City of SACRAMENTO

City Council Report

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File ID: 2021-00702 June 8, 2021 **Discussion Item 18**

Title: (City Council) Joint Powers and Public Benefits Agreements with California Municipal Finance Authority (CMFA) Special Finance Agency (the Agency) creating a Missing Middle Housing Program

Location: Citywide

Recommendation: Receive and provide direction.

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Presenter: La Shelle Dozier, Executive Director, (916) 440-1319, Sacramento Housing and Redevelopment Agency, John Colville, City Treasurer, (916) 808-8297

Attachments:
1-Description/Analysis
2-Project Information H16 and Eleanor Buildings
3-Initial comments from CTO and CAO re: CMFA's Middle-Income Housing Program

Description/Analysis

Issue Detail: Sacramento Housing and Redevelopment Agency (SHRA) was directed to review a proposed Joint Powers Agreement with California Municipal Finance Authority (CMFA) Special Finance Agency to create a Middle Income Housing Program.

On May 11, 2021 the City Council directed the City Treasurer, City Attorney and SHRA to review the CMFA proposal and provide recommendations. SHRA was directed to reach out to the Sacramento Housing Alliance to get their feedback. The information provided in this report contains observations and recommendations from SHRA, City Treasurer, and City Attorney. The Sacramento Housing Alliance will provide their observations and recommendations in the form of a separate letter to the City Council.

Middle Income Programs

Missing Middle, or Moderate Income Housing Programs, have been developed and marketed by three entities: California Municipal Finance Authority, California Community Housing Agency (CalCHA), and California Statewide Communities Development Authority (CSCDA).

The basic mechanics of the program involve the City electing to become a member of a JPA as a non-voting alternate member. The JPA structure allows for the issuance of tax-exempt public purpose bonds, these bonds are used to purchase multifamily properties, and because they are government owned, they are not subject to property taxes.

The financial structure relies on two sets of bonds, (1) for the purchase, reserves, up front Sponsor fees, and (2) bond issuance fees and the other “B” series, to pay the Project Sponsor fees. The property tax exemption is the key to enabling income-restricted units without any additional funding.

Income Restriction

This program is designed to serve missing middle households. Income restrictions on transactions range from households at 80% of Area Median Income (AMI) to 120% AMI. Rent increases may also be capped at no more than a 4% per year.

Affordability Period

The affordability period range is between 15 to 30 years, based on when the property is sold.

Sale of Property

At year 15 the City has a right of first refusal to purchase the property for the amount of debt on the property. If bondholders on either set of bonds foreclose on the property, this right is lost.

The City can decline to purchase the property between years 15-30. If the City declines to exercise the option by year 30, the JPA must sell the property, pay off existing debt and distribute any net sales proceeds remaining to taxing entities The first repayment is to the City's portion of deferred taxes, followed by the County, and lastly, the school districts and other taxing entitles. If there are any remaining sales proceeds after the taxing entities have been paid, the remaining amount would go to the City.

It should be noted that this is a new program. Therefore, it is difficult to project what will exist at the point of sale. There is no Federal, State or local government oversight for this program. Without regulations, the amounts or the mechanism of how, the taxing entities will be reimbursed is undetermined.

Cities Joining JPAs

To date, many cities with larger finance and housing departments have declined to join these JPAs, including the Cites of Oakland, San Francisco, San Jose, San Mateo and San Diego. Two larger cities have joined these JPAs. Long Beach has joined CSCDA and CalCHA, while Anaheim has joined CSCDA and CMFA. According to CMFA they have acquired their first Middle Income Housing project in the City of Anaheim.

CMFA Joint Powers and Community Benefits Agreements

The Special Finance Agency is an affiliate joint powers authority of the CMFA. Through the Middle-Income Housing Program, the Agency issues government bonds to acquire market-rate apartment buildings. These properties are then converted to rent-restricted units for middle income households.

When a property is acquired by the JPA, the City executes a Public Benefit Agreement. Under the Public Benefit Agreement, the City, at its sole discretion, may force a sale of the property between Year 15 and Year 30 of the bonds, and the City, along with certain other taxing agencies could receive a portion of the net sale proceeds.

In order for the CMFA to have the authority to serve as the issuer of the bonds for projects, it is necessary for the City of Sacramento to become a member of the CMFA Special Finance Agency.

The Joint Exercise of Powers Agreement provides that the Agency is a public entity, separate and apart from each member executing such agreement. The debts, liabilities and obligations of the Agency do not constitute debts, liabilities or obligations of the members executing such agreement.

California Municipal Finance Authority

The CMFA was created on January 1, 2004 pursuant to a joint exercise of powers agreement to promote economic, cultural and community development, through the financing of economic development and charitable activities throughout California. To date, over 300 municipalities, including the City of Sacramento have become members of CMFA, to allow for the construction of infrastructure, health, educational and other facilities. In 2019, mixed-income housing was added to the financing option.

Staff Analysis/Recommendation

To more fully understand this program, staff has spent significant time reaching out to other cities and housing authorities. In addition, there has been a series of meetings with CMFA. CMFA has proposed to acquire two recently constructed buildings, H16 is located at 731 16th Street and Eleanor Apartments is located at 501 16th Street. Each building has 95 units and is jointly known as the Project (see Attachment 2: Project Information). Beyond discussing the general parameters of the program, staff will focus their attention on the acquisition of these buildings. As a result, staff has the following observations and recommendations:

1) Rent Levels

CMFA proposed to restrict rents equally at the following levels:

Rent Levels	Units
61%- 80% AMI	33%
81%- 100% AMI	33%
101%-120% AMI	33%

In the case of the Project, 120% AMI rents are above the existing Downtown Sacramento market rents and 100% AMI rents are equal to existing market rents. *80% AMI rents are below current market rents downtown*.

Staff Recommendation: Require more units at the deeper affordability level of 61%- 80% AMI, which are below downtown market rents.

Staff proposes and CMFA has agreed to unit restrictions at the following affordability levels for the Project:

Rent Levels	Units
61%- 80% AMI	40%
81%- 100% AMI	20%
101%-120% AMI	40%

In addition, staff recommends requiring all unit types to be split evenly by the 40%/20%/40% as illustrated below.

	61% - 80% AMI Rents	**81% - 100% AMI Rents**	**101% - 120% AMI Rents**	**Total**
Studios	34	16	34	84
One Bedroom	33	16	33	82
Two Bedroom	10	4	10	24
Total	77	36	77	190

While staff would ideally like to see more than 40% of the units restricted to 61%-80% AMI, CMFA has informed us that the project would not generate sufficient revenue to cover operating costs and fees if rents were reduced. Unfortunately, CMFA was not able to provide a cash flow proforma for staff to confirm. Further, CMFA states they will start their financial due diligence after the JPA has been approved by the City Council.

2) Property Tax and Transfer Tax Revenues

Property tax and transfer tax revenues are significant over time. Staff is unable to confirm the exact amount of tax revenue loss over the 15 to 30-year period. The current assessed value of the Project will be approximately $65.6 million. At one percent of the value, it is estimated $656,000 of the initial property tax revenue will not be distributed to the follow taxing entities annually:

Educational Revenue Augmentation Funds (ERAF) (27%)
Sacramento City Unified School District (26%)
City of Sacramento (26%)
County of Sacramento (17%)
Los Rios Community College District (3%)
Sacramento County Office of Education (1%)
Sacramento –Yolo Mosquito (1%)

If the properties remain taxed, the assessed value will likely increase over time, thereby increasing the amount of revenue lost by the various taxing entitles.

CMFA states that at the time of sale of the properties, the debt on the property will be repaid and remaining funds will then repay forgone taxes in the following order: 1) City, 2) County, 3) School and then other taxing entities. The complexities or liabilities that will exist at the point of sale are unknown. The mechanisms of how the taxing entities will be reimbursed are to be determined.

Staff recommendation: No recommendation.

3) Project Specific JPA/Community Benefit Agreements

CMFA originally proposed one JPA agreement with the City to cover all Middle Income projects and individual Community Benefit Agreements for each project.

Staff recommendation: Require a new JPA and Community Benefit Agreement per Project with City Council approval. This will allow greater transparency and oversight.

4) Monitoring Restricted Rents and Income

No Federal, State, or Local government regulations or oversight requirements have been adopted for this type of bond issuance. CMFA will be the sole monitoring entity assuring that incomes and rents limits are being enforced by the property manager.

Staff recommendation: No recommendation. According to CMFA, any additional oversight is considered a liability and may put the bonds as jeopardy. CMFA has compliance experience.

5) Transaction fees and Compensation

The Series B bond ($3 million for the Project) compensates the Project Sponsor. This bond is repaid by net cash flow. No interest is paid for the first few years while the project stabilizes. In addition, there is an up-front payment to the Project Sponsor of $1.2 million for the Project.

The issuance fee for CMFA is between $200,000-$300,000 for the Project. In addition, the annual fee is between $100,000-$150,000 annually. These are the fees staff has identified to date. Additional on-going annual fees and charges for property management and asset management will be paid to the Owner (CMFA), Project Sponsor (HOMEFEED), and proposed property management company (FPI).

Staff recommendation: While CMFA has established their fee for the proposed Project, staff recommends working with CMFA to lower fees.

Policy Considerations: If a property is purchased by the Agency, the property will be exempt from paying property taxes, resulting in loss of revenue to the general fund.

Under the terms of the Public Benefit Agreement, if a property generates surplus cash flow through the proceeds of the sale of a property, the City will receive a portion of the surplus revenue.

Economic Impacts: None beyond the loss of property tax revenue.

The indicated economic impacts are estimates calculated using a calculation tool developed by the Center for Strategic Economic Research (CSER). CSER utilized the IMPLAN input-output model (2009 coefficients) to quantify the economic impacts of a hypothetical $1 million of spending in various construction categories within the City of Sacramento in an average one-year period. Actual impacts could differ significantly from the estimates and neither the City of Sacramento nor CSER shall be held responsible for consequences resulting from such differences.

Environmental Considerations:

California Environmental Quality Act (CEQA) and National Environmental Policy Act (NEPA): There is no action being taken, therefore this is not a project pursuant to CEQA Guidelines Section 15378, and is an administrative action under NEPA and is therefore exempt pursuant to 24 Code of Federal Regulations 58.34(a)(3).

Sustainability: Not applicable.

Commission/Committee Action: The Sacramento Housing and Redevelopment Commission did not review the information contained in this report.

Rationale for Recommendation: This is a new unproven financing option that provides an opportunity to expand housing affordability. In the short term it delivers units to the market without public funding. However, the long-term financial implications are undetermined. This presents the opportunity for the City Council to establish a policy regarding the use of this funding option.

Financial Considerations: Loss of property taxes revenue for multiple taxing entitles.

Local Business Enterprise (LBE)/Minority and Women's Business Enterprise (MBE/WBE): Local Business Enterprise requirements do not apply to this report.

Attachment 2

Project Information

H16 and Eleanor Apartments

H16 is located at 731 16th Street and Eleanor Apartments is located at 501 16th Street. Both properties were recently completed by SKK Development. While H16 is leased and has existing resident, the Eleanor remains empty. Amenities include rooftop terraces, fitness centers, pet spa and gated on-site parking.

Each building consists of 42 Studios, 41 one bedroom, and 12 two bedroom units. Studios range from 492-570 square feet, one bedroom units 536-694 square feet, and two bedroom units 945-1,095 square feet.

No existing tenants would be displaced in connection with the acquisition of these properties, however, this may mean that incomes and rents will exceed the 120% rents unit resident turnover is achieved through attrition.

Proposed Owner/Management

Owner:	CMFA
Project Sponsor:	HOMEFEED Corp. (subsidiary of Jefferies Group)
Property Manager:	FPI Management Inc.
Underwriting:	Jefferies Group
Bond Counsel:	Jones Hall

Rents and Incomes

Rent levels depend on the resident income. All rents will be restricted to 61% - 120% AMI in a recorded Regulatory Agreement for the 15-30-year ownership period. Annual rent increases would be capped at no more than 4%.

Rent Comparison
Rents at 35% of Income**

	Current H16 Rents	80% AMI Rents	100% AMI Rents	120% AMI Rents
Studio (84 units)	$1,740 - $1,940	$1,481	$1,852	$2,222
One Bedroom (82 units)	$2,050 - $2,300	$1,691	$2,114	$2,537
Two Bedroom (24 units)	$2,699 - $3,385	$1,904	$2,380	$2,856

*Assumes one occupant per bedroom plus one.
**CMFA requirement

Incomes

	80% AMI Income	100% AMI Income	120% AMI Income
Studio (84 units)	$50,800	$63,500	$76,200
One Bedroom (82 units)	$58,000	$72,500	$87,000
Two Bedroom (24 units)	$65,280	$81,600	$97,920

*Assumes one occupant per bedroom plus one additional occupant

SHRA Recommended Rent Restrictions*

	61% - 80% AMI Rents	81% - 100% AMI Rents	101% - 120% AMI Rents	Total
Studios	34	16	34	84
One Bedroom	33	16	33	82
Two Bedroom	10	4	10	24
Total	77	36	77	190

*Rents	Regulated Units
61%- 80% AMI	40%
81%- 100% AMI	20%
101%-120% AMI	40%

Sources and Uses

CMFA provided the source and uses information below. These amounts will likely change after CMFA begins their due dalliance such as completing appraisals and market studies. As previously noted, staff has not been able to obtain a proposed operating budget to verify this financial information.

Example
Sources and Uses
H16 and Eleanor

Sources		**Uses**	
A Bond Par Amount	$73,467,000	Project Acquisition Account	$ 70,000,000
A Bond Premium	$ 8,450,174	Capitalized Interest Account	$ 4,061,900
B Bond Proceeds (offset in uses)	$ 3,000,000	Coverage Reserve Fund	$ 734,670
		Senior Debt Service Reserve Fund	$ 3,673,350
		Cost of Issuance	$ 1,469,340
		Upfront Payment to Project Administrator	$ 1,200,000
		Subordinate Contribution (offset B Bond)	$ 3,000,000
		Extraordinary Expense Fund	$ 500,000
		Operating Reserve Fund	$ 165,519
		Operating Account	$ 112,395
Total Sources	**$84,917,174**	**Total Uses**	**$ 84,917,174**

This document serves as the City Treasurer's Office's view of the proposal that Sacramento Housing and Redevelopment Agency (**SHRA**) received requesting that the City of Sacramento enter into a Joint Exercise of Powers Agreement (the **Agreement**) with California Municipal Finance Authority (**CMFA**) to create a public agency to implement Middle-Income Housing Program (the **Program**).

Issue Detail: The City Treasurer's Office (CTO) was directed to review the proposal submitted by SHRA to partner with CMFA to develop a Program through an Agreement. The Program would issue tax-exempt public purpose bonds to purchase two already completed SKK Developments, LLC projects (H16 and Eleanor Apartments located at 731 16th Street and 501 16th Street, respectively) (the **Properties**).

Analysis: The information that has been provided to the City Treasurer's Office is very preliminary and raises some concerns that may or may not be mitigated through further negotiation with CMFA and a public benefit agreement that identifies the council's objectives and necessary reporting requirements to ensure compliance. In performing our due diligence, we had a discussion with finance staff from the City of San Jose to understand their recommendation to their council to not pursue a similar program. In addition, we reviewed an independent consultant's report conducted by HR&A Advisors that was contracted by the City of Long Beach. This report was extremely thorough and shares many of our concerns. We also consulted with the Sacramento City Attorney's Office.

Concerns:

1. **Limited number of affordable units:** CMFA has proposed a small number of units (33%) that will be designated 61% to 80% of the Area Median Income. The remaining units will be at or above market rate in the monthly rent range of $1,800 – 3,400.

2. **Opportunity Cost:** For a very limited number of affordable residential units, the Properties would not be on Sacramento County's secured property tax roll due to the proposed structure of the Program, which would call for CMFA (a governmental entity) to own the Properties. Analysis needs to be completed to determine the assessed value of the properties to evaluate the foregone annual ad valorem property tax versus the projected annual reduction in rents.

3. **Fees:** Need to identify the fees paid to CMFA for facilitating the bond issuance and the ongoing annual property management fees.

4. **Property Valuation:** Need to request an independent appraisal of the two properties to ensure credible valuations for the two properties.

5. **Project Financing:** As a non-voting member of the Joint Powers Authority (the **JPA**), I am concerned that the city would not be involved in the derivation of the financing model, including the property valuation, repayment schedule (debt service), revenue expectations (rents and occupancy levels) and future sale of the buildings. While the city's direct legal or financial risk associated with the transaction is minimal, our involvement with the JPA could potentially expose the city to reputational risk.

6. **City Attorney's Office (CAO) Initial Comments:** This is not a risk-free proposition for the city. As the Agreement is currently structured, the city would assume some legal liability for the torts committed by the CMFA and the public agency in performing the Agreement. To mitigate this risk, the CAO recommends that terms be added to the Agreement that require the CMFA and the joint powers authority to defend and indemnify the city to the fullest extent allowed by law. Furthermore, the Agreement does not provide the city with any representation on the board of directors that administers the public agency (in other words, the city has no ability to control how the Program is implemented). The CAO recommends that the

Agreement be modified to provide the city with voting seats on the board of directors so that the city has an opportunity to influence how the Program is implemented.

Staff Recommendation: Given the extreme housing affordable problems the city is facing; it is our responsibility to seek out viable solutions to address this crisis. It is the recommendation of the CTO that council direct SHRA and city staff to work with CMFA to produce a term sheet and public benefit agreement to purchase the Projects. Once the terms are agreed upon a more thorough analysis of the program's viability can be performed and a more specific recommendation can be rendered. Additional due diligence may include, but not be limited to discussions with other large Northern California cities that have opted not to join a JPA to address their middle-income housing needs and also to potentially engage a firm such as HR&A Advisors to provide quantitative and qualitative analysis that can better aid the city in decision making.