KEYSER MARSTON ASSOCIATES.
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

MEMORANDUM

To: Kellee Fritzal, Deputy Director of Community & Economic Development
City of Fullerton

From: Julie Romey
Tim Bretz

Date: September 26, 2021

Subject: Middle-Income Housing Program – Aspect Apartments

The City of Fullerton (City) has requested that Keyser Marston Associates, Inc. (KMA) evaluate the Middle-Income Housing Program (MIH Program) transaction proposed by the California Statewide Communities Development Authority – Community Improvement Authority (CSCDA-CIA), Standard Communities (Standard) and Faring (Faring) (collectively "CSCDA Team"). The Proposed Transaction would allow CSCDA, a joint powers authority (JPA), to issue Essential Housing Revenue Bonds (Essential Bonds) for the purposes of acquiring the existing Aspect apartment complex (Property) and subsequently converting the market-rate multi-family rental units to moderate/middle-income housing (Proposed Transaction).

The following memorandum presents a general overview of the MIH Program and the Proposed Transaction, and the probable costs and benefits to the City as a result of the Proposed Transaction.

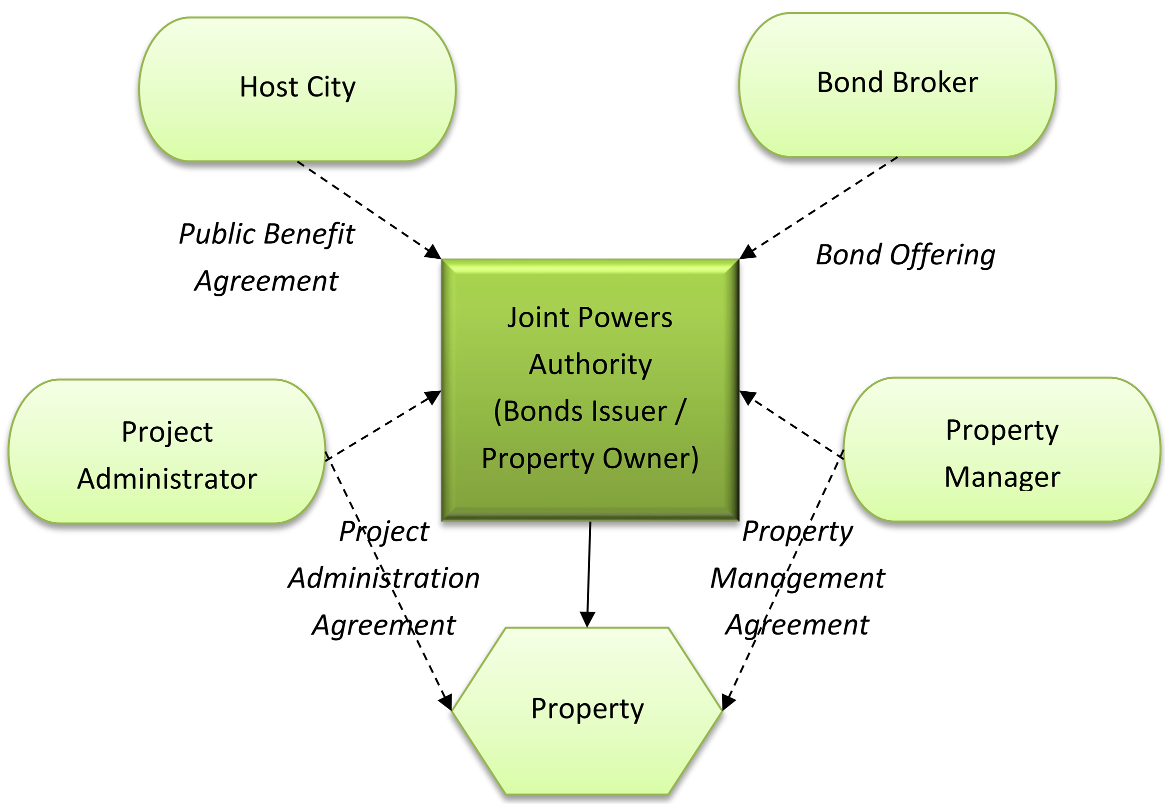
OVERVIEW OF MIH PROGRAM

In recent years, a number of financial entities have been submitting proposals to local jurisdictions to use tax-exempt bonds coupled with a property tax-exemption to secure rental housing for households earning up to 120% of the Area Median Income (AMI). These programs are generally referred to as Middle-Income Housing Programs. It is important to understand that the MIH Program terms vary from jurisdiction-to-jurisdiction based on negotiations between the parties.

While there are some minor variations between the MIH Programs, the general program structures are the same. The following summarizes the general parameters of the MIH Program, the typical financial structure and terms, as well as describes the three entities that are currently promoting the MIH Program in California.

MIH Program Structure

The purpose of the MIH Program is to acquire existing market rate apartment projects and then subsequently restrict the units to households earning up to 120% AMI. To accomplish this, the MIH Program relies on the following structure:



Since the JPA is considered a governmental entity, property owned by the JPA is able to receive a governmental property tax exemption. This means that ownership by the JPA automatically exempts the property from property taxes, aside from direct assessments. The JPA is also able to issue tax-exempt government bonds that are referred to as Essential Housing Revenue Bonds (Essential Bonds), which provide favorable financing to acquire residential properties. The combination of the property tax-exemption and favorable financing enables the JPA to outbid typical multifamily investors when competing to acquire a property. As a public benefit, the JPA commits to restrict the units to households that earn up to 120% AMI. The mix of income restrictions to be applied to the property are subject of negotiations between the JPA and the local jurisdiction.

The Essential Bonds must be issued through a JPA, of which the local jurisdiction must become a member. Therefore, the local jurisdiction is asked to adopt a resolution to become a member of the JPA as well as enter into a Public Benefit Agreement (PBA). However, as a member of the JPA, the local jurisdiction has no liability or financial obligation for the Essential Bonds and is also not required to provide cash financial assistance to enable the transaction. Therefore, in most cases, the local jurisdiction's only financial impact is the loss of property tax revenue during the term of the Essential Bonds, which is typically 30 to 35 years.[1]

Since the JPA is essentially a legal entity solely designed to issue bonds, the JPA enters into a Project Administration Agreement with an asset management entity that is typically a multifamily property investor. The Project Administrator participates in the transaction negotiations and assumes the asset management responsibilities upon purchase of the Property. The JPA will also enter into a Property Management Agreement with a property management firm that typically has experience with the MIH Program and affordable housing.

While the Essential Bonds are typically issued for a 30 to 35 year term, the local jurisdiction, through the PBA, has the right to require the JPA to sell the property (or the local jurisdiction can purchase the property directly) at any point between Year 15 and the end of the Essential Bonds term.

[1] For the purposes of the Proposed Transaction, the JPA Team is proposing to pay the City's share of property tax revenue on an annual basis while the bonds are outstanding. This is reflected as a "Host City Charge" in the operating expenses.

If the option is exercised, the following will occur:

Sale on Open Market

- JPA and Local Jurisdiction agree on a Minimum Sales Price per the terms of the PBA
- If Minimum Sales Price cannot be achieved, the Property is not sold
- If Minimum Sales Price is met,
  - Property is sold;
  - Outstanding Essential Bonds are paid off;
  - Affordability Restrictions and Property Tax Exemption may be removed; and
  - Local Jurisdiction receives Net Proceeds.

Sale to Local Jurisdiction

- Local Jurisdiction agrees to purchase the property for the Minimum Sales Price (outstanding Essential Bonds amount plus closing costs).
- Local Jurisdiction can either purchase the Property directly or assign the sale to another entity at the Minimum Sales Price.
- Local Jurisdiction can enter into a new Regulatory Agreement to continue or deepen the Affordability Restrictions, and the Property Tax Exempton continues as long as the Local Jurisdiction owns the Property.

Essential Bonds

The following describes the typical terms for Essential Bonds in MIH Program:

1. The Essential Bonds are typically underwritten at a 1.00 to 1.10 debt service coverage ratio (DSCR). In other words, the debt service payments are equal to approximately 100% of the project's estimated net operating income (NOI).

2. The Essential Bonds are issued as Series A Bonds that are sold to institutional investors, and often include an issuance premium. Series B bonds are also issued, which provide a potential future payment to the Project Administrator.

3. The Essential Bonds are structured so that the project is required to make interest only payments for the term of the Essential bonds. As such, after the Essential Bonds interest payments are made, any surplus cash flow is to be first applied to the Essential Bonds principal. As a result,

   a. During the first several years, the debt service is comprised of interest-only debt service payments;

   b. The debt service payments escalate as the NOI increases; and

   c. The outstanding principal balance at Year 15 could be only slightly lower than the original bonds proceeds and there could still be outstanding bonds in Year 30 to 35.

   d. Therefore, the debt service structure implicitly requires rents to continually increase in order for the project to support principal payments in future years.

4. The Essential Bond issuance amount also typically exceeds the purchase price of the project by a significant amount so that the Essential Bonds are underwritten at more than 100% loan to cost (or value).

5. These "additional" bond proceeds are used to fund the following:

   a. The creation of large debt service and interest reserve accounts to be used if the NOI is insufficient to cover the required debt service payments;

   b. Upfront fees to the members of the JPA team, which typically equate to between 2% and 5% of the bond issue amount;

   c. Immediately required repair costs; and

   d. Closing costs and miscellaneous fees.

Typical Participants

The following summarizes the typical participants in a MIH Program transaction as well as their roles and compensation.

Joint Powers Authorities

There are three primary JPAs that have been marketing MIH Programs to local jurisdictions in California:

- California Community Housing Agency (CalCHA);
- California Statewide Communities Development Authority (CSCDA); and
- California Municipal Finance Authority (CMFA).

	CalCHA	CSCDA	CMFA
Year Established	2019	1988	2004
Sponsors	Kings County & Housing Authority of Kings County	League of Cities, CA State Association of Counties	N/A
MIH Program Established	2019	2020	2021
MIH Program JPA Name	CalCHA	CSCDA-Community Improvement Authority (CSCDA-CIA)	CMFA Special Finance Agency
MIH Program Responsibilities	Issue Bonds, Own Property, Hire Project Administrator		
Projects Acquired as of August 2021	9	14	3
Project Administrators	Catalyst Housing Group	Waterford Group, Plenary Americas, Manatt Housing Solutions, Standard-Faring JV	Catalyst Housing Group, Manatt Housing Solutions
Property Managers	Greystar, FPI	Varies	Greystar, FPI
Issuer Fee	$500,000 Flat Fee	1% of Essential Bonds	$250,000 Flat Fee*
Annual Administration Fee	$125,000, No Escalations	$250,000, No Escalations	$62,500, No Escalations*
Fee Sharing *	No	No	25% of Fees shared with Local Jurisdiction, 25% of Fees shared with local charity
City Share Property Tax Reimbursement	No	Yes	No

PROJECT ADMINISTRATORS

The JPA, or a party approved by the JPA, acts as a Project Administrator of the MIH Program. KMA refers the JPA and the Project Administrator as the "JPA Team." The Project Administrator facilitates the purchase of the property and oversees the operation of the property on behalf of the JPA until the debt is repaid and the property is sold to the City or another entity. In that role, the Project Administrator is entitled to fees that are negotiated between the JPA and the Project Administrator.

The Project Administrator does not provide an equity contribution to the project but receives the following compensation that is not tied to performance.

Developer Fee

- These fees typically range from 1% of the purchase price to $3,000,000.

Asset Management Fee

- $250,000 per year, increasing annual at 3%

Deferred Developer Fee

- Approximately $6,000,000
- This fee is funded by the Series B bonds and distributed to the Project Administrator when at the earliest of the project being sold or the Essential Bonds redeemed between years 15 and 35.

PROPERTY MANAGERS

The JPA also enters into a Property Management Agreement with a Property Manager, which could be a related party to the Project Administrator. The Property Manager conducts the day-to-day operations of the project under the Project Administrator's supervision. Typical property management firms involved with MIH Programs are Greystone, FPI, and related parties to the various project administrators.

Bond Underwriters

The JPA and a selected bond company execute a Trust Indenture pursuant to which the JPA issues tax exempt bonds for the purchase of the property. The JPA and the Bond Trustee also execute a Regulatory Agreement and Declaration of Restrictive Covenants which govern the income and rent restrictions on the property for a term of not less than 30 years or until all debt on the property is retired. Typical underwriters used for Essential Bonds in MIH Program projects are Jeffries, Stifel and Citibank, Goldman Sachs. Based on KMA's experience, the underwriting fees range from 1.3% to 1.5% of the Essential Bonds issuance.

Current Property Owners

Class A market rate apartment projects are typically targeted for the MIH Program as these projects generate significant property tax revenue. With the property tax exemption only partially offset by the affordability restrictions and fees associated with the MIH Program, the seller of the property achieves a higher sales price than if the property was sold on the open market. Given that information is not known for the highest and best use fair market value of each of the projects that have transacted through the MIH Program over the past few years, it is difficult to estimate the premium property owners receive when properties are sold as a MIH Program transaction over what would be achieved by selling to typical investor groups.

PROPOSED TRANSACTION

The following summarizes the proposal received by the City from the CSCDA Team on September 21, 2021.

Property Description

The Property is a Class A, four-story apartment complex with 323 units located at 251 and 252 Orangefair Avenue. The Property was built in 2017 and consists of approximately 300,000 square feet of residential building area on 6.38 acres. The Property includes a mix of studio, one-, and two-bedroom units.[2]

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[2] Per Costar.

The following table summarizes the Property description:

Property Description	
Site Area	6.38 Acres
Gross Building Area	299,777 SF
Number of Stores	4 Stories
Unit Mix	
Studio Units	10
1-Bedroom Units	162
2-Bedroom Units	151
Total Units	**323**

The current market rents for the Property, which appears to be fully occupied, are as follows:

Current Market Rents		
	Number of Units	**Market Rents**
Studio Units	10	$2,250
1-Bedroom Units	162	$2,500
2-Bedroom Units	151	$3,500
Totals / Averages	**323**	**$2,960**

As the CSCDA Team did not provide a Property Condition Report (PCR) for the Property, it is not known the level of capital improvements that are necessary for the Property to remain a Class A residential building. However, the proposal states that an estimated $30,000 of immediate repairs are necessary. These costs are likely included in the Property's operating expenses in Year 1. In addition, the CSCDA Team estimates that long-term (Years 1 through 12) rehabilitation costs are estimated at $1,400,000. The Proposed Transaction includes both a $1.86 million capital expense fund and a $500,000 extraordinary expense fund, both of which can be used for capital expenses. Finally, the CSCDA Team's cash flow includes deposits to the capital expense fund equal to $96,900 in Year 1 and escalated 3.0% per year. However, these deposits can on be made if there is sufficient cash flow.

Transaction Structure

The CSCDA Team proposes to acquire the Property for the purposes of converting the market rate units to moderate/middle income housing. The CSCDA Team plans to achieve this through the following actions:

1. The City must become a member of CSCDA-CIA and adopt a resolution prepared by the CSCDA Team. It should be noted that the City will be a non-voting alternate member and will not have an ownership interest in the Property except for an option to force the sale of the Property beginning in Year 15.

2. The City must enter into a PBA with CSCDA-CIA that defines the term under which the City can acquire the Property after Year 15. Note that the City may wish to negotiate terms such as selection criteria for new tenants, property management practices, and a requirement that reports are provided annually.

3. The CSCDA Team estimates approximately $198,400,000 in Essential Bonds will be issued to acquire the Property as well as pay all other acquisition / capital improvement costs. An additional $4,078,000 will be provided as an Original Issue Premium.[3]

4. No cash investment will be required from the CSCDA Team or the City. In most proposed MIH Program transactions, the local jurisdiction would lose its share of property tax revenue while the Essential Bonds are outstanding. However, the CSCDA Team proposes to provide the City with $275,000 per year, increasing at 2% per year, as property tax reimbursement payments.

5. 100% of the units will be restricted as follows:

    a. 34%, or 109 units will be restricted to 80% AMI;

    b. 33%, or 107 units will be restricted to 100% AMI households; and

    c. 33%, or 107 units will be restricted to 120% AMI households.

[3] The draft PBA mentions Series A, B and C. However, the pro forma does not indicate a third series of bonds.

6. The following summarizes the compensation that is proposed for the CSCDA Team:

    a. CSCDA-CIA will receive a 1% issuer fee, or $1,984,000 when the Essential Bonds close as well as a $250,000 administrative fee annually until the Property is sold and the Essential Bonds are paid in full.

    b. The Standard-Faring partnership will receive a $3,000,000 developer fee when the Property closes escrow as well as a deferred developer fee of $6,000,000 that will be paid out when the Essential Bonds expire or the Property is sold (therefore, the deferred fee will be received between years 15 and 35, regardless to the performance of the Project Administrator. In addition, as the asset manager of the Property, Standard-Faring will also receive a $250,000 per year fee, which will increase at 3% annually.

Financial Structure

While the CSCDA Team provided a proforma and rent analysis, an appraisal, PCR and purchase and sale agreement for the Property have not yet been provided. Also, it is not clear whether soft costs related to acquisition and closing are included in the purchase price.

Proposed Sources & Uses			
	Total	**Per Unit**	**Other**
Sources			
Essential Bonds (Series A & B)	$198,400,000	$614,200	98% of Total Uses
Original Issue Premium	4,078,000	12,600	2% of Total Uses
Total Sources of Funds	**$202,478,000**	**$626,900**	100% Debt Financed
Uses			
Project Purchase Price	$175,500,000	$543,300	87% Debt Financed
Capitalized Reserve Funds			It should be noted that it is not clear what happens to remaining reserves when property is sold or the bonds have expired.
Capitalized Interest Reserve	$479,000	$1,500	Subsidizes Series A interest payments in years 1 and 2.
Capital Expense Fund	1,857,000	5,800	Shown to be used in year 9
Operating Reserve Fund	490,000	1,500	3 months of Expense Coverage
Coverage Reserve Fund	1,900,000	5,900	For debt service coverage that has not been explained
Senior Debt Service Reserve Fund	6,734,000	20,800	1 year of Series A Interest
Extraordinary Expense Fund	500,000	1,500	Allowance
Operating Account	350,000	1,100	Has not been explained.
Subtotal Capitalized Reserve Funds	$12,310,000	$38,100	
Series B Bond / Deferred P.A. Fee	$6,000,000	$18,600	3.4% of Purchase Price
Upfront Project Administrator Fee	3,000,000	9,300	1.7% of Purchase Price
Issuer Fee to JPA	1,984,000	6,100	1.0% of Series A/B Bonds
Underwriter Fee	2,947,000	9,100	1.5% of Total Bonds
Other Costs of Issuance	736,000	2,300	0.36% of Total Bonds
Total Uses	**$202,478,000**	**$626,900**	

It should be noted that it is not clear what happens to remaining reserves when property is sold or the bonds have expired.

The following are the proposed terms on the Essential Bonds:

	Senior Bonds (Series A)	Subordinate Bonds (Series C)
Type of Bonds	Social Bonds	N/A
Par Amount	$192,400,000	$6,000,000
Coupon Rates	3.50%	10.00%
Term	35 Years	35 Years
Refinancing / Sale / Pay Off of Bonds	Years 15 - 35	Years 15 – 35
Secured by Property	1st DOT	3rd DOT

While the City is proposed to have an option to force a sale of the Property between years 15 and 35, the CSCDA Team projects the following:

	Year 15	Year 35
Property is Sold on Open Market		
Estimated Sales Price	$268,738,000	$485,371,000
(Less) Projected Closing Costs	(5,3745,000)	(9,707,000)
(Less) Outstanding Bonds	(174,635,000)	0
Net Proceeds to City	**$88,728,000**	**$475,665,000**
Per Unit	$274,700	$1,472,700
Net Proceeds to City (2021 $)[4]	**$37,023,000**	**$61,886,000**
Per Unit	$114,600	$191,600
City Acquires Property		
Outstanding Bonds to be Repaid	$174,635,000	$0
Closing Costs	5,375,000	9,707,000
City Cash Payment	**$180,010,000**	**$9,707,000**
Per Unit	$557,300	$30,100
City Cash Payment (2021 $)[5]	**$75,112,000**	**$1,263,000**
Per Unit	$232,500	$3,900

[4] Present value of net proceeds to City is based on a 6% discount rate.
[5] Present value of City cash payment is based on a 6% discount rate.

Affordability Restrictions

The CSCDA Team proposes to restrict the rent to households earning between 80% and 120% AMI, as shown below:

Proposed Affordability Mix		
Restriction	**# of Units**	**% of Total Units**
80% AMI	109	34%
100% AMI	107	33%
120% AMI	107	33%
Total Affordable Units	**323**	**100%**

It is important to note that no existing tenants at the Property will be displaced during the conversion process. The MIH Program relies on natural turnover of units to replace market rate units with income restricted units. Generally, the CSCDA Team expects this to occur within the first few years.

Property Tax Exemption / Reimbursement

Once acquired by the CSCDA Team, the Property will be exempt from paying all property taxes (aside from direct assessments). Based on the current assessed value and property tax rate, the City receives 15.64% of the general 1% property tax levy, or approximately $213,161 per year. However, for the Proposed Transaction, the CSCDA Team has proposed to pay the City's share of the property taxes on an annual basis during the Essential Bonds term. This payment is reflected as an annual "Host City Charge" in the Property's operating expenses. It should be noted that $275,000 will be paid to the City, which is based on an assessed value of approximately $175,500,000.

While only the City's share of property taxes will be reimbursed according to the proposal, it has been pointed out that the Fullerton School District is not in a Basic Aid district, and any shortfalls experienced by the district will be filled by the State of California.

POTENTIAL IMPACTS OF PROPOSED TRANSACTION

This section presents an overview of the potential benefits and risks associated with the City's participation in the Proposed Transaction.

Potential Benefits of City Participation

The potential benefits to the City as a result of participation in the Proposed Transaction include the following factors:

1. CSCDA-CIA is the entity that will issue the Essential Bonds, which will be secured by the Property. CSCDA-CIA is a public entity separate and apart from its members, and any debts, liabilities, and obligations incurred by the CSCDA-CIA will not constitute debts, liabilities or obligations of its member agencies. As such, there will be no direct financial risk to the City if the Essential Bonds are not repaid.

2. The City can obtain income restricted units for at least 15 years and may be able to extend the affordability covenants beyond the 35 year term of the Essential Bonds if the City acquires the Property directly or sells the Property to an entity that agrees to extend the affordability covenants.

3. The sale of the Property on the open market may generate excess sale proceeds that the City can use at their own discretion. One option is to share excess proceeds with the other taxing jurisdictions.

4. The proposed structure targets income levels between 80% AMI and 120% AMI, an income band that is not typically served by other affordable housing programs at the federal, state and local levels, which target income of 80% AMI and below. However, it is important to note that the CSCDA Team's maximum allowable affordable rents are higher than current market rents at most of the proposed income levels.

5. No affordability monitoring or other oversight are required to be performed by the City.

Potential Issues Related to City Participation

The following are issues related to the proposed financial structure, affordability structure and property tax exemption to consider with respect to the Proposed Transaction.

Financial Structure

It is important to note that the structure of the MIH Program is based on very aggressive underwriting assumptions:

	Proposed Transaction	Potential Impact to City
Essential Bonds Rating	Unrated, which means the bonds will not be assessed by rating agencies and, thus, may expose investors to elevated levels of risk.	Many cities have bond underwriting standards that would not allow them to issue unrated bonds, MIH Programs may cause a conflict with City policies.
Equity Investment by CSCDA Team	The owner will not have a financial stake in the Property.	Typically trying to achieve a required return incentivizes a property owner to run a project efficiently and to solve problems before a default occurs.
Bonds as a % of Acquisition Costs	113%, which is higher than the 80% loan to cost ratios typically utilized by conventional affordable housing projects	
Foreclosure Risk for CSCDA Team	None. Only the bondholders are liable in the event of a foreclosures. In contrast, most typical real estate transaction involve both a development entity with at least a partial financial responsibility as well as a major lender or financial institution.	If bondholders on either set of bonds foreclose on the Property during the first 15 years, the City's Option to force a sale will be lost.
Refinancing in Years 1-15	No mention in the proposal	The City will have no control as to how much debt is amassed by the Property in its first 15 years.
CSCDA Team Fees	The fees are not tied to performance.	The City will not have any leverage if the Property has operating issues.

Financial Underwriting

The MIH Program caps annual rent increase for affordable households at no more than 4.0% per year. However, the City's financial benefits are predicated on future sale of the Property that fully repays any outstanding debt. As such, variations in rent growth or operating expenses will have an impact on the potential sales proceeds in Years 15 to 35. Since the bonds are structured so that only interest payments are required to be paid each year, the principal on the Essential Bonds gets paid down only if there is cash flow after all expenses, fees and Series A and B interest payments.

The CSCDA Team provided a 35-year cash flow for the Proposed Transaction. In order to show that the Essential Bonds can be fully repaid within 35 years, the CSCDA Team utilizes the following cash flow assumptions:

1. The rents are escalated at 3.0% per year;

2. The operating expenses are escalated at 3.0% per year; and

3. The other annual expenses are escalated as follows:

    a. The Host City Charge is escalated at 2.0% per year;

    b. The Other Administrative Expenses are escalated at 2.0% per year;

    c. The Agency Administration Fee remains constant;

    d. The Capital Expense Requirement is escalated at 3.0% per year; and

    e. The Project Administrator Management Fee is escalated at 3.0% per year.

As noted above, the CSCDA Team's cash flow relies on the assumptions that affordable rents will increase at 3% per year. However, while the chart below shows that the historical HUD AMI escalation has averaged 4.07% per year, it should be noted that there were several years, due to the financial crisis, that the incomes did not increase.

Orange County AMI for a 4 Person Household	TCAC AMI	% Change
2010	$92,900	
2011	$92,300	(0.65%)
2012	$96,300	4.33%
2013	$96,300	0.00%
2014	$96,300	0.00%
2015	$96,300	0.00%
2016	$97,500	1.25%
2017	$104,300	6.97%
2018	$109,300	4.79%
2019	$118,700	8.60%
2020	$128,100	7.92%
2021	$134,500	5.00%
Total Change (2010-2021)		**44.78%**
Annual Average Change		**4.07%**

As discussed above, the projected performance of the Property is dependent on numerous factors. Small deviations from projected rent increases, interest income, and operating expenses could have significant impacts on the Property's ability to pay down the outstanding bond principal, pay the City's share of property taxes each year, reimburse other taxing agencies for foregone property tax revenues, and/or generate surplus sales proceeds for the City.

CSCDA Team Fees

The Property's financing does not require an investment of cash equity and all debt is secured solely by the revenue generated by the Property. However, the JPA Team collects high fees, which are not tied to the JPA Team's performance or development risk.

The Proposed Transaction includes upfront fees to the JPA Team totaling approximately $11.0 million, as shown below.

CSCDA Team Compensation (2021 $)	Sale in Year 15	Sale in Year 35
CSCDA-CIA:		
Issuer Fee	$1,984,000	$1,984,000
Administrative Fees[6]	2,984,000	5,372,000
Total CSCDA-CIA Compensation	**$4,968,000**	**$7,356,000**
Standard-Faring:		
Developer Fee	$3,000,000	$3,000,000
Asset Management Fee[7]	3,651,000	8,495,000
Deferred Developer Fee[8]	3,851,000	2,132,000
Total Standard-Faring Compensation	**$10,492,000**	**$13,627,000**
Total CSCDA Team Compensation (2021 $)	**$15,460,000**	**$20,983,000**
Per Unit	$47,900	$65,000
As a % of Essential Bonds	8%	11%
As a % of Purchase Price	9%	12%

Compensation to CSCDA Team is not directly tied to parties' performance or risk taken.

Deferred Developer Fee

It's important to note that the CSCDA Team is entitled to receive a $6.0 million fee payable through a Series B Bond as outlined in the table above. The Series B Bond carries a 10% annual interest rate, and the $600,000 in annual interest payments are paid with available cash flow. This annual interest payment acts similar to a preferred equity return. The CSCDA Team's projections illustrate that the Series B Bond will be fully paid in Year 34 after the Series A Bond is repaid in full, unless a sale occurs sooner. KMA has not independently verified these repayment assumptions.

[6] Present value of $250,000 annual fees (flat), discounted at 3% since the compensation is not based on performance.
[7] Present value of $250,000 annual fees (flat), discounted at 3% since the compensation is not based on performance.
[8] Present value of $250,000 annual fees (flat), discounted at 3% since the compensation is not based on performance.

Public Identification (City Reputation)

Regardless of the legal and ownership structure intended to isolate the City from Property ownership and operations, the City will be the most public-facing entity of the transaction.

- If property maintenance or other issues arise, tenants will likely seek assistance from the local jurisdiction.
- While the local jurisdiction has no direct responsibility to cure any financial issues with the project, the local jurisdiction may be coerced into providing financial assistance in order to avoid a foreclosure on income-restricted units.
- To date, it does not appear that there have been any legal challenges involving the MIH Program. However, the City should discuss with their legal counsel the potential risk of any legal liability associated with the MIH Program.

The City will not have oversight or monitoring rights with respect to the maintenance, building repairs, and on-going capital upgrades. If the property reverts to the City at the end of the bond term, the property will be conveyed in an "as is" condition, and the City may inherit deferred maintenance liabilities beyond its control.

AFFORDABILITY STRUCTURE

General Affordability Concerns

1. The issuance of Essential Bonds through the JPA is a form of acquisition financing. As such, the MIH Program nominally repurposes existing rental housing rather than producing new units.

2. The maximum allowable affordable rents per the CSCDA Team's rent calculations are not aligned with the City's affordability standards. Moreover, generally the Property's current market rents are lower than the CSCDA Team's maximum allowable rents – especially at the 100% AMI and 120% AMI levels. See detailed discussion below.

3. The affordability restrictions terminate when the Essential Bonds are fully repaid (typically between 30 to 35 years) unless a sale is completed earlier. In contrast, most typical affordable housing projects have a 55-year affordability covenant.

4. No third party exists to oversee ongoing income compliance, which has no obvious mitigants, decreases the structure's public value and escalates the structures audit and reputational risks.

    a. Under the MIH Program structure, the CSCDA Team is responsible for overseeing its acquired Property, including its effective management as the Property owner.

    b. The City as only an "Alternate Member" of CSCDA-CIA and will not have the ability to enforce compliance with the affordability restrictions. If the City were to receive reports indicating non-compliance, the City would be required to review and issue letters acknowledging noncompliance even though the City will not have power to enforce compliance.

5. There are no enforcement mechanisms for the City to utilize if the CSCDA Team does not comply with income qualification of tenants on an annual basis.

6. It is the KMA understanding that the City cannot count these units towards its Regional Housing Needs Assessment (RHNA) obligation.

Affordability of Proposed Transaction

Pursuant to the Proposed Transaction, a regulatory agreement would be recorded against the Property that would restrict the occupancy and monthly rents to households earning no more than 120% AMI. Annual rent increases for income-qualified tenants would be limited to no more than the increase in the AMI or 4%, whichever is less. The income and rent restrictions would be in place for the term of the bonds.

The CSCDA Team's proposed methodology for calculating affordable rents relies on the income limits published by the California Tax Credit Allocation Committee (TCAC). However, the CSCDA Team's maximum affordable rents are calculated based on 35% of the household income limits, while most other affordable rents are calculated based on 30% of the household income limits. In addition, most affordable housing programs require that a utility allowance be deducted from the affordable rents. However, a utility allowance is not deducted from the CSCDA Team's affordable rents. Therefore, the effective housing costs paid by the 80% to 120% AMI households is higher than even 35% of their household income.

Furthermore, many of the funding sources that are available to local jurisdictions, as well as California Density Bonus Law, are aligned with the income limits published by the California Department of Housing and Community Development (HCD). The affordable rents for these programs are set based on the median incomes published by HCD.

As shown in the chart below, the maximum affordable rents allowed by the CSCDA Team's Proposed Transaction are significantly higher than the rents that would be permitted by the HCD median incomes.[9]

	Studio Units	1-Bedroom Units	2-Bedroom Units
A. Maximum Rents – Per CSCDA Team's Proposal			
80% of AMI	$2,198	$2,511	$2,826
100% of AMI	$2,748	$3,138	$3,532
120% of AMI	$3,297	$3,766	$4,239
Weighted Average	$2,649	$3,311	$3,974
B. Maximum HCD Rents			
80% of AMI	$1,353	$1,552	$1,712
100% of AMI	$1,727	$1,979	$2,192
120% of AMI	$2,100	$2,406	$2,673
Weighted Average	$1,888	$2,167	$2,403
C. Difference (A-B)			
80% of AMI	$845	$959	$1,114
100% of AMI	$1,021	$1,159	$1,340
120% of AMI	$1,197	$1,360	$1,566
Weighted Average	$761	$1,144	$1,571

Additionally, it is important to note that in almost all cases, the current average in-place market rents are lower than the CSCDA Team's maximum allowable affordable rents. In other words, most of the rents at the Property already qualify as an affordable rent under the JPA Team's proposed rent restrictions.

[9] Based on the utility allowance schedule published on 12/1/2020 by the Orange County Housing Authority, the following utility allowances were deducted from the HCD rents: $141 for studio units; $155 for one-bedroom units; and $209 for two-bedroom units.

	Studio Units	1-Bedroom Units	2-Bedroom Units
Average In-Place Market Rents – Per CSCDA Team			
Weighted Average	$2,250	$2,500	$3,050
Maximum Allowable Rents – Per CSCDA Team Rent Restrictions			
80% of AMI	$2,198	$2,511	$2,826
100% of AMI	$2,748	$3,138	$3,532
120% of AMI	$3,297	$3,766	$4,239
Weighted Average	$2,649	$3,311	$3,974
% Above/(Below) Market	18%	32%	30%

Thus, on average, the maximum affordable rents per the rent calculations allowed by the CSCDA Team are between 18% and 32% above the current market rents. This implies there is almost no affordability benefit if the CSCDA Team's maximum allowable affordable rents are utilized.

However, the CSCDA Team has verbally committed to restricting rents across the entire project by an average of approximately 10%. As such, the following table provides the CSCDA Team's proposed rents immediately upon purchase of the Property:

	Studio Units	1-Bedroom Units	2-Bedroom Units
Average In-Place Market Rents – Per CSCDA Team			
Weighted Average	$2,250	$2,500	$3,050
CSCDA Team's Proposed Affordable Rents Upon Purchase			
80% of AMI	$1,884	$2,152	$2,422
100% of AMI	$1,995	$2,325	$2,775
120% of AMI	$2,128	$2,350	$2,800
Weighted Average	$1,991	$2,276	$2,667
% Above/(Below) Market	(12%)	(9%)	(13%)

The CSCDA Team did not provide information related to how the proposed rents were determined. Furthermore, it is unclear how this rent differential will be regulated as it has not been included in sample regulatory agreements shared with KMA.

Property Tax Exemption Issues

1. The MIH Program's structure requires that the Property become exempt from property taxes while the Property is owned by the JPA. Typically, the Property would be exempt from all property taxes except for direct assessments.

2. However, the CSCDA Team proposes to pay the City's share of property tax revenue from the Project's cash flow. This payment is represented as an annual "Host City Charge." However, the Host City Charge would only be paid during years in which there is sufficient cash flow (i.e. revenue is greater than operating expenses). The Host City Charge is estimated at $275,000 in Year 1 and escalated at 2.0% per year. The Year 1 amount is calculated as follows:

City Share of Property Taxes: Year 1	
Purchase Price (Assessed Value)	$175,500,000
Base Levy (% of Assessed Value)	1.0%
Base Levy	$1,755,000
City Share of Base Levy	15.64%
City Share of Property Taxes	$274,482

3. In order to ensure that there is sufficient cash flow to pay the Host City Charge (i.e. City's share of property taxes), the Property's revenue must off-set the Property's operating expenses. As such, this applies more pressure to increase affordable rents at the maximum levels allowable each year.

4. Even though the CSCDA Team has agreed to pay the City's share of property taxes on an annual basis, the Proposed Transaction still requires a property tax exemption for all of the other taxing entities. The City/CSCDA establishes the property tax exemption and the other taxing entities automatically forfeit their share of the property tax revenue form the project. No approval is required from other taxing entities.

SUMMARY OF ANALYSIS

1. CSCDA-CIA is the entity that will issue the Essential Bonds as well as own the Property. As such, there will be no direct financial risk to the City if the Essential Bonds are not repaid.

2. However, it is important to note that the structure of the MIH Program is based on very aggressive underwriting assumptions:

    a. The Essential Bonds are unrated.

    b. The CSCDA Team does not provide any capital or equity to the project.

c. The Essential Bonds equate to approximately 113% of the acquisition cost of the project. In contrast, conventional affordable housing projects typically utilize an 80% loan-to-cost (LTC)/loan-to-value (LTV) ratio.

d. The Essential Bonds are underwritten based on a DSCR of 110% or less. In addition, the debt service escalates annually. In comparison, conventional affordable housing projects typically utilize level debt service payments that are based on a 115% to 120% DSCR.

e. The MIH Program is structured so that only the bondholders are liable in the event of failure. Neither the CSCDA Team nor CSCDA-CIA are responsible for the repayment of the Essential Bonds. In contrast, most typical real estate transactions involve both a development entity with at least partial financial responsibility as well as a major lender or financial institution.

3. The proposed structure targets income levels between 80% AMI and 120% AMI. However, it is important to note that the CSCDA Team's maximum allowable affordable rents are higher than current market rents at most of the proposed income levels.

4. There are no enforcement mechanisms for the City to utilize if the CSCDA Team does not comply with income qualification of tenants on an annual basis.

5. The City will not have oversight or monitoring rights with respect to the maintenance, building repairs, and on-going capital upgrades. If the property reverts to the City at the end of the bond term, the property will be conveyed in an "as is" condition, and the City may inherit deferred maintenance liabilities beyond its control.

6. It is the KMA understanding that the City cannot count these units towards its Regional Housing Needs Assessment (RHNA) obligation.

LIMITING CONDITIONS

1. Value estimates assume that property titles are good and marketable; no title search has been made, nor has KMA attempted to determine property ownership. The value estimates are given without regard to any questions of boundaries, encumbrances, liens, or encroachments.

2. KMA is not advising or recommending any action be taken by the City with respect to any prospective, new, or existing municipal financial products or issuance of municipal securities (including with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues).

3. KMA is not acting as a Municipal Advisor to the City and does not assume any fiduciary duty hereunder, including, without limitation, a fiduciary duty to the City pursuant to Section 15B of the Exchange Act with respect to the services provided hereunder and any information and material contained in KMA's work product.

4. The City shall discuss any such information and material contained in KMA's work product with any and all internal and/or external advisors and experts, including its own Municipal Advisors, that it deems appropriate before acting on the information and material.