



Legislation Details (With Text)

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Title: Recommendation to: (1) Based on the analysis provided, consider the request to (i) adopt resolution authorizing the City to support the California State Communities Development Authority Community Improvement Authority’s (CSCDA) issuance of bonds under its Middle-Income/Workforce Rental Housing Program to enact moderate-income deed restrictions on the existing Oceanaire apartment project, at 150 West Ocean Boulevard (Project), and (ii) authorize the execution of a Public Benefits Agreement (PBA) with CSCDA in connection therewith that includes a provision that shares any future sale profits with taxing bodies proportionate to the current tax allocation;

(2) Request City Manager to develop a proposed policy for any future similar projects that participate in the Middle Income/Workforce Rental Housing Program; and

(3) If action (1) is approved, designate the Project as a pilot, with no similar projects to be approved until the City Council has an opportunity to consider the City Manager’s proposed policy. (District 2)

Sponsors: Development Services

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Attachments: 1. 021621-NB-20sr&att.pdf, 2. 021621-NB-20 PowerPoint.pdf, 3. RES-21-0013.pdf

Date	Ver.	Action By	Action	Result
2/16/2021	1	City Council	approve recommendation and adopt	Pass

Recommendation to: (1) Based on the analysis provided, consider the request to (i) adopt resolution authorizing the City to support the California State Communities Development Authority Community Improvement Authority’s (CSCDA) issuance of bonds under its Middle-Income/Workforce Rental Housing Program to enact moderate-income deed restrictions on the existing Oceanaire apartment project, at 150 West Ocean Boulevard (Project), and (ii) authorize the execution of a Public Benefits Agreement (PBA) with CSCDA in connection therewith that includes a provision that shares any future sale profits with taxing bodies proportionate to the current tax allocation;

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On November 17, 2020, the City Council directed the City Manager, the Department of Development Services, and the City Attorney to study the benefits of adopting a Resolution

authorizing the City to support the California State Communities Development Authority Community Improvement Authority's (CSCDA) issuance of bonds under its Middle-Income/Workforce Rental Housing Program (Middle-Income Housing Program) to enact moderate-income deed restrictions on the existing Oceanaire apartment project, located at 150 West Ocean Boulevard (Project), analyze the process enacted by other California cities, and return within 60 days with a proposed Resolution authorizing participation in a similar program.

To respond in the timeframe requested by the City Council, staff contracted with HR&A Advisors, Inc. (HR&A), a real estate and economic development consultancy, to conduct a detailed financial analysis of the potential impacts of the Project and the CSCDA's Middle-Income Housing Program. The material in this letter is based on a report issued by HR&A, a preliminary draft of which was reviewed and commented on by the CSCDA and the Waterford Property Group (Waterford). Additionally, staff sought to maximize the local benefits of this program and is presenting general policy guidance based on best practices from other cities using this and similar programs.

Over the past few years, City Council has discussed at length and taken actions to address the statewide housing shortage and related issues. In 2017, the City Council adopted 29 policies aimed at creating new revenues and increasing incentives for the production of affordable and workforce housing. Policy 1.5 directs staff to continue to partner with developers and other community stakeholders in the pursuit of grant funding and other third-party resources such as Metro, Federal, State, County, etc., for affordable housing development, support services, and mobility enhancements and programs that support new housing development.

There are currently limited Federal and State funding programs to produce or preserve the growing shortfall of below-market-rate rental housing for moderate-income households earning between 80 and 120 percent of the Area Median Income (AMI). Currently, most affordable housing programs in California, such as the Affordable Housing and Sustainable Communities (AHSC) program, focus on providing housing for low- and very low-income households earning below 80 percent of AMI. Federal funding sources such as the Low-Income Housing Tax Credit (LIHTC) program are targeted at even deeper affordability levels, 60 percent of AMI or below. This has left a "missing middle" comprised of households that earn too much to qualify for traditional affordable housing programs, but who increasingly do not earn enough to afford market-rate housing.

Summary of Proposed Transaction

Waterford and CSCDA presented an opportunity to the City Council to convert the Project into moderate-income housing. The proposed Project is a Class A, 216-unit apartment building developed in Downtown Long Beach in 2019. Waterford secured the right to purchase Oceanaire in an off-market competition for \$122 million, or \$564,000 per unit. As of January 2021, Oceanaire is 71 percent occupied, with approximately 40 percent of the tenant households classified as moderate-income, although they are paying unrestricted market

rents.

The CSCDA proposes to purchase the Oceanaire from Waterford, which is simultaneously purchasing from Lennar, the current owner and developer of the Project. The CSCDA will partner with Waterford to act as the Project administrator and asset manager. The relationship between CSCDA and Waterford will be governed by a Regulatory and Property Administration Agreement. Greystar Real Estate Partners (Greystar) will act as the property manager pursuant to a Property Management Agreement with the CSCDA. The City would join the CSCDA as a “member” and enter into a Public Benefit Agreement (PBA), and the CSCDA would thereafter act as the issuer of the tax-exempt bonds. There would be no agreement between the City and Waterford or parties other than the CSCDA. Pursuant to applicable law, the Project is allowed to forego paying *ad valorem* property taxes, which would be shared among the City and numerous other taxing entities, so long as the Project remains under CSCDA ownership.

The PBA explicitly allows the City to require a sale or refinancing of the Project after 15 years, up to the 30th year of the transaction. Sale or refinancing proceeds would be applied first to outstanding principal and interest on the bonds and any other financing, second to all transaction costs incurred by the CSCDA, third to foregone property tax revenues, which would otherwise have been payable to the City, Los Angeles County, the Long Beach Unified School District, and the Long Beach Community College District. Any remaining surplus may be retained by the City or distributed to other taxing bodies at the option of the City.

The acquisition of the Project will be fully financed by a \$139.4 million tax-exempt Essential Housing Revenue Bond (Series A) issued by the CSCDA as well as a subordinate \$5.0 million Series B bond providing what HR&A describes as preferred equity to Waterford. The Series A bond covers the \$122.0 million purchase price, \$8.2 million in reserve funds, \$2.0 million in fees for Waterford, \$1.4 million in fees for the CSCDA, \$2.1 million in fees for Goldman Sachs, and another \$3.8 million in fee reserves and brokerage fees. Sources and uses total \$144.4 million. Additionally, the proposed financial structure includes annual ongoing fees of \$700,000 to Waterford, \$121,315 to Greystar, \$206,185 to CSCDA, and \$15,000 to Goldman Sachs.

Findings of Analysis

As previously mentioned, HR&A was engaged to conduct a detailed and independent programmatic and financial review of the proposed transaction. The analysis included several approaches to fully understand the scope and implications of the transaction, including a detailed review of draft transaction documents provided by the CSCDA to City staffs and available related documentation of similar transactions in the City of Anaheim; meetings with transaction parties to understand assumptions; and, projections within the transaction underwriting process. In addition, HR&A conducted additional independent research using third-party sources. After an initial draft analysis was prepared, the CSCDA and Waterford agreed to provide additional units in the 80 percent AMI category, and agreed to an annual monitoring review and monitoring fee, which are memorialized.

The HR&A analysis identifies affordability benefits to the City but considers them modest. HR&A also identified several potential issues (risks and uncertainties) for City Council consideration if the City Council chooses to adopt the Resolution and enter into the PBA as proposed. These include an appearance of financial structure misalignment with City fiscal and policy goals, and that the return of the foregone property tax revenues is contingent on a projected sale price utilizing very aggressive market assumptions. These potential issues are detailed below and are based on the HR&A study.

Affordability Benefits

As proposed, the CSCDA would impose a moderate-income deed restriction on all 216 units. These would be split 40 percent at a maximum of 80 percent of AMI, 20 percent at 100 percent of AMI, and 40 percent at 120 percent of AMI. A close look at the transaction's mechanics and definition of affordability shows that the affordable housing gains are modest overall when compared to market rents, with the only significant rent reductions occurring at the 80 percent AMI level. In fact, the proposed restricted rents appear to be higher than current market rate rents for 103 of the 129 total units designated for 100 percent and 120 percent AMI households. It is also important to note that 40 percent of the current residents already meet the definition of moderate income, although they are currently paying market rent.

The Project uses a non-traditional definition of affordability, which under current regulations would not allow the City to include these units toward its Regional Housing Needs Assessment (RHNA). The proposed transaction documents require that rental payments must not exceed 35 percent of the relevant income limit. This exceeds California State law's definition of "affordable housing cost," which is 30 percent of gross household income, including utility allowances. Therefore, California State Housing Element Law currently does not allow units converted to moderate-income under the transaction circumstances to be counted toward the City's RHNA progress; however, future legislation may allow for this possibility in the future.

State law limits the counting of existing unit conversions toward RHNA to (1) only those serving very low- and low-income households; (2) only projects with at least a 55-year covenant on restricted rents; and, (3) only projects using affordable rents calculated using the State Income Limits schedule, which are lower than the income limits proposed in the transaction.

The Project also involves the conversion of an existing Class A market-rate apartment building. This arrangement places income restrictions for up to 30 years on all 216 units, ensuring that future rents for this market-rate luxury building remain affordable to moderate-income households. However, since no new units are created, the Project does not further the City's goal of alleviating the overall supply shortage of housing units. Furthermore, it is difficult to determine how quickly a full conversion to restricted income rents could occur. Waterford has estimated that this could take four years.

Fiscal Structure of Transaction has Issues Impacting Benefits

The purchase of the Oceanaire would be funded through a tax- exempt bond issue. There is no investment or equity provided by either Waterford or the CSCDA and there is no investment or development risk to Waterford. There is also no risk to the City associated with the purchase. Over the first 15 years of the Project, \$20.8 million in fees are charged to the Project including the following:

- \$11.5 million for Waterford
- \$2.1 million for the CSCDA as a fee for managing the transaction
- \$2.3 million for Goldman Sachs for bond issuance fees
- \$2.6 million for Greystar for property management
- \$1.8 million for real estate brokerage fees
- \$0.5 million for the City's annual affordable housing monitoring fee

These fees, combined with the financing structure, limit the Project's flexibility to accommodate unforeseen capital expenses, leasing issues, or other changes in market conditions. Furthermore, it is not clear that the structure can accommodate major maintenance and renovation costs likely required after the first ten years. The financial structure provides projected capital (renovation) reserves of \$4.9 million over 30 years but no capital expenditure plan was provided. Without a long-term capital expenditure plan, it is unclear that there are sufficient resources for major renovations that will almost certainly be needed. However, Waterford has made verbal representations that they are invested in Long Beach and intend to maintain the property and the expected regular inspections by the City will help ascertain status.

As previously described, the PBA allows the City to force a sale of the Project any time after 15 years. It appears very unlikely that the City would willingly force a sale after 15 years because in order to maximize sales proceeds to apply toward outstanding bond debt the affordability restrictions would have to be removed from the Project. From the information HR&A received from Waterford, most of the bonds will be outstanding after 15 years and it appears that the cash flow projections do not provide for the bonds to be paid off at the end of the 30-year bond term. This seems to imply that a sale may be required at that end of the bond term to pay off the bonds and the City may not have other practical options.

The potential financial benefit to the City is highly sensitive to the rent growth assumptions. Waterford assumes rent grows at 3 percent annually. A market research report by the Concord Group, provided by Waterford, shows that Long Beach has only achieved rent growth at or above 3 percent for 3 of the last 20 years. This market reality makes the 3 percent growth critically high for both maintaining occupancy and affordability. As a result, there are likely situations where the City and other taxing bodies do not recover foregone property tax or make a profit.

Property Tax Impact

Based on HR&A analysis, the initial lost property tax revenue would be about \$1.5 million (all taxing bodies) in year one, which includes \$264,000 for the City. Over 30 years, the lost revenue would have a present value of \$43 million (all taxing bodies) and \$8 million for the City. Effectively, the City would be dedicating this current revenue stream from all taxing bodies to subsidize this housing and the loss of revenue would likely effectively require some reduction in services elsewhere.

If and when the property is sold (most likely at the 30-year point), the City would most likely benefit from the net proceeds of the sale, less any distribution as determined by the PBA to other taxing entities.

Recommendations

Pilot project with policy to be developed for any similar future proposed transactions

This transaction proposes housing benefits by providing needed “missing middle” housing units, but the transaction also raises a number of issues, including uncertainty of the financial outcome of the Project or the level of benefits to the City in the long-term. Only a very few of these projects have been approved and there is effectively no operating experience and no examples that show how the long-term may actually play out; it will take many years before the City can actually see if this model is successful or not. From the HR&A analysis, the proposed transaction appears attractive in terms of return on investment to developers and approving one project may lead the City to see a number of requests for similar transactions.

As a result, it is recommended that the City Council consider designating this particular transaction to be a pilot project (if approved) and, in addition, that the City Council request the City Manager develop a draft policy for this type of project to include a thorough vetting of the issues and modeling, prior to consideration of approval of any other similar transactions. Waterford is a well-known developer with substantial investment in the City, including ownership of major assets like City Place and World Trade Center. Staff support engaging in a single pilot program given Waterford’s success and history in Long Beach.

Sharing of Net proceeds (or costs) from the sale of the property

The City has the option of determining if the net proceeds of the potential eventual sale of the property (most likely at 30 years) will be shared with other taxing bodies as reimbursement for foregone property tax revenues. Staff recommend that the net proceeds be shared.

This matter was reviewed by Deputy City Attorney Richard F. Anthony and by Finance Director John Gross on February 12, 2021.

STATEMENT OF URGENCY

City Council direction on February 16, 2021 is needed as staff wishes to report back on this item in a timeframe that is responsive to the City Council's request on November 17, 2020, as well as to allow the developer to proceed with the Project in a timely manner.

City Council action is requested on February 16, 2021, to meet the timeframes requested by City Council and the developer.

As described above, the Middle-Income Housing Program is structured such that there are no direct annual operating costs to, or up-front investments required by, the City for up to 30 years.

The property would become tax exempt for at least 15 years and more likely 30 years or longer. HR&A estimates the net present value of lost property tax revenue to the City is approximately \$3.99 million over a 15-year period and up to \$7.8 million over a 30-year period based on a net present value calculation. The initial year tax loss to the City is estimated at approximately \$264,000. The overall initial annual tax loss (all taxing bodies) is about \$1.5 million.

Projecting the total amount of public proceeds depends on several key assumptions that when altered slightly could lead to unrecovered foregone property taxes. For instance, assuming that future owners must account for property taxes and that rents growth at 3.0 percent a year, then public proceeds are \$8.1 million at year 15 and \$169 million at year 30. In this scenario, all foregone property taxes are recovered with a profit of \$48.8 million to be distributed to local taxing bodies. Yet, if rent growth drops to 2.5 percent the property value would be insufficient to force a sale at year 15 and by year 30 there would be \$93.8 million in public proceeds leading to a profit of just \$7.9 million.

The Project will be required to pay an annual monitoring fee of \$160 per unit (\$34,560 annually) to the City to offset administrative costs associated with monitoring of the affordability covenants. Additionally, Waterford agreed to reimburse the City for all costs associated with the preparation of this report, including HR&A's consulting fee. Otherwise, this recommendation has no staffing impact beyond the normal budgeted scope of duties and is consistent with existing City Council priorities. There is no local job impact associated with this recommendation.

Approve recommendation.

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OSCAR W. ORCI
DIRECTOR OF DEVELOPMENT SERVICES

APPROVED:

THOMAS B. MODICA
CITY MANAGER