



DATE: May 7, 2018

TO: Mayor and Members of the City Council

VIA: Kevin M. Miller, City Manager

FROM: Curtis Banks, Community Development Director

SUBJECT: WORKFORCE HOUSING PROPOSAL FOR PHASE C OF PILGRIM TRITON PROJECT

RECOMMENDATION

It is recommended that the City Council review and, by Minute Order, approve this report. In doing so, City staff also requests that the City Council indicate whether the alternative approach described below for the construction of the Workforce Units is acceptable.

EXECUTIVE SUMMARY

This report provides information on staff work completed since the City Council's October 27, 2017 approval of a Term Sheet for a workforce housing project to be constructed in conjunction with development of Pilgrim Triton Phase C. Direction given in response to this report will provide guidance to City staff as it continues to draft proposed final documents for the City Council's review.

BACKGROUND

Pilgrim Triton Phase III FC LP, ("Developer") has filed an application to change the entitlement for the Phase C of the Pilgrim Triton Master Plan site, which currently includes development of both commercial space and multifamily units (up to 17), to an all residential, for-sale market-rate townhome project of up to 70 units. If this change in entitlement is approved, under the City's current 20% affordability mandate, Developer would be required to designate 14 of the 70 townhomes as affordable. As an alternative, Developer has proposed to meet its affordability requirement by acquiring

the remaining 1.2-acre portion of Phase B, and donating a portion of the combined site to the City for the construction of a separate 22 unit residential building (rental) for income qualified workforce housing ("Workforce Units").

On October 27, 2017, the City Council indicated a willingness to explore this proposal by approval of a "Term Sheet" outlining the major business terms for this transaction. The Term Sheet provides for Developer to donate land, construct both the Workforce Units and the market rate townhome projects, and convey the building and land containing the Workforce Units to City upon completion. In addition to the land donation, Developer would also contribute three million dollars (\$3 million) toward the cost of constructing the Workforce Units. The City would be responsible to pay the remaining costs associated with construction of the Workforce Units.

As the Developer and City staff began to draft documents to implement the Term Sheet, it was determined that the interactive design and budget process called for in the Term Sheet could cause delays and add costs to the project. In order to address these issues, Developer and City staff have begun to explore an alternative approach which would reduce financial risks to both the City and Developer by providing greater certainty on project costs, simplifying the project administration during the design and construction phase, and ultimately providing the City with the opportunity to acquire the units at a lower cost. The specifics of this proposal are discussed in more detail in the Financing Options section of this report.

The balance of this report provides information on options for determining who would be eligible for the Workforce Units, project financing, and management of the Workforce Units.

ANALYSIS

Definition of Workforce Housing

In 2010, Foster City approved a Master Development Agreement (MDA) for the Pilgrim Triton Master Plan Project. Consistent with the City's Housing Element, the MDA requires 20% of all residential units in each phase to be restricted to an affordable housing program (BMRs); all of the residential projects constructed so far have complied with this requirement. The Plaza has 60 BMR units, 100 Grand has 33 BMR units, and The Triton will have 48 BMR units.

In order to meet the 20% requirement for Phase C, at least 14 of the proposed 22 rental units would need to be designated as "affordable housing units" within the meaning of State law with tenants who are income qualified.

Developer's proposal for workforce housing comes at an interesting time based on a

series of recent State housing law changes. The State's legislature passed a series of housing laws in late 2017. These laws were passed to address the State's housing crisis by granting incentives to developers of housing projects and to create a variety of punitive measures for cities that fail to provide for the creation of new housing units. These bills include a number of provisions aimed at increasing local jurisdictions' accountability for ensuring construction of housing units. Among these, AB 879 expands the level of information cities must provide in their annual compliance reports to the California Department of Housing and Community Development (HCD), including detailed descriptions of cities' progress in meeting their Regional Housing Need Allocation (RHNA) numbers, and actions taken toward completion of the programs within the timelines identified in their housing elements. AB 72 provides HCD with broad new authority to "decertify" its finding of compliance if it determines that a jurisdiction fails to act in compliance with its housing element, and it allows HCD to refer certain violations of law to the Attorney General.

Under the enhanced reporting requirements and review by HCD, the City is required to report all actions taken in compliance with the programs in its Housing Element, and to provide detailed information and analysis about why projected numbers or programs are not completed or on track to be achieved. In this environment, cities are focused on ensuring compliance with their Housing Element requirements, and looking for opportunities to obtain affordable housing units because consequences of non-compliance include loss of certification of the Housing Element, and imposition of State mandated streamlined housing approvals which would limit City's discretion in reviewing future proposed residential development projects. The proposal from Developer gives the City an opportunity to provide more affordable housing units than anticipated in the City's projections and thereby helps the City to assure that it will retain local control of its land use planning and approval process.

As discussed above, in order to meet the City's 20% affordable housing obligation, 14 of the proposed 22 Workforce Units in Phase C could be offered to the City's income qualified "first responders." The meaning of the term "first responders" has not yet been defined by the City. The Merriam Webster Dictionary defines it as "a person (such as a police officer or an EMT) who is among those responsible for going immediately to the scene of an accident or emergency to provide assistance." Under State law, all public employees are declared to be "disaster service workers" and disaster service activities may be assigned to them by their superiors or by law (Gov't Code Sec. 3100). The number of employees who might qualify for the workforce housing would depend on what meaning the City ascribes to the term "first responders."

In order to count towards the City's 20% affordable housing requirement, City employees occupying the 14 Workforce Units would need to be income qualified.

In order to determine whether or not an affordable workforce housing program for 14 of

the 22 units would be feasible, Human Resources was asked to compile information on how many of the City's current employees would qualify in each of the San Mateo County Income Eligibility Categories (i.e., Extremely Low Income, Very Low Income, Low Income, Median Income, and Moderate Income). This analysis was done assuming all public employees as "disaster service workers" would be eligible for the program.

Each employee's base salary was used to determine income categories. Using base salary information, a total of 98 City employees currently fall within 4 of the 5 income eligibility categories (0 Extremely Low, 2 Very Low, 33 Low Income, 16 Median Income, and 47 Moderate Income). It should be noted that this list is compiled without information on salaries earned by employees' spouses. Presuming that a number of employees have working spouses, the number of eligible employees will decrease. If employees have been paid overtime, the numbers may further decrease.

Information was also collected on employees' genders, age, and ethnicity; factors which would also need to be considered in order to avoid claims of discrimination when implementing the program. Based on this information it appears that the group of eligible employees is diverse in terms of gender, age, and race/ethnicity.

Priority for Workforce Eligibility

The approved Term Sheet does not define "affordable workforce housing unit," but the Housing Element defines "Workforce Affordable Housing" as "Housing that is affordable to the workforce in the community earning a moderate income or below." (Housing Element, page 4-11.) The City Council has previously prioritized eligibility for the City's affordable housing units in the following order:

1. Persons who live and work in Foster City;
2. Persons who live in Foster City;
3. Employees of the City of Foster City;
4. Classroom teachers who are employees of the San Mateo-Foster City School District, the San Mateo Union High School District or the San Mateo Community College District;
5. Persons who work in Foster City; and
6. All others who are income qualified.

Additionally, Housing Element guideline H-E-2-a further emphasizes that priority for affordable units should be given to people who live and work in the community, teachers, local government and public safety employees.

As the City Council crafts a workforce housing program for this development, it could re-order its affordable housing eligibility criteria to be applied to this project to give first

priority to public employees who are defined by State law as disaster service workers. This option addresses concerns about providing affordable housing opportunities to eligible City staff and other public employees who would be needed in the community in the event of a disaster. This option would comply with City's Housing Element requirements and create new affordable inventory for the City.

Under this proposal the eligibility list for the 14 affordable units could be reordered as follows:

1. Employees of the City of Foster City;
2. Classroom teachers who are employees of the San Mateo-Foster City School District, the San Mateo Union High School District or the San Mateo Community College District;
3. Persons who live and work in Foster City;
4. Persons who live in Foster City;
5. Persons who work in Foster City; and
6. All others who are income qualified.

The application process could be handled in the same manner as the other affordable housing offerings in the City with a lottery to establish the initial waiting list. The process would include:

- Advertising the availability of applications for an affordable housing lottery, including the due date to submit an application;
- Assigning lottery applicants to the appropriate preference category;
- Conducting the lottery in order by preference categories, to establish the initial waiting list;
- As units become available, conducting detailed income screening/qualification of applicants in order by preference category and lottery number;
- Opening the waiting list to new applicants who would be assigned to the appropriate preference category and added to the waiting list by preference category and application date; and
- Utilizing the waiting list to fill vacancies, in order by preference category.

Designation of Units As Very Low, Low, and Moderate Units

The City would have flexibility in designating the proportion of very low-, low- and moderate-income units within the project. Because the 20% requirement would be met by designating 14 of the 22 units as affordable, the remaining 8 units could be identified for recruitment and retention purposes regardless of income qualification. The chart below shows the Regional Housing Needs Allocation (RHNA) requirements for Foster City and City's compliance status to date.

| Units Approved | Very Low | Low | Moderate | Above-moderate | TOTAL |
|-----------------------------------------------|-----------|-----------|-----------|----------------|--------------|
| <i>Triton Pointe (Pilgrim Triton Phase D)</i> | 10 | 18 | 5 | 133 | 166 |
| <i>Waverly (Pilgrim Triton Phase B)</i> | 8 | 31 | 9 | 192 | 240 |
| <i>Pilgrim Triton Phase C*</i> | 2 | 2 | 1 | 12 | 17 |
| Foster Square | 66 | 0 | 0 | 331 | 397 |
| Second Units (Projected) | 4 | 1 | 1 | 0 | 6 |
| TOTAL | 90 | 52 | 16 | 668 | 826 |
| RHNA | 148 | 87 | 76 | 119 | 430 |
| Percent of Need Met | 61% | 60% | 21% | 561% | 192% |
| Remaining Units Needed (Surplus) | 58 | 35 | 60 | (549) | (396) |

As noted above, 8 of the proposed 22 units could be used for recruitment and retention purposes without income qualification. If the City Council wished to use these units for recruitment and retention purposes to ensure that first responders such as police, fire, and EMT's would be readily available to respond to local disasters, the eligibility list could be as follows:

1. First Responders (more narrowly defined than disaster service workers);
2. All other employees of the City of Foster City;
3. Classroom teachers who are employees of the San Mateo-Foster City School District, the San Mateo Union High School District or the San Mateo Community College District;
4. Persons who live and work in Foster City;
5. Persons who live in Foster City;
6. Persons who work in Foster City; and
7. All others who are income qualified.

FINANCING OPTIONS

Based on the proposal outlined in the Term Sheet, City staff has estimated that the cost to the construct 22 Workforce Units is approximately \$11,000,000. It provides that Developer would construct both the Workforce Units and, in conjunction, the market rate townhome projects. Upon completion, Developer would convey the building and

land containing the Workforce Units to City. Under the approved Term Sheet, Developer would provide the land at no cost to the City and contribute an additional \$3,000,000 toward construction. This leaves an estimated \$8,000,000 that would need to be financed when the project is completed.

As noted in the Background section of this report, an alternate approach has been identified and is currently being analyzed by City staff. The alternate approach would call for the Developer to design and build both the market rate and Workforce Units as one project, controlled and financed by the Developer. The Developer would be required to record an affordability covenant that would restrict occupancy of 14 of the Workforce Units to a mix of low, very-low, and moderate occupants and the remaining 8 units to above moderate occupants. Developer would grant City the option to purchase the Workforce Units and land upon completion. If the City opted not to exercise its option to purchase, then Developer would be obligated to sell the Workforce Units and land to a qualified affordable housing operator who would take title subject to the City's affordable housing covenant and be obligated to rent the units to income eligible occupants as established by the City's priority list.

This approach would generally simplify the construction process and result in cost savings because the Developer would be building both the market rate units and Workforce Units as one project. While the City would, through the planning entitlement process, have control over design aspects of the Workforce Units, the Developer would be accepting all risks associated with the construction schedule, and costs of the entire project. Once complete, the City would have the option to purchase the Workforce Units and land for a fixed price. This option price would be established by determining the below market rate for these units if they were to be sold instead of rented.

Using this approach, and based on 2018 Income Limits, the estimated option price would be approximately \$6.5-\$6.7 million. This price could vary to some degree based on the Income Limits at the time the project is complete.

Based on the \$6.7 million sales price discussed earlier in this report, several financing options would be available:

1. The City has a Capital Asset Acquisition and Replacement Fund (Fund) that is projected to have \$38 million available at the end of the current fiscal year. The borrowing of \$6.7 million from the Fund would commit these monies for up to 30 years. At an estimated borrowing rate of 3.50%, total debt service would be \$10.83 million which would be retained by the Fund as repayment of the principal and interest collected.
2. Based on the preliminary proforma of the Project, net operating income (before debt service) in year one is estimated to be \$531,173. Over a 30-year period,

total net operating income (based on annual rent increases of 2% and annual expense increase of 3%) is estimated to be \$20.19 million. The City may seek mortgage-like financing from a federal agency (FHA or Freddie Mac) through a commercial bank for this project using the property as collateral and net operating income as the source of mortgage repayment. Depending on interest rates at the time of financing, the project would need to generate sufficient net cash flow (net operating income less debt service) to meet debt service coverage requirements for a FHA loan. Based on a projected year one net income of \$531,173, the City would need a 30-year mortgage with an interest rate at or below 4.875% (assuming a mortgage insurance rate of 0.35%) to meet the FHA required annual coverage ratio of 1.18. There would also be an upfront cost for the FHA loan of approximately \$200,000 to \$220,000. The FHA product requires the developer to be original borrower and use it as part of their construction proceeds. Upon completion of the project and the transfer of title to the City, the loan would also transfer over to the City. Staff also received a preliminary indication from Freddie Mac requiring a higher coverage ratio of 1.25 which would be less favorable compared to the FHA loan product.

3. A third alternative option would be the consideration of issuing revenue bond. This option would necessitate issuance costs of approximately \$150,000 to \$250,000. City staff would also need to consult with legal counsel and bond counsel on regulatory considerations and statutory authority to issue and structure such bonds.

Below is a proforma with a comparison of interest rate scenarios using a \$6.7 million option price:

| | FHA Mortgage | FHA Mortgage | FHA Mortgage* | Loan from Capital Asset Fund |
|--------------------------------------------------------------|--------------|--------------|---------------|------------------------------|
| Principal | \$6,700,000 | \$6,700,000 | \$6,700,000 | \$6,700,000 |
| Loan Term (Years) | 30 | 30 | 30 | 30 |
| Loan Term (months) | 360 | 360 | 360 | 360 |
| Estimated Commercial Loan Rate | 4.875% | 5.000% | 5.125% | |
| Estimated General Fund Loan Rate | | | | 3.50% |
| Monthly Debt Service | \$35,457 | \$35,967 | \$36,481 | \$30,086 |
| Mortgage Insurance (PMI) @ 0.35% | \$23,450 | \$23,450 | \$23,450 | N/A |
| Total Debt Service | \$ 448,933 | \$ 455,055 | \$ 461,218 | \$ 361,032 |
| Estimated Net Operating Income in Year 1 before debt service | \$ 531,173 | \$ 531,173 | \$ 531,173 | \$ 531,173 |
| Debt Coverage Ratio (minimum 1.18x for FHA) | 1.183 | 1.167 | 1.152 | N/A |
| Net Operating Income over 30 years per proforma | 20,195,506 | 20,195,506 | 20,195,506 | 20,195,506 |
| Total Debt Service over 30 year period | 13,468,002 | 13,651,838 | 13,836,526 | 10,830,958 |
| Net Cash Flow after Debt Service over 30 year period | 6,727,504 | 6,543,668 | 6,358,980 | 9,364,548 |

* With interest rate at 5.0%, the City would have a debt coverage of 1.167 and fail the minimum requirement of 1.18.

Management

The existing affordable units owned by the City are managed by HIP Housing with oversight provided by CDD and Finance. HIP Housing screens tenants and deals with routine maintenance issues. They have their own maintenance staff who take care of minor maintenance issues and/or evaluates the problem to determine if outside services are needed. They answer the typical questions and complaints that occur in an apartment complex.

Monthly rent payments are submitted directly to the Finance Department. The Community Development Department (CDD) works with HIP Housing to address questions about the program and approve maintenance for the units and processes the HIP Housing invoices for payment by the Finance Department. City staff recommends that this project be managed similarly. In addition to HIP Housing, there are other groups such as HELLO Housing and MidPen that City could potentially engage to take on management of the units. Based on discussions with HIP Housing, annual costs of managing the BMR and Workforce Units are anticipated to be between \$15,000 and \$20,000 for a 22 unit project. This does not include staff time for Finance and CDD personnel.

Also, there is a law that requires an onsite management representative for any building over 16 units. The responsible person, either the owner or its representative, must reside on the premises. This person would be available when the property management office is closed and serve as an onsite link to management. We could comply by having one of the residents serve in this capacity and compensating them with a reduction in rent. This cost is accounted for in the preliminary proforma.

CONCLUSION

As noted earlier, this report is provided in order to update the City Council on staff work to date and to obtain the City Council's initial thoughts on the alternative approach outlined in this report. Based on the City Council's direction, City staff will continue to draft documents needed in order to bring this project to the City Council for its consideration.

