City Council Staff Report

Subject: **Public Benefit Analysis and Study for the "Engine House" Below-Market Ground Lease at 1875 Homestake Road**
Author: **Erik Daenitz**
Department: **Economic Development and Data Analytics**
Date: **June 7, 2023**
Type of Item: **Legislative**

Summary

We recommend that City Council authorize Park City Municipal Corporation ("PCMC") to enter into a below-market ground lease to JF ENGINE HOUSE DEVELOPER, LLC ("JF ENGINE HOUSE", "Developer") to facilitate the Engine House affordable housing project located at 1875 Homestake Road ("City Property"). The Engine House project will deliver 123 total and 99 deed-restricted rental affordable housing units in Park City, furthering one of the City Council's top two critical community priorities as determined by the Council at its 2023 strategic planning retreat on March 2, 2023.

Under Utah law,[1] a formal analysis of the benefits received by PCMC in exchange for the benefit provided to Developer is required. Based on this analysis, a below-market ground lease for the City Property is an appropriate use of City resources.

Legal Framework

Municipalities may appropriate funds and resources for "corporate purposes only." Utah Code § 10-8-2(1)(a)(i). A corporate purpose is one that, "in the judgment of the municipal legislative body, provides for the safety, health, prosperity, moral well-being, peace, order, comfort, or convenience of the inhabitants of the city." Utah Code § 10-8-2(3).

Generally, the municipal legislative body establishes the criteria for a determination of corporate purpose. Utah Code § 10-8-2(3)(b)(i). But the value received is "measured on a project-by-project basis over the life of the project" and legislative body "may consider intangible benefits received by the municipality in determining net value received." Utah Code § 10-8-2(3)(a), (c). Notably, the determination of value received "shall be presumed valid unless it can be shown that the determination was arbitrary, capricious, or illegal." Utah Code § 10-8-2(3)(b)(ii).

Before the legislative body makes any decision to appropriate any funds or non-monetary assistance for a corporate purpose, the legislative body must hold a public hearing. If the entity receiving the benefit is a for-profit entity, then a study (Study") that demonstrates the purpose for the appropriation must be undertaken and posted for review by the public at least 14 days before the public hearing. Utah Code § 10-8-2(3)(e). The following factors are to be considered in the Study:

---

[1] Utah Code § 10-8-2.

(i) what identified benefit the municipality will receive in return for any money or resources appropriated;

(ii) the municipality's purpose for the appropriation, including an analysis of the way the appropriation will be used to enhance the safety, health, prosperity, moral well-being, peace, order, comfort, or convenience of the inhabitants of the municipality; and

(iii) whether the appropriation is necessary and appropriate to accomplish the reasonable goals and objectives of the municipality in the area of economic development, job creation, *affordable housing*, blight elimination, job preservation, the preservation of historic structures and property, and any other public purpose.

Utah Code § 10-8-2(3)(e)(i)-(iii) (emphasis added). This Study examines each of these factors below.

Background

Multiple factors contribute to the economic conditions associated with Park City's real estate market and the need for a range of affordable housing, with some drivers caused by national policy and others by local policy. Nevertheless, the conclusion is unavoidable. Today, Park City homes generally cannot be acquired by salaried or hourly wage earners and the scarcity of affordable housing is at crisis levels.

On the national front, the U.S. Federal Reserve ("Federal Reserve"), in response to the Great Financial Crisis ("GFC") of 2008, pursued historically unorthodox balance sheet policies. Starting in 2008, the Federal Reserve reached a local peak of purchasing more than $85 billion per month of U.S. Treasury debt and U.S. Agency mortgage debt in its efforts to recapitalize broker-dealers and banks of the United States. This asymmetric source of demand for debt from a single institution restarted a process of lowering U.S. Treasury and U.S. mortgage rates nationally.

As financing costs and home prices frequently move in opposing directions, lower funding costs drove home prices higher nationally. This effect acted as a subsidy to credit-worthy homebuyers from 2009 to 2019, after which the Federal Reserve began to momentarily taper its balance sheet purchases. Some of the aftershocks are very relevant in and around Park City today, such as the pre-covid housing median home price soaring despite record-breaking supply increases all along the Wasatch Back and Front.

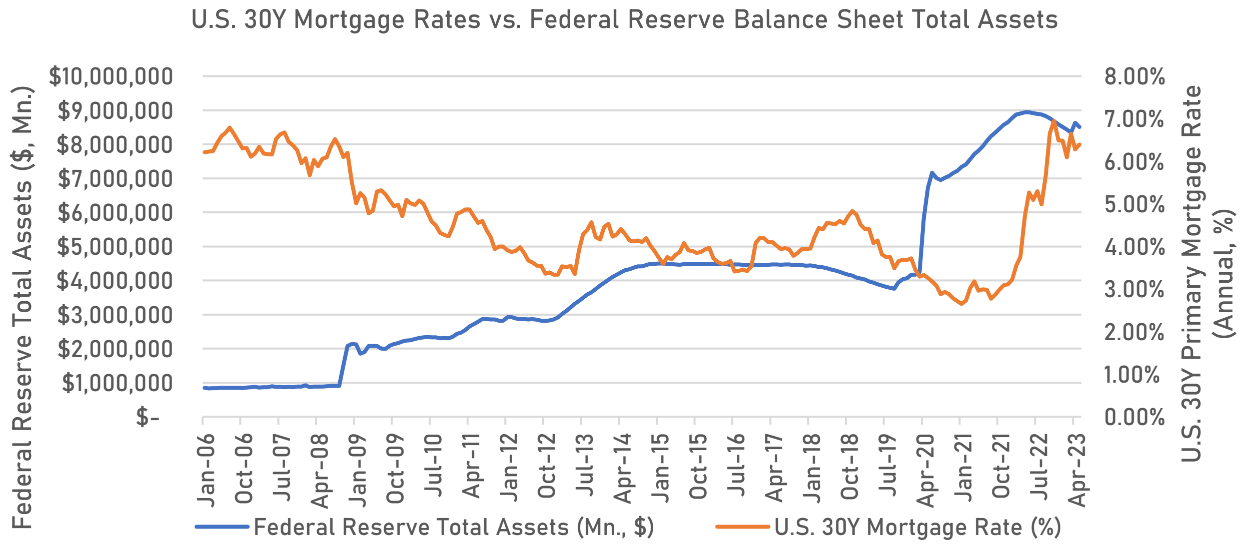

Figure 1, Source: St. Louis Federal Reserve, U.S. Federal Reserve Total Assets & U.S. 30Y Primary Mortgage Rate Average.

Next, still on the national front, tools developed in response to the GFC were again deployed, at an even larger scale, in response to the COVID crisis starting in 2020. Indeed, at the peak of the COVID crisis, the Federal Reserve purchased more than $100 billion per month of U.S. Treasury and U.S. Agency mortgage debt, while also bringing the overnight Federal Funds rate to the zero lower bound. This spike in additional asset purchases, a reduction in short and medium-duration funding costs, and a further drop in mortgage rates can be observed again in Figure 1 above, between the period March 2020 to October 2021.

However, counter to the post-GFC process, the response to COVID included direct payments to individuals, businesses, and governments exceeding $4 trillion combined between the $2.2 trillion Coronavirus Aid, Relief, and Economic Security Act (“CARES”) and the $1.9 trillion American Rescue Plan Act (“ARPA”). Both CARES and ARPA were not primarily funded with new tax receipts but through money supply expansion facilitated by the U.S. Treasury and U.S. Federal Reserve using tools pioneered in the GFC.

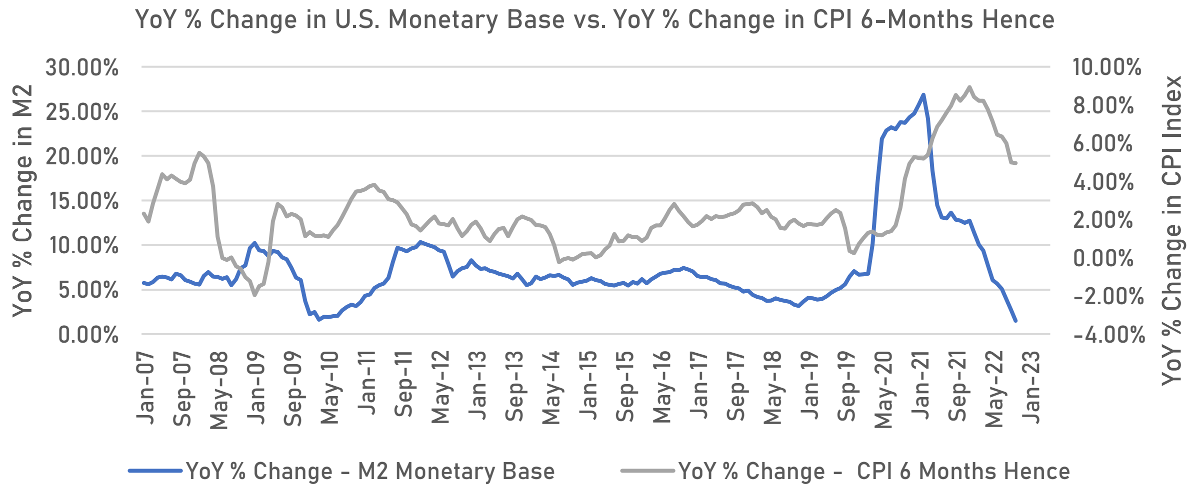

Figure 2, Source: St. Louis Federal Reserve, YoY % Change in U.S. M2 Money Supply vs. YoY % Change in U.S. CPI Index.

This strategy largely contributed to the well-known inflationary trends of 2021 through 2023, whereby goods, services, and many assets were repriced to higher levels. This trend touched both real estate purchase prices and rents across the United States, particularly so in places like Park City.

Over the period, national conditions interacted with local conditions to price Park City real estate at premium-sized multiples over the national average. Park City's limited remaining buildable geography, land use policies, low property tax policies, proximity to a major city, and easy access to outdoor and recreation opportunities led to a combination of limited new housing supply paired with extremely strong demand.

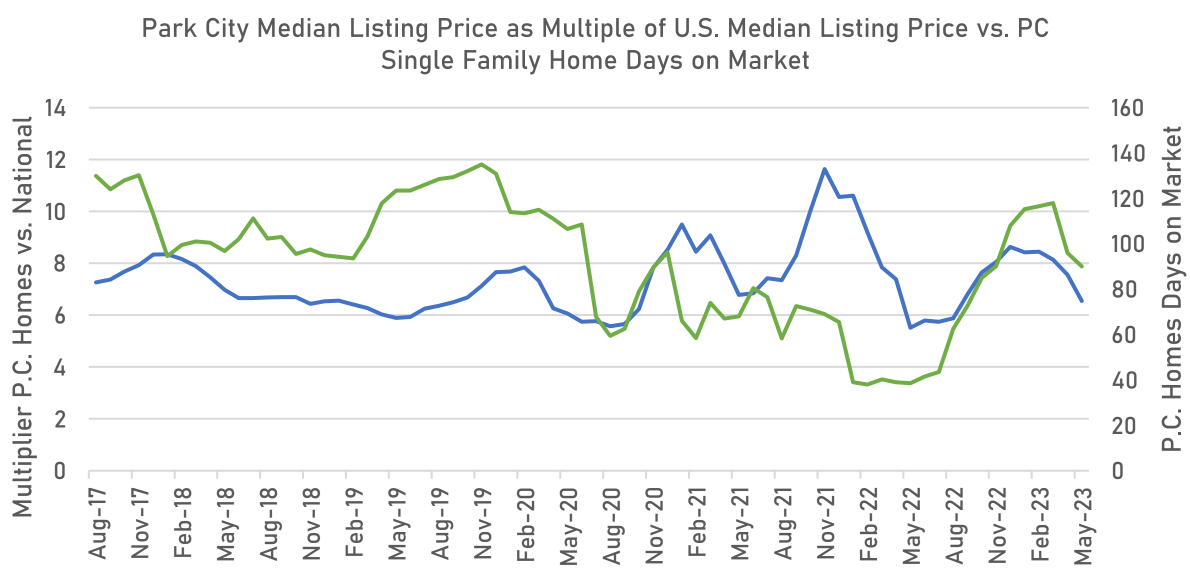

Figure 3, Source: Realtor.com, Park City Homes Median Listing Price as Multiple of National Listing Price vs. Park City Homes Days on Market.

As visible in Figure 3, Park City single-family homes have seen record-breaking demand over the period analyzed since 2017 as days-on-the-market for a single-family listing has been on a downward trend for multiple years. However, this trend accelerated during the COVID crisis as days-on-market hit a record low, under 40 days, while median home prices rose to 12 times the national median during the same period. Over the long-term, median Park City homes sell for approximately seven times the national median, despite growth in production of units up and down the Wasatch Back.

Through an additional lens, median listing price-per-square-foot provides a consistent metric to review residential real estate costs across home types. Since the COVID crisis and its aftermath, the inflationary jump in price-per-square-foot is visible in the Park City market. Today, median Park City residences trade for approximately $1,100 per square foot.

Figure 4, Source: Realtor.com, Park City Homes Median Listing Price per Square Foot.

Amid these trends, neither salaried nor hourly wage-earning workers have a reasonable chance at purchasing a Park City single-family home or even a condominium. As of the end of calendar quarter one, 2023, the Park City Board of Realtors cites the median sale price of a Park City single-family home at $3,913,380 and the median price of a Park City condominium at $1,600,000. While income growth for workers has been positive since the start of the COVID crisis, it has not kept pace with the two other primary drivers of housing affordability, interest rates, and prices.

The Housing Team maintains a mortgage qualification model for both 100% Area Median Income ("AMI") wage earners and 50% AMI wage earners, in both cases modeled as a family of four.

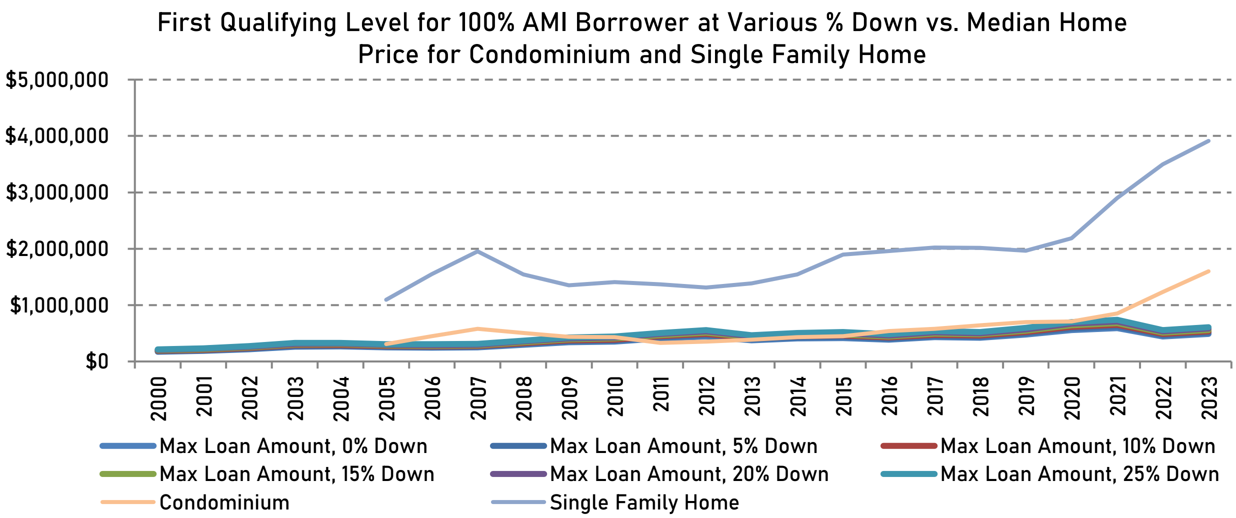

Figure 5, Source: PCMC, Mortgage Qualifying Amounts for a 100% AMI Family of Four, vs. Park City Median Single Family and Condominium Prices

As shown in Figure 5 above, a 100% AMI family of four borrower earns $148,600 annually, qualifying this borrower for approximately a $500,000-$600,000 mortgage. This qualifying level previously allowed a 100% AMI borrower to purchase a Park City condominium. However, this opportunity is now far out of reach, as Park City condominiums cost 2-3 times this price today. Additionally, since before 2007, a 100% AMI borrower has never been able to qualify to purchase a Park City single-family home.

In comparison to a 100% AMI borrower, the picture for a 50% AMI borrower is even more dire.

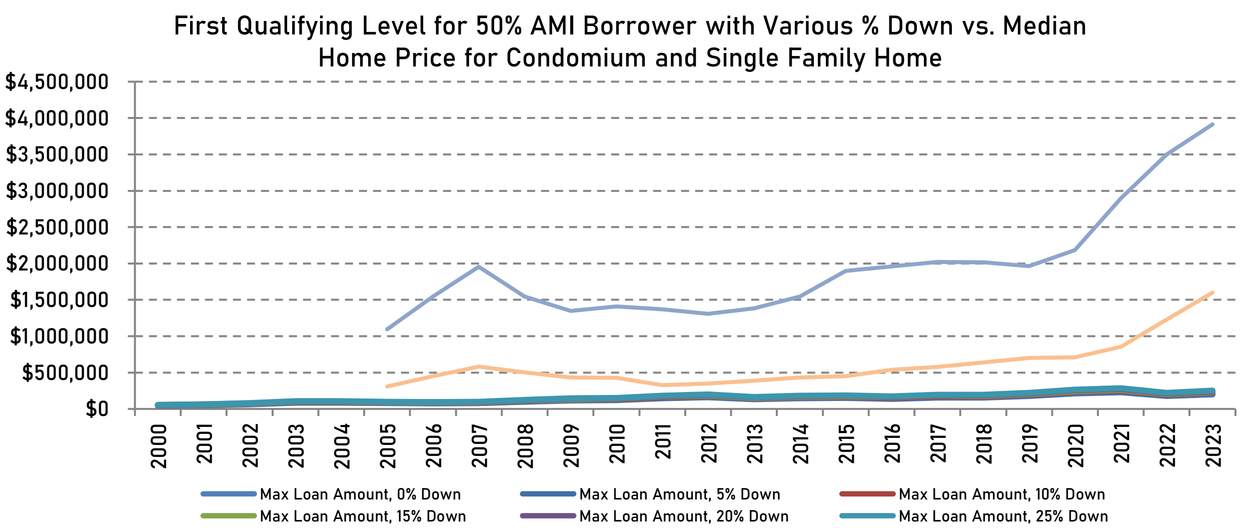

Figure 6, Source: PCMC, Mortgage Qualifying Amounts for a 50% AMI Family of Four vs. Park City Median Single Family and Condominium Prices

Figure 6 demonstrates that a 50% AMI borrower has never qualified for a mortgage large enough to purchase a Park City condominium or single-family home.

In light of these trends, PCMC recently commissioned an update to its housing needs assessment, which found the following key points:

- Park City has an inventory of 650 deed-restricted affordable housing units. However, this supply falls well short of demand. The 99% percent occupancy rate is one indisputable indication of the need for additional units.
- The need for additional affordable units is also shown by Park City residents' housing cost burdens. Forty percent of all renters and 22% of owners pay at least 30% of their income for housing and utilities. Most troubling is the share of renters paying more than 50% of their income for housing in Park City, defined as a severe housing cost burden. Thus, one in five Park City renters has a severe housing cost burden.
- Park City is also the only city in Utah where workers (11,000) outnumber the population (8,500). The workforce and local economy need more housing opportunities. Today, over 8,000 workers with an average wage of less than $40,000 commute daily from homes out of Summit County to jobs inside Park City. This large reservoir of pent-up demand all but guarantees rapid absorption of additional affordable housing units and, until then, has a host of ancillary impacts (more traffic and congestion, degradation in service levels, staffing shortages, etc.); and
- Demand for affordable housing could absorb as many 1,000 units over the next five years.

In light of the current housing need, after several years of operating as a successful developer (Snow Creek Cottages, The Retreat, and Woodside Park Phase 1 to create 40 new affordable housing units), the City Council strategically pivoted to Public-Private Partnerships (PPPs) as the preferred tool to deliver more affordable housing. For background, PPPs provide several of the following benefits:

- Efficient use of resources: The private sector brings expertise, innovation, and efficiency in project management, operations, and service delivery. By leveraging the strengths of both sectors, PPPs can enhance productivity and cost-effectiveness.
- Risk sharing: PPPs distribute risks between the public and private sectors.
- Access to private sector expertise: Private sector partners often have specialized knowledge, technical expertise, and experience in delivering complex projects or services.
- Innovation and quality improvement: The profit motive in the private sector can incentivize innovation and the delivery of high-quality services.
- Accelerated project delivery: PPPs can expedite the delivery of projects by leveraging private sector resources and efficiency.
- Long-term value for money: Private partners often bear responsibilities for maintaining and operating the infrastructure or service over an extended period, ensuring a focus on long-term performance and sustainability.

Although PPPs come with potential drawbacks and risks that need to be carefully managed, land, time, and materials are at all-time premiums and risk is inherent in any strategy we deploy. The Engine House project brings less risk, more expertise, and accelerated project delivery to help offset the housing crisis faster than otherwise possible with the City as the developer. Further, our internal teams have partnered with an outside firm with expertise in PPPs to help navigate the specific project context, objectives, and robust risk management mechanisms in the ground lease to ensure that public interests are safeguarded.

Accordingly, on December 9, 2021, the City Council approved (Staff Report, Minutes) an MOU with JF ENGINE HOUSE to outline Project goals and detail the responsibilities of each party. The MOU offered assurances to both parties, provided minimal financial commitments, and was intended to steer a "partnership" toward a final Development Agreement and long-term ground lease. The Development Agreement has been ratified by the Planning Commission and finalized.

Terms of the Ground Lease

The initial duration of the proposed ground lease is 65-years, with three automatic extensions, unless JF Engine House affirmatively opts out:

- Two 11-year extensions; and
- One 12-year extension.

The total term with all potential extensions would be 99 years. Based on feedback from the other communities we consulted and Ballard Sphar, this is a reasonable time period. The City of Boise, for example, recently entered into a ground lease with a private developer for 75 years.

Based upon our analysis, we recommend a 65-year term with three extensions, not to exceed 99 years.

Analysis

After careful consideration of the required legal factors, entering into a below-market lease for the City Property is a valid corporate purpose. The City Property is a good fit for the proposed use for several reasons, though some of the public comment received to date suggests a desire to forestall the project. We believe the urgent need for affordable housing, particularly housing for income earners below 100% AMI, outweighs these factors.

The Engine House development will help expand the stock of deed-restricted affordable housing in the core of Park City. Further, maintenance of the City Property will no longer be required as the Developer will operate and maintain the property. In addition, the development will provide a catalyst for the evolution of the Bonanza Park Area, and can be incorporated into the study area, just the same way any other existing property is incorporated.

Upon review, the many public benefits that the development of the City Property will bring to the City are as follows:

1. Affordable Housing Units

    a. The neighborhood will be provided with a new housing resource known as “Engine House” which will consist of 123 new rental housing units. 99 units will be affordable, deed-restricted units.

    b. Affordable units will be offered at 60% AMI, well below the current market-rate rental rate.

2. Market Rate Housing Units

    a. 24 units will consist of market-rate units.

    b. The integration of affordable and market-rate units creates a diverse and dynamic community in the core of Park City.

3. Publicly Accessible Open Courtyard Greenspace

    a. The Engine House will provide an approximately 20,000 square foot greenspace entryway that remains open to the public year-round. This amenity will provide an outdoor social gathering area for residents of Engine House and the neighborhood alike.

4. Promotion of Alternative Transportation

    a. Engine House provides 500 square feet of internal bicycle storage and e-bike charging facilities for residents, which will accommodate 50+ bicycles.

    b. Additionally, bicycle parking and storage is available external to the facility for residents, guests, and neighbors with space up to 15 bicycles

    c. The Engine House’s Condition of Approval also offers the potential for Summit County Bike Share to provide a location onsite if it so chooses.

5. Music and Child Play Rooms

    a. Engine House will provide interior rooms for music study and child play areas available for residents.

6. Electric Vehicle Charging Stations

    a. The development provides a minimum of two electric vehicle charging stations with accommodation of future growth to 20 charging stations.

7. Rideshare Integration

    a. The Engine House site plan provides two dedicated surface parking spaces for rideshare services.

8. Accommodation for Future Roadway Infrastructure

    a. The development's site plan also accommodates future infrastructure investment in Munchkin Road, which will significantly increase connectivity in the Bonanza Park area.

    b. The site plan also provides for the accommodation of increased pedestrian connectivity on Homestake Road.

The Engine House creates a fundamental investment in affordable housing in the core of Park City, allowing residents to live in an area with direct access to Park City's transit and trails, shopping and dining, public transit, schools, and more.

Conclusion

The development of the Engine House affordable housing project will provide opportunities for housing units at 60% of AMI, constructed using a sustainability EUI rating of 28, using a below-market ground lease that is an appropriate use of City resources. The costs to the City of providing below-market lease terms are thus justified by the tangible and intangible benefits to the City.

Department Review

This report has been reviewed by Economic Development and Data Analytics, Housing, City Attorney's Office, and City Manager.