



City of Huntington Beach

File #: 21-531

MEETING DATE: 7/20/2021

REQUEST FOR CITY COUNCIL ACTION

SUBMITTED TO: Honorable Mayor and City Council Members

SUBMITTED BY: Oliver Chi, City Manager

PREPARED BY: Ursula Luna-Reynosa, Director of Community Development

Subject:

Approve Middle Income Housing Program by adopting Resolution No. 2021-43 and Resolution No. 2021-44; Authorize the City Manager to enter into Public Benefit Agreements and execute Middle-Income Housing Program agreements, and determine that these actions are not subject to the California Environmental Quality Act

Statement of Issue:

City Council approval is requested for the following items related to the Middle Income Housing Program, in order to enable the acquisition and conversion of two market-rate apartment complexes into workforce housing within the City of Huntington Beach:

1. Resolutions approving, authorizing, and directing execution of joint exercise of powers agreements supporting the issuance of bonds for the production, preservation, and protection of essential middle-income rental housing;
2. Joint Exercise of Powers Agreements;
3. Public Benefit Agreements, which may result in the City receiving surplus revenue from the future sale of the projects; and
4. Regulatory Agreements and Declaration of Restrictive Covenants.

Financial Impact:

If approved, the Middle Income Housing Program would result in the creation of 649 middle income housing units at the two current market-rate apartment complexes in question. Based on the terms of the program, the identified units would be created at an average cost of \$23,169 per door, which is an efficient and cost-effective way of establishing affordable housing units.

Based on current market conditions, the estimated cost of acquiring and rehabilitating 649 units and income restricting them at "middle income" levels would be between \$56,000 and \$85,000 per door,

depending on the level of income targeting. For further comparative purposes, the City's recent experience with an affordable housing project being developed by Jamboree Housing for permanent supportive units resulted in an approximate cost of \$70,000 per door cost, and the City of Santa Ana's average subsidy is approximately \$90,000 per door for similarly restricted units.

To fund the Middle Income Housing Program, the City would have to forgo future property tax revenues for up to a 30 year period, with the first year amount estimated at \$370,655. Assuming a 2% increase in property values annually, the average annual property tax subsidy over a 30 year period would be \$501,225. However, of note, between Year 15 and Year 30 (the end of the life of the bonds), the City, at its sole discretion, may force a sale of the middle-income rental housing projects and the City would receive the sale proceeds. Over a 30-year period, the City could realize \$647,620,251 in proceeds at Year 30, following payoff of debt.

Recommended Action:

A) Adopt Resolution Nos. 2021-43 and 2021-44 approving, authorizing, and directing execution of joint exercise of powers agreements relating to the CMFA Special Finance Agency VII and VIII (collectively the "Agency") supporting the Agency's issuance of bonds for the production, preservation, and protection of essential middle-income rental housing ("Middle-Income Housing Program"); and,

B) Authorize and direct the City Manager to enter into Public Benefit Agreements, substantially in the form attached, with the Agency, which may result in the City receiving surplus revenue from the future sale of the Projects; and,

C) Authorize and direct the City Manager to execute related documents and take any additional actions that may be required to implement the Middle-Income Housing Program; and,

D) Determine that this action is not subject to the California Environmental Quality Act (CEQA) pursuant to CEQA Guidelines Sections 15060(c)(2) and 15060(c)(3), because it will not result in a direct or reasonably foreseeable indirect physical change in the environment, and it is not a "project" pursuant to Section 15378(b)(5) of the State CEQA Guidelines.

Alternative Action(s):

Do not adopt the resolutions, enter into the Public Benefit Agreements, or execute related documents, or take any additional actions that may be required to implement the Middle-Income Housing Program.

Analysis:

A. BACKGROUND

City Council held a work study session on February 16, 2021, to evaluate a middle income workforce housing program as a means of achieving the public policy objective to create a continuum of affordable housing. Middle income housing is designed for persons earning 80% and up to 120% of area median income (AMI). This segment is considered the "missing middle" between lower income ($\leq 80\%$ AMI) affordable housing and market-rate ($> 120\%$ AMI) housing since no funding sources exist for this housing population. At their January Strategic Planning Session, the City Council expressed

the importance of providing middle income workforce housing as a means to transition people out of lower-income affordable housing. Currently, one-third of the City's affordable housing portfolio, or 660 units, are moderate income units between 110% - 120% AMI. Of the 660 units, half are rental units and half are for-sale units.

California Community Housing Agency (CalCHA), working with Catalyst as the project sponsor, was the first Joint Powers Authority (JPA) to acquire a residential apartment project with tax-exempt "essential government bonds". They have since closed on nine transactions. There are other JPAs and other project sponsors doing similar transactions. As a public agency, the JPA is a tax-exempt entity that is not required to pay property taxes. This property tax abatement, coupled with the tax-exempt financing, provides a significant advantage in terms of cash flow, which allows the JPA to compete with market-rate buyers, and enables the JPA to make the units available to low and moderate income households. The typical split of units is one third at 80% AMI, one third at 100% AMI, and one third at 120% AMI. It is important to note that a non-government entity could acquire a property and restrict units to 80% AMI, and those units would qualify for the "welfare exemption" and would not have to pay property taxes on any units at 80% AMI or less.

The project sponsor acts on behalf of the JPA as the asset manager. For all intents and purposes, the residents of these projects interface with the project sponsor or their designated property management firm. Annual rent increases would be capped at no more than 4%, which is less than the rent limits under AB1482, the recently adopted State tenant protection legislation. It is important to note, existing tenants are not displaced, regardless of household income, as the conversion of market-rate units to middle income units occurs over a few years as leases expire and current tenants move on to other housing opportunities.

The JPA issues the tax exempt governmental bonds. As the bond issuer, the JPA will oversee the underwriting of the bonds prior to issuance and the performance of the project sponsor during the life of the bonds.

Opportunity to Acquire Two Existing Apartment Complexes

Catalyst has approached the City with an opportunity to acquire two existing apartment complexes in Huntington Beach and convert them into "workforce housing" units, as market-rate leases come due. Elan and Breakwater are the two apartment complexes (the "Properties"), where the rents range from \$1,984 - \$3,255 per month. Collectively, between the Properties, there are a total of 676 dwelling units that generate a combined \$2,647,536 annually of basic levy property tax revenue. The City's annual 14% share is \$370,655. Based upon the current valuation (2020-21 Secured Property Tax) and a two percent annual increase in valuation, the City would have reduced property tax revenue of an estimated \$6,409,893 over 15 years, and \$15,036,763 over 30 years for the Projects.

Elan is located at 18504 Beach Boulevard, Huntington Beach and is comprised of a total of 274 units (27 units are restricted at 110% AMI per the City's Inclusionary Zoning Ordinance). This project was completed in 2015 and generates \$1,253,400 annually of basic levy property tax revenue. The City receives 14% which equates to \$175,476 annually. The market-rate units rent in the range of \$1,984 - \$3,034 with a current overall vacancy rate of 5.11%. This property last sold in July 2016 for \$131,000,000. Catalyst has negotiated a sales price of \$136,000,000.

Breakwater is located at 16761 Viewpoint Lane, Huntington Beach and is comprised of a total of 402

units (all market rate). This project was completed in 1972 and generates \$1,394,136 annually of basic levy property tax revenue. The City's annual 14% share is \$195,179. The rents range from \$2,319 - \$3,255 with a current vacancy rate of 5.77%. This property last sold in December 2017 for \$134,000,000. Catalyst has negotiated a sales price of \$185,000,000. Since the 2017 sale, the current owner has invested significantly in renovations and capital improvements.

California Municipal Finance Authority

California Municipal Finance Authority (CMFA) is the City's preferred JPA whose track record and fee structure are appealing. 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. CMFA is the largest issuer in the State for all conduit bond financing. They have a 16 year track record with zero housing defaults on over 1,000 transactions of which 600 are affordable housing projects. To date, over 325 municipalities, including the City of Huntington Beach, have become members of CMFA. CMFA is the only financing authority which has granted over \$25M dollars directly to local governments and 501c3 nonprofit organizations during the past sixteen years. CMFA will grant 25% of the issuance fees to the general fund of the City. Such grant may be used for any lawful purpose of the City. CMFA will donate 25% of the issuance fees to a charitable organization of the City's choice within the host municipality for each transaction.

Execution of the Joint Exercise of Powers Agreement

In order for the Agencies to have the authority to serve as the issuer of the bonds for the Properties, it is necessary for the City of Huntington Beach to become a member of the Agency (CMFA Special Finance Agency VII and VIII).

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.

The bonds to be issued by the Agency for the Properties will be the sole responsibility of the borrower, and the City will have no financial, legal, moral obligation, liability or responsibility for Properties or the repayment of the bonds for the financing of the Properties. All financing documents with respect to the issuance of bonds will contain clear disclaimers that the bonds are not obligations of the City or the State of California, but are to be paid for solely from funds provided by the borrower.

There are no costs associated with membership in the Agency and the City will in no way become exposed to any financial liability by reason of its membership in the Agency. In addition, participation by the City in the Agency will not impact the City's appropriations limits and will not constitute any type of indebtedness by the City.

B. ANALYSIS

The Properties require a City subsidy in the form of forgone property taxes for the duration of the essential governmental bonds over a thirty-year period. Due to the required subsidy, City staff, with the support of the National Development Council (NDC) who serves as the City's technical advisor, has independently evaluated the public benefit of the Middle Income Housing Program as it relates to the Properties as well as preliminary project feasibility analysis.

Public Benefit

To evaluate the public benefit, staff has reviewed whether the amount of subsidy is appropriate for the level of affordability in terms of the proposed “cost per door” for each unit. In the City’s recent experience with an affordable housing project being developed by Jamboree Housing, the City subsidy represented a cost of approximately \$70,000 per door for permanent supportive housing (33 units at 30% AMI, 9 units at 50% AMI, and one manager’s unit). The City of Santa Ana’s average subsidy is approximately \$90,000 per door for similarly restricted units. The city subsidy is leveraged with other funding sources so the total subsidy per door is much greater than the city subsidy alone.

Some of the units are currently rent restricted at 110% AMI with 55 year covenants. Excluding the restricted units there are 649 market-rate units within the Properties. The City currently receives approximately \$370,655 annually in property taxes for the Properties. As previously stated, the City will forego approximately \$15,036,763 in property taxes over 30 years (\$23,169 per door) to create 649 middle income rent restricted units. These figures assume a 2% annual increase in property taxes and represent the City’s 14% share of the base tax levy. Further, these numbers don’t factor in a net present value calculation and simply assume the City has access to 100% of the foregone property tax revenue today, which clearly is not the case. If a 3% net present value calculation is applied, the cost per door is approximately \$7,000 per door less.

The above per door subsidy calculations are not a compatible comparison as the per door examples are for new construction and extremely low and very low income levels. If an affordable housing developer were to approach the City with a proposal to acquire and rehabilitate 649 units and income restrict them at “middle income” rents, staff expects that the requested subsidy, assuming that the City is the sole funding source, would be between \$56,000 and \$85,000 per door depending on the level of income targeting. This subsidy is calculated by subtracting an average, blended restricted rent from the average, blended market rent to determine the revenue gap (due to the artificial restriction on rents) on the 649 units over 30 years. As an example, if the blended rental rate was \$200 less than the market-rate rent over 30 years, this would amount to a subsidy of \$72,000 per unit. Therefore, this range of \$56,000 to \$85,000 is significantly higher than the cost per door utilizing the essential government bonds program. Further, the City would likely be reluctant to utilize restricted affordable housing funds on moderate income units and would prefer to use such funds on more deeply restricted units, such as very low and low income units. Staff’s conclusion is that this essential government bond program to provide middle income housing units is a cost effective way to create such housing units.

While staff is overall supportive of this program should the City Council desire to further middle income or workforce housing, it should be noted that the foregone property tax revenue is unrestricted, General Fund revenue and can fund public safety services as well as parks and other infrastructure needs. It is a policy decision to prioritize the public benefits that can be achieved with this money. Further, while there is pending legislation, as of today, under State Law, these units cannot count toward the City’s Regional Housing Needs Allocation (RHNA) for the 2021-2029 cycle. If Assembly Bill 787 were to pass, the bill would authorize the City to include qualifying converted units in its annual progress report and reducing the City’s share of regional housing need for the income category of the converted units on a unit for unit basis. The bill would apply only to converted units that meet specified requirements, including that the rent for the unit prior to conversion was not affordable to very low, low-, or moderate-income households and the initial post

conversion rent for the unit is at least 10% less than the average monthly rent charged over the 12 months prior to conversion. Based on the current draft legislation, approximately 232 of the units would meet the specified requirements.

Public Equity

Beyond the public benefit of creating the restricted middle income units, the Properties also represent an investment opportunity with long term financial benefits for the City in the form of public equity. Under a recorded Public Benefit Agreement, the City, at its sole discretion, may force a sale of the Properties between year 15 and year 30 (the end of the life) of the bonds, and the City would receive the net sale proceeds. Since the Properties are financed through the issuance of tax-exempt bonds and there are no equity partners, all excess sale proceeds after payoff of the bonds go the City. Over a 30-year period the Properties could realize \$647,620,251 in valuation at the end of year 30 (assuming an annual appreciation of 1.8%). The City could realize significant value in owning major real estate assets that could be sold to market-rate buyers, thereby maximizing value to the City. Or the assets could be sold to affordable housing developers to be rehabilitated with new, more deeply restricted affordable housing covenants recorded on the Properties. This decision could be made in the future depending upon the City's needs and policy priorities.

From an investment perspective, if the City were to invest the foregone property taxes in the Local Agency Investment Fund (LAIF) at 3%, the average annual rate of return over the past 30 years, the City's investment would grow to \$18,163,088 over 30 years. The average rate of appreciation for real estate in California is approximately 6% annually. If the City were to invest the foregone property taxes in real estate instead of LAIF, and assume a 6% annual rate of return, the City's investment would grow to \$31,061,511 (a difference of almost \$13 million). Investing the foregone property taxes in real property will create significant public equity that can help secure the financial stability of the City of Huntington Beach.

Environmental Status:

Pursuant to Sections 15060(c)(2) and 15060(c)(3) of the California Environmental Quality Act (CEQA) guidelines, CEQA does not apply to this action because it will not result in a direct or reasonably foreseeable indirect physical change in the environment and it is not a "project" pursuant to Section 15378(b)(5) of the State CEQA Guidelines.

Strategic Plan Goal:

Strengthen long-term financial and economic sustainability

Attachment(s):

1. Resolution No. 2021-43 for The Elan
2. Resolution No. 2021-44 for The Breakwater Apartments
3. Public Benefit Agreement by and between CMFA Special Finance Agency VII and the City of Huntington Beach relating to the issuance of Essential Housing Revenue Bonds for The Breakwater Apartments
4. Public Benefit Agreement by and between CMFA Special Finance Agency VIII and the City of Huntington Beach relating to the issuance of Essential Housing Revenue Bonds for The Elan
5. Joint Exercise of Powers Agreement relating to the CMFA Special Finance Agency VIII for The

Elan

6. Joint Exercise of Powers Agreement relating to the CMFA Special Finance Agency VII for The Breakwater Apartments
7. Regulatory Agreement and Declaration of Restrictive Covenants by and between CMFA Special Finance Agency VIII and Wilmington Trust, National Association, as Trustee relating to The Elan
8. Regulatory Agreement and Declaration of Restrictive Covenants by and between CMFA Special Finance Agency VII and Wilmington Trust, National Association, as Trustee relating to The Breakwater Apartments