ATTACHMENT 8

City of Milpitas

California State Communities Development Authority (CSCDA) Community Improvement Authority (Turing Apartments) Bond Proposal Review

February 7, 2022

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BACKGROUND

The City of Milpitas ("City") was approached by the California State Communities Development Authority ("CSCDA") and the Waterford Property Company, LLC ("Waterford") with a proposal to acquire the existing Turing Apartments (Project) comprised of 371 market rate multi-family units and create the equivalent number of moderate-income housing units. CSCDA would accomplish this by lowering rent levels in the Project to existing income eligible residents by approximately 10% with an average rent reduction of $323 per month and capping these rent levels annually to maintain this moderate-income level for the life of any bonds issued in connection with the Project acquisition. In addition, annual rent growth will be limited to no more than 4%. As current tenants' leases expire, they will be eligible to go through the income qualification process. If they do not qualify for the restricted rents, they would have the option to remain at their current market rent. All other residents who qualify, would have their rent restricted and capped as described above.

Under this proposal, CSCDA would acquire the property by financing the acquisition price through the issuance of the following tax-exempt governmental bonds:

CSCDA Community Improvement Authority, Essential Housing Revenue Bonds
$232,490,000[1] Series 2022A ("Senior Bonds"),
$65,500,000[1] Series 2022B ("Mezzanine Bonds"),
$5,000,000[1] Series 2022C ("Subordinate Bonds"), and together (the "Bond" or "Bonds").

This would make the property exempt from property tax, resulting in the loss of such revenues for impacted taxing entities such as the City, the County of Santa Clara, and the San Jose-Evergreen Community College District. Lost property tax revenue for the Milpitas Unified School District would be backfilled by the State. Additionally, while the debt obligations would no longer be levied on the property, property taxes on other taxable properties in the various jurisdictions would increase in order to meet the debt obligation on existing debt as well as for any future bonds backed by property taxes that may be issued by these municipal entities. The City would enter into a Public Benefit Agreement (PBA) with CSCDA whereby the City, along with the other impacted taxing entities, would receive any potential surplus revenue if and when the property is sold or refinanced. Under the PBA, the City, at its sole discretion, may force a sale of the property beginning in year 15 from the issuance date to the final maturity date of the tax-exempt bonds, upon which it would receive the net sale proceeds.

As part of the City's due diligence review of the Project and related Bonds, the City engaged Fieldman, Rolapp & Associates, Inc. ("Fieldman") to review the proposed Bond financing structure as it relates to the City, and the potential financial risk exposure to the City in the event of default and fiscal stress on the Project.

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[1] Preliminary, subject to change. Provided by Goldman Sachs on January 25, 2022.

SOURCE INFORMATION

Fieldman's review of the Bonds was based on the information provided by Goldman Sachs, the underwriter on the Bonds (the "Underwriter"), Waterford, the City, and the City's consultants. The key documents and the basis of our analysis are the bond cash flows provided by the Underwriter and the financial pro formas provided by Waterford and the Underwriter. Copies of these source documents are attached to this report as Attachment A and Attachment B, respectively. For purposes of our analysis, we have based our analysis primarily on the pro forma provided by the Underwriter as this was the pro forma that reflected the latest detailed bond cash flows provided to the City. However, we note that the City's annual host fee is not reflected in the Underwriter's pro forma but was reflected in the Waterford pro forma model. Additionally, we note that a copy of the draft Indenture for the Bonds was not reviewed by Fieldman as a copy of the draft Indenture was not available at the time of this report.[2]

We have also reviewed City Council Meeting staff reports and viewed Council Meetings related to the Project. Lastly, we participated in several conference calls/virtual meetings with City staff, CSCDA, Waterford and the Underwriter to discuss the Project and related cash flows.

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[2] Per a conference call held on January 12, 2022, with Fieldman, City staff, and representatives from the Underwriter and Waterford.

EXECUTIVE SUMMARY

In order to reduce and to mitigate the level of risk of the Project to the City, Fieldman recommends the following:

- Utilize conservative growth rate assumptions in the Project pro forma and require limits on bond structure. Key bond structure limits should include:
    - Minimum of 25% of total aggregate principal paid down within the first 10 years of bond issuance;
    - Limit term of bond financing to be no greater than 35 years; and
    - Utilize an optional redemption feature of a minimum of 10 years with no call premium.
- Require bond principal redemptions to be on parity with bond interest payments.
- Require annual fee payments to the bond issuer (CSCDA) and to the Project Administrator (Waterford) be payable after payment of bond interest and principal payments, and any bond reserve fund deposits, and payable with annual excess cash flow only.
- Require the annual City's host fee and CFD payments be in a senior position to Bond interest and principal payments, deposits to Bond reserve funds, and annual fee paid to the bond issuer and Project Administrator.
- Require limits to bond issuance expenses such as limiting the fees to the bond issuer and the Project Administrator to be in line with other similar middle income housing programs in California.
- Require the City's written consent prior to the issuance of any future additional bonds in the form of new money and/or refunding bonds.
- Require the bond issuer send the City notification of any material changes in connection with the Project as long as the Bonds are outstanding.

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FINANCIAL STRUCTURE[3]

A. Sources and Uses

The table below provides a breakdown of the preliminary Bond Sources and Uses of funds for the Project.

Sources:		Series 2022A Senior Bonds	Series 2022B Mezzanine Bonds	Series 2022C Subordinate Bonds	Total
Bond Proceeds:					
	Par Amount	232,490,000.00	65,500,000.00	5,000,000.00	302,990,000.00
	Original Issue Discount	(21,629,506.60)	(8,387,275.00)		(30,016,781.60)
		210,860,493.40	57,112,725.00	5,000,000.00	272,973,218.40

Uses:		Series 2022A Senior Bonds	Series 2022B Mezzanine Bonds	Series 2022C Subordinate Bonds	Total
Project Fund Deposits:					
	Purchase Price	181,239,058.36	51,060,941.64		232,300,000.00
Other Fund Deposits:					
	Operating Account	408,041.44	114,958.56		523,000.00
	Capital Expense Fund	4,525,125.00	1,274,875.00		5,800,000.00
	Administration and Authority Fee Fund	1,092,271.55	307,728.45		1,400,000.00
	Operating Reserve Fund	612,452.26	172,547.74		785,000.00
	Senior Debt Service Reserve Fund	7,987,150.00			7,987,150.00
	Coverage Reserve Fund		2,121,430.00		2,121,430.00
	Mezzanine Debt Service Reserve Fund		2,620,000.00		2,620,000.00
	Extraordinary Expense Fund	390,096.98	109,903.02		500,000.00
	Capitalized Interest Account	1,332,000.00	1,310,000.00		2,642,000.00
		16,347,137.23	8,031,442.77		24,378,580.00
Delivery Date Expenses:					
	Cost of Issuance	936,774.99	263,920.01		1,200,695.00
	Underwriter's Discount	3,194,658.12	865,636.09		4,060,294.21
	Initial Payment to Project Administrator	3,000,000.00			3,000,000.00
	CSCDA Fee	2,363,909.70	665,990.30		3,029,900.00
	Consideration for Purchase Rights to Proj Admin			5,000,000.00	5,000,000.00
		9,495,342.81	1,795,546.40	5,000,000.00	16,290,889.21
Other Uses of Funds:					
	Contingency	3,778,955.00	(3,775,205.81)		3,749.19
		210,860,493.40	57,112,725.00	5,000,000.00	272,973,218.40

The upfront bond issuance expenses of $16.29 million represents approximately 5.38% of the total principal amount issued of $302.99 million. For comparison, for typical municipal investment grade rated financings, issuance expenses are generally around 2% of the total principal amount. A recent study by Keyser Marston Associates ("KMA") compared bond issuer and Project Administrator fees for middle income housing programs by the California Community Housing

[3] Preliminary, subject to change. Provided by the Underwriter on January 25, 2022.

Agency (“CalCHA”), CSCDA, and California Municipal Finance Authority (“CMFA”), and provided the following issuance expense comparisons:

	CalCHA	CSCDA	CMFA
Upfront Issuer Fee	$500,000 Flat Fee	1% of Bonds	$250,000 Flat Fee*
Annual Administration Fee	$125,000 no escalations	$250,000 no escalations	$62,500 no escalations*

*25% of fees shared with local jurisdiction, 25% of fees shared with local charity.

B. Bond Structure

As discussed earlier, the purchase of the Project would be funded through a tax-exempt bond issue. Neither CSCDA nor Waterford provide any equity or other investment and since the Project is already well established, there is no development risk to Waterford. The Bonds are structured based on cash flow projections assuming annual revenue growth of 3% beginning in 2025 through the final term of the Bonds. The resulting debt service coverage ratio of annual net revenues to annual Bond interest and principal payments is estimated at 1.00x in each year. The financing structure as currently contemplated poses certain risks and uncertainties that necessitate further discussion.

Original Issue Discount Bonds. An original issue discount bond is a bond that is sold for less than its face value and specifically, when the coupon rate of a bond is lower than the yield purchased by investors. In the case of the proposed Bonds, the financing is structured with multiple term bonds with significant level of original issue discount totaling approximately $30.02 million. The original issue discount bond structure is utilized to cover the high issuance costs and fees as outlined in the Sources and Uses table above, and to create a cash flow to maintain the 1.00x debt service coverage ratio for Bond interest and principal payments. In our view this is an extreme structure and has similarities to a capital appreciation bond structure. The following table provides the preliminary bond structure summary with respect to the Series 2022A Bonds and the Series 2022B Bonds.

Bond	Principal	Estimated Final Maturity	Coupon Rate	Yield	Price	Total Discount
Series 2022A-1	$60,000,000	9/1/2047	3.25%	3.80%	$91.072	$5,356,800
Series 2022A-2	$172,490,000	9/1/2057	3.50%	4.00%	$90.566	$16,272,707
Series 2022B-1	$65,500,000	9/1/2057	4.00%	4.75%	$87.195	$8,387,275
Totals	**$297,990,000**					**$30,016,782**

The Series 2022C Bonds are structured as a bullet term bond with a principal of $5,000,000 maturing in 2056. This Bond carries a 10% interest rate and the interest payment is deferred with initial interest payments paid from net revenues beginning in March 1, 2026 through September 1, 2056. As shown in the Sources and Uses table above, no financing costs are applied to the Series 2022C Bond and the entire $5,000,000 bond proceeds will be delivered to Waterford. This is essentially a type of “preferred equity” or deferred development fee and is paid to Waterford in exchange for Waterford’s assignment of its purchase and sale agreement for the Project asset to

CSCDA. This is in addition to other upfront and ongoing fees that Waterford will receive through the term of the Bonds.

Turbo Bonds and Financing Term. The financing includes multiple term bonds structured as turbo bonds. The initial principal amortization for turbo bonds represents the anticipated paydown schedule and is not mandatory which is the more typical structure for tax-exempt municipal bonds. Principal redemption of turbo bonds will be paid only when annual cash flows produce excess revenues. If there are no excess revenues, then principal is not paid and will be deferred. While the financing term is currently estimated at 35 years with the final maturity due in 2057, the final term of the financing is market driven and will be determined when bonds are sold. Therefore, each bond series could have a final term of up to 40 years.

Principal Amortization. Assuming annual revenue growth at 3% as presented by Waterford and the Underwriter, the Bonds are currently anticipated to have a term up to 35 years with 100% of principal paid in year 34. However, at the end of year 15, over 91% of the principal amount of the Series 2022A bonds would remain outstanding, while 100% of the Series 2022B and Series 2022C bonds would be outstanding. In fact, the Series 2022A bonds do not begin to amortize principal until 2027, and at the end of 30 years, 67% of the initial par amount would remain outstanding. As indicated by CSCDA, these Bonds are not contemplated to be refunded during the life of the Bonds and with the Turbo Bond structure, there is a very large risk of the potential inability to pay off the outstanding bond principal and interest payments at the end of the financing. Provided below is a current amortization schedule of the Bonds.

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Preliminary Principal Amortization Schedule

Term		Principal				% of Total	
Year	Maturity Date	Series 2022A	Series 2022B	Series 2022C	Total	Annual	Cumulative
1	9/1/2023	-	-	-	-		0.0%
2	9/1/2024	-	-	-	-		0.0%
3	9/1/2025	-	-	-	-		0.0%
4	9/1/2026	-	-	-	-		0.0%
5	9/1/2027	190,000	-	-	190,000	0.1%	0.1%
6	9/1/2028	545,000	-	-	545,000	0.2%	0.2%
7	9/1/2029	920,000	-	-	920,000	0.3%	0.5%
8	9/1/2030	1,320,000	-	-	1,320,000	0.4%	1.0%
9	9/1/2031	7,745,000	-	-	7,745,000	2.6%	3.5%
10	9/1/2032	2,190,000	-	-	2,190,000	0.7%	4.3%
11	9/1/2033	2,560,000	-	-	2,560,000	0.8%	5.1%
12	9/1/2034	3,065,000	-	-	3,065,000	1.0%	6.1%
13	9/1/2035	3,595,000	-	-	3,595,000	1.2%	7.3%
14	9/1/2036	4,160,000	-	-	4,160,000	1.4%	8.7%
15	9/1/2037	4,760,000	-	-	4,760,000	1.6%	10.2%
16	9/1/2038	5,390,000	-	-	5,390,000	1.8%	12.0%
17	9/1/2039	6,050,000	-	-	6,050,000	2.0%	14.0%
18	9/1/2040	6,755,000	-	-	6,755,000	2.2%	16.3%
19	9/1/2041	7,495,000	-	-	7,495,000	2.5%	18.7%
20	9/1/2042	8,275,000	-	-	8,275,000	2.7%	21.5%
21	9/1/2043	9,115,000	-	-	9,115,000	3.0%	24.5%
22	9/1/2044	10,000,000	-	-	10,000,000	3.3%	27.8%
23	9/1/2045	10,940,000	-	-	10,940,000	3.6%	31.4%
24	9/1/2046	11,930,000	-	-	11,930,000	3.9%	35.3%
25	9/1/2047	12,965,000	-	-	12,965,000	4.3%	39.6%
26	9/1/2048	14,065,000	-	-	14,065,000	4.6%	44.2%
27	9/1/2049	15,220,000	-	-	15,220,000	5.0%	49.3%
28	9/1/2050	16,435,000	-	-	16,435,000	5.4%	54.7%
29	9/1/2051	17,710,000	-	-	17,710,000	5.8%	60.5%
30	9/1/2052	19,055,000	-	-	19,055,000	6.3%	66.8%
31	9/1/2053	20,470,000	-	-	20,470,000	6.8%	73.6%
32	9/1/2054	9,570,000	20,495,000	-	30,065,000	9.9%	83.5%
33	9/1/2055		23,855,000	-	23,855,000	7.9%	91.4%
34	9/1/2056		21,150,000	5,000,000	26,150,000	8.6%	100.0%
35	9/1/2057			Current final term date			
36	9/1/2058						
37	9/1/2059						
38	9/1/2060						
39	9/1/2061						
40	9/1/2062			Potential final term date			
	Total	232,490,000	65,500,000	5,000,000	302,990,000		

In contrast to the Bonds which are non-rated, investment grade rated financings typically amortize principal at a much faster pace. For instance, Standard & Poor's generally favors 25% of principal amortized in the first five years and 50% of the debt retired within the first ten years. The paydown ratios for the Bonds are 0.1% and 4.3% in the first five and ten years, respectively.

Optional Redemption. Based on information provided by the Underwriter, the Series 2022A and Series 2022B bonds will be structured with a standard municipal bond 10-year optional redemption with no premium at 100%. The Series 2022C bonds will be optionally callable between year 10 and year 35 with a premium at 110%. After year 35, there will be no premium and the call price would be at 100%. This higher call premium would essentially make it less likely to refinance for economic savings in the future.

Additional Debt. Per the Underwriter, issuance of future additional bonds would be allowed for any senior refunding bonds, mezzanine refunding bonds, or mezzanine new money bonds. If the debt service coverage ratio on the mezzanine bonds fall short of 1.20x, then consents would be required. At present, the City is not a party to receive any consents and it is unclear which party would provide the consents to issue additional bonds. Any issuance of additional new money bonds, refunding bonds or any encumbrances is a risk factor to the City as the City would have no control in the structure of the debt issuance.

PRO FORMA FLOW OF FUNDS.

Bond Payment Flow of Funds

Total Operating Revenue

Less, Total Operating Expenses

Plus/Less, Certain Fees and Revenues
(Includes City's Host Fees)

Less, Series 2022A (Senior Bonds)
Interest Payments

Less, Series 2022B (Mezzanine Bonds)
Interest Payments

Less, Payments to Waterford and CSCDA

Less, Series 2022C (Subordinate Bonds)
Interest Payments

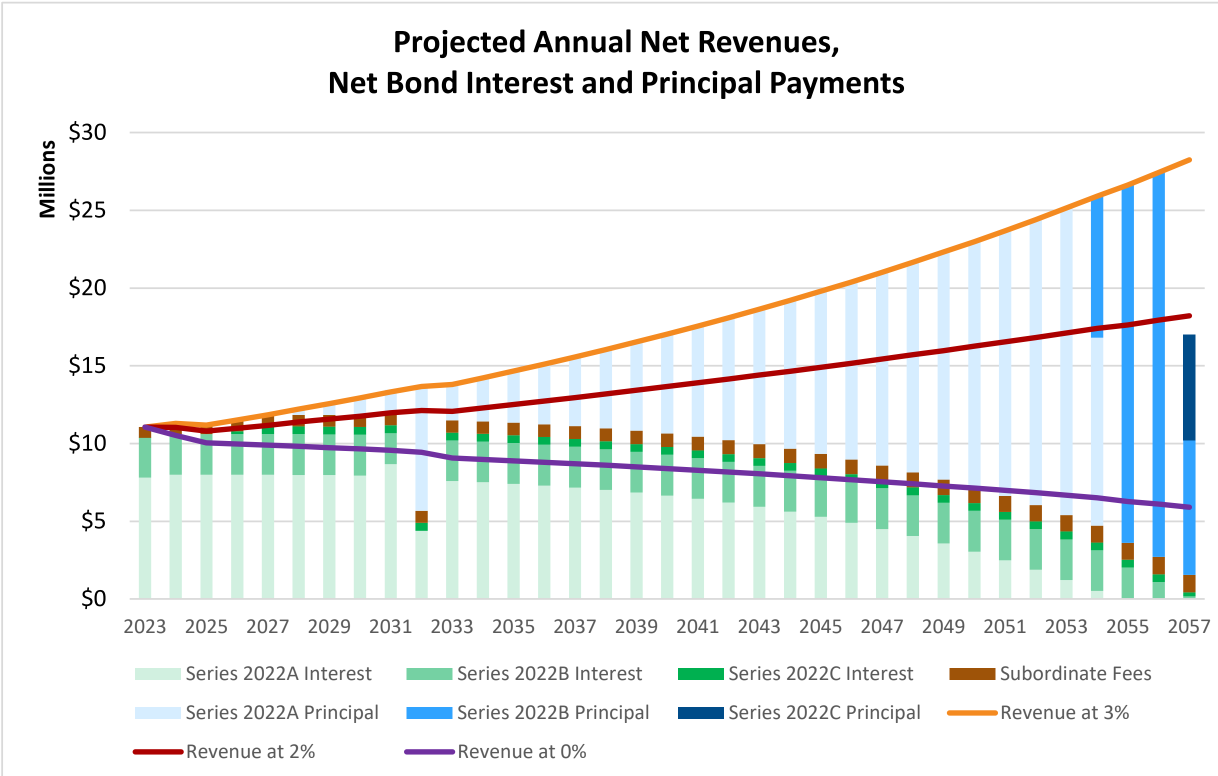
If Excess Cash Flow is available, funds will be applied to Bond Principal Redemption
If no Excess Cash Flow is available, Bond Principal Redemption will be delayed

Based on the provided pro formas from Waterford and the Underwriter, any net operating income goes first toward the Series 2022A and Series 2022B bonds interest payments, then to the payment of the annual ongoing fees to Waterford as Project Administrator and CSCDA as the issuer plus the funding of administration and Authority reserve fund part of which is used in year 10. Only then, if there are positive cash flows, does interest on the Series 2022C bonds get paid, after which any excess net income can be applied toward bond principal repayment. As mentioned previously, the cash flows provided by the Underwriter do not currently reflect the City's host fee which is estimated to be initially at $361,970 payable in 2023 and increasing annually by 2% over the entire term of the financing. Based on our understanding, the City's host fee would be paid ahead of any bond interest payment. We note that in order to incorporate the City's annual host fee into the pro forma, a larger original issue discount and/or a longer deferred principal amortization schedule would need to be utilized.

The financing structure, coupled with the high ongoing fees, limits the Project's flexibility to absorb any changes in the economy that would impact the market for rental housing, leasing rates, and rent payment conditions, and its ability to accommodate major maintenance and repair costs and unforeseen capital expenditures. In fact, the financial structure provides for projected repair and maintenance expenses of $9.3 million over 35 years and projected capital reserve of $7.7 million. Over this same period of time, Waterford will receive $15.1 million and CSCDA will receive $15.8 million and this is in addition to the upfront fees that they will receive from Bond proceeds as outlined in the Sources and Uses table mentioned previously. Thus, it is unclear if there would be sufficient resources from the Project to cover major renovations down the road. Provided in the above chart is an illustration of the Bond payment flow of funds.

Pro forma Performance and Stress Test Scenarios. As indicated above, the pro forma as presented produces a debt service coverage ratio of approximately 1.00x to cover the payment of interest and principal on the Bonds and assumes an annual rental growth rate of 3% beginning in 2025 and on. Supplementing the Underwriter's and Waterford's base case analysis, Fieldman reviewed additional scenarios of the pro forma assuming rental revenue growth rates of 2%[4] and 0% and assuming the bond interest and principal paydown schedules as presented in the Underwriter's pro forma. In the 2% Revenue Scenario, net revenues will be able to support the payment of all interest and approximately 59% of principal. In this scenario, unpaid principal in the amount of approximately $125 million would be deferred. In the 0% Revenue Scenario, net revenues will be insufficient by approximately $18.6 million to pay all interest due and will not support any principal redemption. The chart below illustrates the net revenue projections assuming growth rates of 3%, 2% and 0%, as well as the projected annual interest and principal payments.

[4] As part of the City's due diligence process in reviewing the Project, the City KMA to review the merits and the affordability of the Project in 2021. Based on KMA's review, KMA recommended that rental rates assume a lower growth rate of 2%.



Although the PBA affords the City the opportunity to force the sale of the Project any time after the 15th year, it is highly unlikely that the City would be willing to do so at that time for a number of reasons. First and foremost, the majority of the Bonds would still be outstanding at that time (nearly 91% of the Series 2022A and 100% of the Series 2022B and Series 2022C bonds), so the City would first need to pay off those Bonds with the sale proceeds. Selling the property would also raise issues related to the future rent affordability of the Project and if it were to be converted to market rate units, a change in the tenant composition of the Project would be required. Even though the Bonds are callable after 10 years (but the City can require the sale or refinancing after 15 years), the City cannot predict what the bond market conditions would be like after 15 years and if such refinancing would be economical. Moreover, since the Bonds are not issued by the City, even though it could request a refinancing be considered, it would not be in a position to ensure that it occurs.

KEY FINANCIAL RISKS TO CITY

Revenue Insufficiency. Since the City of Milpitas is not a direct party to the issuance of the Bonds, the City is not responsible for curing any shortfalls in revenue for the repayment of the Bonds. However, as illustrated in the stress test scenarios, if rent were to grow at a lower rate than 3% and vacancies were higher, revenues would be insufficient and presume that the Bonds cannot be paid off at the end of the financing term except from the potential sale proceeds of the Project. However, it is uncertain what the real estate market would be like at that time, what the demand for housing would be then and what the physical condition and market value of the Project would be. Thus, the overall potential financial benefit to the City from CSCDA's proposal is dependent on a series of assumptions such as, but not limited to, rent growth, vacancy rates, and real estate market conditions during the life of the bonds and at the time of potential sale of the Project. This does not include the potential risk of additional bonds and refundings without the City's consent.

Slightly offsetting this risk is the City's annual host fee payment with the total estimate over a 35-year period at approximately $17.96 million. Considering all this and the uncertainty of the Project's market value at that time, there could be a scenario under which the City and the other taxing entities cannot recover their foregone property tax revenues or make a profit. Since these projects are relatively new and there is no operating history, there is no way for the City to vet the proposed assumptions and know if the Project would be successful.

However, we note that in the relatively short history of other similar bond programs in California, the $189.335 million Workforce Housing Revenue Bonds Series 2019A (Annadel Apartments) issued by the California Community Housing Agency for a project in the City of Santa Rosa, projected revenues have fallen short of the bond interest costs. In the case of this financing, the project administrator infused cash three time in the last 14 months totaling $1.3 million in exchange for notes bearing 10% annual interest. This cure in the cash flow prevented a bond default and also prevented potential greater headline risk of harming future similar programs.[5] Other examples of similar financings that have gone into default and bankruptcies are the bond financings issued by the Illinois Finance Authority.

CITY OF MILPITAS' DEBT MANAGEMENT POLICY

The City adopted its current debt management policy on October 17, 2017. The policy provides guidance to the City in the prudent issuance and management of long-term and short-term debt issued by the City, assessment district, community facilities district or other special district, and conduit-type financing by a covered entity for multifamily housing or industrial development projects. While the City is not a direct party to the issuance of the Bonds, we note the Bonds as currently contemplated would not fall within the parameters of the City's current debt management policy. Under the City's policy goals, we note that "it is a policy goal of the City and the Covered Entities to protect taxpayers, ratepayers (if applicable) and constituents by utilizing conservative financing methods and techniques so as to obtain the highest practical credit ratings (if applicable) and the lowest practical borrowing costs."

KEY BOND RECOMMENDATIONS

- **Bond Structure and Project Pro Forma**. Fieldman agrees with the findings of KMA's analysis of utilizing a more prudent and conservative revenue growth rate assumption of 2%. Additionally, we recommend limiting the bond financing term to be no greater than 35 years, utilizing a minimum 10-year optional redemption with no call premium for all bonds, and incorporating a minimum principal paydown of 25% within the first 10 years of the Bond issuance date. Using a more conservative growth rate assumption and incorporating these bond parameters will reduce the level of risk to the City and will ensure a more timely paydown of principal.

[5] "California Scheming," Forbes, December 2, 2021.

- **Lien Levels / Order of Bond Principal and Interest Payments.** In order to ensure the timely payment of principal, we recommend that bond principal redemptions be made on the same lien level as the corresponding bond interest payments.
- **Bond Issuance and Project Expenses, and Priority of Expenses.** We recommend limiting certain upfront and ongoing issuance expenses of the Project to be no greater than the fees charged by other similar bond programs in the State. These expenses include the fees to the bond issuer (CSCDA) and to the Project Administrator (Waterford). Additionally, we recommend that all ongoing expenses to CSCDA and to Waterford be subordinate to all Bond principal and interest payments including any required deposits to reserve funds. Ongoing payments to CSCDA and to Waterford should be paid from annual excess revenues only.

- **City's Host Fee.** We recommend that the City receive a minimum of 5% or approximately $900,000 of the City's host fee upfront, payable from Bond proceeds.

- **Additional Bonds.** We recommend that any issuance of additional bonds either in the form of new money bonds or refunding bonds require the written consent of the City. We recommend that this provision be included in the Bond Indenture where there will be assurance of enforceability.

- **Bond Disclosures.** We recommend that the City be a party to receive any event-based disclosures. This will ensure that the City receives timely notification of any material changes or events. We recommend that this requirement be reflected in the Bond Continuing Disclosure Agreement.

Attachment A - Preliminary Bond Cash Flows as of January 25, 2022

Attachment B – Financial Pro Formas