



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Leslye Corsiglia
Julia H. Cooper

SUBJECT: SEE BELOW

DATE: February 4, 2013

Approved

Date

2/12/13

COUNCIL DISTRICT: 3

SUBJECT: APPROVAL OF THE ISSUANCE OF A TAX-EXEMPT MULTIFAMILY HOUSING REVENUE NOTE, LOAN OF NOTE PROCEEDS, AND RELATED DOCUMENTS FOR THE THIRD STREET RESIDENTIAL DEVELOPMENT

RECOMMENDATION

Adopt a resolution:

- a. Authorizing the issuance of a tax-exempt multifamily housing revenue note designated as “City of San José Multifamily Housing Revenue Note (Third Street Residential Development), Series 2013A” in an aggregate principal amount not to exceed \$7,000,000 (the “Series 2013A Note”);
- b. Approving a loan of Series 2013A Note proceeds to San José Third Street Associates, L.P., a California limited partnership to finance the construction of the Third Street Residential Development located at 1010 South Third Street in San José;
- c. Approving in substantially final form the Borrower Loan Agreement, Funding Loan Agreement, Assignment of Deed of Trust, and Regulatory Agreement and Declaration of Restrictive Covenants (collectively, the “Series 2013A Documents”); and
- d. Authorizing and directing the City Manager, Director of Finance, Acting Assistant Director of Finance, Acting Treasury Division Manager, Debt Administrator, and Director of Housing, or their designees, to execute and deliver the Series 2013A Documents and other related Series 2013A Note documents as necessary.

OUTCOME

Approval of the recommended actions will enable the issuance of the Series 2013A Note for the purpose of constructing a 37-unit rental apartment project, composed of 36 units that will be affordable for a period of at least 55 years and one manager's unit that will be unrestricted. This project will serve low-, very low-, and extremely low-income residents with current annual incomes between \$25,200 per household for one-bedroom units at 30% of area median income ("AMI") and \$63,000 per household for three-bedroom units at 60% of AMI.

EXECUTIVE SUMMARY

In accordance with the requirements under the City's Policy for Issuance of Multifamily Housing Revenue Bonds (the "City's Policy"), Pacific West Communities, Inc. (the "Developer") has requested that the City issue the Series 2013A Note as a non-rated, non-credit-enhanced tax-exempt multifamily housing revenue note to be privately placed with California Bank & Trust, as the initial purchaser. The proceeds of the Series 2013A Note will be loaned to San José Third Street Associates, L.P., a California limited partnership (the "Borrower"), in an amount not to exceed \$7,000,000. These proceeds, together with other funds, will be used by the Borrower to finance the construction of 37-unit rental apartment housing project to be known as Third Street Residential Development (the "Project"). The Project will consist of 36 units that will be affordable for at least 55 years and one (1) manager's unit that will be unrestricted. The affordable units are comprised of 13 one-bedroom units, 11 two-bedroom units, and 13 three-bedroom units serving residents with incomes between \$25,200 and \$63,000.

BACKGROUND

Borrower. The Borrower, San José Third Street Associates, L.P., is a California limited partnership consisting of: (1) Foundation for Affordable Housing V, or an affiliate, a California non-profit affordable housing developer ("FFAH"), as the Managing General Partner; (2) TPC Holdings IV, LLC, a California limited liability corporation formed by the Developer, as Administrative General Partner and (3) Wells Fargo Bank or an affiliate thereof, as the tax credit investor limited partner.

The Borrower has requested that the City issue the Series 2013A Note for the purpose of lending the Series 2013A Note proceeds to the Borrower. The proceeds of the Series 2013A Note, together with other funds, will be used by the Borrower to finance the construction of the Project.

Project Overview. The Project involves the construction of 37 one-bedroom, two-bedroom and three-bedroom apartment units. Upon completion of the Project, 11 percent of the units (4 units) will be initially rented to individuals and families with incomes that do not exceed 30% of AMI; 36 percent of the units (13 units) will be rented to individuals and families with incomes that do not exceed 50% of AMI; and 53 percent of the units (19 units) will be rented to families with incomes that do not exceed 60% of AMI. One of the Project's 37 units will be an unrestricted

manager's unit. The rental restrictions for the Project will remain in place for a period of 55 years.

No City Loan for the Project. The City is not providing a separate loan of City funds for this Project.

City as Issuer of Multifamily Housing Bonds. The City's Policy encourages developers of multifamily housing projects in the City to utilize the City as the bond issuer if a project is using tax-exempt multifamily revenues bonds as a source of financing.

Sources of Project Funding. The Series 2013A Note will be structured as a fixed rate obligation in the principal amount of approximately \$6,630,000 during construction and approximately \$3,775,000 following construction and lease-up ("at permanent"). Series 2013A Note proceeds will fund a portion of the total Project costs, which are currently estimated to be \$12,283,353. The estimated sources of funding for the Project's construction phase and permanent phase are as follows:

| City of San José | | |
|---|---------------------|------------------|
| Third Street Residential Development | | |
| Plan of Finance – Sources of Funding¹ | | |
| Source | Construction | Permanent |
| Note Proceeds..... | \$ 6,630,000 | \$ 3,775,000 |
| Seller Carry Back | 1,000,000 | 1,000,000 |
| State of California IIG Funds (Infill Grant)..... | 1,648,800 | 1,648,800 |
| Cal Re-use Funds..... | 546,500 | 546,500 |
| Tax Credit Equity | 825,474 | 4,268,321 |
| Deferred Fees and Costs..... | <u>1,632,579</u> | <u>1,044,732</u> |
| Total | \$ 12,283,353 | \$ 12,283,353 |

Financing History of Project

Borrower. San José Third Street Associates, L.P. is the second borrower for the Project. The original borrower for the Project was Third Street Residential Development, L.P., a California limited partnership (the "Original Borrower") consisting of (1) FFAH, (2) an entity formed by Global Premier Development, Inc. ("Global") and (3) a to-be-determined tax credit limited partner. On June 1, 2012, a new borrower was created involving FFAH and an entity formed by the Developer to assume the interest of Global and the Original Borrower in developing the Project.

¹ Estimated as of the date of this report. The actual amounts may vary from these estimates.

TEFRA. On July 25, 2011, the City's Assistant Director of Finance, pursuant to Municipal Code Section 5.06.430, held a TEFRA Hearing to receive public comment regarding the issuance of bonds by the City for the Project on behalf of the Original Borrower. On November 26, 2012, the Acting Director of Finance held a second TEFRA hearing regarding the issuance of tax-exempt multifamily housing bonds in an amount not to exceed \$7,000,000 to finance the construction of the Project by the Borrower.

Planned Development Permit. The original Planned Development Permit (File No. PD07-003) for the Project was issued on February 29, 2008 and lapsed on February 28, 2012. The Planning Director held a hearing on January 23, 2013, following proper notice, for the issuance of a new Planned Development Permit (File No. PD12-050) (the "PD Permit") for the Project. At the hearing staff recommended approval of the PD Permit and no one spoke in opposition of the recommendation. The PD Permit was issued on January 25, 2013 and no appeals regarding the Planning Director's actions, or conditions of, the permit were filed within the 10-day appeal period ended at 5:00 p.m. on February 4, 2013.

CDLAC. On July 29, 2011, the Director of Housing, on behalf of the Original Borrower, submitted an application to CDLAC for an allocation of up to \$7,298,412 in private activity bonds for the Project, pursuant to the Joint Authority of the Directors of Housing and Finance under San José Municipal Code Section 5.06.425. On September 28, 2011, the City received a private activity bond allocation of \$7,298,412 from CDLAC as requested (the "Original Allocation"). On December 14, 2011, at the request of the City and Global, CDLAC transferred the Original Allocation to a "carry forward" allocation, thereby enabling its use by the City for a three-year period.

On November 5, 2012, at the direction of CDLAC, the City returned the Original Allocation to CDLAC and submitted new CDLAC application materials reflecting the new Borrower. The initial plan was for CDLAC to award the new allocation at its meeting on December 12, 2012. Because the PD Permit for the Project would not be final by December 12, 2012, however, consideration of the new private activity bond allocation was deferred to CDLAC's hearing on March 13, 2013, when the City expects to receive a new private activity bond allocation.

ANALYSIS

This portion of the report is divided into several sections to address the items in staff's recommendation to proceed with the financing for the Project. These sections describe the financing structure, financing documents, financing team participants and financing schedule.

Overview of the Multifamily Note Financing

General Multifamily housing financing typically involves the issuance of bonds on behalf of private developers of qualifying affordable rental apartment projects. The bonds are issued by the City with the proceeds loaned to the developer/borrower. The bonds are typically issued as tax-exempt obligations. The advantages of tax-exempt financing to developers include: below-

market interest rates and qualification for low-income housing tax credits – features not available with a conventional multifamily housing mortgage loan. The bonds are limited obligations of the City, payable solely from loan repayments by the borrower.

The Series 2013A Note operates in a very similar manner to multifamily housing bonds. The Series 2013A Note is issued pursuant to the same provisions of state law (California Health and Safety Code Section 52075 -52098) and uses a portion of the State's federal tax-exempt private activity cap allocated by CDLAC. The Series 2013A Note also allows the Project to qualify for Low Income Housing Tax Credits provided through the California Tax Credit Allocation Commission (TCAC). The Series 2013A Note is a limited obligation of the City, payable solely from loan repayments by the Borrower. This note structure has been used in prior City tax-exempt multifamily housing financings.

Requirements for Tax-Exemption. For a multifamily housing revenue note or bond to qualify for tax-exemption, federal law generally requires that one of two restrictions must apply: either (1) at least 20% of the units in the housing development must be reserved for occupancy by individuals and families whose income is up to 50% of AMI or (2) at least 40% of the units must be reserved for occupancy by individuals and families whose income is up to 60% of AMI. This second restriction (at least 40% of units at 60% of AMI) will be incorporated into the Regulatory Agreements for the Series 2013A Note.

Structure of the Series 2013A Note

Private Placement Structure. The Series 2013A Note will be structured as a non-rated and non-credit enhanced obligation that is privately placed with California Bank & Trust ("CB&T" or "Private Placement Purchaser"), the initial private placement purchaser. Pursuant to the City's policies regarding non-credit enhanced notes, the Private Placement Purchaser will sign an Investor Letter acknowledging that it is a "qualified institutional buyer" or an "accredited investor", that is, a large institutional investor who understands and accepts the risks associated with an unrated note secured solely by the project rents. If the Private Placement Purchaser wishes to transfer the Series 2013A Note, the new Series 2013A Note holder must sign and deliver a similar Investor Letter to Wells Fargo Bank, National Association, as the fiscal agent (the "Fiscal Agent"). Minimum denominations of each Series 2013A Note will be \$250,000.

Principal Amount and Terms. The Series 2013A Note is anticipated to be issued in the amount of \$6,630,000 but in no event to exceed \$7,000,000. After the Project is completed and leased up, and conversion to the permanent loan phase occurs (the "Conversion Date"), the principal balance of the Series 2013A Note is expected to be paid down with tax credit equity funds to approximately \$3,775,000.

After the Conversion Date, estimated to be 18 months after the issuance of the Series 2013A Note, and subject to a one six-month extension, the Series 2013A Note will convert to a fixed-rate tax-exempt note with a maturity of approximately 18 years, amortized on a 30 year basis.

The remaining balance will be due at maturity and likely will be repaid either from a refinancing or another funding source to be identified by the Borrower at that time.

Interest Rates. The Series 2013A Note will pay interest at the rate set before the Series 2013A Note closing based on a formula equal to the 10-Year Treasury Bond rate plus 2.93%. In the current market, the rate would be approximately 4.75%.

Financing Documents

The following is a brief description of each document the City Council is being asked to approve and authorize its execution. Copies of these documents will be available in the City Clerk's Office on or about February 14, 2013.

Funding Loan Agreement. The Series 2013A Note will be issued under a Funding Loan Agreement (the "Agreement") between the City, CB&T, as funding lender, and Wells Fargo Bank, National Association, as the fiscal agent. The Agreement will be executed by the Director of Finance, Acting Assistant Director of Finance, or other authorized officers on behalf of the City, and attested by the City Clerk. Pursuant to the Agreement, the Fiscal Agent is authorized to receive, hold, invest, and disburse Series 2013A Note proceeds and other funds established under the Agreement; to authenticate the Series 2013A Note; to apply and disburse payments to the Series 2013A Noteholder(s); and to pursue remedies on behalf of the Series 2013A Noteholder(s). The Agreement sets forth the guidelines for the administration, investment and treatment of investment earnings generated by each fund and account, and restrictions relating to any subsequent transfer of the Series 2013A Note. The Borrower Loan Agreement (described below) obligates the Borrower to compensate the Fiscal Agent for services rendered under the Agreement.

Borrower Loan Agreement. This document (the "Loan Agreement") will be entered into by the City and the Borrower. The Loan Agreement will be executed by the Director of Finance, Acting Assistant Director of Finance or other authorized officer on behalf of the City. The Loan Agreement provides for the loan of Series 2013A Note proceeds to the Borrower for construction and permanent financing of the Project, and for the repayment of such loan by the Borrower. The loan is evidenced by a note (the "Loan Note") in an amount that corresponds to the principal amount of the Series 2013A Note. The City's rights to receive payments under the Loan Note will be assigned to the Fiscal Agent, along with certain other rights under the Agreement, the Loan Agreement and the Series 2013A Note; however, certain reserved rights have been retained by the City, such as the City's right to indemnification.

Regulatory Agreement and Declaration of Restrictive Covenants. Additionally, there is an agreement (the "Regulatory Agreement") among the City, the Fiscal Agent, and the Borrower that contains certain covenants and restrictions regarding the Project and its operations intended to assure compliance with the Internal Revenue Code of 1986. The Regulatory Agreement is executed by the Director of Finance, Acting Assistant Director of Finance, Director of Housing, or other authorized officers on behalf of the City. The Regulatory Agreement restricts the rental

of Project units (except for the one manager's unit) to low-income residents for a period of at least 55 years as previously described.

Assignment of Deed of Trust. The Borrower's loan repayment obligations to the City will be secured by a Deed of Trust, of which the City is the beneficiary. The sole source of funds for the City's repayment of the Series 2013A Note will be payments from the Borrower with respect to such loan from the City. Therefore, at closing the City will assign (without recourse) its rights as beneficiary under the Deed of Trust, thereby permitting the holder(s) of the Series 2013A Note to pursue the remedies set forth in the Deed of Trust against the Borrower directly.

CDLAC Approval

The City expects a private bond allocation from CDLAC for the Series 2013A Note on March 13, 2013. While this approval occurs after the City Council meeting date, Staff has a high degree of confidence that CDLAC will award the private activity bond allocation for two reasons. First, CDLAC, for technical reasons, requested the City to return the Original Allocation in exchange for a new allocation. Second, on or about February 15, 2013, CDLAC will have posted the preliminary staff recommendation to award a new allocation for the Project. Under no circumstances will the City close the Series 2013A Note until such new CDLAC allocation is awarded.

Financing Team Participants

The financing team participants for the Series 2013A Note consists of:

- City's Financial Advisor: Ross Financial
- Bond Counsel: Hawkins, Delafield & Wood, LLP
- Fiscal Agent: Wells Fargo Bank, National Association
- Private Placement Purchaser: California Bank & Trust

All costs associated with the financial advisor, bond counsel and fiscal agent are contingent upon the sale of the Series 2013A Note and will be paid by the Borrower from a source other than from Series 2013A Note proceeds.

Financing Schedule

The current proposed schedule is as follows:

- Council Approval February 26, 2013
- Pre-Close Series 2013A Note March 11, 2013
- CDLAC Approval March 13, 2013
- Close Series 2013A Note March 15, 2013
- CDLAC Deadline for Series 2013A Note Closing June 11, 2013

EVALUATION AND FOLLOW-UP

This Memorandum presents the set of recommendations related to the City Council's approval of the issuance of the Series 2013A Note for the Project and requires no follow-up to the City Council. Once the Series 2013A Note closes, anticipated on March 15, 2013, and the construction of the Project commences, the Housing Department will provide updates in its Quarterly Construction Reports to the City Council.

PUBLIC OUTREACH/INTEREST

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings and Notice in appropriate newspapers)**

This action does not meet any of the above Criteria. The method of notifying the community of the City's intent to issue a tax-exempt private activity note is the Tax Equity and Fiscal Responsibility Act (TEFRA) Hearing. TEFRA Hearings were held on July 25, 2011 and November 26, 2012, by the Director of Finance. The public hearing notice for the November 26, 2012 hearing was published in the *San José Mercury News* on or before November 8, 2012. This memorandum will also be posted on the City's website in advance of the February 26, 2013 Council meeting.

COORDINATION

This report has been prepared by the Finance Department in coordination with the Housing Department and the City Attorney's Office.

FISCAL/POLICY ALIGNMENT

This action is consistent with the City's *2007-2012 Five-Year Housing Investment Plan*, adopted by City Council on June 12, 2007, to increase the supply of affordable housing, and with the City's *Consolidated Plan 2010-2015* to provide housing units for very low- and extremely low-income households.

COST SUMMARY/IMPLICATIONS

All issuance costs will be paid by the Borrower from a source other than Series 2013A Note proceeds. The Series 2013A Note is a tax-exempt obligation secured by a mortgage loan payable from the Project and will not be paid from, nor secured by, the general taxing power of the City or any other City asset. Based on expected initial size of \$6,630,000, the City will receive upfront an issuance fee of \$33,150. The City will also receive an annual fee for monitoring the Project. Under the City's Policy, the annual fee is equal to the greater of one-eighth of a point (0.125%) of the original principal amount of the bonds (or notes) or a minimum fee of \$7,500. Based on this formula and initial amount of the Series 2013A Note, the annual fee will be \$8,288.

No appropriation of funds is required at this time. Compensation for the financing team participants (financial advisor, bond counsel, and fiscal agent), as well as the costs of the financings, are contingent on the sale of the Series 2013A Note and will be paid from a source of funds other than Series 2013A Note proceeds.

CEQA

Not a Project, PP10-069, City Organizational and Administrative Activities.

/s/
JULIA H. COOPER
Director of Finance

/s/
LESLYE CORSIGLIA
Director, Housing Department

For questions, please contact Peter Detlefs, Debt Administrator at (408) 535-7015.

ATTACHMENT

Arial Map

