COUNCIL AGENDA: 02-24-04
ITEM:

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Scott P. Johnson
Leslye Corsiglia

SUBJECT: **SEE BELOW**

DATE: February 4, 2004

Approved Date

COUNCIL DISTRICT: 6
SNI AREA: Burbank/Del Monte

SUBJECT: APPROVAL OF THE ISSUANCE OF BONDS, LOAN OF BOND PROCEEDS AND RELATED DOCUMENTS FOR TRESTLES APARTMENTS

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 Variable Rate Demand Multifamily Housing Revenue Bonds (Trestles Apartments) Series 2004A-1 (the "Senior Bonds") and City of San José Subordinate Multifamily Housing Revenue Bonds (Trestles Apartments) Series 2004A-2" (the "Subordinate Bonds") in an aggregate principal amount not to exceed $8,625,000 (collectively, the "Bonds");

(b) Approving a loan of Bond proceeds to Fairfield Trestles, L.P., a California limited partnership, for financing the acquisition and rehabilitation of Trestles Apartments located at 1566 Scott Street in San Jose;

(c) Approving in substantially final form the Bonds, Trust Indenture, Financing Agreement, Indenture of Trust, Loan Agreement, Regulatory Agreement and Declaration of Restrictive Covenants, Intercreditor Agreement, Bond Purchase and Placement Agreement and Official Statement; and

(d) Authorizing the Director of Finance and Director of Housing to execute and, as appropriate, to negotiate, execute and deliver these bond documents and other related bond documents as necessary.

BACKGROUND

Fairfield Affordable Housing, LLC (the "Developer") has requested that the City issue tax-exempt multifamily housing revenue bonds for the purpose of lending the bond proceeds to a limited partnership (the "Borrower") created by the Developer. The Borrower will include the Developer as the administrative general partner, Wakeland Housing and Development Corporation, a California nonprofit public benefit corporation, as the managing general partner, and the tax credit investor, the Paramount Financial Group, as the limited partner. The proceeds of the loan will be used by the Borrower to finance a portion of the costs of acquiring and rehabilitating 71 units of family rental apartment housing to be known as Trestles Apartments (formerly known as "Del Oro Apartments") (the "Project").

Upon completion of the rehabilitation, 10% of the occupied units in the Project will be rented to families with incomes that do not exceed 50% of the area median income and 90% of the occupied units in the Project will be rented to families with incomes that do not exceed 60% 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.

On April 4, 2003, 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 $9,500,000 in tax-exempt multifamily housing revenue bonds to finance the construction of the Project. On April 15, 2003, the Mayor approved Certificate No. 2003-7, 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 $9,500,000 in private activity bonds. The Developer submitted a CDLAC allocation request for the Project in June 2003, but failed to get an award due to strong competition. On October 31, 2003, the City submitted another request to CDLAC for an allocation of $8,625,000. On December 17, 2003, the City received an allocation from CDLAC for this amount.

Total Project costs and financing requirements are estimated to be $15,190,000. It is estimated that this amount will be funded with: (1) Bond proceeds of $8,625,000; (2) tax credit equity of approximately $3,444,000; and (3) cash flow during construction and deferred fees of approximately $3,121,000. No City funds will be used in connection with the Project.

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 April 5, 2004. It is anticipated that the Bonds will close on or about March 4, 2004.

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 bond financing structure, bond financing documents, 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 (including acquisition and rehabilitation) 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 permanent financing – features not readily available in the conventional multifamily housing loan mortgage market. The Bonds are limited obligations of the City, payable solely from loan repayments by the Borrower and any credit enhancement.

Requirements for Tax-Exemption For multifamily housing revenue bonds to qualify for tax-exemption, generally 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). In the case of the Project, 10% of the occupied units will be rented to families with incomes that do not exceed 50% of the area median income and 90% of the occupied units will be rented to families with incomes that do not exceed 60% of the area median income. The one manager's unit will be unrestricted.

Structure of the Bonds

Principal Amount and Term The Bonds will be issued as a two series of tax-exempt bonds each with a term of approximately 33 years. The Senior Bonds (Series 2004A-1) will be variable rated demand bonds credit enhanced by Freddie Mac in an amount not to exceed $7,325,000. The Subordinate Bonds (Series 2004A-2) will be non-rated fixed rate bonds in an amount not to exceed $1,300,000.

Interest Rate During the acquisition/rehabilitation and lease-up period, the Senior Bonds will pay interest only. Once the Project is stabilized (i.e., 90% of the units after rehabilitation) are rented for 3 consecutive months and the Project has achieved the required debt service coverage), amortization of the Senior Bonds will commence on a 30-year basis. E.J. De La Rosa (the "Remarketing Agent") will reset the interest rate on the Senior Bonds on a weekly basis. The interest rate on the Senior Bonds will be subject to an interest rate cap hedge arrangement to be obtained and paid by the Borrower prior to the closing of the Senior Bonds.

The Subordinate Bonds will bear interest at a rate of 4% and will provide for payments based on a 33 year amortization schedule.

Credit Enhancement The Senior Bonds will be credit-enhanced by Freddie Mac – resulting in a AAA/A1+ rating from S&P. As Freddie Mac is a permanent lender and does not take construction or lease-up risk, the Borrower has arranged for East-West Bank and the Federal Home Loan Bank Board to issue standby-letters of credit to Freddie Mac during the acquisition/rehabilitation and lease-up periods.

The Subordinate Bonds will be unrated and privately placed by E.J. De La Rosa, Inc. to a single investor, who qualifies as an "accredited investor" under the City Council's adopted "Policy for the Issuance of Multifamily Housing Revenue Bonds". The Subordinate Bonds will be issued in a single denomination of $1,300,000 and can be transferred only to "qualified institutional investors." The Subordinate Bonds will be paid solely from a portion of the Project's net cash flow after payment of the Senior Bonds and other costs. It is expected that in approximately 7 years, all or a portion of the Subordinate Bonds will be remarketed with Freddie Mac credit enhancement on a parity with the Senior Bonds.

Bond Financing Documents

The following is a brief description of each document presented for City Council authorization for approval and execution. Copies of these documents will be available in the City Clerk's Office on or about February 17, 2004.

Official Statement This document is the public offering statement for the issuance of the Senior Bonds, and is executed by the Director of Finance or other authorized officer on behalf of the City and by authorized officers of the Borrower. The Official Statement is prepared by the Underwriter's counsel. This document describes the financing program, the terms of the Senior Bonds, the security for the Bonds, the economic and financial characteristics of the transaction, the Project and the participants. The City will not mail the Official Statement until Freddie Mac has issued its commitment to provide the credit enhancement and has given all other approvals. Because the Senior Bonds are issued in variable rate form, there will be no preliminary official statement for this transaction.

A copy of the draft Official Statement, in substantially final form, will be distributed under separate cover on or about February 17, 2004. Staff has carefully reviewed the information contained in the draft Official Statement and believes it to be accurate and complete in all material aspects. ***If any council member has any personal knowledge that any of the material information in the Official Statement is false or misleading, the council member must raise these issues prior to approval of the distribution of the document. City staff, bond counsel, and a representative of the Borrower will be available at the City Council meeting on February 24, 2004 to address any questions, issues and/or concerns.***

Trust Indenture The Senior Bonds will be issued under a Trust Indenture (the "Senior Indenture") among the City, Wells Fargo Bank, National Association, as the trustee (the "Trustee") and the Borrower. The Senior Indenture is executed by the Director of Finance, or other authorized officers on behalf of the City. Pursuant to the Senior Indenture, the

Trustee is given the authority to receive, hold, invest and disburse Senior Bond proceeds and other funds established under the Indenture; to authenticate the Senior Bonds; to apply and disburse payments to Senior Bondholders; and to pursue remedies on behalf of the Senior Bondholders. The Senior Indenture sets forth the guidelines for the administration, investment and treatment of investment earnings generated by each fund and account. The Senior Indenture also contains provisions relating to the conversion of the Subordinate Bonds to Parity Bonds. The Senior Indenture obligates the Borrower to compensate the Trustee for services rendered under the Indenture.

Financing Agreement This agreement (the "Financing Agreement") is among the City, the Trustee and the Borrower, and is executed by the Director of Finance or other authorized officer on behalf of the City. The Financing Agreement provides for the loan of the Senior Bond proceeds to the Borrower for the acquisition and rehabilitation of the Project and for the repayment of such loan by the Borrower. The interests of the City in receiving payments under the Financing Agreement and enforcing the receipt of such payments under the Financing Agreement have been assigned to the Trustee under the Senior Indenture; however, certain reserved rights have been retained by the City, such as the City's right to indemnification.

Indenture of Trust The Subordinate Bonds will be issued under an Indenture of Trust (the “Subordinate Indenture”) among the City, Wells Fargo Bank, National Association, as the trustee (the “Trustee”) and the Borrower. The Subordinate Indenture is executed by the Director of Finance, or other authorized officers on behalf of the City, and attested by the City Clerk. Pursuant to the Subordinate Indenture, the Trustee is given the authority to receive, hold, invest and disburse all funds established under the Indenture; to authenticate the Subordinate Bonds; to apply and disburse payments to Subordinate Bondholder; and to pursue remedies on behalf of the Subordinate Bondholders. The Subordinate Indenture sets forth the guidelines for the administration, investment and treatment of investment earnings generated by each fund and account. The Subordinate Indenture obligates the Borrower to compensate the Trustee for services rendered under the Indenture.

Loan Agreement This agreement (the "Loan Agreement") is among the City, the Trustee and the Borrower, and is executed by the Director of Finance or other authorized officer on behalf of the City. The Loan Agreement provides for the loan of the Subordinate Bond proceeds to the Borrower for the acquisition/rehabilitation of the Project and for the repayment of such loan by the Borrower. The interest of the City in receiving payments under the Loan Agreement and enforcing the receipt of such payments under the Loan Agreement have been assigned to the Trustee under the Subordinate Indenture; 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 Directors of Housing and Finance 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 Internal Revenue Code of 1986. The Regulatory Agreement restricts the rental of Project units to the appropriate percentage of low or very-low income individuals or families for a period of years required to maintain the tax-exempt status of the Bonds. In the case of the Project, 100% of the units will be restricted for a period of 55 years to individuals and families earning 50% and 60% of area median income.

Intercreditor Agreement This agreement (the "Intercreditor Agreement") is among the City as Issuer, the Trustee, East-West Bank (the "Construction Phase Credit Facility Provider") and Freddie Mac. This document is executed by the Director of Finance or other authorized officer on behalf of the City. The Intercreditor Agreement prioritizes certain rights and remedies of the City, Trustee, the Construction Phase Credit Facility Provider and Freddie Mac in the event that the Borrower defaults under either the Construction Phase Credit Facility or the Freddie Mac documents.

Bond Purchase and Private Placement Agreement The Bond Purchase and Private Placement Agreement (the "Purchase and Placement Agreement") is a contract between the City, the Borrower and E.J. De La Rosa, Inc.. (the "Underwriter/Placement Agent"), and is executed by the Director of Finance or other authorized officer on behalf of the City. The Purchase and Placement Agreement specifies the representations and warranties of the City, the Borrower and the Underwriter/Placement Agent, the documents to be executed at closing, and the conditions that allow the Underwriter to cancel its purchase and placement of the Bonds.

Financing Team Participants

The financing team participants consist of:

- City's Financial Advisor: Ross Financial
- Underwriter/Placement Agent: E.J. De La Rosa & Co., Inc.
- Remarketing Agent: E.J. De La Rosa & Co., Inc.
- Bond Counsel: Jones Hall, A Professional Law Corporation
- Trustee: Wells Fargo Bank, National Association

All costs associated with the financial advisor, underwriter/placement agent (including its counsel), bond counsel and trustee are contingent on the sale of the Bonds and will be paid from Bond proceeds and/or Borrower equity.

Financing Schedule
The current proposed schedule is as follows:

• Council Approval of Bond Documents	February 24, 2004
• Pricing of the Bonds	March 3, 2004
• Pre-Close and Close Bonds	March 4, 2004
• CDLAC Deadline for Bond Closing	April 5, 2004

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 April 4, 2003 by the Director of Finance. The public hearing notice was published in the San Jose Mercury News on March 20, 2003.

CEQA

Exempt (PP04-02-028).

RELOCATION

If the relocation survey analysis determines that some of the households are over the income limits set by the City's affordability restrictions, those households will be relocated. The Developer has agreed to provide relocation assistance to any displaced tenant.

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 or Borrower equity. The Bonds are tax-exempt obligations secured by mortgage loans and, in the case of the Senior Bonds, are credit enhanced by Freddie Mac. The cost of the Freddie Mac credit enhancement is provided at the expense of the Borrower. 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: (1) an up-front fee of one-half of one percent (0.50%) or approximately $43,125 and (2) an annual fee equal to one-eighth of a point (0.125%) of the original principal amount of the Bonds, approximately

$10,781.25, for the staff work involved in the issuance of the Bonds and monitoring of the Bonds and the Regulatory Agreement.

No City funds will be required in connection with the Project or the Bonds. Compensation for the financing team participants (financial advisor, underwriter and placement agent, 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 either Bond proceeds or Borrower equity. This action is consistent with the Mayor's Budget Strategy adopted by the City Council on February 4, 2003, under both General Principles and Economic Recovery.

SCOTT P. JOHNSON	LESLYE CORSIGLIA
Director, Finance Department	Director, Housing Department