Date: March 15, 2019

To: Barbara Liebold, City Attorney, City of Lake Elsinore

From: Michael P. Busch, President and CEO
Steven H. Dukett, Managing Director

Memorandum – Cottages at Mission Trail: Project Analysis – Updated March 2019

The purpose of this updated memorandum is to provide the City of Lake Elsinore an evaluation of the proposal submitted by Mission Cottages LP ("Developer"), with respect to the proposed Cottages at Mission Trail multi-family housing project ("Project"), an affordable housing development, per the Developer's financial model of March 14, 2019. In addition and as further background information, Cottages Management, LLC is the Developer's Administrative General Partner and AOF Mission Trails, LLC is the Developer's Managing General Partner.

The Developer anticipates financing the Project using a variety of resources available for affordable housing project including, but not limited to private activity bond financing, Low-Income Housing Tax Credits ("LIHTCs"), Lake Elsinore Successor Agency-funded loan, City "Fund 106" loan, Developer loans, etc. In addition, the Developer has a long and successful background with respect to development low- and moderate-income housing projects and appears well-suited to develop the Project.

Description Summary

1. The Project site is located along the western side of Mission Trail at Sedco Boulevard, Lake Elsinore, California.
2. The Project will include 143 units (142 rental and 1 manager unit) and related amenities.
3. In total, the Project will consist of 161,492 square feet of building area.
4. The Project is 99.3% affordable to lower and very-low income tenants (20 units at very-low, 122 at lower and 1 manager unit, which may possibly be a lower income unit).

Analysis of Development Costs (per the HUNT Financial Model of 3-14-19)

1. The Developer has projected that the Project will cost $42,058,943 (say $42.0 million) to develop or $294,118.48 per unit (say $294,000 average per unit).
2. The average cost per square foot is $260.40 (say $260).
3. The cost by unit type is:

    a. 2 bedrooms of 829 sf x $260/sf = $215,540
    b. 2 bedrooms of 969 sf x $260/sf = $251,940
    c. 3 bedrooms of 1147 sf x $260/sf = $298,220
    d. 3 bedrooms of 1,203 sf x $260/sf = $312,780
    e. 3 bedrooms of 1,219 sf x $260/sf = $316,940
    f. 3 bedrooms of 1,222 sf x $260/sf = $317,720

4. The CTCAC basis limits per unit by bedroom count for 4% LIHTCs in Riverside County for 2018 are provided below. The 2018 numbers are used in lieu of the 2019 limits, which have not yet been published, but are likely to be greater. Therefore, the 2018 limits are used in this analysis and are as follows:

    a. 2 bedrooms = $309,600
    b. 3 bedrooms = $369,288

Based on the above, the Project is well below the maximum cost per unit established by CTCAC for 2018 and since it is believed that the 2019 CTCAC limits will be greater, the overall development costs are considered reasonable and should be eligible for 4% LIHTCs.

Analysis of Affordability Covenants and Rent Schedule (2018)

Because of the Project's funding sources, the Project is subject to both Health and Safety Code ("HSC") and CTCAC renter income affordability limitation criteria, as follows:

1. From the perspective of the HSC, the Project's renter income limitations are divided into two categories, i.e., very-low (i.e., not more than 50% of AMI) and lower (i.e., not more than 80% of AMI).

2. From the perspective of the CTCAC, the Project's renter income limitations are divided into two categories, i.e., very-low (i.e., not more that 50% of AMI) and lower (i.e., not more than 60% of AMI). In addition, when a LIHTC applicant applies for tax credits, the applicant must irrevocably elect one of the following minimum federal set-aside requirements:

    a. A minimum of 40% of the units must be both rent-restricted and occupied by households whose incomes are 60% or less of AMI; or
    b. A minimum of 20% of the units must be both rent-restricted and occupied by households whose incomes are 50% or less of AMI.

    Despite this minimum set-aside election, most project applicants designate all of the units in a project for occupancy by low-income households, since credits are allocated <u>only</u> for restricted units. Hence, the greater the number of restricted units results in more tax credits being awarded and in more equity funding being contributed to a project. In this case, the Developer has set-aside all of its rentable units (i.e., not including the single on-site manager's unit).

    It is important to state that the use of LIHTCs does not mandate the set-aside of units at the extremely low-income level.

Allowable Rent

The Project's rent limits with respect to the "Restricted Units" are defined in § 2.2, Allowable Rent, of the LMIHAF ("Low- and Moderate-Income Housing Asset Fund") Regulatory Agreement. Allowable Rent, including a reasonable utility allowance, shall not exceed the lesser of the maximum allowable rent to be charged by the Developer pursuant to any applicable Tax Credit Regulatory Agreement or the following calculations, as applicable:

i) Low Income Rent. Subject to certain variations resulting from increases in income by existing tenants, as described within § 2.3 of the Regulatory Agreement, the rent charged to tenants of the low-income units shall not exceed one-twelfth (1/12th) of thirty percent (30%) of sixty percent (60%) of adjusted median income ("AMI"), as adjusted for "Assumed Household Size".

ii) Very Low Income Rent. Subject to certain variations resulting from increases in income by existing tenants, as described within § 2.3 of the Regulatory Agreement, the rent charged to tenants of very- low-income units shall not exceed one-twelfth ($1/12^{th}$) of thirty percent (30%) of fifty percent (50%) of AMI, as adjusted for "Assumed Household Size".

Assumed Household Size.

In calculating the Allowable Rent for the Restricted Units, the following Assumed Household Sizes shall be utilized:

Number of Bedrooms	**Assumed Household Size**
Two (2) Bedrooms	Three (3) Persons
Three (3) Bedrooms	Four (4) Persons

Notwithstanding the foregoing, during any period in which the CTCAC Regulatory Agreement encumbers the Property, the Developer may utilize the assumed household size determined by, or utilized by, CTCAC, as permitted by Health & Safety Code § 50052.5 (h).

Based on the foregoing, the Project's rental rate limitations for 2019 are projected to be as follows (rounded):

a. 2 bedroom @ 50% of AMI = $809/month
b. 2 bedroom @ 60% of AMI = $971/month
c. 3 bedroom @ 50% of AMI = $898/month
d. 3 bedroom @ 60% of AMI = $1,077/month

It is important to note that the above rental rate limitations are based on median income estimates provided by Novogradac & Company, LLP for 2019. The Novogradac data is used in this analysis as such information is not yet available from HUD and HCD. Further, UFI believes that given the circumstances (i.e., that HUD and HCD 2019 data are not currently available) that is it sensible to use the Novogradac's estimates, which are a fair and reasonable source for the analysis of the Project.

In addition, the Developer's proposed rental rate limitations are consistent with the above and are therefore also deemed to be a fair and reasonable. Ultimately, when the Project is brought into service, the Developer will update its rental rate schedule to comport with those that are effective at that time.

Analysis of Financing Plan

The Developer's financing plan, as reflected in the HUNT financial model of March 14, 2019, is clearly presented in a comprehensive fashion consistent with the data expectations of the CTCAC. It is in a format that reflects an intimate understanding of how affordable housing projects are currently financed. In addition, this analysis compares the Developer's financing plan to the limitation specified in:

i) The City's June 13, 2017 letter specifying the Loan Commitment for Rental Housing Project – Cottages Affordable Housing ("City Loan Commitment Letter"); and

ii) The loan proposal letter dated March 6, 2019 by Red Stone Tax Exempt Funding II, LLC ("Red Stone Letter").

The City's financial limitations are particularly described within the last paragraph on page 2 of the Loan Commitment Letter, which continues to page 3 and reads, as follows:

> "Developer anticipates issuing tax exempt bonds in an original principal amount of approximately Eighteen Million Dollars ($18,000,000) to finance a portion of the construction costs of the Project (**Bonds**). A portion of the Bonds, in such original principal amount as is necessary to result in net proceeds to the Project of up to Five Million Dollars ($5,000,000), will be secured by Developer's pledge of future Pledged Housing Funds under the DDA (**TIF Bonds**). Accordingly, solely to the extent such funds are available under the terms of the DDA, the City agrees to release to Developer Pledged Housing Funds in future years in an annual amount not to exceed an amount sufficient to fund the aggregate of (i) annual debt service on the TIF Bonds (**Annual Debt Service**), (ii) any additional amount necessary to provide the minimum debt service coverage ratio required for the Bonds (**DSCR Funds**), and (iii) payments on deferred developer fee not funded by operations until such deferred developer fee is paid in full (**Developer Fee Funds**). In no event shall the City be obligated to release more than the annual amount of Pledged Housing Funds to which the Developer is entitled under the DDA in any given year. In the event the City releases Pledged Housing Funds in any given year in excess of the amount needed to fund the foregoing, any excess funds shall be returned to City for deposit into accrued Pledged Housing Funds and to be held in accordance with the terms of the DDA."

Based on the foregoing, the HUNT financial model approximates consistency with the City Loan Commitment Letter and the Red Stone Letter. The variations are a result of several economic factors, not least of which relate to rate changes in the financial markets. For the purposes of the above, the Developer has proposed the use of the pledged funds for two purposes. The first is to cover debt service payments on an approximately $20 million loan from Red Stone, representing approximately $11.3 million to be supported by the Project's net operating income (i.e., the first loan) and approximately $8.7 million to be supported by tax increment income (i.e., Redevelopment Property Tax Trust Fund income) (i.e., the second loan). The second use of pledged funds is to meet the cash-flow needed to fund debt service coverage ratios required by the lender and to ensure that the Developer fee is paid pursuant to CTCAC requirements. The Project's operating proforma shows how the pledged funds are used for these purposes and confirms that such funds are reasonably required to develop the Project.

Because of the variations in the Project's costs and method of financing, it is recommended that the City consider modifying its financial limitations as described within the last paragraph on page 2 of the Loan Commitment Letter, which continues to page 3. The recommended modifications are, as follows:

> "Developer anticipates issuing tax exempt bonds in an original principal amount of approximately Twenty-Five Million Dollars (**$25,000,000**) to finance a portion of the construction costs of the Project (**Bonds**). A portion of the Bonds, in such original principal amount as is necessary to result in net proceeds to the Project of up to Eight-Million Six-Hundred Fifty Thousand Dollars (**$8,650,000**), will be secured by Developer's pledge of future Pledged Housing Funds under the DDA (**TIF Bonds**). Accordingly, solely to the extent such funds are available under the terms of the DDA, the City agrees to release to Developer Pledged Housing Funds in future years in an annual amount not to exceed an amount sufficient to fund the aggregate of (i) annual debt service on the TIF Bonds (**Annual Debt Service**), (ii) any additional amount necessary to provide the minimum debt service coverage ratio required for the Bonds (**DSCR Funds**), and (iii) payments on deferred developer fee not funded by operations until such deferred developer fee is paid in full (**Developer Fee Funds**). In no event shall the City be obligated to release more than the annual amount of Pledged Housing Funds to which the Developer is entitled under the DDA in any given year. In the event the City releases Pledged Housing Funds in any given year in excess of the amount needed to fund the foregoing, any excess funds shall be returned to City for deposit into accrued Pledged Housing Funds and to be held in accordance with the terms of the DDA."

Only the dollar amounts in the foregoing paragraph have been modified from the original text. The balance of the text remains unchanged. In addition, it is anticipated that the actual amount of the Bonds will be less than $25 million.

Merits for Subsidies (per June 13, 2017 Loan Letter)

On an overall basis, the Project's financing structure is not unusual, as a combination of a primary loan and LIHTCs do not cover the true costs of developing affordable housing projects. In addition, the effect of lower rental receipts (due to affordable rent restrictions) has a concomitant effect on reducing the Project's net operating income, which is the source for making debt service payments. Consequently, affordable housing projects in the current market place require additional soft and patient sources of financing to enable the economic viability of an affordable housing project. In this instance, the Developer has proposed a financing structure, if approved, that is typical in type and essence to ensure the economic viability of the Project.

Conclusion

Based on the forgoing, the Project's financing plan is viable, and the Developer's expertise is sufficient to ensure the development of the Project.

In addition, this analysis assumes that the cash flow needed from the City and/or Successor Agency is feasible in the amount and the time frames needed. No separate analysis was conducted for that purposes as it is assumed that staff are satisfied with the feasibility of the cash flow requested.

Further, the Project will create twenty (20) very- low-income and one-hundred and twenty-two (122) low-income covenanted affordable housing units that may be counted toward compliance with SB 341. UFI will provide a separate analysis of the City's accomplishments and obligations with respect to SB 341 in a separate report.

Thank you for providing UFI the opportunity of preparing this analysis for the City. If there are any questions, please direct them to either Michael Busch at (714) 283-9334 or michaelb@urbanfuturesinc.com or to Steven Dukett at (714) 923-3542 or stevend@urbanfuturesinc.com.

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