COUNCIL AGENDA: 9/9/14
ITEM: 3.5

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Leslye Corsiglia
Julia H. Cooper

SUBJECT: SEE BELOW

DATE: August 18, 2014

Approved [signature]

Date 8/29/14

COUNCIL DISTRICT: 9

SUBJECT: APPROVAL OF THE ISSUANCE OF A TAX-EXEMPT MULTIFAMILY HOUSING REVENUE NOTES AND LOAN OF NOTE PROCEEDS AND RELATED DOCUMENTS FOR THE CAMBRIAN CENTER PROJECT

RECOMMENDATION

Adopt a resolution of the City Council:

a. Authorizing the issuance of (a) tax-exempt multifamily housing revenue notes designated as "City of San José Multifamily Housing Revenue Notes (Cambrian Center), Series 2014A-1 (the "Series 2014A-1 Note") and Series 2014A-2 (the "Series 2014A-2 Note, with, the Series 2014A-1 Note, the "Series 2014A Tax-Exempt Notes") in an aggregate principal amount not to exceed $38,069,000 and (b) taxable multifamily housing revenue notes designated "City of San José Multifamily Housing Revenue Notes (Cambrian Center), Series 2014A-3 (the "Series 2014A-3 Note") and Series 2014A-4 (the "Series 2014A-4 Note", with the Series 2014A-3 Note, the "Series 2014A Taxable Notes") in an aggregate principal amount not to exceed $5,000,000;

b. Approving a loan of Series 2014A Tax-Exempt Note and Series 2014A Taxable Note proceeds to Eden Cambrian, L.P., a California limited partnership created by Eden Housing Inc., to finance the acquisition and rehabilitation of the Cambrian Center apartments located at 2360 Samaritan Place, in San José (the "Project");

c. Approving in substantially final form the Funding Loan Agreement, Borrower Loan Agreement, Assignment of Deed of Trust, and Regulatory Agreement and Declaration of Restrictive Covenants (the "Series 2014A Documents"); and

d. Authorizing and directing the City Manager, Director of Finance, and Director of Housing, or their designees, to execute and, deliver the Series 2014A Documents and other related Series 2014A Tax-Exempt Note and Series 2014A Taxable Note documents as necessary.

OUTCOME

Approval of the recommended actions will enable the issuance of four multifamily housing revenue notes for the purpose of financing the acquisition and rehabilitation of a 153 unit rental apartment project, of which 139 units will be affordable to seniors and 12 units will be affordable to persons with special needs for a period of at least 55 years, plus two managers units. This Project will serve low-, very low- and extremely low-income residents with current annual incomes between $21,400 and $57,050.

EXECUTIVE SUMMARY

In accordance with the requirements under the City's Policy for Issuance of Multifamily Housing Revenue Bonds, Eden Housing, Inc. (the "Developer"), has requested that the City issue (a) two series of tax-exempt multifamily housing revenue notes in an aggregate amount not to exceed $38,069,000 and (b) two series of taxable multifamily housing revenue notes in an aggregate amount not to exceed $5,000,000. One series of tax-exempt notes and one series of taxable notes will be initially purchased and funded by Citibank, N.A. ("Citi"); the other series of tax-exempt notes and taxable notes will be initially purchased and funded by Bank of America, N.A. ("BofA").

The proceeds of the Series 2014A Tax-Exempt Notes and Series 2014A Taxable Notes (collectively, the "Series 2014A Notes" or the "Notes") will be loaned to Eden Cambrian, L.P., a California limited partnership (the "Borrower"). These proceeds, together with other funds, will be used by the Borrower to finance the acquisition and rehabilitation of a 153-unit rental apartment housing project known as Cambrian Center (the "Project").

The City does not have, and is not making, a loan on the Project. None of the Notes will be paid from or secured by the general taxing power of the City or any other City asset.

BACKGROUND

Borrower. The Borrower is a California limited partnership. The Borrower will consist of: (1) Eden Cambrian LLC, a limited liability corporation formed by the Developer, as General Partner, with Catalonia, Inc., a California non-profit public benefit corporation formed by the Developer as its sole member and manager and (2) Bank of America, N.A., or an affiliate thereof, as the tax credit investor limited partner.

The Developer has requested that the City issue the Series 2014A Notes for the purpose of lending Series 2014A Note proceeds to the Borrower. The proceeds of the Series 2014A Notes, together with other funds, will be used by the Borrower to finance the acquisition and rehabilitation of the Project.

Project Overview. The Project involves the acquisition and rehabilitation of 153 studio, one-bedroom and two- bedroom rental apartment units. Upon completion of the rehabilitation of the Project:

- 11 percent of the units (16 units) will be rented to seniors and persons with special needs with incomes that do not exceed 30 percent of the area median income ("AMI");
- 20 percent of the units (31 units) will be rented to seniors and persons with special needs with incomes that do not exceed 40 percent of AMI;
- 40 percent of the units (61 units) will be rented to seniors and persons with special needs with incomes that do not exceed 50 percent of AMI; and
- 28 percent of the units (43 units) will be rented to seniors and persons with special needs with incomes that do not exceed 60 percent of AMI.

Two of the Project's 153 units will be unrestricted managers' units. The rental restrictions for the Project will remain for a period of 55 years.

The Project is currently owned by Catalonia, Inc., a non-profit subsidiary of the Developer. Catalonia acquired the Project in 2013 through a HUD-approved Transfer of Physical Assets from the prior owner, Cambrian Center, Inc. Cambrian Center, Inc. had been required by HUD to change the Project's management and to transfer the Project's ownership for failure to rectify non-compliance issues with HUD over the prior three year period. The existing financing of the Project consists of a HUD Section 202 mortgage loan and a Section 8 contract. The Series 2014A Notes will refinance the HUD Section 202 mortgage loan, with the Section 8 contract to be transferred to the Borrower.

No City Loan for the Project. The City does not have, and is not making a loan, with respect to the Project.

Sources of Project Funding. Initially, during the acquisition and rehabilitation period, the Series 2014A Notes will consist of two variable rate Series 2014A Tax-Exempt Notes in an aggregate amount not to exceed $38,069,000 and two variable rate Series 2014A Taxable Notes in an aggregate amount not to exceed $5,000,000. The Series 2014A Notes will be purchased/funded in equal amounts by Citi and BofA.

Following the rehabilitation of the Project and its lease-up, the Series 2014A Notes are anticipated to consist of two fixed-rate Series 2014A Tax-Exempt Notes in the aggregate principal amount of approximately $23,964,000, with Citi as the sole holder/permanent lender.

Series 2014A Note proceeds will fund a portion of the total Project costs, which are currently estimated to be $65,731,040. The sources of funding for the Project's acquisition and rehabilitation phase and permanent phase are estimated as follows:

City of San José
Cambrian Center
Plan of Finance – Sources of Funding[1]

Source	Acquisition-Rehabilitation	Permanent
Tax-Exempt Note Proceeds	$ 38,069,000	$ 23,964,000
Taxable Note Proceeds	2,641,493	0
Seller Carryback	14,987,422	14,987,422
Tax Credit Equity	2,296,910	22,968,204
Income from Operations	2,416,572	2,416,572
Existing Reserves	1,394,842	1,394,842
Deferred Costs and Fees	3,924,801	0
Total	$ 65,731,040	$ 65,731,040

Financing History of Project – Key Dates. On February 24, 2014, the Director of Finance held a TEFRA hearing regarding the issuance of tax-exempt multifamily housing revenue bonds in an amount not to exceed $41,533,000 to finance the acquisition and rehabilitation of the Project. On March 21, 2014, the Borrower applied to the State Treasurer's California Debt Limit Allocation Committee ("CDLAC") for a private activity bond allocation in the amount of $38,069,000. On May 21, 2014, the City received a private activity bond allocation in the amount of $38,069,000 as requested. On June 11, 2014, the Project received from the State Treasurer's California Tax Credit Allocation Committee ("CTCAC") an allocation of federal tax credits of $1,643,829 per year and a total of $4,309,676 in state tax credits.

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.

Note Financing Structure

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 City typically will issue the bonds and loan the proceeds to the developer/borrower. The bonds are typically issued as tax-exempt obligations. The advantages of tax-exempt

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

financing to developers include: below-market interest rates and 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 Notes are not secured by the general taxing power of the City or any other City asset.

The Series 2014A Notes operate in a very similar manner to multifamily housing bonds. The City Charter provides that the City may issue revenue bonds and execute and deliver revenue notes pursuant to California law. The City is authorized to issue the Notes pursuant to California Health and Safety Code Section 52075 -52098, as amended (the "Act"), which authorize cities to issue revenue bonds and execute and deliver revenue notes for the purpose of financing the acquisition and rehabilitation of multifamily rental housing. Section 52011 of the California Health and Safety Code defines "bonds" to include notes for purposes of the Act. The Series 2014A Tax-Exempt Notes use a portion of the State's federal tax-exempt private activity cap allocated by CDLAC. The Series 2014 Tax-Exempt Notes also allow the Project to qualify for tax credits provided through CTCAC. The Series 2014A Notes are limited obligations of the City, payable solely from loan repayments by the Borrower.

The note financing structure outlined herein is being utilized because of a ruling of the Office of the Comptroller of the Currency ("OCC") that distinguished loans from bonds for purposes of counting maximum Community Reinvestment Act ("CRA") credits. The change occurred when the regulatory compliance of Citi, one of the lenders for the Project, was shifted to OCC from the Office of Thrift Supervision ("OTS"). OTS had viewed tax-exempt financing activity as lending and not as an investment, whether structured as a bond or note, since proceeds of the financing were loaned to the borrower. However, OCC will only treat tax-exempt bond financing activity as an investment, which is considerably less beneficial to Citi than a loan. Citi and BofA believe that the Series 2014A Note financing approach meets OCC's definition of a CRA loan as well as CDLAC's requirements for tax-exempt financing with respect to the Series 2014A Tax-Exempt Notes.

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 50% or less of area median income or (2) at least 40% of the units must be reserved for occupancy by individuals and families whose income is 60% or less of area median income. This second restriction will be incorporated into the Regulatory Agreement for the Series 2014 Tax-Exempt Notes.

Structure of the Series 2014A Notes

Direct Purchase/Funding Structure. The Series 2014A Notes will be structured as non-rated and non-credit-enhanced obligations that are directly purchased/funded by Citi and BofA as the initial purchasers/lenders (each a "Purchaser/Lender"). Citi will purchase/fund the Series 2014A-1 Note and Series 2014A-3 Note. BofA will purchase/fund the Series 2014A-2 Note and Series 2014A-4 Note. Pursuant to the City's policies regarding non-credit-enhanced notes, each Purchaser/Lender 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 either Purchaser/Lender wishes to transfer any Series 2014A Note, the new Series 2014A Note holder must sign and deliver a similar Investor Letter to the Fiscal Agent. Minimum denominations of each Series 2014A Note will be $100,000.

Principal Amounts and Terms. The Series 2014A-1 Note and Series 2014A-2 Note are anticipated to be issued in the amount of $19,034,500 each; the Series 2014A-3 Note and Series 2014A-4 Note are anticipated to be issued in the amount of $1,320,747 each based on current projections[1]. After the Project is rehabilitated and leased up, and conversion to the permanent loan phase occurs (the "Conversion Date"), the aggregate principal balance of the Series 2014A-1 Note and Series 2014A-2 Note is expected to be paid down to approximately $23,964,000 and the principal balance of the Series 2014A-3 Note and Series 2014A-4 Note is expected to be paid down in full - with tax credit equity funds.

After the Conversion Date, estimated to be no later than 25 months after the issuance of the Series 2014A Notes, the Series 2014A Tax Exempt Notes will convert from a variable-rate to a tax-exempt fixed-rate.

The maturity of the Series 2014A Tax-Exempt Notes is anticipated to be 35 years after closing but in no event more than 35 years from the Conversion Date (no more than 38 years from Closing). Principal of the Series 2014A Tax-Exempt Notes remaining on the Conversion Date will amortize on a 35-year basis commencing on the Conversion Date. Citi has an option to require the Borrower to prepay in full the Series 2014A Tax-Exempt Notes 18 years after Closing, with six months' prior notice. Assuming the exercise of such mandatory prepayment option, the Borrower will need to refinance the remaining balance of the Series 2014A Tax-Exempt Notes or to repay the remaining balance from another funding source.

Interest Rates. During the construction period, the Series 2014A Notes will pay interest only at a variable rate equal to 30 day LIBOR (London Inter-Bank Offered Rate) plus a margin of 1.75%.

[1] The resolution authorizes the issuance of up to $5,000,000 aggregate principal amount of Series 2014A Taxable Notes in case the projections change at the time of Closing.

After the Conversion Date, the interest will be paid at a fixed rate that is estimated to be approximately 5.405% based on current market conditions.

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 August 26, 2014.

Funding Loan Agreement. The Series 2014A Notes will be issued under a Funding Loan Agreement (the "Agreement") among the City, Citi and BofA, as funding lenders, and Wilmington Trust, National Association, as the fiscal agent (the "Fiscal Agent"). The Agreement will be executed by the Director of Finance, or another authorized officer, 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 2014A Note proceeds and other funds established under the Agreement; to authenticate the Series 2014A Notes; to apply and disburse payments to the Series 2014A Note holders; and to pursue remedies on behalf of the Series 2014A Note holders. 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 a Series 2014A 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") is between the City and the Borrower. The Loan Agreement will be executed by the Director of Finance, or another authorized officer, on behalf of the City. The Loan Agreement provides for the loan of Series 2014A Note proceeds to the Borrower for the acquisition-rehabilitation and permanent financing of the Project, and for the repayment of such loan by the Borrower. The loan is evidenced by four notes (the "Loan Notes") in amounts that correspond to the principal amount of each Series 2014A Note. The City's rights to receive payments under the Loan Notes will be assigned to the Fiscal Agent, along with certain other rights under the Agreement, the Loan Agreement and the Series 2014A Notes; however, certain reserved rights have been retained by the City, such as the City's right to indemnification.

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 2014A Notes will be payments from the Borrower under the Loan Notes. At closing the City will assign (without recourse) its rights as beneficiary under the Deed of Trust, thereby permitting the holders of the Series 2014A Notes to pursue the remedies set forth in the Deed of Trust against the Borrower directly.

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 and Director of Housing, or other authorized officers, on behalf of the City. The Regulatory Agreement restricts the rental of Project units (except for the two manager's units) from low- to extremely low-income residents for a period of at least 55 years.

<u>Financing Team Participants</u>

The financing team participants for the Series 2014A Notes consist of:

• City's Financial Advisor:	Ross Financial
• Bond Counsel:	Quint & Thimmig LLP
• Fiscal Agent:	Wilmington Trust, National Association
• Funding Lenders:	Citibank, N.A. and Bank of America, N.A.

All costs associated with the Financial Advisor, Bond Counsel and Fiscal Agent are contingent upon the sale of the Series 2014A Notes and will be paid from Series 2014A Note proceeds, tax credit equity, and/or Borrower funds.

<u>Financing Schedule</u>

The current proposed schedule is as follows:

• Council Approval of Notes/Note Documents	September 9, 2014
• Pre-Close Notes	September 16, 2014
• Close Notes	September 18, 2014
• CDLAC Deadline for Note Closing	September 29, 2014

<u>EVALUATION AND FOLLOW-UP</u>

This memorandum presents the set of recommendations related to the City Council's approval of the issuance of the Series 2014A Notes and requires no follow-up to the City Council. Once the Notes close, anticipated in mid-September 2014, and the acquisition and rehabilitation 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 the tax-exempt private activity notes is the Tax Equity and Fiscal Responsibility Act (TEFRA) Hearing. The TEFRA Hearing was held on February 24, 2014 before the Director of Finance. The public hearing notice for the February 24, 2014 hearing was published in the *San José Post - Record* on February 7, 2014.

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 from proceeds of the Series 2014A Notes, tax credit equity, and/or Borrower funds. The Series 2014A-1 Note and Series 2014A-2 Note are tax-exempt obligations and the Series 2014A-3 Note and Series 2014A-4 Note are taxable obligations, collectively secured by a mortgage loan payable from the Project. None of Series 2014A Notes will be paid from, nor secured by, the general taxing power of the City or any other City asset. Based on initial sizes of $38,069,000 for the Series 2014A Tax-Exempt Notes and $2,641,493 for the Series 2014A Taxable Notes, the City will receive an upfront issuance fee of $126,776.23. The City will also receive an annual fee for monitoring the Project. Under the City's Policy for the Issuance of Multifamily Housing Revenue Bonds applicable to non-profit borrowers, the annual fee is equal to one-eighth of a point (0.125%) of the principal amount of the bonds (or notes) on the Conversion Date, with a minimum fee of $7,500. Based on this formula and an expected $23,964,000 principal amount of Series 2014A Tax-Exempt Notes to be outstanding on the Conversion Date, the annual fee will be $29,955.

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 Series 2014A Notes, are contingent on the sale of the Series 2014A Notes and will be paid from Series 2014A Note proceeds, tax credit equity, and/or Borrower funds.

CEQA

CEQA: EIR resolution 72768 adopted June 21, 2005, file number PDC07-101

/s/	/s/
JULIA H. COOPER	LESLYE CORSIGLIA
Director of Finance	Director, Housing Department

For questions, please contact Julia Cooper, Director of Finance at (408) 535-7011.

ATTACHMENT

SITE MAP

CAMBRIAN CENTER
2360 Samaritan Place