



# Memorandum

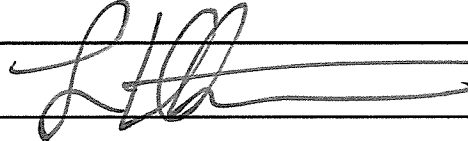
**TO:** HONORABLE MAYOR AND CITY COUNCIL

**FROM:** Julia H. Cooper  
Leslye Krutko

**SUBJECT:** SEE BELOW

**DATE:** May 14, 2007

Approved

 Date 5/16/07

**COUNCIL DISTRICT:** 3  
**SNI AREA:** University

**SUBJECT: APPROVAL OF THE ISSUANCE OF BONDS, LOAN OF BOND PROCEEDS AND RELATED DOCUMENTS FOR THE CASA FELIZ STUDIO APARTMENTS PROJECT**

## RECOMMENDATION

Adoption of a resolution of the City Council:

- (a) Authorizing the issuance of tax-exempt multifamily housing revenue bonds designated as "City of San José Multifamily Housing Revenue Bonds (Casa Feliz) Series 2007A" in an aggregate principal amount not to exceed \$11,000,000 (the "Bonds");
- (b) Approving a loan of Bond proceeds to Casa Feliz Studios, L.P., a California limited partnership, for financing the construction of the Casa Feliz Studio Apartment project located at 525 South Ninth Street in San José;
- (c) Approving in substantially final form the Bonds, Indenture, Loan Agreement, Regulatory Agreement and Declaration of Restrictive Covenants and Bond Purchase Agreement; and
- (d) Authorizing the City Manager or other authorized officers to execute and, as appropriate, to negotiate, execute and deliver these bond documents and other related bond documents as necessary.

## OUTCOME

Approval of the recommended actions will allow for the issuance of multifamily housing revenue bonds for the purpose of constructing 60 studio apartment units, 59 of which will be affordable for 55 years.

## **EXECUTIVE SUMMARY**

First Community Housing and The John Stewart Company (collectively, the “Developer”) have requested that the City issue tax-exempt multifamily housing revenue bonds for the purpose of lending the bond proceeds to Casa Feliz Studios, L.P., a California limited partnership (the “Borrower”) created by the Developer. The proceeds of the loan, together with other funds, will be used by the Borrower to finance the construction of 60 studio apartment units to be known as Casa Feliz Studio Apartments (the “Project”). Upon completion of the Project, 100% of the affordable units (59 units) in the Project will be rented to individuals with incomes that do not exceed 35% of the area median income. These restrictions will remain for a period of 55 years. One of the Project’s units is an unrestricted manager’s unit.

## **BACKGROUND**

On February 2, 2007, the Director of Finance pursuant to Municipal Code Section 5.06.430 held a TEFRA Hearing to receive public comment on the City's expressed intent to issue up to \$11,000,000 in tax-exempt multifamily housing revenue bonds to finance the construction of the Project. On January 18, 2007, the Mayor approved Certificate of the Mayor, which among other things, authorized the Director of Housing to file an application with the California Debt Limit Allocation Committee (CDLAC) for an allocation of up to \$11,000,000 in private activity bonds. On January 18, 2007, the City submitted a request to CDLAC for an allocation of \$11,000,000. On March 21, 2007, the City received an allocation from CDLAC for this amount.

Total costs for the Project are estimated to be approximately \$16,206,971. During construction, the Project will be funded from several different sources: (1) Bond proceeds, (2) City loans, (3) tax credit equity, (4) developer equity (5) lease-up income, and (6) Special User Housing Rehabilitation Program (SUHRP) loan. After completion of the Project, the Project’s permanent funding will be: (1) City loan, (2) California Housing and Community Development’s Multifamily Housing Program (“MHP”); (3) tax credit equity; and (4) developer equity. Funds from the State of California Department of Housing and Community Development (MHP) and a portion of the tax credit equity funds received at completion of construction of the Project will be used to retire the Series 2007A bonds in full.

One of CDLAC’s requirements is that the bond closing for the Project must occur within the time period set by CDLAC. The Bond closing for this Project must occur by June 29, 2007. It is anticipated that the Bonds will close on or about June 13, 2007.

## **ANALYSIS**

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

### **Bond Financing Structure**

#### **Overview of Multifamily Bond Financing**

***General*** As a brief summary, multifamily housing revenue bonds are issued to finance the development by private developers of certain rental apartment projects. The City issues the bonds and then loans the proceeds to the developer/borrower. The bonds are typically issued as tax-exempt securities. The advantages of tax-exempt bonds to developers include below-market interest rates and long-term fixed rate financing – features not available in the conventional multifamily housing construction loan mortgage market. The Bonds are limited obligations of the City, payable solely from loan repayments by the Borrower.

***Requirements for Tax-Exemption*** For multifamily housing revenue bonds to qualify for tax-exemption, federal law generally requires that one of two restrictions must apply: either (1) at least 20 percent of the units in the housing development must be reserved for occupancy by individuals and families of very-low income (50% of area median income) or (2) at least 40 percent of the units must be reserved for occupancy by individuals and families of low income (60% of area median income). This last restriction will be incorporated into the Regulatory Agreement for the bonds. Further, in consideration of the City loans, the Project will be restricted as follows: 100% of the occupied units in the Project will be rented to individuals with incomes that do not exceed 35% of the area median income. These restrictions will remain for a period of 55 years. The one manager's unit will be unrestricted.

#### **Structure of the Bonds**

***Private Placement Structure*** The Bonds will be non-rated and not credit-enhanced and will be structured as a private placement with U.S. Bank National Association ("U.S. Bank") as the initial private placement purchaser. U.S. Bank will sign an Investor's Letter acknowledging that it is an "accredited investor" – i.e., a large institutional investor which understands and accepts the risks associated with unrated bonds secured by a first priority lien on the property located at 525 South Ninth Street and to be repaid from funds from a California Housing and Community Development Multifamily Housing Program (MHP) loan and a portion of tax credit equity funds at the time of completion of the Project. If the Bank wishes to transfer the Bonds, the new bondholder must sign and deliver a similar Investor Letter to the Bond Trustee. Unless they are rated "AA" or higher by Standard & Poor's or "Aa2" or higher by Moody's Investors Service, the Bonds may be held by no more than one holder at a time.

**Principal Amount and Term** The Bonds will be issued as tax-exempt bonds in an aggregate amount not to exceed \$11,000,000. The final maturity of the Bonds will be 24 months and can be extended in three month intervals as needed at the request of the developer and with the Bond Purchaser's concurrence. It is anticipated that the developer will repay the Bonds in approximately two years, after completion of the Project, from California Housing and Community Development Multifamily Housing Program (MHP) funds and a portion of the tax credit equity funds.

**Interest Rate** The Bonds will pay interest at a variable rate. The variable rate on the Bonds will be one of two variable rates, as determined from time to time by the Borrower: (i) the U.S. Bank prime rate less one percent (1%) multiplied by a tax-exempt conversion factor (currently, 75.218%) or (ii) 1.75% plus the 1, 2, 3, 6 or 12 month LIBOR rate multiplied by the tax-exempt conversion factor noted above.

Simultaneous with entering into the Bond Purchase Agreement, the Borrower and the Bond Purchaser, U.S. Bank, will enter into a Swap Agreement. The City is not a party to the Swap Agreement. Pursuant to the Swap Agreement the Borrower will pay U.S. Bank a fixed rate of interest. The interest rate swap is expected to provide an economic advantage to the project and is projected to be in excess of a 50 basis point interest rate differential.

**Draw Down Bond Structure** The Bonds are structured as draw down bonds; therefore, only a small amount of Bond proceeds will be released to and held by the Trustee on the issuance date. U.S. Bank will purchase the Bonds incrementally as the Project is constructed and requests for payment are received, in an aggregate amount not to exceed \$11,000,000.

### **Bond Financing Documents**

The following is a brief description of each document the City Council is being asked to approve and authorize the execution of. Copies of these documents will be available in the City Clerk's Office on or about May 25, 2007.

**Trust Indenture** The Bonds will be issued under a Trust Indenture (the "Indenture") between the City and Wells Fargo Bank, National Association, as the trustee (the "Trustee"). The Indenture is executed by the City Manager, or other authorized officers on behalf of the City, and attested by the City Clerk. Pursuant to the Indenture, the Trustee is given the authority to receive, hold, invest and disburse the Bond proceeds and other funds established under the Indenture; 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, and restrictions relating to any subsequent transfer of the Bonds. The Loan Agreement (described below) obligates the Borrower to compensate the Trustee for services rendered under the Indenture.

**Loan Agreement** This agreement (the "Loan Agreement") is among the City, U.S. Bank National Association, as Bondholder Representative and Bondholder and the Borrower, and is executed by the City Manager or other authorized officer on behalf of the City. The Loan Agreement provides for the loan of the Bond proceeds to the Borrower for the construction of the Project and for the repayment of such loan by the Borrower. The loan is evidenced by a Convertible Note and a Construction Note (collectively, the "Notes") in amounts that correspond to the Bonds. The interest of the City in receiving payments and other rights under the Indenture, the Loan Agreement and the Notes, will be assigned to the Trustee; 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** This agreement (the "Regulatory Agreement") is among the City, the Trustee and the Borrower, and is executed by the City Manager, or other authorized officers on behalf of the City. The Regulatory Agreement contains certain covenants and restrictions regarding the Project and its operations intended to assure compliance with the Tax Equity and Fiscal Responsibility Act (TEFRA). The Regulatory Agreement restricts the rental of Project units to the appropriate percentage of low-or very-low income individuals for a period of years required to maintain the tax-exempt status of the Bonds. The Regulatory Agreement restricts the rental of occupied Project units (59 units) to low income individuals for a period of 55 years.

**Bond Purchase Agreement** The Bond Purchase Agreement (the "Purchase Agreement") is a contract between the City, the Borrower and U.S. Bank (the "Private Placement Purchaser"), and is executed by the City Manager or other authorized officer on behalf of the City. The Purchase Agreement: sets forth the Private Placement Purchaser agreement to purchase the Bonds; specifies the representations and warranties of the City, the Borrower, and the Private Placement Purchaser; identifies the documents to be executed at closing; and, specifies the conditions that allow the Private Placement Purchaser under certain circumstances to terminate the Purchase Agreement.

### **City Funding**

The Housing Department will provide a loan to the Borrower in an aggregate amount not to exceed \$1,000,000 to purchase the property. The final transfer of the property to Casa Feliz Studios, L.P. is expected to occur on May 15, 2007. The funding commitment for items was approved by the City Council on August 15, 2006, Resolution No. 73353.

### **Financing Team Participants**

The financing team participants consist of:

- City's Financial Advisor                      E. Wagner & Associates, Inc.
- Bond Counsel                                      Nixon Peabody LLP
- Trustee    Wells Fargo Bank, National Association
- Private Placement Purchaser                U.S. Bank, National Association

All costs associated with the financial advisor, bond counsel and trustee are contingent on the sale of the Bonds and will be paid from Bond proceeds.

### Financing Schedule

The current proposed schedule is as follows:

- Council Approval of Bond Documents June 5, 2007
- Pre-Close and Close Bonds June 11-13, 2007
- CDLAC Deadline for Bond Closing June 29, 2007

### PUBLIC OUTREACH

The method of notifying the community of the City's intent to issue tax-exempt private activity bonds is for the City Council to hold a Tax Equity and Fiscal Responsibility Act (TEFRA) Hearing. The TEFRA Hearing was held on February 2, 2007 by the Director of Finance. The public hearing notice was published in the *San José Post Record* on January 10, 2007.

- Criteria 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criteria 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)**
- Criteria 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, Notice in appropriate newspapers)**

### COORDINATION

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

### COST IMPLICATIONS

All costs will be paid from Bond proceeds, California Department of Housing and Community Development Multifamily Housing Program funds and/or Borrower equity. The Bonds are tax-exempt obligations secured by a first priority lien against the 0.34 acre site located at 525 South Ninth Street. No payment of the Bonds will be paid from or guaranteed through the general taxing power of the City or any other City asset. The City will receive an issuance fee of

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approximately \$52,500. The City will also receive an annual fee for monitoring the Bonds and the Regulatory Agreement. Under current City policy, the annual fee is equal to one-eighth of a point (0.125%) of the original principal amount of the Bonds (approximately \$13,750).

No appropriation of funds is required at this time. Compensation for the financing team participants (financial advisor, trustee and bond counsel), as well as the costs of the financing, are contingent on the sale of the Bonds and will be paid from Bond proceeds.

**BUDGET REFERENCE**

This section is not applicable to the issuance of Bonds requested in this Staff Report.

**CEQA**

Mitigated Negative Declaration file number PDC05-020.



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