



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Jacky Morales-Ferrand
Julia H. Cooper
Nanci Klein

SUBJECT: SEE BELOW

DATE: December 14, 2020

Approved

Date

12/15/20

SUPPLEMENTAL

SUBJECT: PUBLIC PURPOSE BONDS ISSUED BY A JOINT POWERS AUTHORITY FOR MODERATE-INCOME RENTAL HOUSING

REASON FOR SUPPLEMENTAL

This supplemental memorandum includes further considerations for a future agreement to join any joint powers authority (JPA) offering to provide moderate-income rental housing in the City.

BACKGROUND

On December 2, 2020, the Rules Committee received a report that summarized staff analysis and work to date on unsolicited proposals for the City to join a joint powers authority to provide moderate-income housing.

Staff believes that these new programs present an interesting potential for the creation of moderate-income housing. However, questions were raised in the report about the structure and ability to meet the City's objectives. Staff submitted a recommendation that more time is needed to assess these programs and negotiate modifications to the terms, giving it a "yellow-light" status as the bandwidth of staff across the three departments is very limited given the City's emphasis to address the current pandemic, key staff vacancies, and other City Council priorities. However, at the Rules Committee meeting, staff acknowledged that this product is part of the Housing Department's moderate-income housing strategy and, once the Department has additional staff resources, staff could return to the City Council with next steps in the spring.

There are now at least two bond issuers offering a similar financial product structure (CalCHA and CSCDA), with at least one other issuer reportedly about to offer a similar product (CMFA). Other

financial organizations are also advertising products that achieve similar goals. Additional time allows staff to compare these offerings, rather than just recommending the first provider.

At the Rules Committee hearing, staff further suggested that rather than sole sourcing this tax-subsidized program to one party working with a single developer, the most appropriate way to compare these programs would be to issue a request for responses. This would allow all interested parties to submit information to the City about their programs and would provide a transparent way for staff to negotiate the terms of entering one (or more) JPAs.

ANALYSIS

For purposes of Council discussion, staff has outlined below some of the issues and/or terms that it would address in joining any of the JPAs. Staff had limited time to compile this list, and it is neither exhaustive nor complete in defining the details that comprise a program and the City's desired terms. There may still be other issues or considerations the City may wish to pursue.

It also should be noted that while some cities have joined JPAs with agreements that do not limit the number of transactions, other cities have joined on a more limited basis whereby the city only authorizes a specific number of units or projects at a time, until its officials authorize additional transactions under the program.

- 1. Underwriting standards:** Identification of prudent underwriting parameters acceptable to the City for each transaction to maximize the likelihood the City can acquire a profitable, well-run property between years 15 and 30.
 - a. Potential cap for upfront and long-term fees for JPA team, to right-size amount of debt and incentives.
 - b. Adequate levels of replacement reserves appropriate for Class A properties and 30-year life span, to support long-term property quality.
 - c. Rent increases no higher than allowed under the City's Apartment Rent Ordinance (5%).
 - d. Possible requirement for rents to be at least 10% below market at all times, to ensure healthy unit demand and low vacancy rates.
 - e. Adequate operating expenses based on type and age of building, to ensure ability to cover expenses and maximize likelihood of timely B bonds payment.
 - f. Reasonable debt service coverage ratio, to ensure property is not over-leveraged.
 - g. City receives a small administrative fee each year (escalating at rate such as CPI) as an obligation paid senior to payment of B bonds, to reimburse staff work associated with public inquiries and reviewing reports.

- 2. Depth of affordability:** Desired levels of affordability for properties, with percentages of units, sizes of units, and rent levels for low-income and moderate-income residents.
 - a. Ideal affordability mix, which could vary based on the specifics of an individual purchase.

- b. Minimum number, or percentage, of units at an income and rent level, if any.
 - c. Maximum number, or percentage, of units at an income and rent level, if any.
 - d. Relationship of rent and income levels to State Health & Safety Code definitions (so they could potentially qualify for future RHNA credit).
 - e. Potential set-aside of some apartments for residents with rental vouchers.
 - f. Details on method to fill unoccupied apartments or those that voluntarily turn over, and how to reach overall affordability mix target.
- 3. Reporting to City:** Willingness for entities to commit to regular reporting to the City on San Jose properties.
- a. Annual reporting from JPA on rents, incomes and affordability of households.
 - b. Annual financial reporting from JPA regarding status of remaining debt.
 - c. Notification when property management company is changed, with information on new contacts.
 - d. Requirement that property owner or manager required to respond promptly to City's reasonable requests for information.
 - e. Commitment to post upcoming vacancies and waiting list openings to Housing Department's apartments portal (*Doorway*).
- 4. Approval Process:** City Council approval process for transactions.
- a. City Council approval required for each transaction.
 - b. Whether approval of any terms would be delegated to the City Manager or Director of Housing.
 - c. Timeline of hearing process – balanced to give transparent consideration of project moving quickly enough to meet market demands.
- 5. Administrative Fee:** One-time City fee to cover up-front City staff time for proposal review, analysis, holding local hearing, and other activities related to approval of a JPA project proposal.
- a. Amount and timing of payment.
 - b. Whether fee should be indexed to inflation.
- 6. Ensuring sound long-term property condition:** Ways that the City can ensure a safe, habitable and well-maintained property in its jurisdiction without resorting to the use of Code Enforcement powers.
- a. Possibility of a San Jose-specific rider to Bond Regulatory Agreement that provides for a capital replacement reserve and enables City to enforce safe, habitable and well-maintained property in role as Additional Member to JPA if property owner does not (perhaps after standstill period).

- b. Document requirements for competent and professional asset managers, property managers, developers, and other staff to serve based on industry standard practices, and a tenant appeal process.

- 7. Location of units:** Ability for the City to provide input and direction on the number and location of properties using these financial products in a given geographic area.
 - a. Number of properties or apartments allowed in a given geographic area using these financial products.
 - b. Potential to focus use of the product in certain geographic areas to achieve the goal of a range of housing choices and price points.

- 8. Implementation of City policy priorities:** Ability for properties to accommodate City's policy priorities.
 - a. Implementation of Council-approved tenant preferences.
 - b. Documentation ensuring no displacement of existing tenants at time of property acquisition, with additional details on how implementation of affordability requirements will be administered.
 - c. Documentation ensuring no displacement of existing tenants at time of property disposition if City elects not to purchase.
 - d. Definition of minimum relocation benefits that market-rate purchaser in year 30 would have to meet or exceed for existing tenants, and notification requirements to tenants.

- 9. JPA Team:** Any requirements for number, type, and qualifications of team members overseeing originations and operations of properties for JPA.
 - a. Desired number of partners fulfilling each role in the transaction, and responsibilities.
 - b. Desired qualifications for team members, any required certifications or experience requirements, and evidence to provide.
 - c. Whether an independent, MSRB-registered municipal advisor paid from cost of issuance should work on behalf of City's interests for each transaction.

- 10. Transparency of bond issuance:** Information and documents to be posted on transactions approved under the program, to meet industry standards and for public transparency.
 - a. Issuer's website required contents and timeline to post information.
 - b. Ability for the public to subscribe to issuer's notifications.
 - c. Project documents to be posted to JPA meeting agendas.
 - d. Posting required to MSRB EMMA website for publicly-sold bonds.
 - e. Other posting location for privately-placed bonds.

- 11. City required approvals for B bonds and additional subordinate debt:** In addition to general underwriting, approvals of specific transaction parameters which may directly affect the schedule and price for City's property acquisition, or may reduce the length of required affordability.
- a. Approval of amount of B bonds approved for each deal.
 - b. Parameters of the distribution and use of net cash available after required payments are made, and specifics on how payments are applied to the B bonds' balance, to the extent deferred payments on B bonds could increase the amount of interest payments required to retire the B bonds.
 - c. Approval of the amount and terms of additional subordinate debt over a minimum threshold after the initial issuance of bonds, which could contain 'call' provisions that jeopardize the provision of long-term affordability.
- 12. Transfer price and process:** Details on the process, timeline, price and rights of the City in electing to purchase a property.
- a. Ability for City to assign its Option to Purchase to nonprofit developer/owner.
 - b. Details on purchase price if City elects to purchase before B bonds are paid off, to discourage unintended incentives and possible moral hazard.
 - c. Additional details needed on process and timeline.

In addition, the following considerations would be outside of negotiations with financial providers, but would be part of the City's work to define its use of these products:

- a. Resolution defining allowed uses of City's property net cash flows after acquisition and/or sales proceeds upon disposition to a third party, for uses such as affordable housing, homelessness, preservation, and other anti-displacement strategies.
- b. Planning requirements between years 15 and 30 to deepen affordability after purchase upon unit turnovers.
- c. Funding commitment possibly required in years 10 to 29, to fund a debt service reserve potentially needed for City to acquire property between years 15 and 30.

Proposed Timeline

Given its other priorities, staff estimates that it could return to the Council in April with proposed terms for City Council review and approval. After receiving Council feedback, staff will finalize the proposed terms and will release the terms in a request for responses shortly after the Council meeting. To the extent that a respondent agrees to all terms, the staff would be able to select an entity or entities before the end of the fiscal year. If respondents do not accept all the terms, staff will need additional time to negotiate final terms for Council approval. Additionally, if the City were to join, specific projects/purchases could be brought forward for approval by the City Council at the same time the City agrees to join a JPA. This timeline assumes that the Housing Department

is successful in hiring additional Policy staff and that the workload is not increased due to COVID-19.

CONCLUSION

Staff has provided this high-level analysis to assist with Council discussion. However, more time is needed to work through these issues and/or terms with interested parties. Additionally, staff would like time to more fully compare the multiple offerings using this new JPA structure, and allow all interested parties the opportunity to respond to the issues that have been raised in a clear and transparent process.

/s/
NANCI KLEIN
Director, Office of
Economic Development

/s/
JACKY MORALES-FERRAND
Director, Housing

/s/
JULIA H. COOPER
Director, Finance

For questions, please contact Jerad Ferguson, Office of Economic Development, Housing Catalyst, (408) 535-8176; Kristen Clements, Housing Department, Division Manager, at (408) 535-8236.