COUNCIL AGENDA: 06-01-04
ITEM:

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Leslye Corsiglia

SUBJECT: **SEE BELOW**

DATE: May 14, 2004

Approved

Date

COUNCIL DISTRICT: 3
SNI AREA: N/A

SUBJECT: APPROVAL OF THE ISSUANCE OF BONDS, LOAN OF BOND PROCEEDS AND RELATED DOCUMENTS FOR THE VINTAGE TOWER 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 Multifamily Housing Revenue Bonds (Vintage Tower Apartments) Series 2004B" in an aggregate principal amount not to exceed $5,500,000 (the "Bonds") to be issued and delivered in two sub-series designated as Series 2004B-1 in the estimated principal amount of $4,350,000 and as Series 2004B-2 in the estimated principal amount of $1,150,000;

(b) Approving a loan of bond proceeds to First Methodist Church Tower Properties, L.P., a California limited partnership, for financing the acquisition and rehabilitation of the Vintage Tower Apartments located at 235 East Santa Clara Street in San Jose;

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

(d) Authorizing the City Manager or other authorized officer to execute and, as appropriate, to negotiate, execute and deliver these documents and other related documents as necessary.

BACKGROUND

The First United Methodist Church of San Jose (the "Developer") has requested that the City issue tax-exempt multifamily housing revenue bonds for the purpose of lending the bond proceeds to First Methodist Church Tower Properties, L.P., a California limited partnership (the "Borrower") created by the Developer. The proceeds of the loan (the "Mortgage Loan") will be used by the Borrower, together with other funds, to finance the acquisition and rehabilitation of 59 units of family rental housing known as Vintage Tower Apartments (the "Project"). The Redevelopment Agency acquired the Project through a foreclosure and intends to transfer the Property to the City, which in turn will transfer the Property to the Borrower for the aggregate amount of $5,250,000 through a Disposition and Development Agreement approved by the City Council on April 27, 2004, Resolution No. 72803.

Upon the rehabilitation of the Project, all of the units, including the manager's unit, will be restricted to the rental to families of low and very low income. These restrictions will remain in effect for 55 years.

On February 9, 2004, 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 $6,000,000 in tax-exempt multifamily housing revenue bonds to finance the acquisition and rehabilitation of the Project. On February 18, 2004, the City submitted a request to CDLAC for an allocation of $5,500,000. On April 21, 2004, the City received an allocation from CDLAC for this amount.

Total Project financing requirements, including reserves and financing costs, are estimated to be $10.722 million. The difference between the aggregate par amount of the Bonds and total Project costs will be funded with a loan in an amount of $2.225 million from the City to the Borrower; tax credit equity of approximately $2.821 million; a loan from the Developer in the amount of $330,000; and deferred developer fee in the amount of approximately $996,000. After completion of the Project, the Series 2004B-2 Bonds will be redeemed from tax credit equity for 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 July 20, 2004. It is anticipated that the Bonds will close on or about June 9, 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, City loan, 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. 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, 41% of the units will be rented to families earning no more than 50% of area median income and 59% of the units will be rented to families earning no more than 60% of area median income.

Structure of the Bonds

Principal Amount and Term The Bonds will be issued in two sub-series (Series 2004B-1 and Series 2004B-2) as tax-exempt bonds in an aggregate amount not to exceed $5,500,000. It is anticipated that the Series 2004B-1 Bonds will have a par amount of $4,325,000 and a final maturity of approximately 33 years. It is anticipated that the Series 2004B-2 Bonds will have a par amount of $1,150,000, a final maturity of approximately 2.5 years and will be repaid from tax credit equity at or prior to maturity.

Interest Rate Each sub-series of the Bonds will bear interest at fixed tax-exempt rates. The interest rate will be determined at pricing of the Bonds, which is planned to occur on or about June 2, 2004. It is anticipation that the rate on the Series 2004B-1 Bonds will be in effect through January 2025 at which time it will be reset.

Fannie Mae Private Placement Structure The Fannie Mae private placement structure is generally similar in structure to a publicly offered fixed-rate Fannie Mae issue, except that the Bonds are not rated nor are they sold to the public. Fannie Mae will purchase the Bonds through a direct placement. Fannie Mae will sign an Investor's Letter acknowledging that it is an "accredited investor" with no intention to resell the Bonds. If Fannie Mae wishes to transfer the Bonds to another purchaser at a later date, the subsequent purchaser must deliver a similar Investor Letter to the Trustee and the City. The Bonds can only be transferred in whole.

During rehabilitation and lease-up of the Project, and until the conversion date when the Project is complete and rent stabilization/debt service coverage is achieved for a requisite period (the "Conversion Date"), the construction lender (Silicon Valley Bank) will issue a letter of credit for the benefit of Fannie Mae. On the Conversion Date, which is anticipated to be approximately two and a half years after the issuance of the Bonds, the letter of credit will terminate and the principal of the Series 2004B-1 Bonds will commence amortization over the remaining 30 years. Also, at that time it is anticipated that the Series 2004B-2 Bonds will be repaid from tax credit equity. It is anticipated that the final commitment for Fannie Mae to purchase the Bonds will be received from ARCS Commercial Mortgage, the Fannie Mae DUS Lender, on or about May 26, 2004.

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 24, 2004.

Trust Indenture The Bonds will be issued under a Trust Indenture (the "Indenture") between the City, Wells Fargo Bank, National Association, as the trustee (the "Trustee") and the Borrower. 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 Bond owners; and to pursue remedies on behalf of the Bond owners. The Indenture sets forth the guidelines for the administration, investment and treatment of investment earnings generated by each fund and account. The 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 City Manager or other authorized officer on behalf of the City. The Financing Agreement provides for the loan of the Bond proceeds (the "Mortgage Loan") to the Borrower for the 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 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 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 Internal Revenue Code of 1986. The Regulatory Agreement restricts the rental of Project units to low and very-low income families for a period of 55 years as previously described.

Bond Purchase Agreement The Bond Purchase Agreement (the "Agreement"), is a contract between the City and Fannie Mae (the "Bond Purchaser"), and is acknowledged and agreed to by the Borrower. The Bonds will be directly privately placed with the Bond Purchaser. The Agreement specifies the representations and warranties of the City, the Borrower and the Bond Purchaser and the documents to be executed at closing. This document is executed by the Director of Finance or other authorized officer on behalf of the City. The interest rate will be a fixed rate to be determined upon pricing of the Bonds on or about June 2, 2004.

Assignment of Mortgage Loan This document (the "Assignment") is among the City (the "Assigner"), the Trustee, and Fannie Mae (the "Assignee" and jointly with the Trustee the "Assignees"). The purpose of this document is to assign the City's rights and interests under the Mortgage Loan, including the right to receive payments under the Mortgage Note evidencing the Mortgage Loan (including all proceeds of insurance or condemnation awards), and in and to all funds and accounts (other than the Rebate Fund) held, maintained or administered by the Trustee to the Trustee and to Fannie Mae as their interests may appear.

City Housing Loan

The Housing Department will make a loan to the Borrower in an amount not to exceed $2,225,000. The funding commitment for this loan to the Borrower was approved by the City Council on April 27, 2004, Resolution No. 72803.

Financing Team Participants

The financing team participants consist of:

- City's Financial Advisor: Ross Financial
- Bond Counsel: Hawkins, Delafield & Wood
- Trustee: Wells Fargo 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 and/or Borrower equity.

Financing Schedule

The current proposed schedule is as follows:

- Council approval of Bond documents June 1, 2004
- Pricing of the Bonds June 2, 2004
- Pre-Close and Close Bonds June 7-9, 2004
- CDLAC Deadline for Bond Closing July 20, 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 February 9, 2004 by the Director of Finance. The public hearing notice was published in the San Jose Post Record on January 23, 2004.

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 that are payable from Project revenues. 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 up-front fee of $27,500 and an annual fee equal to one-eighth of a point (0.125%) of the original principal amount of the Bonds, approximately $6,875, for the staff work involved in the issuance of the Bonds and monitoring of the Bonds and the Regulatory Agreement.

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

CEQA

Exempt (PP03-03-090).

LESLYE CORSIGLIA
Director, Housing Department