



CITY OF MILPITAS AGENDA REPORT (AR)

Item Title:	Consider resolution to adopt Draft Goals and Performance Measures to provide a framework for evaluating potential City participation in middle-income workforce housing projects; and consider proposal to convert the Turing Apartments to low, median, and moderate income-housing with housing bonds from the California Statewide Communities Development Authority Community Improvement Authority (Authority).
Category:	Community Development
Meeting Date:	2/15/2022
Staff Contact:	Ashwini Kantak, Assistant City Manager, 408-586-3053
Recommendations:	<ol style="list-style-type: none">1. Consider resolution to adopt Draft Goals and Performance Measures to provide a framework for evaluating potential City participation in middle-income workforce housing projects, with revisions as directed by the Council;2. Consider proposal to convert the Turing Apartments located at 1355 McCandless Drive to low, median, and moderate-income housing; and3. Consider resolution to authorize the City to become a member of the Authority and City Manager to execute a Public Benefit Agreement that allows for future acquisition of the property by the City, with recommended amendments pertaining to: Affordability covenant; Local preference policy; City financial risks; Host and other fees; Property conveyance; Capital improvement reserves; Management and maintenance plans; and City enforcement authority.

Executive Summary

On November 1, 2021, the City Council directed staff to return with a framework and goals for evaluating the Turing Apartments proposal as well as future middle-income workforce housing proposals that may be considered by the Council; and to work further with the Turing Project Team (Project Team) to resolve identified concerns consistent with the framework and goals. The Council further authorized staff to require the project proponent to fund additional work by staff, consultants, and City Attorney to complete the evaluation of the proposal.

In response to Council direction at the September 21, 2021, and November 1, 2021, meetings (refer to agenda reports in Attachments 1 and 2), staff has prepared Draft Goals and Performance Measures (Attachment 3) to provide a policy framework for evaluating workforce housing proposals. This policy framework has been applied to further evaluate the proposal from the California Statewide Communities Development Authority Community Improvement Authority (Authority) to purchase and convert the Turing Apartments (Project) into low, median, and moderate-income housing.

An updated proposal from the Project Team was submitted on January 20, 2022 (Attachment 4). A revised Public Benefit Agreement (PBA) was also submitted that includes provisions to respond to some of the Council and staff concerns. A key change is that an annual Host Fee of \$361,970 will be

provided to fully cover the City's lost property taxes and property tax in lieu of vehicle license fee (PTILVLF) with an annual 2% increase. However, several items have been modified from their earlier commitments. The Project Team is no longer agreeing to City review and approval authority for any refinancing or restructuring of the bond debt. They have also indicated that Local Preference Guidelines cannot be included in the Regulatory Agreement.

The following table summarizes conformance of the Project with Council direction from the November Council meeting. A complete assessment of the Project regarding conformance to the Draft Goals and Performance Measures is provided in Attachment 5.

TABLE A

Conformance of Turing Proposal to Council-Approved Measures		
Measures (November 2021)	Comply?	Notes
1. Rents set below market rate in Milpitas	No	Latest submittal proposes 10-18% rent deduction below current rents for qualifying existing tenants, but no language in Regulatory Agreement.
2. Rents and increases conform to California Department of Housing and Community Development (HCD) standards for low/moderate-income households.	No	Rents for new qualifying tenants based on higher standards from California Tax Credit Allocation Committee (CTCAC) with no deduction for utility allowance.in maximum rents.
3. Capital improvement covered through 35-year bond term	No	Capital improvement coverage increased to \$17.8 million, but cashflow assumptions are optimistic to cover higher cost.
4. Refinancing subject to City approval	No	No approval authority included in Public Benefit Agreement.
5. City authority to enforce affordability standards	No	No enforcement provisions included in Public Benefit Agreement.
6. Annual report confirming affordability compliance	Yes	Annual report will be submitted to City.
7. Certification of affordability covenants	Yes	Project Administrator/Property Manager will submit to City annual certification of affordability and program requirements.
8. Cashflow projections based on conservative assumptions	No	Higher cashflow and debt coverage risks with optimistic revenue assumptions.
9. Bond advisor to analyze City bond risk and exposure	Yes	Project Team has funded bond advisor.
10. Submittal of tenant selection plan, maintenance plan, staffing plan, and marketing plan	No	Project Team has agreed to submit, but no language in Public Benefit or Regulatory Agreement
11. Submittal of annual financial and management reports	Yes	Project Administrator/Property Manager will submit annual financial and management reports.
12. Delineation of roles of City and project team	Yes	Public Benefit Agreement defines role of City as "Host"; agreements define role of Owner, Trustee, Project Administrator, and Property Manager.
13. City enforcement abilities, remedies, and consequences for Items 6, 7, 10, 11, and 12	No	Public Benefit Agreement does not address project oversight and enforcement authority by the City.
14. City Property Tax and PTILVLF Backfill	No	Host Fee to backfill for lost property taxes and PTILVLF, but no guarantee or senior lien position for annual payment.

While the Project meets many of the Council-approved measures, other previously identified issues and concerns remain unresolved. Summarized below are outstanding issues with staff recommendations to

comply with the Council-approved measures and the Draft Goals and Performance Measures. The Project Team's most recent responses to the recommendations are also noted. The Draft Public Benefit Agreement has been amended to incorporate the recommendations (Attachment 6: Project Team submittal, Attachment 7: redlined version with staff recommendations). A fuller discussion of these issues is contained in the Analysis section of this agenda report.

Affordability Considerations

- 1) Deeper Affordability: The Authority references income and rent limits from the California Tax Credit Allocation Committee (CTCAC). These are higher than the recommended limits set by the California Department of Housing and Community Development (HCD). For the Project, 40% of the units would have allowable rents that exceed the HCD rent limit for moderate-income households as well as existing market rents in Milpitas. No housing units would be affordable to low-income households as defined by HCD.

Recommendation: *Deepen the affordability level for the Project by applying the HCD household income and rent limits for Santa Clara County. Set maximum rents at 120% AMI per HCD standards so that all units will be affordable for low to moderate-income households. Allow City approval of rent increases to confirm long-term affordability.*

Project Team Response: *DECLINE deepening affordability for Project, but 10-18% rent reduction for qualified existing tenants will be specified in Regulatory Agreement.*

- 2) Local Preference Policy: The Project Team has agreed to implement a local preference program, but details are pending.

Recommendation: *Require Owner or Project Administrator to submit a proposal for review and approval by the City prior to issuance of any bonds.*

Project Team Response: *AGREE to include provision in Regulatory Agreement.*

- 3) Regional Housing Needs Allocation (RHNA) Credit: As presented to the City Council on November 1, 2021, the Project will not qualify for RHNA credits.

Recommendation: *Continue to evaluate the feasibility of RHNA credits for future proposals.*

Project Team Response: *Not applicable (Staff did not recommend RHNA credit.)*

Financial Considerations

- 4) City Financial Risks: The Bond Proposal Review from Fieldman, Rolapp & Associates (Attachment 7) describes the financial risks to the City with participation in the Project, including the uncertain fiscal condition of the Project for conveyance of the property to the City at the end of the 35-year bond term. The analysis underscores the importance of incorporating the recommended amendments into the PBA to allow for greater project oversight by the City.

Recommendation: *Require a more progressive paydown of the bond principal consistent with investment grade financing. Require City approval of any proposed refinancing or issuance of additional encumbrances. Add language to indemnify and limit the City's liability as the Host.*

Project Team Response: *DECLINE progressive bond principal paydown, City approval of refinancing, and Host indemnification. AGREE to limit Host liability.*

- 5) Host, Infrastructure, and Monitoring Fees: The Host Fee backfills lost City property taxes and PTILVLF. The Infrastructure Fee covers the existing special tax levied under Community Facilities District 2008-1. The Monitoring Fee pays City staff costs for ongoing monitoring and compliance. Whereas prior understanding was that the City would receive an upfront lump sum Host Fee payment for the entire bond period, annual payments are now proposed. If operating revenue is insufficient to cover operating expenses, debt service, administrative fees, the City may not receive the annual fees.

Recommendation: Require City fees to be paid in advance of the annual payment of Owner or Project Administrator fees and the interest and principal due on the bonds.

Project Team Response: AGREE to senior position for Host Fee payment. DECLINE payment of Monitoring Fee.

- 6) Property Conveyance: Language in the PBA is uncertain about the City's obligation to share net proceeds with other taxing entities when the property is conveyed to the City. Proposal is to deliver property in "As Is" condition.

Recommendation: Remove uncertainty regarding the City's obligation to share net proceeds. Require the Owner to fund a Property Conditions Assessment and appraisal. Require Project to be delivered in "good and clean" condition except for normal wear and tear with repairs and capital improvements satisfactorily completed.

Project Team Response: AGREE to remove uncertainty and to prepare assessment and appraisal. DECLINE property delivery condition (propose "As Is").

Level of Capital Investment

- 7) Capital Improvement Reserves: The cashflow model for the Project has been modified to fund projected capital needs for the full 35-year bond term. Sufficient capital reserves should be maintained until conveyance of the Project.

Recommendation: Prepare a Capital Needs Assessment with approval of the consultant by the City, and require replenishing capital reserves, as necessary, to fully cover capital needs for the entire bond term.

Project Team Response: DECLINE City approval of consultant and reserves replenishment.

Transparency and Oversight

- 8) Management and Maintenance Plans: The Project Team has agreed to have the Property Manager submit management and maintenance plans to the City.

Recommendation: Require early submittal of management and maintenance plans for City review and approval before issuance of any bonds for the Project.

Project Team Response: DECLINE to submit for City approval; management plan addressed in Regulatory Agreement

- 9) City Enforcement Authority: Annual reports and certifications will be submitted to confirm compliance with project conditions and affordability covenants.

Recommendation: Owner should fund an independent assessment of annual reports, if requested, and define the City's enforcement authority with remedies, and consequences if the Project is found to be deficient or non-compliant with conditions and covenants.

Project Team Response: DECLINE City assessment, enforcement authority, and remedies.

Background

In May 2021, the Council received a proposal from the California Statewide Community Development Authority Community Improvement Authority (Authority) to purchase the Turing Apartments, located at 1355 McCandless Drive in the Milpitas Metro Specific Plan area (herein referred to as the "Project,") for the purpose of converting the Project to "missing middle" or workforce housing. The Authority is a joint powers authority that through its Workforce Housing Program, issues tax-exempt government bonds to acquire market-rate apartment buildings. The program was created to respond to the financing gap for

much needed housing for moderate-income households, defined as households earning between 81-120 percent of area median income (AMI).

The Project is currently owned by Lyon Living and consists of 371 market-rate studio, one-bedroom, two-bedroom, and three-bedroom units. The ground-level commercial space would remain privately owned by Lyon Living and would not be transferred to the Authority. The acquisition would be financed through the issuance of a series of Authority bonds; the longest bond term would be 35 years. The Authority would be the “Owner” of the Project while the City of Milpitas would be the “Host.” As the Host, through a Public Benefit Agreement (PBA) executed between the Authority and the City, the City would have the option to purchase the Project after 15 years and could choose to own it at the end of the 35-year bond term. In addition to executing a PBA, the City would become a member of the Authority which does not require a financial commitment.

The Authority would enter into a separate Regulatory Agreement with Wilmington Trust National Association, the “Bond Trustee.” While the City would not be a party to the Regulatory Agreement, it is an essential agreement that defines qualifying households, affordability covenants, and requirements for administering and managing the Project. The Authority further proposes to enter into agreements with Waterford Property Company, LLC, to serve as the “Project Administrator,” and with Greystar Management Services, LP, to serve as the “Property Manager.”

Extensive discussion has occurred with the Project Team to assess the Turing proposal since the Authority/s Workforce Housing Program is a recently created bond financing program. The City Council considered the Turing proposal on September 21, 2021, and November 1, 2021. Staff identified primary concerns relating to the level of affordability, the financial assumptions for project cashflow and debt coverage, the level of capital investment during the bond term, and lack of City oversight and enforcement remedies. Recommendations were outlined by staff to alleviate these affordability and financial concerns.

The Council directed staff to return with a framework and goals for evaluating the Turing proposal as well as future workforce housing or Authority proposals that may come before the Council for consideration; and to work further with the Project Team to resolve issues pertaining to the PBA and Regulatory Agreement consistent with the framework and goals for creating middle-income workforce housing. The Council further authorized staff to require the Project Team to fund additional work by staff, consultants, and City Attorney to complete the evaluation of the proposal.

Analysis

Policy Framework: Draft Goals and Performance Measures

As directed by the Council, staff has prepared Draft Goals and Performance Measures that provide a policy framework for evaluating middle-income workforce housing proposals. This framework incorporates the staff and consultant recommendations that were previously approved by the Council on November 1st.

The Draft Goals and Performance Measures are not specifically prepared for the Turing proposal and are intended to provide a policy framework for evaluating other Authority or similar housing proposals that might be presented to the City. Additional goals and performance measures are included for the intended broader application of the framework to other middle-income housing programs beyond the Authority’s program. The following goals are grouped into four categories and specific performance measures for each goal are included in Attachment 3.

AFFORDABILITY CONSIDERATIONS

- GOAL A Affordability Level: Project will primarily serve Moderate-Income Households during the entire bond period as defined by HCD.
- GOAL B Rent Increases: Rent increases will be limited to maintain the affordability of the project for primarily Moderate-Income Households during the entire bond period.
- GOAL C Existing Tenants: Existing tenants will not be displaced by the public benefit, regulatory, or other agreements.
- GOAL D Local Preference Policy: A preference program will be established for qualifying residents and employees with a primary work location in the City of Milpitas.
- GOAL E Regional Housing Needs Allocation (RHNA) Credit: Project will qualify for full or partial RHNA credit, if feasible.

FINANCIAL CONSIDERATIONS

- GOAL F Qualifications of Project Team: Project will be owned and managed by a highly experienced and reputable Project Administrator and Property Manager.
- GOAL G City Evaluation of Proposals: Proposals will be evaluated for compliance with adopted Goals and Performance Measures with required professional and technical assistance funded by the Project.
- GOAL H City Revenue: City participation will not result in a loss of property taxes, special taxes, and property tax in lieu of vehicle license fees (PTILVLF).
- GOAL I Project Financial Viability: Project demonstrates positive cashflow and ability to fully cover its debt service and operating expenses during the bond or agreement period to reduce financial risks and assure long-term viability.
- GOAL J City Risks: The financial plan for the project is sound and consistent with industry standards for multi-family revenue bonds and reduces City risks and liability.
- GOAL K Debt Refinancing/Additional Debt: City will have the authority to approve any refinancing, restructuring, or issuance of additional debt or encumbrances.

LEVEL OF CAPITAL INVESTMENT

- GOAL L Capital Improvements: Capital improvement needs for the project are fully identified and funded for the entire bond or agreement period.

TRANSPARENCY AND OVERSIGHT

- GOAL M City Enforcement Authority: City will have enforcement authority over management of the project to ensure compliance with goals and performance measures during the bond or agreement period.
- GOAL N Monitoring and Reporting: City will be provided with regular reports on the financial and operational performance of the project during the bond or agreement period for project monitoring.
- GOAL O Project Management and Management: Project proponent demonstrates to the City that the project will comply with best real estate practices for management of residential property.

Conformance of Turing Project to Draft Goals and Performance Measures

Ongoing discussions between the Project Team and staff have occurred since the November 1st Council meeting to address Council direction and the staff recommendations presented at that meeting. The Project Team has submitted an updated Project proposal that responds to the Draft Goals and Performance Measures (Attachment 4). Staff has prepared a table that indicates where the Project

complies or does not comply with the Draft Goals and Performance Measures (Attachment 5). While the Project complies with many of the Draft Goals and Performance Measures, staff could not reach resolution with the Project Team on other items. The following analysis highlights key issues where provisions should be added or revised in the PBA or Regulatory Agreement to ensure conformance to the Draft Goals and Performance Measures.

Affordability Considerations

- 1) Deeper Affordability: The primary public benefit of authorizing the acquisition of the residential development through the Authority housing bond program is that market-rate units would be reserved for median and moderate-income households. Annual rent increases would also be capped at a maximum of four percent or the percentage set by the federal Department of Housing and Urban Development (HUD), whichever is less. Existing tenants would benefit from a reduction in their existing rents. The Project Team proposes to reduce rents for current qualifying tenants as follows: 18% for households at 80% AMI or below, 12% for households at 81-100% AMI, and 10% for households at 101-120% AMI. They tentatively indicate that 131 existing households or 35 percent of the units could qualify for a rent reduction, but the Regulatory Agreement does not contain language regarding the 10-18% rent reduction for qualifying tenants. Non-qualifying tenants consisting of 197 existing households or over half (53 percent) of the units would not qualify for this benefit, but they could continue to occupy their unit after transfer of the property to the Authority.

Staff continues to recommend basing the affordability level on the definitions of low, median, and moderate-income households as established by the California Department of Housing and Community Development (HCD) for Santa Clara County. HCD income and rent limits are commonly referenced by communities to formulate their housing policies and programs. These income and rent definitions are universally used by the state to set each jurisdiction's Regional Housing Needs Allocation (RHNA) by income level. Housing Elements also report housing needs and production in accordance with the HCD income standards.

The Authority program defines median and moderate-income households using different standards established by the California Tax Credit Allocation Committee (CTCAC). Based on CTCAC standards, the following affordability levels are proposed by the Project Team:

- 40 percent of units restricted for moderate-income households (101-120% AMI)
- 20 percent of the units restricted for median-income households (81-100% AMI)
- 40 percent of the units restricted for low-income households (80% or below AMI)

The CTCAC income ranges and associated rent limits are higher than the corresponding HCD standards. The upper rent range also exceeds current market rents in Milpitas. Applying HCD standards, Project rents would not be low enough to be affordable to low-income households. Additionally, maximum allowable rents for the upper income tier (101-120% AMI), which consists of 40% of the units, would exceed the affordability range for moderate-income households. Therefore, only 60% of the units would have maximum rents affordable to median and moderate-income households using HCD standards.

The variance between CTCAC and HCD incomes and rents are illustrated in Tables B and C below. The two tables provide a representative comparison of the proposed Turing maximum income and rents (based on CTCAC) with the corresponding HCD maximum income and rents for Santa Clara County in 2021. Incidentally, the HCD income and rent limits for Santa Clara County are the highest in the state, which reflect the elevated housing costs in the County.

TABLE B

Comparison of Turing and HCD Maximum Household Income (two-person household)				
Household Category	Turing	HCD	Difference	% Diff. (1)
Low Income (80% AMI)	\$106,080	\$ 94,200	\$11,880	13%
Median Income (100% AMI)	\$132,600	\$121,050	\$11,550	10%
Moderate Income (120% AMI)	\$159,120	\$145,250	\$13,870	10%

1. Percentage Turing maximum household income exceeds maximum household income.

TABLE C

Comparison of Turing and HCD Maximum Base Rents (1) (excluding utility costs paid by tenants)				
Apartment Type (2)	Turing	HCD	Difference	% Diff. (3)
One-bedroom:				
Low Income (80% AMI)	\$2,652	\$2,169	\$483	22%
Median Income (100% AMI)	\$3,315	\$2,840	\$475	17%
Moderate Income (120% AMI)	\$3,978	\$3,445	\$533	16%
Two-bedroom:				
Low Income (80% AMI)	\$2,984	\$2,434	\$550	23%
Median Income (100% AMI)	\$3,730	\$3,188	\$542	17%
Moderate Income (120% AMI)	\$4,476	\$3,869	\$607	16%

Notes:

1. Maximum housing cost (which include both base rent and utility costs) is typically defined by HUD as not exceeding 30 percent of gross household income.
2. The Turing Apartments consist of 19 studios, 193 one-bedrooms, 150 two-bedrooms, and 9 three-bedrooms units.
3. Percentage Turing maximum base rent exceeds HCD maximum base rent.

Recommendation: Deepen the affordability level for the Project by applying the HCD household income and rent limits for Santa Clara County (highlighted column in Tables B and C). Set maximum rents at 120% AMI per HCD standards so that all units will be affordable to low to moderate-income households. Allow City approval of rent increases to confirm long-term affordability.

These affordability adjustments will ensure that the entire Project meets the goal of benefitting low to moderate-income households in Milpitas as defined by HCD. **A reduction in rents will impact rental income and cashflow, so reassessing the financial model for the project is recommended.**

- 2) **Local Preference Policy:** Council has expressed interest in incorporating a Local Preference Policy for the Project that provides priority or a preferential status for public school employees that have a primary work address in the City of Milpitas and meet the income qualifications for a rent-restricted unit. Subject to compliance with state and federal fair housing laws, the Project Team has agreed to develop a local preference program for City review and approval. They have shared administrative procedures and criteria from another city where they have implemented a similar program. Details for a City of Milpitas program are pending but can be adapted from existing program examples. The program should include administrative guidelines, tenant selection criteria, and a marketing and outreach plan. The Council might wish to comment on whether the Local Preference Policy should be expanded to include other employee classifications such as income qualifying medical and emergency workers.

Whereas previously the Project Team indicated their agreement to include Local Preference Guidelines in the Regulatory Agreement, they now indicate that this is no longer possible. If this goal will be a Project requirement, a separate agreement is advisable to document implementation of this policy in accordance with City expectations.

Recommendation: *Require the Owner or Project Administrator to submit a proposal for review and approval by the City prior to issuance of any bonds.*

- 3) Regional Housing Needs Allocation (RHNA) Credit: The Draft Goals and Performance Measures include qualifying projects for RHNA credits to assist the City in meeting its Housing Element goal of producing “missing middle” or moderate-income housing units (81-120% AMI). In accordance with AB787, qualifying housing units could receive partial RHNA credit (0.25 credit/unit) if specified criteria are met. One criterion is that the Project must be restricted for moderate-income housing for 55 years. While the Project Team has agreed to this condition, Authority ownership of the Project would be maximum 35 years or the length of the bond term. It would be the decision of the City to extend the affordability covenant after it acquires the Project. The Council has previously stated that the 55-year affordability covenant and partial RHNA credit are not essential for this Project.

Another AB 787 criterion is that converted housing units cannot be pre-existing very low, low, or moderate-income units. While verification would be needed, the Project Team has tentatively indicated that 131 units in the Project are currently occupied by low or moderate-income households. Therefore, it is conceivable that only a portion of the Project could qualify for RHNA credit. Furthermore, AB 787 stipulates that rents cannot exceed the CTCAC 100% AMI rent limit. Units in the moderate-income rent range (101-120% AMI), which comprise 40 percent of the Project, would not qualify for RHNA credit. While RHNA credit should be a goal for evaluating middle-income workforce housing proposals, the Project would not comply with AB 787 criteria for RHNA credit.

Recommendation: *Continue to evaluate the feasibility of RHNA credit for future proposals.*

Financial Considerations

- 4) City Financial Risks: The City engaged Fieldman, Rolapp & Associates, Inc., a foremost expert in municipal bond financing, to further review the proposed Authority bond structure for the Project and to assess the potential financial risk exposure to the City in the event of default and fiscal stress on the Project. Findings from the consultant’s Bond Proposal Review (Attachment 8) are as follows:
- a. Bond Fees: Upfront bond issuance fees of 5.38% of the total principal amount of \$302.99 million are extraordinarily high relative to industry standards for investment grade municipal bonds which are generally no greater than 2% of the total principal amount.
 - i. Through bond proceeds, Waterford will receive an initial \$8 million payment plus annual fees. The Authority will receive an initial \$3 million payment plus annual fees. Neither the Authority or Waterford will contribute equity or other investment to the Project.
 - b. Bond Principal: While the payment schedule for the bonds is amortized (principal and interest), payment of principal is not mandatory and is only paid if excess project revenue is available. If not available, the principal is deferred, and the bond period could be extended to 40 years.
 - i. It will be infeasible for the City to exercise its purchase option at Year 15. At best, only about 5% of the bond principal will be paid. For comparison, Standard and Poor’s favors 50% of the debt retired after 10 years for investment grade financing.
 - ii. Modeling project cashflow using more conservative income assumptions that reflect historic market trends, **40% to 50% of the bond principal would remain unpaid at Year 35.** The outstanding principal would be due upon sale of the property to the City.
 - c. Cashflow: The cashflow analysis uses optimistic revenue projections to demonstrate a 1.0 debt coverage ratio (DCR).

- i. Modeling with more prudent assumptions, the Project would not be able to fully cover its administrative fees, debt service, and operating expenses with operating income only.
 - ii. With the financing structure and high annual fees for the Owner and Project Administrator, the Project will have difficulty adjusting to a weak economy or soft rental housing market. The ability to fund major repairs and unforeseen capital expenses would be at risk.
- d. Debt Management Policy: The City's debt management policy (adopted October 17, 2017) provides guidance for issuance and management of long-term and short-term debt. While the City is not a direct party to issuance of the bonds, the bond structure does not conform with the City's policy to use conservative financing methods to protect taxpayers and constituents.

Recommendation: *The consultant offers the following recommendations:*

1. Bond Payment Schedule:
 - i. *Require a more progressive paydown of the bond principal of a minimum of 25% of the total principal amount to be paid within the first 10 years which is more consistent with investment grade rated financings.*
 - ii. *Limit the term of the bonds to be no greater than 35 years.*
 - iii. *Require all bonds to be optionally redeemable within 10 years of issuance with no call premium which is consistent with investment grade rated municipal bonds.*
 - iv. *Require bond principal redemptions be mandatory and paid under the same lien position as interest payments.*
 2. Fees:
 - i. *Require annual fee payments to the Authority and to the Project Administrator be payable from excess revenues after payment of bond interest and principal payments, and any deposits to Bond reserve funds.*
 - ii. *Require the City's host, infrastructure, and monitoring fees be in a senior position to bond interest and principal payments, deposits to Bond reserve funds, and annual fee payments to the Authority and to the Project Administrator.*
 - iii. *Limit bond issuance and ongoing expenses to be no greater than fee charges by other similar programs in the state.*
 3. City Notification and Approval:
 - i. *Require any refunding, issuance of additional bonds, or any encumbrances receive the written consent of the City; and*
 - ii. *Require the City to receive all event-based disclosures and timely notification of material changes to the Project.*
- 5) Host, Infrastructure, and Monitoring Fees: City staff and the Project Team have reached agreement on the amount of the annual Host Fee (\$361,970 for 2022) that would be paid through project income to fully cover the City's lost property taxes and property tax in lieu of vehicle license fees (PTILVLF). The Host Fee would be increased by two percent each year until the property is transferred to the City. The Project Team indicates that the Host Fee would be paid as an operating expense solely from available Project revenue.

The City is also requesting an annual Monitoring Fee of \$100 per unit or \$37,100, with annual two percent increase, to cover ongoing staff costs for project oversight and monitoring during the term of the PBA. The Project Team had previously agreed to this fee, but with the increase in the Host Fee, they are indicating that this fee is now included in the Host Fee.

The Project would continue to pay the Community Facilities District 2008-1 (CFD) special tax for the residential units during the bond term, which is described as an "Infrastructure Fee" in the PBA. The estimated fee for 2022 is \$275,693 for 371 residential units, which will be adjusted annually in accordance with the provisions of the CFD. Additionally, the ground floor commercial space will continue to be privately owned and this portion of the property will continue to be assessed property taxes through an apportionment of the property tax bill.

A concern is ensuring or guaranteeing the payment of annual City fees and the position of this obligation relative to other fees, liens, and expenses. The PBA is deficient on this issue. The bond analysis indicates that the Project could experience a revenue shortfall that could affect the ability to pay its debt service and operating expenses if income projections are not met. Because the City's fees will come from net operating revenue, certainty or high assurance that these fees will be paid should be specified in the agreement.

Recommendation: *Require the annual City fees to be paid in advance of annual payment of Owner and Project Administrator fees and the principal and interest due on the bonds.*

- 6) Property Conveyance: A future concern pertains to uncertain language in the PBA regarding the City's obligation to share net proceeds with other taxing entities when the property is conveyed to the City. The sharing of proceeds relates to the loss of property taxes incurred by other entities when the property becomes tax exempt upon acquisition by the Authority. Currently, the language suggests that the City has the sole discretion to share net proceeds, but the wording is not clear and could result in conflicting interpretations. This uncertainty should be resolved before executing the Agreement.

The PBA also proposes conveying the property to the City in "As Is" condition. Before conveyance, any necessary repairs and capital improvements should be completed by the Owner.

Recommendation: *Remove uncertainty regarding the City's obligation to share net proceeds. Require the Owner to fund a Property Conditions Assessment and appraisal. Require the Project to be delivered in "good and clean" condition except for normal wear and tear with repairs and capital improvements satisfactorily completed.*

Level of Capital Investment

- 7) Capital Improvement Reserves: The Project Team has amended the Project Conditions Report and cashflow model to incorporate improvement needs for the Project during the 35-year bond term. The estimated cost for capital improvements totals \$17.8 million (\$11.9 million in 2021 dollars) for the bond term. Capital needs include: building upgrades; exterior wall/roof resurfacing; refurbishing landscaping, parking, site improvements, and common area facilities; replacement of mechanical, plumbing, electrical, fire sprinkler, and HVAC systems; and apartment remodeling and appliance replacement. Capital needs would be funded through initial reserve funds and annual contributions from operating revenue. A Capital Needs Assessment would be completed every ten years by an independent consultant to reassess the capital improvement needs for the property. The sufficiency of capital reserves is essential to fund scheduled and unexpected capital needs and to preserve and enhance the market value of the property.

Recommendation: *Prepare a Capital Needs Assessment with approval of the consultant by the City, and require replenishing capital reserves, as necessary, to fully cover capital needs for the entire bond term.*

Transparency and Oversight

- 8) Management and Maintenance Plans: The Project Team has agreed to have the Property Manager submit management and maintenance plans to the City. However, this item is currently not addressed in the Regulatory Agreement or PBA. Provisions should be added that specifies the plans to be submitted, the timing for submittal, and the City's ability to review and approve the plans. Requested plans include the following:
- Tenant Leasing Plan

- Local Preference Policy
- Maintenance Plan
- Property Management Plan, including staffing
- Marketing Plan

Recommendation: *Require early submittal of management and maintenance plans for City review and approval before issuance of any bonds for the Project.*

9) City Enforcement Authority: The Project Team added provisions in the Draft PBA that partially respond to the staff recommendations in the November 1st agenda report to address project monitoring and reporting. These provisions include:

- Annual report and certification of compliance with affordability covenant
- Preparation of a Capital Needs Assessment every ten years
- City authority to review any replacement Property Manager and to address deficiencies in property management
- Annual Property Maintenance Report to document completed capital improvements and the condition of the property.

Staff is requesting that the annual reports and certifications include information on: a) all capital expenditures completed in the previous year and scheduled of capital expenditures for the following year; b) current rent roll and vacancy rate; c) past year's and next year's projected operating income and expenses; d) cash flow projection, current operating funds, and current reserve funds; e) bond interest and redemption payments and all bond specific payments; and f) a description and reasonable photo documentation of the Project's general condition.

While the annual reports will be beneficial for ongoing project oversight and monitoring, the PBA is silent on the City's enforcement authority. This could be problematic if the reports reveal deficiencies or non-compliance with project conditions or covenants. As the Host participant, the City should have recourse to resolve issues that might arise and to ensure that the Project complies with management, maintenance, and affordability requirements until conveyance of the property to the City. Reports should cover affordability, financial condition, cashflow and debt service status, capital improvements, and property management. City oversight and enforcement authority are essential and should be inserted in the PBA to address this outstanding concern

Recommendation: *The Owner should fund an independent assessment of these reports, if requested, and define the City's enforcement authority with remedies and consequences if the Project is found to be deficient or non-compliant with conditions and covenants.*

Policy Alternatives

Alternative 1: Do not approve the Draft Goals and Performance Measures.

Pros: The Draft Goals and Performance Measures will provide project proponents with Council policy direction and expectations and establish a framework for evaluating workforce housing proposals.

Cons: No policy framework would be in place for evaluating workforce housing proposals. This could lead to inconsistencies and considerable staff time to evaluate each proposal independently without Council policy guidance or standards.

Reason not recommended: The Draft Goals and Performance Measures would outline for project proponents the City's expectations and standards and would facilitate the review of future proposals.

Alternative 2: Approve the Public Benefit Agreement without staff recommended changes.

Pros: Unless the PBA is amended to address outstanding concerns, Host participation would expose the City to performance uncertainties, financial risks, and lack of enforcement oversight. Conveyance of the property at the end of the bond period could be financially infeasible if Project revenue is deficient and the unpaid bond principal is significant.

Cons: The City would not realize the potential housing affordability benefits from the Authority's acquisition and financing of the Project to create rent-restricted workforce housing at a transit-oriented location.

Reason not recommended: None

Fiscal Impact

Joining the Authority as a member and participating in the Project as the Host do not require any financial contribution from the City. The Project Team has agreed to fully fund the City's lost property taxes and PTILVLF through payment of a Host Fee (\$361,970 for 2022). The Project will continue to pay the CFD 2008-1 special tax for the residential units (estimated \$275,693 for 2022), and all property taxes for the commercial portion of the property will continue to be paid.

The Council had inquired about the fiscal impact of the Project on school districts since the residential portion of the Project would be tax exempt upon sale of the property. It has been confirmed that the Milpitas Unified School District's lost property tax revenue from the Project would be backfilled by the State (\$716,786 levied in Tax Year 2021-22), but the San Jose-Evergreen Community College District, as a "Basic Aid" district, would not qualify for a property tax backfill (\$116,245 levied in Tax Year 2021-22). Further, the Turing property tax bill includes general obligation bonds issued by the County, the School Districts, and other agencies totaling \$317,363 for Tax Year 2021-22. These obligations would no longer be levied on the property, but the property tax on other properties in the issuers' territories would slightly increase to fulfill the debt service obligation.

The Project Team has substantially covered the City's staff, attorney, and consultant costs to evaluate their proposal. If Council chooses to approve the PBA as amended, a monitoring fee is included to cover ongoing City administrative costs. The agreement also requires coverage of consultant services as needed.

The potential fiscal benefits for the City at the end of the 35-year bond period is highly speculative and is predicated on rental housing market conditions and the ability of the Project to meet its optimistic revenue projections, fund capital and operating expenses, and pay down the principal on the Authority bonds. The net proceeds that the City could receive will also be dependent on the future sale price of the property.

California Environmental Quality Act

The project consists of adoption of a policy framework with goals and performance measures for evaluating potential City participation in acquiring and converting existing residential projects to middle-income workforce housing. The project also includes authorizing the acquisition and financing of an existing residential project with Authority tax-exempt government bonds. Both actions do not include or require any physical alteration or expansion of the residential project. The City finds that the project is not subject to the California Environmental Quality Act (CEQA) pursuant to Section 15061 of the CEQA Guidelines because it can be seen with certainty that there is no possibility that the project will have a significant effect on the environment.

Recommendations:

1. Consider resolution to adopt Draft Goals and Performance Measures to provide a framework for evaluating potential City participation in middle-income workforce housing projects, with revisions as directed by the Council;

2. Consider proposal to convert the Turing Apartments located at 1355 McCandless Drive to low, median, and moderate-income housing; and
3. Consider resolution to authorize City to become a member of the Authority and City Manager to execute a Public Benefit Agreement that allows for future acquisition of the property by the City, with recommended amendments pertaining to: affordability covenant; local preference policy; City financial risks; host and other fees; property conveyance; capital improvement reserves; management and maintenance plans; and City enforcement authority.

Attachments

1. Council Agenda Report, September 21, 2021
2. Council Agenda Report, November 1, 2021
3. Resolution for Adoption of Goals and Performance Measures
4. Turing Project Team Project Proposal, January 20, 2022
5. Conformance of the Authority Turing Proposal to Draft Goals and Performance Measures
6. Draft Public Benefit Agreement (Turing Project Team submittal)
7. Resolution for City Membership in the Authority and adoption of Public Benefit Agreement
8. Bond Proposal Review, Fieldman, Rolapp & Associates, Inc., February 7, 2022