Comments on the Upper Hearst (GSPP) development

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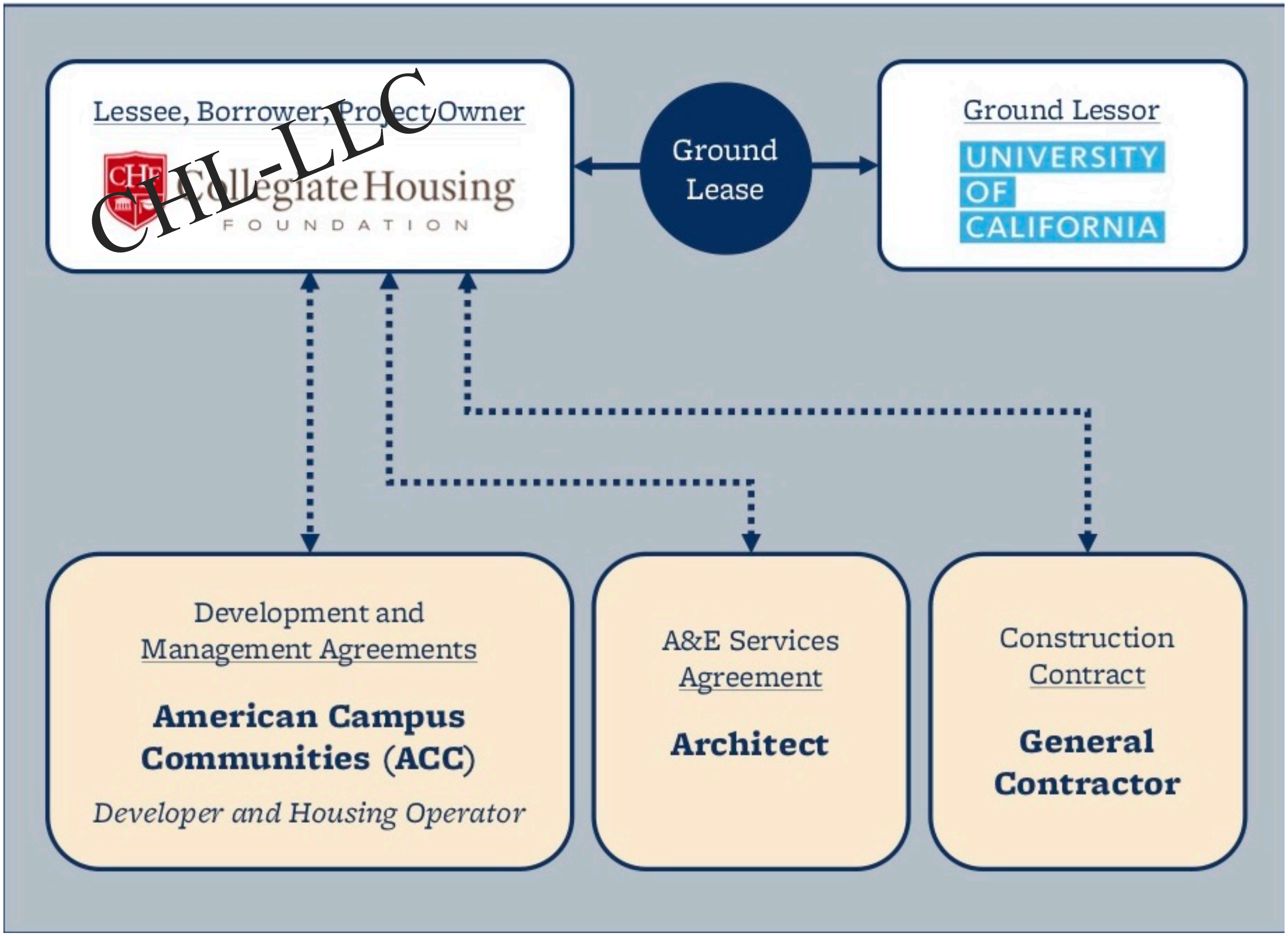
Caveat

- We had seen no financial details on this project until 8:00am Thursday, April 25
- A series of questions was submitted to the campus late Friday afternoon, April 26
- Answers were received mid morning April 30
- This summary was prepared the afternoon of April 30

Executive Summary

- Debt structure in deal exposes us to higher interest rates and in reality does not shield us from balance sheet risk. Risk is assigned to an LLC (holding only the property as an asset) – campus is fully at risk.
- Campus receives payments only after all other stakeholders are compensated.
- Assumptions about rent and occupancy are weakly supported at best.
- Under best assumptions:
  - Rent subsidies consume 100% of residual payments to campus
  - Replacing lost parking spaces consumes another 100%.
    - Observe, this is parking we already own and will have to repurchase
- Market study is unconvincing (only 4 faculty in focus group); sampling methodology is statistically suspect.

Schematic for the Upper Hearst Financing Structure: Note LLC



Financing

- The borrower of the $116M debt is a limited liability affiliate of Collegiate Housing Foundation (CHF), who in name only assume the risk. Note the University pays an annual fee to CHF.
- Debt rating on deal (BBB-) is much lower than UC's (AAA), costing about **$250,000/yr in extra interest**, plus fees to CHF.
- Note, the university **still bears the risk; CHF LLC does not have its own capital assets beyond the structure to back the deal. In the words of Will Givhan, President and CEO of CHF:**
  - "People that buy the bonds that are issued for our projects, and we ourselves, know that if a project gets in trouble the belief is that **the university is gonna step up to make sure that the project is successful however they gotta to do it: whether they gotta master lease some beds, take the facility back in their own ownership portfolio…**"

    http://studenthousingmatters.com/the-benefits-of-nonprofit-ownership-of-student-housing-with-will-givhan/
    - » See time stamp 8.54 and 10.30

Priority of payments to campus

- Usually, in a real estate deal, rent payments to land owner have **top** priority, ahead of payments to management companies, maintenance, etc.
- For this deal, payments to the land owner (UCB) have the **lowest** priority of all project cash flows. Here the priority is CHF, then ACC, then UCB.
  - Campus receives **nothing** unless money is left over.
  - This goes to zero (or below) if:
    - Vacancy rates are higher than forecasts, or
    - Rent subsidies exceed 15% of total rent, or
    - Building expenses are higher than (very low) forecasts.
  - Parking mitigation is likely to consume the remainder.

Rent assumptions

- Assumed **occupancy rate 95%** starting the first year of operation, July 2021- June 2022.
  - This is high by industry standards.
- Assumes **rent grows at 3% per year**
  - Also high given intended renters.
  - Rents are already high in relation to rents preferentially paid by current new faculty.[1]
- If the assumptions do not hold true, then bonds are at **risk of downgrades**.

[1]See "Faculty Housing Strategy Working Group Final Report," Feb. 25, 2019

Rental subsidies (are not included in project financials)

- 35% is the established rule of thumb for housing costs as percent of gross income.
- Average income of new assistant professors at UC Berkeley is **$116,000,** so maximum supportable rent is **$3,383**.[1]
    - » **Studio subsidy, none.**
    - » **One-bedroom subsidy, $3,320 per year: potential cost to UCB, $268,920 per year.**
    - » **Two-bedroom subsidy, $14,120 per year, potential cost to UCB, $762,480 per year.**
- Total subsidy **($1.2M)** could exceed 100% of payment to campus from the project. Campus's own projection is actually higher.

[1]See "Faculty Housing Strategy Working Group Final Report," Feb. 25, 2019; note salaries are substantially lower in many decanal units

Parking mitigation (is not in the project financials)

- Construction requires moving 250 - 350 parking slots.
- The University already owns these slots but it appears also to be paying to mitigate their loss (as opposed to the for-profit operator)
  - Back of the envelope loss estimate: 300 x $50,000 = $15,000,000
  - This amount consumes **almost 100%** of the projected residual payment to the university but is not reflected in the project budget
- In-lieu payments are not computed on a supportable basis and not fully planned.

MGT market study, 9/2018

- Eligible renters include faculty, graduate students, post docs, and staff, but study does not include coupled salary and population breakdowns.
  - Only **4** individuals included in the “faculty focus group.”
  - Projections for “faculty” interest are made on a current UC Berkeley “faculty” count of **3,885** (thus includes non-ladder faculty)
- Surveyed population show only ~1-2% interest in rental units in the project.
  - Extrapolation to the campus population requires the validation of the tail estimation problem, which has not been conducted.
- Campus did not answer any questions about the MGT study.
  - For one related question, they provided an answer from ACC, which said ‘trust us’.