For affordable housing production, the City Council adopted an inclusionary ordinance in 2018 to increase the supply of affordable units in the community. Currently, the City has approximately 50 moderate-income units that are projected to be built in the next few years. While this helps, it is not sufficient to meet the Regional Housing Needs Allocation goal of 565 units in the moderate-income category. State financing tools for moderate-income rental housing are also limited. For the next Regional Housing Needs Allocation cycle, through the upcoming Housing Element and Assessment of Fair Housing, the City will plan for new housing growth in a way that responds to the City's unique context and to promote fair housing opportunities throughout the community.

On May 11, 2021, at the request of Councilmember Phan, the City Council directed staff to retain a consultant to analyze a proposal by Lyon Living (Owner) to convert the apartments at Turing to moderate income housing via a California Statewide Communities Development Authority (CSCDA) program. The project team is comprised of the Owner, CSCDA, and Waterford Residential (Administrator). Since this direction was received, staff have been approached by several other entities to request consideration of similar programs.

In order for this proposal to move forward the City would need to join the Community Improvement Authority (Authority), which is an affiliate of CSCDA, and support the conversion through the adoption of a resolution and approval of a public benefit agreement. Council directed that all consultant costs were to be paid for by the project Owner.

In consultation with the project team, City staff retained the services of Keyser Marston Associates, Inc. (Consultant). At the time of preparation of the consultant professional services agreement in June, the consultant services were estimated to cost \$38,000. Due to additional meetings and analytical work starting in late August, including meetings with the project team and Housing Subcommittee, and further anticipated work, the Consultant updated the estimated service costs to \$63,000. The project Owner agreed to fund this amount for consultant services.

Staff asked the Consultant to review the proposal from the project team and to assess the following:

1. The degree to which the proposed rent reductions will enhance the affordability of the project and meet the City's affordable housing objectives.
2. The potential financial returns to the City relative to the value of foregone property tax revenues over the 30+ year term.
3. Economic aspects of transaction structure and potential risks and liabilities to the City.
4. The factors that led three other cities to decline to participate in a similar offer by CSCDA.

To undertake this review, the Consultant received and reviewed the following:

1. Financial pro forma information provided by the proposed Project Administrator, Waterford Residential. The information provides estimates of sources and uses of funds for the purchase of the Project by the Authority, proposed reductions in unit rental rates, anticipated operating projections for a 34-year term and anticipated reversion value to the City of Milpitas upon conveyance. Waterford also provided recent property tax assessments, an appraisal of the property, and a property condition report.
2. A Draft Public Benefit Agreement for execution by the CSCDA Community Improvement Authority (Owner) and the City of Milpitas (Host).
3. A Draft Project Administration Agreement for execution by the CSCDA Community Improvement Authority (Owner) and Waterford Property Company, LLC (Administrator).
4. Draft Purchase and Sale Agreement for execution between Milpitas -District 1 Owner, LLC (Owner) and Waterford Residential 8, LLC (Buyer).
5. Draft Property Management Agreement between CSCDA Improvement Authority (Owner) and Greystar California, Inc. (Manager).
6. Information from the City of Milpitas regarding the City's affordable housing goals. Market information from CoStar and other public sources on the City of Milpitas and the subject property.
7. Santa Clara County Controller data on ad valorem property taxes and property tax assessments that apply to the Project.
8. A sample trust indenture, which Waterford proposes would be similar to the indenture for the Turing transaction.

Time was of the essence for the project team and the Consultant and City staff did their best to complete and review the analysis respectively.

Analysis:

The Consultant prepared a draft report which was shared with the project team and discussed with them on August 27. The proposed program would convert 371 market rate units at the Turing Apartments in Milpitas into moderate income housing. This would be made possible by the sale of the property to the California Statewide Communities Development Authority (CSCDA), which is a Joint Powers Authority. The abatement of property taxes would reduce the Project's operating expenses, which in turn would enable the Authority to decrease monthly rental rates.

Under the terms of the program, the rental rates being charged to existing income eligible residents would be decreased by approximately 10%, as existing leases are renewed. Annual rent increases over the 34-year bond term would be limited to the lesser of the annual increase in the Area Median Income (AMI) or 4%. Rents on units that turn over would be subject to the maximum permitted rents under the Regulatory Agreement. Existing residents who do not meet the income requirements would not be displaced. During the regulatory

term, the City of Milpitas would not bear any responsibility or liability for the operation of the Project or the repayment of the bonds. The Authority is a public entity separate and apart from its members, and any debts or obligations incurred by the Authority will not constitute debt or obligations of its member agencies. The term for the repayment of the bonds is anticipated to be 34 years. The City, at its sole discretion, would be permitted to purchase or force a sale of the Project at any time between year 15 and the end of the bond term. The net proceeds from the sale of the Project after the payment of any outstanding debt would accrue to the City. The Project would be conveyed on an "as-is" basis and the City or future owner would be responsible for making any needed capital improvements as well as paying ad valorem property taxes, which would be reinstated (unless the new owner is a non-profit and eligible for abatement).

Key Considerations

Affordability Considerations

1. The proposed program would provide restricted rents for existing tenants that are within HCD's limits for Moderate Income housing, for a period of 34 years.
2. Under the proposal, rental rates charged to existing tenants would be decreased by a percentage ranging from 8% to 12%, with an average monthly saving of \$323 per unit. Keyser Marston Associates, Inc. Page 2 [\\SF-FS2\wp\16\16005\015\001-004.docx](#)
3. The Turing commands premium rents relative to other market rate projects in Milpitas. As a result, even with an average 10% reduction in rental rates, the proposed reduced rental rates would exceed average market rental rates in Milpitas.
4. The rental rates to be charged on new tenants as spaces turn over would be subject to the CSCDA maximum rents, which exceed market area rents and, in most cases, exceed the current market rate rents currently charged by Turing.
5. Given that the proposed reduced rents would exceed average market rate rents in Milpitas and that the rents on new leases would likely be significantly higher than the market rate rents in Milpitas, the Project's affordability benefits are, at best, very limited.
6. The rent restrictions will not provide the City with any credit towards meeting its Regional Housing Needs Allocation, which is of critical importance to the City of Milpitas

Financial Feasibility Considerations

1. The Project's financing does not require an investment of cash equity and all debt is secured solely by the revenue generated by the Project. The structure of the transaction provides significant up-front compensation to the Administrator (Waterford) (\$4.25 million), CSCDA (\$1.25 million), and the current owner of the Project (\$235.25 million). In contrast, the potential financial returns to the bond holders, the City and other taxing agencies are entirely at risk and subject to the financial performance of the Project.
2. The cash flow is based on an assumption that rents will increase by 3% every year. This is not supported by historical data.
3. The money set aside for capital investment is based upon a project condition report for the first 12 years of the project and does not envision major infrastructure projects that may be required over the 34 year term of the bond. For example, the condition report currently does not anticipate investment in infrastructure elements that will need replacement between 12 and 34 years such as, the roof, windows, doors, or landscaping.

Preliminary Recommendations

Based on the consideration noted above and if Council chooses to participate in the proposed CSCDA program at Turing, the Consultant has developed several preliminary recommendations, which staff concurs with.

1. The rent reductions should be set at levels that are below market rate levels in Milpitas so that the Project truly delivers enhanced affordability. The proposed rent levels exceed average market rate

rental rates, which largely nullifies the argument that the Project will enhance the affordability of apartments in Milpitas.

2. Rent and income restrictions contained in the Regulatory Agreement should conform to the Department of Housing and Community Development (HCD) income and rent formulas. As proposed, the rent and income formulas are not consistent with the HCD formulas and result in significantly higher rents than what would be permitted by HCD.
3. The Property Condition Report should address the Project's needs for a 34-year term and the Project's financing plan provide funding to cover the anticipated capital improvement costs over the 34-year term. The draft property condition report only addresses 12 years of needs. The proposed annual contributions for capital improvements appears to be inadequate.
4. Any refinancing of Project debt should be subject to the City's approval.
5. The Project should be required to submit proposed rent increases to the City's approval to ensure that the affordability restrictions are enforced.
6. The Project should be required to submit an annual report to the City demonstrating that the affordability covenants are being properly implemented and enforced.
7. The Administrator should be obligated to certify that the affordability covenants are being properly implemented and enforced.
8. The Project's cash flow projection should be based on more conservative assumptions to reduce the level of risk and provide greater assurance for long-term viability.
9. The bond underwriting assumptions should be reviewed by an underwriter retained by the City and the City's Financial Advisor to ensure that the financial structure is sound and consistent with industry standards for multifamily revenue bonds and is appropriate for the City's participation.
10. Greystar (Manager) should be required to submit its tenant selection plan, maintenance plan, staffing plan and marketing plan for the City's approval.
11. Greystar (Manager) should be required to submit annual reports on the Project's operations, including the Project's rent roll, that clearly track the annual increase in rental rates, operating expenses, capital improvements, vacancy rates, bond interest and redemption payments, and all bond specific payments.
12. In addition to the preliminary recommendations developed by the consultant, the City should consider entering into an agreement with the project team so as to clearly capture the roles of the project team and the City through the term of the bond and to describe the process for enforcement.

City Council Housing Subcommittee

This topic was agendaized for discussion at the City Council Housing Subcommittee on September 2 and 9, 2021.

On September 2, 2021, the City Council Housing Subcommittee convened to hear a presentation from the Waterford Property Company and CSCDA on the proposed acquisition of the Turing Apartments and its conversion to a workforce housing community. Their presentation provided an overview of the moderate income housing program, the specifics of the Turing Apartments proposal, and an overview of the benefits to the City.

A representative of the Consultant was also present to discuss the findings from the draft report. The Consultant summarized the report findings relating to affordability considerations, financial feasibility considerations, the economics of the transaction structure and potential risks to the City, and a list of recommendations should the City decide to move forward with this proposal.

Councilmember Chua requested a second meeting to further discuss the financial analysis, with specific requests to discuss the repayment of the bond term, bond insurance, property insurance, replacement coverage, and housing availability for tenants during replacement.

Councilmember Phan was interested in an option discussed by Waterford to deepen affordability and agreed that another meeting and more time was needed to discuss the exit value of the property and how the project would be maintained over time.

On September 9, 2021, the City Council Housing Subcommittee held another meeting to further discuss the proposed project and asked follow-up questions.

Councilmember Chua expressed concern over the structure of the project including the fact that Waterford and CSCDA would receive their payment upfront and that payment is not based on performance metrics. The Councilmember also expressed concern that the City was not an oversight partner with the project administrator. The City Attorney representative noted that under this arrangement, the City has no local control or oversight of the project.

Councilmember Phan expressed optimism that the benefits of the project outweigh the potential concerns. The Councilmember noted that Milpitas is in search of housing options for Milpitas residents now, and that this project could serve as a model for other developments regionwide. The Councilmember also expressed a desire to participate in additional similar projects in the future.

Benchmarking

According to a September 13, 2021 Orange County Register article about middle income housing programs, there are 28 middle income housing programs in California, with 21 of them established in 2021, across 16 cities. Of the 28 programs, more than half are located in Southern California, with the rest located in the larger San Francisco Bay Area. There are no programs currently established in Santa Clara County. The closest cities to Milpitas that have one or more of these programs are Dublin and Hayward. The three largest cities in the Bay Area, San Jose, San Francisco, and Oakland did evaluate participation in these programs but decided not to participate.

The San Jose City Council voted not to move forward under this program structure for a variety of reasons. The program gave the City no way to enforce the affordability restrictions. Staff had concerns about the amount of debt the project would carry and whether the bond would actually be repaid in 30 years. The 100% and 120% AMI affordable rent levels were close to market rates rents. Thus, the City did not see a significant affordability benefit to its residents.

The City of Santa Clara also evaluated participation in the program but did not move forward with the proposed workforce housing project. Their reasons echoed those expressed by the City of San Jose, and the units not being able to count toward the Regional Housing Needs Allocation was also a concern.

Staffing Resources

Over the past year, while staff resources were already fully committed to delivering existing services and programs, several new programs and initiatives have been added because of increased federal funding and other Council funded priorities. These include managing the \$1.28 million CDBG and Coronavirus funding compliance process and conducting monitoring and reporting with 23 contract service providers; implementing homeless outreach, assessment, street-based case management services and analyzing monthly data; implementing mobile shower and laundry services for unhoused residents; and working with the Homelessness Task Force and Santa Clara County on homeless resources. Staff has also been working on other major policy initiatives including monitoring the Regional Housing Needs Allocation process; preparing for the Housing Element update and Assessment of Fair Housing; updating the Affordable Housing Ordinance; tracking housing legislation; exploring strategies for the development and disposition of City-owned properties on South Main Street; and developing a new Consolidated Plan for CDBG.

Earlier in 2021, staff was approached with several inquiries regarding other potential moderate-income housing programs and project. If Council provides direction for staff to continue to work on this project as well as other similar projects, staff will need to bring back a discussion to Council on the need for additional resources and prioritization of other workplan items. It is important to note that staff may not be able to pause work on many of the workplan items since there are state and federal requirements associated with those items.

Policy Alternative:

Not Applicable

Fiscal Impact:

Although the consultant costs will be paid for by the Owner, staff has spent a substantial amount of time working with the consultant and project team. If the City moves forward with this proposed project, over a 30-year period, it is estimated that the City would forego a total of \$15.4 million or approximately (\$9.7 million in 2021 dollars) of property tax revenue, comprised of \$12.4 million of ad valorem property tax revenue and \$3.0 million of property tax in-lieu of vehicle license fee revenues from the state that are linked to taxable assessed property values. Including all taxing agencies, foregone tax revenues would approximate \$92.9 million over a 30-year period. At the end of the bond term, the City may be able to recoup this lost revenue. However the amount will depend on the project performance over the term of the bond and the current project performance assumptions may be optimistic, which causes the risk of overstating the net return to the City.

California Environmental Quality Act:

This item is not a Project under CEQA in accordance with CEQA Guidelines Section 15061(b)(3) (Common Sense Exemption) as it can be seen with certainty that a general discussion of funding priorities by the City Council will not have a significant effect on the environment. Further, the item is also not a Project pursuant to CEQA Guidelines Section 15378(b)(4) as it is a government fiscal activity that does not involve any commitment to any specific project which may result in a potentially significant physical impact on the environment.

Recommendation

1. Receive a report on the proposed project proposal for moderate income housing at Turing Apartments through a California Statewide Communities Development Authority program.
2. If Council wishes to pursue the proposed project, (a) provide input to staff on the preliminary recommendations; (b) direct staff to bring back a framework and goals for this type of a moderate income housing program for Council consideration based on staff recommendations and Council input, and (c) direct staff to bring back for Council consideration along with a revised project proposal consistent with the framework and goals for a moderate income housing program.

Attachments:

1. Keyser Marston Associates report dated 9/16/2021