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Date: March 4, 2022

SUBJECT: WORKFORCE HOUSING PROGRAM PROPOSAL - CASALAGO EASTLAKE APARTMENTS PROJECT

The City of Chula Vista ("City") City Council ("City Council") adopted a policy for a "Workforce Housing" program that serves Moderate Income Rental Households via Resolution No. 2021-199. California Statewide Communities Development Authority ("CSCDA"), a Joint Powers Authority ("JPA"), and Opportunity Housing Group ("OHG"), also referred to as the Sponsor ("Sponsor"), submitted a proposal pursuant to this program for the CasaLago Eastlake Apartments Project ("Project"). Section II.C. of the Resolution states that "a third party shall be retained to analyze the financial projections, bond fees, property tax revenues, and other financial terms and conditions of the proposal." RSG, Inc. ("RSG") performed a financial evaluation of the proposal and supporting materials, and our analysis and findings are detailed in the following narrative for City Council consideration.

BACKGROUND

Middle-Income/Workforce Housing Programs

There is currently limited Federal, State, or local subsidies or programs to produce or preserve the growing shortfall of below market rate rental housing for moderate and middle-income households, which are those earning from 80% to 120% of area median income ("AMI"). To date, affordable housing programs in California have almost exclusively focused on providing housing for lower-income households, and State and federal funding sources are almost exclusively targeted to households at or below 60% of AMI. This has left a "missing middle," comprised of households that earn too much to qualify for traditional affordable housing programs but not enough to afford market rate housing.

In the last several years, three different entities have developed similar Middle-Income or Workforce Housing Programs, for the purpose of issuing tax-exempt bonds to acquire market rate

apartment buildings and convert them into income- and rent-restricted units for households earning between 61% and 120% of AMI. The three entities include CSCDA, California Municipal Finance Authority (CMFA), and the California Community Housing Agency (CalCHA). Each entity was formed as a JPA pursuant to California Government Code Sections 6500-6599.

For the JPA to be granted the authority to serve as the issuer of the bonds for the Project, it is necessary for the City to become a member of the JPA. Cities, counties, and housing authorities become non-voting members of the JPA by adopting a Resolution and executing the JPA Agreement. The city authorizes the JPA to issue bonds at no cost or liability to the city. The Joint Exercise of Powers Agreement provides that the JPA is a public entity, separate and apart from each member executing such agreement. The debts, liabilities and obligations of the JPA do not constitute debts, liabilities or obligations of the members executing such agreement. The debt service on the bonds used to acquire property is supported solely from project revenues and receipts. To date, more than two dozen cities across the State have joined one or more of the three JPAs and have approved similar Middle-Income Housing Program acquisition/conversion transactions, including in South Gate, Carson, Anaheim, Long Beach, Glendale, Pleasant Hill, Dublin, Livermore, Fairfield, and Santa Rosa.

Every project acquired by the JPA becomes exempt from property tax. The JPA records a Regulatory Agreement that restricts rents to be affordable for households at different maximum income-limit mixes between 80% and 120% of AMI. If there are existing tenants of an acquired property who income-qualify, their rents are restricted. For non-qualifying tenants, they may remain in place at market rate. As units turnover, they become income- and rent-restricted for the next tenant. Annual rent increases are capped at 4%.

The Regulatory Agreement period is for up to 35 years while the Project is under JPA ownership and the bonds are outstanding. Through its right to repurchase, a city can opt to extend the affordability restrictions beyond the transaction period and/or convey the property to an entity that can operate it as rent-restricted affordable housing. Alternatively, the city also has the option to allow the property to return to market rate rents and thus convey it for a higher market value.

Under the terms of the Public Benefit Agreement, the JPA grants all financial upside to the underlying member jurisdiction. Between years 15 and 35, the city has a right to purchase the property for the amount of outstanding debt. (This right could be lost, however, if bondholders ever foreclosed on the property.) If the city declines to purchase, the JPA must sell the property and distribute the net proceeds to the city.

CasaLago Eastlake Apartments Project

The CasaLago Eastlake Apartments is a 427-unit townhouse style property situated on 30 acres near the Otay Reservoir in eastern Chula Vista. Built in 2013, it includes 79 one-bedroom, 183 two-bedroom, and 165 three-bedroom units, and amenities such as a fitness center, two swimming pools, and dog park. The current owner is John Hancock Life Insurance Company, and there is a Letter of Intent to sell the asset to the Sponsor, who will assign the purchase agreement to CSCDA, contingent on approval of the City to join the JPA and approve a Public Benefit Agreement allowing the conversion to Workforce Housing.

SUMMARY OF KEY FINDINGS

Based on our analysis, below is a summary of RSG's key findings:

- The Project is highly leveraged under the financial structure of the Workforce Housing program, with a debt to value of 117% following acquisition. The issuance of $324 million in bonds will entirely fund the acquisition ($279 million), reserve accounts ($29 million), and payment of transaction, JPA and Sponsor fees ($18 million). CSCDA will be the owner, but without an equity investment or residual interest.

- Based on RSG's projections, the Project will need to rely on reserves to pay debt service for the first seven years, is not expected to begin repaying principal on the Series A bonds until Year 11, and will not achieve a Net Operating Income ("NOI") to debt service coverage ratio of 1.2x until Year 15.

- Following conversion of all units to restricted rents, the Project is estimated to provide a rental savings of more than $3 million annually compared to market rents, according to the Sponsor. This amount will only grow over the life of the Project as market rents and restricted rents continue to diverge over time. However, the Sponsor has assumed some of the initial rents will be higher than current income limit restrictions allow, on the expectation that the AMI limits will grow by at least 3% when announced later this year.

- The City currently receives about $170,000 in property tax from the Project based on its pre-acquisition assessed value. The Sponsor has proposed to provide the City with a "Host City Charge" of $200,000 to mitigate tax revenue losses after purchase by the JPA, since it will be exempt from paying ad valorem property taxes. If not for the exemption, the new assessed value based on the acquisition price would result in property taxes to the City of about $302,000 in the first year. Over the 35-year life of the bonds, this tax gap would total approximately $5.2 million, or about $3 million in 2022 present value dollars.

- RSG projects that by Year 15, when the City has the option to purchase the asset, the estimated Project value of $302 million would not provide adequate proceeds to repay the outstanding debt of more than $325 million.

- RSG projects that by Year 35, over $151 million in bond debt would still be outstanding, but the Project value would have grown to $487 million. The City would be able to reimburse the other taxing entities for their cumulative foregone property taxes, and still retain $211 million. The projected net fiscal benefit to the City of a sale in Year 35 would be about $72 million in present value 2022 dollars.

- The City incurs minimal costs, liabilities, or administrative responsibilities in connection with membership in the CSCDA JPA or participation in the Workforce Housing Program. The City is not the bond issuer and provides no funding or credit enhancement to the transaction. The acquisition bonds do not diminish the City's issuing capacity and are backed solely by the Project revenues. On this basis, participation creates a relatively low risk and high return opportunity for the City.

- However, there is the potential that the Project would become unable to meet debt service due to lower rents, higher operating costs, or other unforeseen events. Ultimately, if the bondholders needed to foreclose on the asset to satisfy outstanding debt, the Regulatory Agreement would be terminated and the rent restrictions would be lifted. Rents could then be increased under the maximum State limits, eventually returning to market level rents.

DETAILED FINDINGS

Income Limits and Program Rents

The Workforce Housing program provides reduced affordable rents to qualifying households with incomes at or below 80% (Low) to 120% (Moderate) of AMI based on the Department of Housing and Urban Development ("HUD") for the County of San Diego. The Sponsor is proposing that the Project will have an allocation of income- and rent-restricted units as follows:

- 33.3% of the units for households below 80% AMI,
- 33.3% of units from 81% to 100% AMI, and
- 33.3% of units from 101% to 120% AMI.

The Project's Regulatory Agreement states that the proposed initial and ongoing maximum rents will be restricted to not exceed 35% of the qualifying income limits for each unit size and income category. The respective qualifying income limits are stated in Table 1 below:

Table 1: Project Income Limits

Unit Type	Household Size	80% AMI	100% AMI	120% AMI
1-bedroom	2 person	$77,600	$97,000	$116,400
2-bedroom	3 person	$87,280	$109,100	$130,920
3-bedroom	4 person	$96,960	$121,200	$145,440

Table 2 details the proposed initial Project Rents for the Project. Most of the units are being set at rents lower than the maximum (35% of qualifying income) amounts allowed by the Regulatory Agreement. The Sponsor's Initial Project Rents range from 23% to 36% of the qualifying income, as shown in Table 3. By starting with lower initial rents, particularly at the 120% AMI level, the Sponsor is building in some assurance that the scheduled rents will be achieved, and have room to grow modestly over time, without being impacted by the maximum rents allowed under the income limits or by market rent. The initial rents at the 80% AMI level are exceeding the program limit as a consequence of the Sponsor assuming that AMI limits that are set by HUD will increase by at least 3% effective April 1, 2022. As noted later herein, as part of its analysis, RSG analyzed the cash flow of the Project assuming initial rents that conform with current income limits and grow more modestly.

Table 2: Project Initial Maximum Monthly Rents

Unit Type	Total Units	80% AMI	100% AMI	120% AMI	Total/Avg
1-bedroom	79	$2,240	$2,250	$2,259	$2,250
2-bedroom	183	$2,622	$2,842	$2,849	$2,771
3-bedroom	165	$2,913	$3,210	$3,245	$3,123
Total/Avg	427	$2,664	$2,875	$2,893	$2,810
	Number of Units	**143**	**142**	**142**	**427**

Table 3: Project Rents as a Percentage of Income Limits

Unit Type	80% AMI	100% AMI	120% AMI
1-bedroom	34.6%	27.8%	23.3%
2-bedroom	36.0%	31.3%	26.1%
3-bedroom	36.1%	31.8%	26.8%

Under the Regulatory Agreement, annual rent increases for all income-qualifying households would be capped at no more than 4%, which is greater protection for tenants than provided under Assembly Bill ("AB") 1482, the recently adopted State tenant protection legislation, which limits rent increases to the change in the Consumer Price Index ("CPI") *plus* 5%. Furthermore, eligible households will only have their rent increased up to the 35% limit.

Based on information provided by OHG, an independent appraiser, and RSG market research, asking market rents in the city are in the following range and averages:

- 1-bedroom: $1,414 to $2,577 avg: $2,354
- 2-bedroom: $1,815 to $3,219 avg: $2,974
- 3-bedroom: $2,520 to $3,819 avg: $3,554

According to OHG, the Project rents will range from 17% to 23% below the current in-place rents and will be about 19% below in-place rents on average. Using those per unit rent differences, multiplied by the distribution of units across the three income limits, OHG calculated the total annual "rental savings" to be more than $3 million annually in the first year compared to current market rents. This rental savings amount will only grow over time because Project rent increases will be limited to 4% per year (and no greater than 35% of the qualifying income limits) while market rents can increase at whatever rate the market commands.

Operating Expenses

The operating expenses assumed by OHG for the Project are based on an evaluation by the firm Greystar, who will be the contracted property management firm. Greystar has extensive experience managing over 700,000 multifamily units, including 280 properties in Southern California with over 60,000 units. RSG compared these estimated expenses with the projected expenses that the independent appraiser prepared and found that Greystar's overall estimate was more conservative. The expenses grow by 3% per annum, which is a reasonable assumption.

Host Fee

In conformance with the City's Workforce Housing Policy, OHG has included a "Host City Charge" among the operating expenses. The Host City Charge is intended to replace the foregone property tax revenue from the Project after acquisition by CSCDA, which is tax-exempt as a government entity. OHG has assumed an initial Host City Charge of $200,000, which is roughly based on the property's existing assessed value of $156 million and the City's tax share of 10.9% of the 1% ad valorem property taxes. The Host City Charge would increase by 2% per annum to match the expected growth from property tax revenue. It should be noted that the proposed purchase price of the Project site is approximately $277 million and, without the property tax exemption, the new assessed value would yield a property tax of approximately $302,000.

Monitoring Fee

OHG has also proposed to pay an annual monitoring fee to the City beginning in year 1 of $27,755. This fee is intended to defray City staff costs for monitoring the Sponsor/Project Administrator's compliance with the Public Benefit and Regulatory Agreements. Although OHG stated the fee would be increased by 3% annually, RSG noted that it was only being increased by 2% in the pro forma submitted for review.

Reserves

The Project will fund initial reserve accounts totaling $29 million, which would be used to pay debt service and fees in the first six to eight years until there is sufficient NOI, as well as any potential need to cover operating expenses or capital improvements. The reserve accounts are shown below in Table 4:

Table 4: Project Reserve Accounts

Senior Debt Service Reserve	$12,735,600
Capitalized Interest	$6,367,800
Coverage Reserve	$2,547,120
Debt Service Reserves subtotal	$21,650,520
Operating Reserves	$1,377,875
Admin & Authority Fees Reserve	$2,664,344
Operating and Fees Reserves	$4,042,219
Capital Reserves	$3,000,000
Extraordinary Expense Fund	$500,000
Total All Reserves	$29,192,739

According to OHG, the types and amounts of reserve accounts are based on standards established by the bond market and are fairly consistent across deals. Appropriate sizing of the reserves is important for the bond buyers and one of the key reasons they are comfortable with

purchasing the bonds. As discussed further below under Financial Projections, RSG evaluated the debt service reserves and found them to be reasonable and adequate to provide protection if NOI is lower than projected.

The Senior Debt Service Reserve is the equivalent of one year of interest on the Series A bonds. This reserve is held for the entire period that the bonds are outstanding, regardless of how much principal has been repaid over time. Both the Capitalized Interest and Coverage Reserves are to be released to the Project once NOI exceeds debt service by 20% for two consecutive 12 month periods. OHG projects this would occur by Year 11, although RSG projects it may not be achieved until Year 15.

The Operating Reserve is equivalent to three months of operating expenses. This reserve is held for the entire period the Series A bonds are outstanding. The Admin & Authority Fees Reserve will be used to pay the Sponsor fees in the first six to eight years. RSG also projects this reserve could be completely exhausted with more modest rent growth than OHG is assuming.

The Capital Reserves of $3 million include $1.9 million for upfront improvements identified in a third-party Property Condition Report prepared by Partner Engineering & Science, Inc. This is equivalent to $7,025 per unit. Since the property is now eight years old, this implies the owner would have needed to set-aside approximately $878 per year to fund improvements. Assuming all up-front improvements are made, the Capital Reserve would retain an upfront balance of $1.1 million (or $2.576 per unit) for unforeseen items and future capital improvements. In addition, the Project pro forma includes a deposit of $700 per unit per year into the Capital Reserve for ongoing and future improvements. RSG finds this and the other Reserve amounts to be reasonable and adequate.

Fees

There are significant transaction costs for a conversion to Workforce Housing, including costs related to the issuance of the bonds and to the Sponsor for arranging the deal, as shown in Table 5 below. Fees that are paid at closing to the bond underwriters, and a premium or discount to bondholders (to adjust from the coupon rate to a market yield), are collectively projected to total $5.9 million. The bond issuance is assumed at a coupon rate of 4% interest with the bonds being sold at par value.

Table 5: Project Fees

Original Issue Premium	$	(6,141)
Costs of Issuance (Net of CSCDA)	$	5,873,000
Bond Costs	$	5,866,859
CSCDA Issuance Fees (at Closing)	$	2,000,000
OHG Fees (at Closing)	$	2,750,000
OHG Series B Bond	$	6,000,000
Total Sponsor/Agency Fees	$	10,750,000
Total Project Fees	$	16,616,859

CSCDA Fees

CSCDA would receive a fee equivalent to 1% of the bond issuance amount, not to exceed $2 million. CSCDA will also receive a $150,000 annual fee during the Project term, with no escalation.

OHG Fees

OHG would receive a fee payment of $2.75 million at closing of the acquisition. According to OHG, this fee is comparable to an acquisition fee standard of 1% that could be earned on a typical market-rate acquisition.

OHG will also be granted a Series B bond in the amount of $6 million in exchange for assigning its market-rate Purchase and Sale Agreement for the asset to CSCDA. Per OHG, this is meant to replicate developer equity since, under the terms of the Workforce Housing program, after payment of the bonds all of the residual equity interest will accrue to the City. This subordinated bond creates a long-term incentive for the Sponsor to manage the asset properly and generate cash flow so that senior bonds can be paid. The interest on this bond is 10% per annum ($600,000 per year) and payment is subordinated and deferred during the first five to seven years while there is insufficient cash flow. The principal and deferred interest are not paid until all Series A bonds have been repaid.

In addition, OHG will receive an Asset Management Fee for its ongoing role as Project Administrator starting at $213,500 ($500 per unit) in the first year and increasing by 3% per year. Per OHG, this fee covers staff costs for administration of the asset including preparation of all reporting, oversight of the property manager and regulatory agreement, compliance with all terms of the indenture, etc.

According to OHG, the fee structure in the program is designed to incentivize conversion of market rate assets to Workforce Housing, as well as to create long-term alignment of interest for the Sponsor/Project Administrator. These fees are similar across all Workforce Housing projects and are intended to conform with the amount of fees generated in other complex, asset-secured bond issuances of this type. For context, RSG compared these fees to a sample of six affordable

housing tax-credit equity financed transactions in and around the greater San Diego market area. Although the total dollar amount of fees for the Project are three to four times larger on average, on a per unit basis they are about 2/3 less than the average for these affordable housing projects.

Acquisition Cost

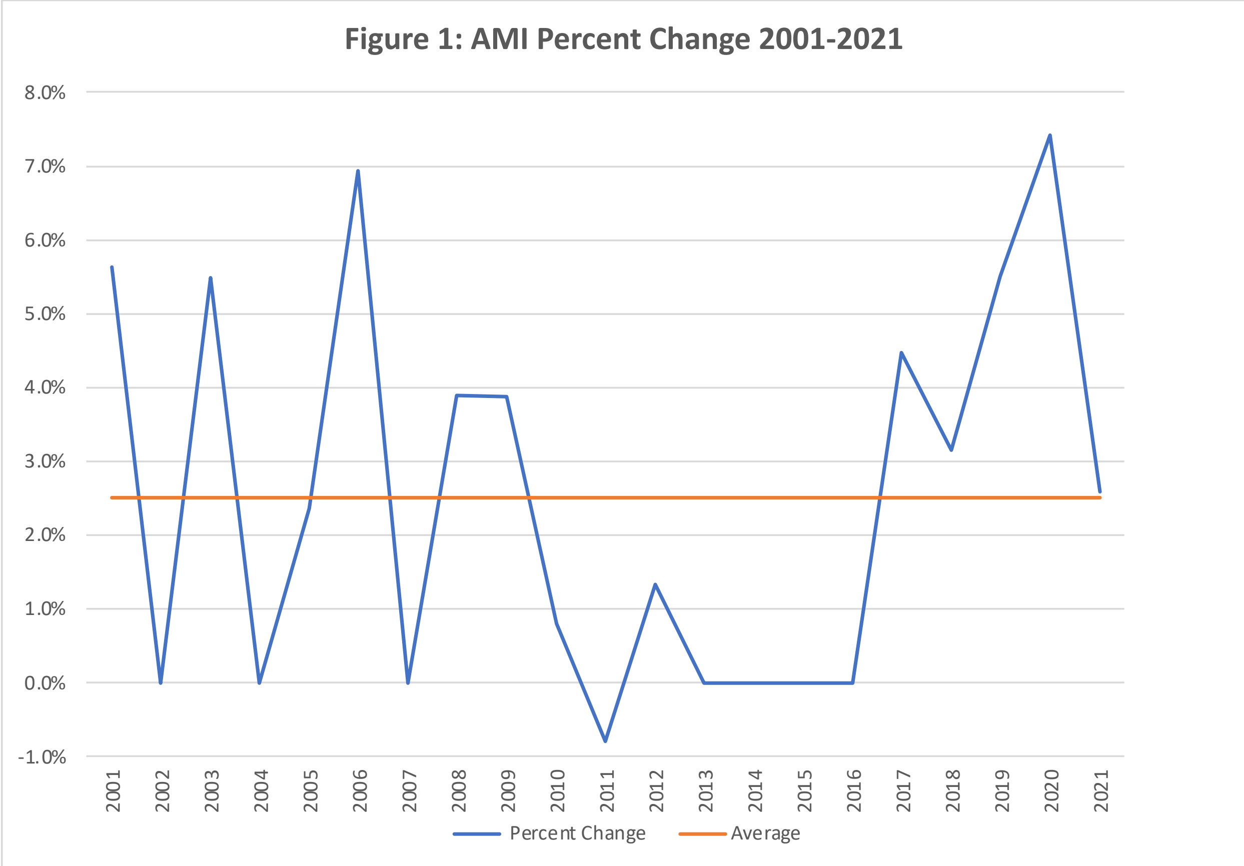
The Sponsor proposes to acquire the property at a market value of around $277 million. This is consistent with an independent appraisal that determined the fair market "as is" value to be $277,200,000. The current assessed value of the Project is $155,854,147, which would imply that the market value has grown by more than 9% per year on average since construction eight years ago.

Financial Projections

The Sponsor provided a pro forma with a multiyear cash flow projection for the 35-year estimated life of the Series A bonds. The Project Rents are assumed to increase by 3% per year and most of the operating expenses are projected to increase by a 3% inflation factor as well (the Host City Charge, monitoring fee, bond admin expenses, and direct assessment all grow by only 2% and the capital reserve deposit is fixed at $298,901 per year).

Under these projections, the Project needs to rely on Reserves to cover Series A bond debt service in the first five years and does not reach a 1.2x debt service coverage ratio until Year 11. There is insufficient cash flow to begin paying principal on the Series A bonds until Year 8. However, as NOI grows over the long term, the potential value of the asset eventually grows large enough to be greater than the outstanding debt after about Year 12.

As part of our evaluation, RSG prepared an adjusted version of the Sponsor's pro forma. In particular, we applied more conservative rent growth assumptions to the multiyear cash flow projection. A review of AMI growth in San Diego County over the past 10, 15, and 20 years indicates that 2.5% is a more reasonable assumption for rent growth since it is capped by the change in AMI. In fact, in four out of the last ten years, AMI did not increase at all, and from 2010 to 2011 it actually declined. Figure 1 below shows the historical variation in AMI increases.



RSG assumed no increase in AMI-based rents for the first year and a 2.5% increase on average thereafter. RSG also assumed that the conversion from in-place market-based rents to Project Rents would occur by the second year, versus over three years as OHG assumed. (The Sponsor has indicated verbally that on other Workforce Housing conversions the replacement of market rate tenants with qualified tenants has been occurring faster than projected.) In addition, RSG increased the capital reserve deposit by the same 3% inflation factor as other expenses, rather than a fixed amount for 35 years.

After RSG made adjustments to the assumptions, the Project's NOI would be insufficient to cover the Series A bond debt service until Year 8, and a 1.2x debt service coverage does not occur until Year 15. The Project is unable to make any principal payments on the Series A bonds until Year 11. Also concerning is that the value of the asset in Year 15, based on the projected NOI with the restricted rents in place, is less than the outstanding Series A bond debt. This implies that, if the City were to exercise its right in Year 15 to acquire the asset from CSCDA for the amount of debt, it would experience a loss. However, over the longer 35-year term of the projections, the bond debt is substantially reduced and the potential residual value to the City grows commensurately.

Distribution of Sales Proceeds

As part of the Public Benefit Agreement to be executed between the City and CSCDA, during the period that is 15 years after issuance of the acquisition bonds through Year 35, the City can exercise a right to cause CSCDA to sell the Project to the City or its designee for the amount of all outstanding debt. This right to purchase allows the City to control the asset and retain the equity value of the Project. If the City has not exercised the right to purchase before all Project debt is retired, CSCDA shall sell the Project within 90 days at a commercially reasonable price.

Following a sale, CSCDA shall apply sales proceeds to prepay, redeem, or defease all outstanding Project debt, pay any fees, amounts due, and transaction costs. The remaining funds ("Surplus Proceeds") shall be transferred to the City and, under the terms of the Public Benefit Agreement, the City is expected to share the Surplus Proceeds, in its sole discretion, with the other taxing agencies in the County as partial or full reimbursement for their foregone property tax revenues. The City would retain any Surplus Proceeds in excess of these distributions.

RSG's projections indicate Surplus Proceeds would be negative by Year 15 but will grow to $334 million by Year 35. After reimbursements to the other taxing entities for foregone property taxes, the City would be projected to receive about $211 million by Year 35. In 2022 present value dollars (using a discount rate of 3% per year), this would be equal to $75 million.

It should be noted that the projections reflect a value based on the assumption that the income- and rent-restrictions would continue beyond the period that the CSCDA Regulatory Agreement would apply to the Project. The City can maintain the affordability restrictions by executing a new regulatory agreement upon re-conveyance and recording it against the property.

Summary Projected Fiscal Impact

Following acquisition of the Project by CSCDA, the property will be exempt from paying the ad valorem property tax (1%) because it would be government-owned. Any direct levies or special taxes and assessments, including local government and school bonds, would still be collected. Therefore, the immediate fiscal impact would be the loss of annual property taxes for up to 35 years, beginning at approximately $302,000 in the first year, which is the amount the General Fund would receive if the Project were a taxable, privately-owned, market-rate apartment complex. However, the Sponsors have agreed to remit an annual Host City Charge to mitigate the loss of property tax starting at $200,000 and increasing at 2% per year. The net cumulative loss of property tax revenue to the City is estimated at about $1.8 million through Year 15 and about $5.2 million through Year 35 (or $1.5 million and $3 million, respectively, in present value 2022 dollars).

However, as part of the Public Benefit Agreement, the City will have the right to cause a sale of the Project after Year 15 and before Year 35 (or when the bonds are fully repaid, if earlier), and the City will receive all net surplus proceeds after payment of all outstanding debt, transaction costs, and other required distributions. Using RSG's more conservative projections, the City would not receive any net proceeds if it caused a sale by Year 15, because the debt would still exceed the Project value. However, the City may yield about $211 million if the Project is sold in 35 years,

even after reimbursing the other taxing entities for their cumulative foregone property. The net proceeds to the City are estimated at $75 million in present value 2022 dollars.

As shown in Table 6 below, under RSG's modified projections, the City would receive a *negative* net fiscal impact of about $1.5 million if the Project were sold in Year 15 (in present value 2022 dollars). However, by Year 35 the net fiscal benefit would be almost $72 million (in present value 2022 dollars). The projected sale proceeds by Year 35 would far exceed the projected cumulative foregone property tax.

Table 6: Fiscal Impact Summary

If Project Sold in Year 15	In 2022 Dollars[1] (Present Value)	Year 1	Year 1-15
Foregone Property Tax	$ (4,113,678)	$ (302,169)	$ (5,225,534)
Host City Charge	$ 2,658,035	$ 200,000	$ 3,392,008
Projected Net Surplus Proceeds	$ -		$ -
Projected Net Fiscal Impact	$ (1,455,643)		

If Project Sold in Year 35	In 2022 Dollars[1] (Present Value)	Year 1	Year 1-35
Foregone Property Tax	$ (8,740,916)	$ (302,169)	$ (15,106,780)
Agency reimbursement	$ 5,720,710	$ 200,000	$ 9,932,204
Projected Net Surplus Proceeds	$ 75,019,716		$ 211,095,162
Projected Net Fiscal Impact	$ 71,999,510		

[1] *based on a 3% discount rate for future years*

Other Considerations

The City incurs no costs, liabilities, or administrative responsibilities in connection with membership in the CSCDA JPA or participation in the Workforce Housing Program (other than staff and consultant time to review and approve the transaction and documentation). The City is not the bond issuer and provides no funding or credit enhancement to the transaction. The acquisition bonds do not diminish the City's issuing capacity and are backed solely by the Project revenues. On this basis, participation creates a relatively low risk and high return opportunity for the City.

However, there is potential that the Project is unable to meet debt service due to lower rents, higher operating costs, or other unforeseen events. Ultimately if the bondholders needed to foreclose on the asset to satisfy outstanding debt, the Regulatory Agreement would be terminated and the rent restrictions would be lifted and rents could be increased under State limits, eventually back up to market rents.