COUNCIL AGENDA: 10/7/14
ITEM: 4.1

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: September 15, 2014

Approved

Date 9/25/14

COUNCIL DISTRICT: 6

SUBJECT: ISSUANCE OF TAX-EXEMPT BONDS AND RELATED ACTIONS FOR PARKVIEW FAMILY APARTMENTS AND PARKVIEW SENIOR APARTMENTS

RECOMMENDATION

Adopt a resolution:

a. Authorizing the issuance of tax-exempt multifamily housing revenue bonds designated as "City of San José Multifamily Housing Revenue Bonds (Parkview Family Apartments), Series 2014B" in an aggregate principal amount not to exceed $14,500,000 (the "Series 2014B Bonds");

b. Approving a loan of Series 2014B Bond proceeds to Parkview Family EAH II, L.P., a California limited partnership created by EAH, Inc. (the "Developer"), to finance the acquisition and rehabilitation of the Parkview Family Apartments (the "Family Project") located at 360 Meridian Avenue in San José;

c. Authorizing the issuance of a tax-exempt multifamily housing revenue bonds designated as "City of San José Multifamily Housing Revenue Bonds (Parkview Senior Apartments), Series 2014C" in an aggregate principal amount not to exceed $15,000,000 (the "Series 2014C Bonds");

d. Approving a loan of Series 2014C Bond proceeds to Parkview Senior EAH II, L.P., a California limited partnership created by EAH, Inc., to finance the acquisition and rehabilitation of the Parkview Senior Apartments (the "Senior Project") located at 355 Race Street in San José;

e. Approving in substantially final form the Trust Indentures, Loan Agreements, Regulatory Agreements and Declaration of Restrictive Covenants, Bond Purchase Agreements and Official Statements (collectively, the "Series 2014B and C Bond Documents");

f. Authorizing and directing the City Manager, Director of Finance, Assistant Director of Finance, Treasury Division Manager, Debt Administrator, and Director of Housing, or their designees, to execute and deliver the Series 2014B and C Bond Documents and other related Series 2014B and C Bond documents as necessary; and

g. Authorizing the Director of Housing to negotiate and execute (i) amendments to existing City loan documents relating to the Senior and Family Projects consistent with the terms described below, and (ii) a subordination agreement with the Department of Housing and Urban Development (HUD) subordinating the City's interest in the Senior and Family Projects to an FHA-insured mortgage.

OUTCOME

Approval of the recommended actions will enable the issuance of two multifamily housing revenue bonds: (1) the Series 2014B Bonds for the purpose of acquiring and rehabilitating a 90-unit family rental apartment project, composed of 88 units that will be affordable for a period of at least 55 years and two managers' units that will be unrestricted and (2) the Series 2014C Bonds for the purpose of acquiring and rehabilitating a 140-unit senior rental apartment project, composed of 138 units that will be affordable for a period of at least 55 years and two manager's units. Collectively, these projects will serve extremely low- and low-income residents with current annual incomes between $22,300 and $68,370.

In addition, approval of the recommended action will enable: (1) the repayment in full of the outstanding City's loan on the Family Project in the amount of $4,298,789, (2) the partial repayment of the City's loan on the Senior Project in the amount of approximately $261,652, (3) the strengthening of the City's affordability restrictions for the Family Project, and (4) the amendment of City loan terms for the Senior Project.

EXECUTIVE SUMMARY

In accordance with the requirements under the City's Policy for Issuance of Multifamily Housing Revenue Bonds, EAH, Inc. (the "Developer") has requested that the City issue two series of tax-exempt multifamily housing revenue bonds, with each series being structured as rated, non-credit-enhanced, cash-collateralized and publicly offered short-term bonds that will be underwritten by Red Capital Markets, LLC:

- The proceeds of the Series 2014B Bonds will be loaned to Parkview Family EAH II, L.P., a California limited partnership (the "Family Borrower"), in an estimated amount of $13,328,223 but in no event more than $14,500,000. These proceeds, together with other funds, will be used by the Family Borrower to finance the acquisition and rehabilitation of the existing 90-unit affordable rental apartment housing project known as Parkview

Family Apartments (the "Family Project"). The Family Project will consist of 88 units that will be affordable for at least 55 years and two (2) managers' units that will be unrestricted. The restricted affordable units are comprised of 5 one-bedroom units, 51 two-bedroom units, 31 three-bedroom units, and 1 four-bedroom unit.

- The proceeds of the Series 2014C Bonds will be loaned to Parkview Senior EAH II, L.P., a California limited partnership (the "Senior Borrower"), in an estimated amount of $14,087,808 but in no event more than $15,000,000. These proceeds, together with other funds, will be used by the Senior Borrower to finance the acquisition and rehabilitation of the existing 140-unit affordable rental apartment housing project known as Parkview Senior Apartments (the "Senior Project"). The Senior Project will consist of 138 units that will be affordable for at least 55 years and two (2) managers' units that will be unrestricted. The restricted affordable apartments are comprised of 138 one-bedroom units.

Additionally, the following actions will occur with respect to the City's existing loans for the Family Project and Senior Project, funded from 20% housing set-aside tax increment funds. First, the Borrower will repay (a) in full, the existing $4,298,789 City loan for the Family Project, plus accrued interest of approximately $438,101 and (b) approximately $ 261,652 of the existing City loan, currently outstanding in the amount of $4,863,926 for the Senior Project. Second, the City will amend the remaining portion of its loan documents for the Senior Project. Third, the City will amend its affordability restriction for the Family Project in order to strengthen the City's ability to ensure ongoing physical and financial feasibility of the building in the absence of the City's loan. The repayment of the City loans for the Family Project (in full) and the Senior Project (in part) will occur in late October 2014 in connection with the closing of the Series 2014B Bonds and Series 2014C Bonds.

The purpose of the proposed bond issuances is to allow for both the acquisition by the new owners of the Family Project and Senior Project—both of which include EAH in the ownership structure—as well as to provide for the Projects' rehabilitation. These actions are intended to ensure the Projects' long-term physical and economic viability to serve as an affordable housing resource for the City.

BACKGROUND

PARKVIEW FAMILY APARTMENTS

Borrower. The Family Borrower, Parkview Family EAH II, L.P., is a California limited partnership managed by the Developer. The Family Borrower will consist of: (1) Parkview Family II, a California limited liability company, as the General Partner and (2) Merritt Community Capital Corporation, or an affiliate thereof, as the tax credit investor limited partner.

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

Project Overview. The Family Project involves the acquisition and rehabilitation of 90 one-, two, three- and four-bedroom apartments that are currently restricted affordable units. Upon completion of the Family Project:

- 11 percent of the affordable units (9 units) will be rented to individuals and families with incomes that do not exceed 30 percent of the area median income ("AMI");
- 30 percent of the units (26 units) will be rented to individuals and families with incomes that do not exceed 50 percent of AMI; and
- 60 percent of the units (53 units) will be rented to families with incomes that do not exceed 60 percent of AMI[1].

Two of the Family Project's 90 units will be unrestricted managers' units. The rental restrictions for the Family Project will restart for a period of 55 years and will conform to the City's rental affordability requirements.

The Family Project is currently owned by Midtown Family Associates, Inc., a California nonprofit public benefit corporation created by the Developer. The existing financing of the Family Project is provided by Pacific Life.

City Loan for the Project. On September 18, 1998, the City made a loan (the "Family Loan") in the amount of $4,513,899 for the original acquisition and construction of the Family Project. The funding source of the Family Loan was 20% housing set-aside tax increment funds. The Family Loan is currently outstanding in the amount of $4,298,789. The Family Borrower intends to repay the Family Loan in full, plus accrued interest of approximately $438,101 at the closing of the Series 2014B Bonds, expected in late October 2014.

City as Issuer of Multifamily Housing Bonds. The City's Policy for Issuance of Multifamily Housing Revenue Bonds requires that if the Housing Department makes a project loan, the City must be the issuer of tax-exempt multifamily housing revenue bonds for the purpose of lending the bond proceeds to the project. Although the Family Borrower intends to repay the Family Loan, it has requested that the City be the issuer of the Series 2014B Bonds.

Sources of Project Funding. The Series 2014B Bonds will be structured as short-term fixed rate obligations in the estimated principal amount of $13,328,223 but in no case more than $14,500,000. The Series 2014B Bonds will be repaid in full following completion of rehabilitation and lease up ("at permanent") by a conventional FHA-insured, fixed rate mortgage, proceeds from the tax credit investor and a seller cash loan from reserves. Series 2014B Bond

[1] Percentages of units by income restriction do not add to 100% due to individual rounding.

proceeds will fund a portion of the total Family Project costs, which are currently estimated to be $26,440,717 during rehabilitation and $26,568,445 at permanent. The estimated sources of funding for the Project's rehabilitation phase and permanent phase are as follows:

City of San José
Parkview Family Apartments
Plan of Finance – Sources of Funding[2]

Source	Construction	Permanent
Bond Proceeds	$ 13,328,223	$ 0
City Loan	0	0
FHA Insured First Mortgage Loan	0	6,445,000
Tax Credit Equity	4,821,533	9,295,684
Seller Takeback	7,790,031	7,790,031
Seller Cash Loan from Current Reserves	0	2,536,800
Deferred Fees and General Partner Contribution	500,930	500,930
Total	$ 26,440,717	$ 26,568,445

Financing History of Family Project – Key Dates. On June 2, 2014, the City's 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 Family Project. On July 8, 2014, the Director of Housing submitted an application to CDLAC for an allocation of up to $14,500,000 in private activity bonds for the Family Project, pursuant to the Joint Authority of the Directors of Housing and Finance under San José Municipal Code Section 5.06.425. On September 17, 2014, the City received a private activity bond allocation of $14,500,000 from CDLAC as requested. In addition, on August 20, 2014, the Family Project received from CTCAC a tax credit allocation of $835,135 per year.

PARKVIEW SENIOR APARTMENTS

Borrower. The Senior Borrower, Parkview Senior EAH II, L.P., is a California limited partnership formed by the Developer. The Senior Borrower will consist of: (1) Parkview Senior II, a California limited liability company, as the General Partner and (2) Merritt Community Capital Corporation, or an affiliate thereof, as the tax credit investor limited partner.

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

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

Project Overview. The Senior Project involves the acquisition and rehabilitation of 140 restricted affordable one-bedroom apartments. Upon completion of the Senior Project:

- 10 percent of the restricted units (14 units) will be rented to individuals and families with incomes that do not exceed 30 percent of the area median income ("AMI");
- 90 percent of the restricted units (124 units) will be rented to individuals and families with incomes that do not exceed 40 percent of AMI; and
- Two of the Senior Project's 140 units will be unrestricted manager's units. The rental restrictions for the Senior Project will restart for a period of 55 years and will conform to the City's rental affordability requirements.

The Senior Project is currently owned by Midtown Senior Associates, Inc., a California nonprofit public benefit corporation created by the Developer. The existing financing of the Senior Project is provided by Pacific Life.

City Loan for the Project. On November 8, 1999, the City made a loan (the "Senior Loan") in the amount of $5,005,405 for the original acquisition and construction of the Senior Project. The funding source of the Senior Loan was 20% housing set-aside tax increment funds. The Senior Loan is currently outstanding in the amount of $4,863,926. The Senior Borrower intends to repay approximately $261,652 of the Senior Loan plus interest of approximately $437,348 at the closing of the Series 2014C Bonds, expected in late October 2014. The City also will be amending the terms of the Senior Loan as subsequently discussed in this Memorandum.

City as Issuer of Multifamily Housing Bonds. The City's Policy for Issuance of Multifamily Housing Revenue Bonds requires that if the Housing Department makes a project loan, the City must be the issuer of tax-exempt multifamily housing revenue bonds for the purpose of lending the bond proceeds to the project.

Sources of Project Funding. The Series 2014C Bonds will be structured as short-term fixed rate obligations in the estimated principal amount of $14,087,808 but in no case more than $15,000,000. The Series 2014C Bonds will be repaid in full following completion of rehabilitation and lease up ("at permanent") by a conventional FHA-insured, fixed rate mortgage, proceeds from the tax credit investor, and a seller cash loan from reserves. Series 2014C Bond proceeds will fund a portion of the total Family Project costs, which are currently estimated to be $25,307,776 during rehabilitation and $27,639,312 at permanent. The estimated sources of funding for the Project's rehabilitation phase and permanent phase are as follows:

City of San José
Parkview Senior Apartments
Plan of Finance – Sources of Funding[3]

Source	Construction	Permanent
Bond Proceeds	$ 14,087,808	$ 0
Assumed City Loan	4,598,931	4,598,931
FHA Insured First Mortgage Loan	0	4,138,000
Tax Credit Equity	1,508,525	8,217,667
Seller Takeback	5,111,690	5,111,690
Seller Cash Loan from Current Reserves	0	5,572,202
Deferred Fees and General Partner Contribution	822	822
Total	$ 25,307,776	$ 27,639,312

Financing History of Senior Project – Key Dates. On June 2, 2014, the City's 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 Senior Project. On July 8, 2014, the Director of Housing submitted an application to CDLAC for an allocation of up to $15,000,000 in private activity bonds for the Senior Project, pursuant to the Joint Authority of the Directors of Housing and Finance under San José Municipal Code Section 5.06.425. On September 17, 2014, the City received a private activity bond allocation of $15,000,000 from CDLAC as requested. In addition, on August 20, 2014, the Senior Project received from CTCAC a tax credit allocation of $866,196 per year.

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 Family Project and Senior Project. These sections describe financing structure, financing documents, the City loans, financing team participants, and financing schedule.

Bond Financing Structure

Overview of the Multifamily Bond 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

[3] 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.

Requirements for Tax-Exemption. For a multifamily housing revenue 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 Agreements for the Series 2014B Bonds and Series 2014C Bonds. Further, in consideration of the existing City loans and affordability restrictions, the Family Project and Senior Project will be subject to the deeper affordability requirements described in the Background section above.

Structure of the 2014B Bonds and 2014C Bonds

Public Offering. The Series 2014B Bonds and Series 2014C Bonds will be publicly offered obligations to be underwritten and marketed by Red Capital Markets, LLC. (the "Underwriter"). Both Series are expected to be rated "AA+" by Standard & Poor's.

Security Features. The Series 2014B Bonds and Series 2014C Bonds will be 100% cash collateralized. Bond proceeds will be held by Wilmington Trust, National Association (the "Trustee") in a Project Fund under a Trust Indenture (as described in the next section of this Memorandum). The Trustee may release Bond proceeds to the respective Borrower for the purpose of acquiring and rehabilitating the Family Project or Senior Project, as the case may be, only if it receives a like amount of funds on behalf of such Borrower for deposit into a Collateral Fund to be held by the Trustee. The funds to be deposited in the Collateral Fund must be bankruptcy-proof. There will be no additional credit enhancement.

Interest on the Series 2014B Bonds and Series 2014C Bonds will be prefunded from subordinate loans. Principal of the Series 2014B Bonds and Series 2014C Bonds will be repaid from separate FHA-insured mortgage loans, tax credit equity and seller loans funded from existing reserves. FHA has issued its firm commitments to provide such insured mortgage loans.

Principal Amounts and Terms. The Series 2014B Bonds and Series 2014C Bonds are anticipated to be issued in the amount of $13,328,223 and $14,087,808, respectively. In no event will the principal amount of the Series 2014B Bonds and Series 2014C Bonds exceed $14,500,000 and $15,000,000, respectively. After the rehabilitation of each Project is completed and such Project is leased, and conversion to the permanent loan phase occurs (the "Conversion Date"), the respective Series will be repaid in full from the proceeds of an FHA-insured mortgage loan, tax credit equity funds and a seller loan funded with existing cash reserves.

Interest Rates. The Series 2014B Bonds and 2014C Bonds will be interest-only at a fixed rate through maturity (approximately 22 months). The interest rate will be based on market conditions at the time of sale (expected on October 16, 2014). Based on current market conditions, the interest rate will be approximately 0.50%.

Financing Documents

The following is a brief description of each document the City Council is being asked to approve and authorize execution. Copies of these documents for both the Family Project and the Senior Project will be available in the City Clerk's Office on or about September 23, 2014, and will be posted to the City's agenda website on or about September 23, 2014. With the exception of the principal amount of the Series 2014B Bonds and the Series 2014C Bonds, the name of the Borrower and the name of the Project, the documents for the Family Project and Senior Project are identical. *For purposes of this section only, the terms "Bond", "Borrower" and "Project" are used without regard to the specific transaction.*

Staff recommends that the City's Director of Finance, Assistant Director of Finance, Director of Housing or other authorized officer of the City be authorized to execute the agreements on behalf of the City as described below ("Authorized Officers"). As modifications may be required prior to the closing, staff also recommends that the Authorized Officers each be authorized to execute the final version of each of these agreements and to approve changes to the Official Statements upon consultation with the City Attorney's Office.

Trust Indenture. The Bonds will be issued under a Trust Indenture (the "Indenture") between the City and Wilmington Trust, National Association as the trustee (the "Trustee"). The Indenture is executed by the Director of Finance, or other authorized officer on behalf of the City, and attested by the City Clerk. The Indenture set forth the terms of the Bonds, including the interest rate, final maturity and redemption provisions. The Indenture establishes various funds and accounts for the deposit of Bond proceeds and repayment sources. Pursuant to the Indenture, the Trustee is given the authority to receive, hold, invest and disburse the bond proceeds and other funds; to authenticate the Bonds; to apply and disburse payments to the Bondholders; and to pursue remedies on behalf of the Bondholders. The Indenture sets forth the guidelines for the administration, investment and treatment of investment earnings generated by each fund and account. The Indenture provides that the Borrower will compensate the Trustee for services rendered thereunder.

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, Assistant Director of Finance or other authorized officer on behalf of the City. The Loan Agreement provides for the loan of Bond proceeds to the Borrower for acquisition and rehabilitation of the Project, and for the repayment of such loan by the Borrower. The loan is evidenced by a Note in an amount that corresponds to the principal amount of the Bonds. The City's rights to receive payments under the Loan Note will be assigned to the Trustee, along with certain other rights under the Agreement, the Loan Agreement and the Bonds; 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 Trustee, 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, 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 two managers' units) to low-income residents for a period of at least 55 years as previously described.

Bond Purchase Agreement. This agreement ("Purchase Agreement") is among the City, the Borrower and Red Capital Markets, LLC. (the "Underwriter"). The Purchase Agreement sets forth the conditions under which the Underwriter will purchase the Bonds. It contains certain representations and warranties of the City and the Borrower, the documents to be executed at closing, and the conditions that may allow the Underwriter to cancel its purchase of the Bonds. This document is executed by the Director of Finance or other authorized officer on behalf of the City.

Official Statement. This document is the public offering statement relating to the Bonds. This document is executed by an authorized officer of the Borrower. The City does not execute the Official Statement. This document, prepared by the Underwriter's counsel. describes the terms and structure of the Bonds, the flow of funds, the Project and the security for the Bonds. During the marketing period for the Bonds, the Official Statement will be issued in preliminary form. After the Bonds are sold, the final pricing information will be included and the Official Statement will become "final".

A copy of each draft preliminary Official Statement, in substantially final form, will be posted on the agenda website on or about September 23, 2014. If any Councilmember has any knowledge that any of the material information in the Official Statement is false, misleading or omitted, he or she should promptly advise City staff of the matter. Material information is information that there is a substantial likelihood would have actual significance in the deliberations of the reasonable investor when deciding whether to buy or sell the bonds. City staff, bond counsel and the financial advisor will be available at the Council meeting on October 7, 2014, to address any questions, issues and/or concerns.

Financing Team Participants

The financing team participants for both the Series 2014B Bonds and Series 2014C Bonds consist of:

• City's Financial Advisor:	Ross Financial
• Bond Counsel:	Jones Hall
• Trustee:	Wilmington Trust, National Association
• Underwriter:	Red Capital Markets, LLC

All costs associated with the Financial Advisor, Bond Counsel and Trustee are contingent upon the sale of each Bond and will be paid from Bond proceeds, tax credit equity and/or Borrower funds.

Financing Schedule

The current proposed schedule is as follows:

• Council Approval of Bonds/Bond Documents	October 7, 2014
• Mail/Post Preliminary Official Statement	October 9, 2014
• Price Series 2014B and Series 2014C Bonds	October 16, 2014
• Pre-closing	October 21, 2014
• Closing	October 23, 2014
• CDLAC Deadline for Closing	December 16, 2014

Bond closing must occur in October for the Family and Senior Borrowers to avoid a significant prepayment penalty under the existing loan documents. Such penalty would affect the feasibility of the Series 2014B Bonds and 2014C Bonds.

City Subordinate Funding

Loan Terms
The City currently has two outstanding loans with respect to the Family Project and Senior Project. The City loan for the Family Project is outstanding in the amount of $4,298,789 and the City loan for the Senior Project is outstanding in the amount of $4,863,926.

At closing of the Series 2014B Bonds, the Family Borrower will repay the City loan for the Family Project in full plus accrued interest of approximately $438,101. The affordability restrictions associated with the City loan for the Family Project will remain in place, but will be subordinated to the FHA-insured mortgage.

At closing of the Series 2014C Bonds, the Senior Borrower will repay approximately $261,652 of the City loan for the Senior Project, leaving a balance of approximately $4,602,274. The City loan terms will be amended as follows:

1. The loan term will be extended for a new 55-year period that commences at Bond closing rather than maturing on November 1, 2029. The City's loan will continue to be repaid from residual net cash receipts, with a projected repayment in 2046 (approximately 32 years).

2. The City's affordability restrictions will be extended for another 55 years to be co-terminus with the Senior Project loan maturity. The current restrictions end in 2052; the restriction will expire in approximately 2069.

3. The interest rate on the City's loan will be increased from a current 2% simple interest to approximately 3% compounded interest. This rate is indexed to the Applicable Federal Rate ("AFR") and may change at closing. The effect of the rate increase is both to extend the payoff period for the City's loan and to increase the interest earned by the City from the loan.

4. The affordability targeting for Parkview Senior will be deepened as part of the refinancing of the Senior Project. Currently, the City requires 138 of the project's units to be restricted at 50% AMI. This restriction will be revised to require 14 units at 30% AMI and 124 units at 40% AMI. The deepening of affordability is consistent with the City's policy direction to provide extremely low-income and low-income homes for the City's residents.

<u>Subordination to HUD's Mortgage</u>

The existing City loan for the Senior Project and the affordability restrictions associated with the City loan for the Senior Project will be subordinated to the FHA-insured mortgage. The form of Subordination Agreement is provided by the U.S. Department of Housing and Urban Development (HUD) and is drafted in a manner to allow HUD substantial control in the event of a default by Borrower under either the FHA-insured mortgage or the City loan. Several of the remedies available to HUD under the Subordination Agreement are not typical of subordination agreements with private sector financing. Specifically, the Subordination Agreement does not allow for the City to exercise its remedies under the City loan documents in the event of a default by the Borrower without HUD's prior written consent. Furthermore, the Subordination Agreement does not allow a default under the FHA-insured mortgage to constitute a default under the City loan documents (a cross-default provision) if no other default exists under the City loan documents. Under the HUD Subordination Agreement, the City loan could be eliminated as a result of a foreclosure by the FHA-insured mortgage if the City is not able to exercise its remedies (i.e. foreclosure) and protect its financial interest in the Senior Project prior to the foreclosure by the FHA-insured mortgage.

Staff has evaluated the risk of the HUD Subordination Agreement and has determined that the risk to the City is minimal for two reasons:

1. Conservative underwriting: The FHA-insured mortgage loan is sized with a debt coverage ratio in excess of 2.0. In other words, the Senior Project's net operating income after payment of operating expenses exceeds debt service on the FHA-insured mortgage loan. This compares to the typical debt service coverage ratio of 1.15 or 1.20 for new projects. This high debt coverage ratio greatly diminishes the risk that the property will experience operating income shortfalls.

2. Operating Deficit Guaranty: The general partner of the Senior Borrower, an EAH affiliate, will be providing a corporate operating deficit guaranty to its investor limited partner. This will require the general partner to fund any operating cash shortfalls out of its corporate cash resources, thereby protecting the limited partner's tax credit investment. The City benefits from this Guaranty as it provides a non-Project source to fund operating shortfalls, if any.

The City is also being compensated for the additional risk of the HUD Subordination Agreement through the interest rate increase and extension of affordability restrictions as discussed above. The net effect of the increased interest rate the City will receive on its loan will be to increase the net present value of the loan to the City.

Consideration to the City

In consideration for agreeing to lengthen the City's loan term, the City will extend the term of its affordability restriction by approximately 15 years. Further, as described above, the units' affordability restrictions will be lowered from all at 50% AMI to a mix at 30% and 40% AMI for the full 55-year period.

In consideration for the subordination of the City's affordability restrictions to the new FHA-insured mortgages, the City will receive strengthened rights during the term of the restriction on both Projects. These changes include rights of ongoing project inspections in order to ensure safe and decent ongoing physical condition, the payment of annual City affordability monitoring fees for both projects, the receipt of ongoing reporting, and the approval of property transfers. These rights are currently in the City's loan documents, so their addition to the affordability restrictions is consistent with City practices and enhances the City's ability to preserve both Projects' long-term affordability and viability.

EVALUATION AND FOLLOW-UP

This Memorandum presents the set of recommendations related to the City Council's approval of the issuance of the Series 2014B Bonds and the Series 2014C Bonds for the Family Project and the Senior Project, respectively, and requires no follow-up to the City Council. Once such Bonds close, anticipated in late October 2014, and the rehabilitation of the Family Project and Senior

Project commence, the Housing Department will provide updates in its Quarterly Construction Reports to the City Council.

PUBLIC OUTREACH

This memorandum and related bond documents will be posted on the City's website for the October 7, 2014, meeting. The method of notifying the community of the City's intent to issue a tax-exempt private activity Bond is the Tax Equity and Fiscal Responsibility Act (TEFRA) Hearing. TEFRA Hearings were held on June 2, 2014 before the Director of Finance. The public notice for the June 2, 2014 hearing was published in the *San José Post Record* on May 19, 2014.

COORDINATION

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

FISCAL/POLICY ALIGNMENT

This action is consistent with the City's *2007-2014 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 Bond issuance costs will be paid from proceeds of the Series 2014B and 2014C Bonds, tax credit equity proceeds and/or Family Borrower/Senior Borrower funds. Each Bond is a tax-exempt obligation that is 100% cash collateralized, with interest paid from capitalized interest and principal repaid from the proceeds of an FHA-insured mortgage, tax credit equity and a seller loan. Neither the Series 2014B Bonds nor Series 2014C Bonds will be paid from, nor secured by, the general taxing power of the City or any other City asset. Based on initial sizes of $13,328,223 for the Series 2014B Bonds and $14,087,808 for the Series 2014C Bonds, the City will receive upfront issuance fees of $58,321 and $60,220, respectively. The City will also receive annual fees for monitoring the Family Project and Senior Project. Under the City's Policy for the Issuance of Multifamily Housing Revenue Bonds, 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 Bonds), with a minimum fee of $7,500. Based on this formula and initial amounts of the Series 2014B Bond and Series 2014C Bond, the annual fees will be $16,660 and $17,610, respectively. Following repayment of the Series 2014B Bonds and Series 2014C Bonds, the annual fee will decline to $7,500 for each transaction for 55 years. Additionally, the integration of the City's ongoing loan and affordability restriction monitoring fees will result in approximately $7,137 in revenues to the City in year one, escalating at 3% per year.

No appropriation of funds is required at this time. Compensation for the financing team participants (Financial Advisor, Bond Counsel, and Trustee), as well as other costs of the Series 2014B Bonds and Series 2014C Bonds, are contingent on the sale of each such Bonds and will be paid from Bond proceeds, tax credit equity proceeds and/or Family Borrower/Senior Borrower funds.

CEQA

Negative Declaration, File No. PDC94-022.

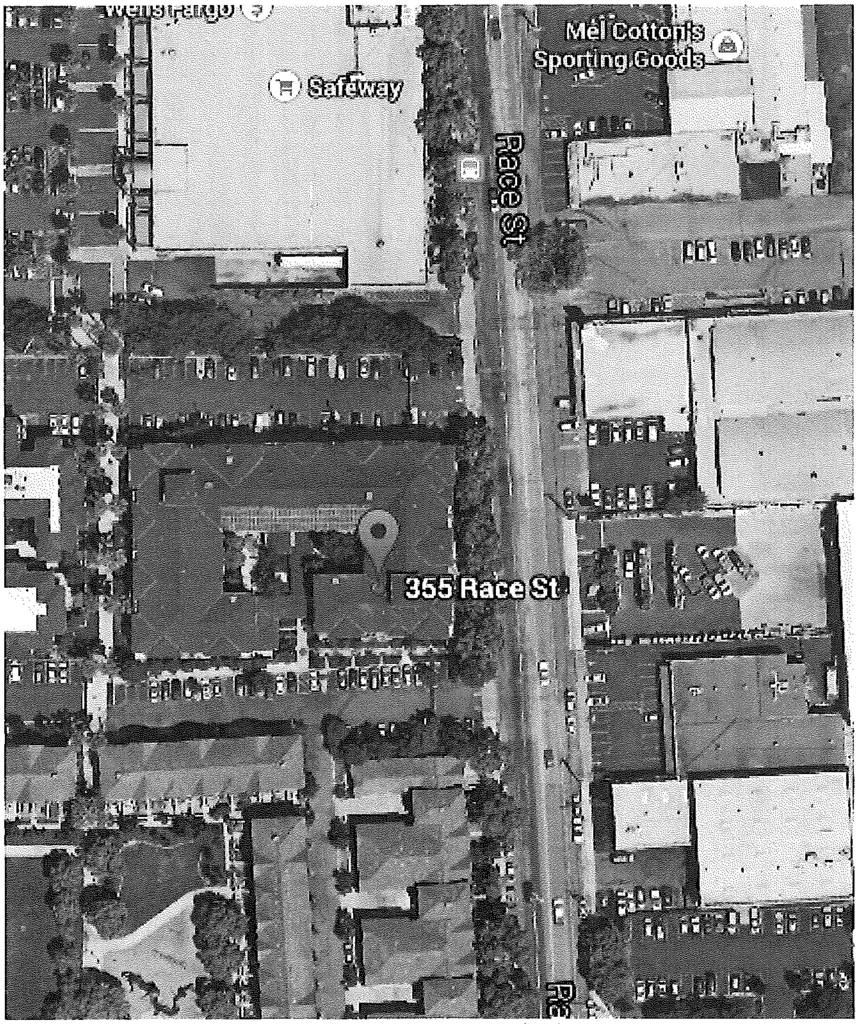
/s/
JULIA H. COOPER
Director of Finance

/s/
LESLYE CORSIGLIA
Director, Housing Department

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

Attachment

Exhibit
355 Race Street (Parkview Seniors)



Parkview (Family)
360 Meridian Avenue