COUNCIL AGENDA: 09-28-04
ITEM: 10.2(a)

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 13, 2004

Approved [signature] Date Sept. 14, 2004

COUNCIL DISTRICT: 3
SNI AREA: N/A

SUBJECT: APPROVAL OF THE ISSUANCE OF BONDS, LOAN OF BOND PROCEEDS AND RELATED DOCUMENTS FOR THE DELMAS PARK 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 (Delmas Park) Series 2004C-1 and Series 2004C-2" in an aggregate principal amount not to exceed $19,379,000 (collectively, the "Bonds" and, individually, the Series 2004C-1 Bonds and Series 2004C-2 Bonds);

(b) Approving a loan of Bond proceeds to Delmas Park Associates, L.P., a California limited partnership, for financing the construction of the Delmas Park Apartments Project located at 598 West San Carlos Street in San Jose;

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

BACKGROUND

CORE Development Inc. (the "Developer") has requested that the City issue tax-exempt multifamily housing revenue bonds for the purpose of lending the bond proceeds to Delmas Park Associates, 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 123 units of family rental apartment housing to be known as Delmas Park Apartments (the "Project"). Upon completion of the Project, 21% of the occupied units in the Project will be rented to families with incomes that do not exceed 30% of the area median income, 33% of the occupied units will be rented to families with incomes that do not exceed 50% of the area median income and 46% of the occupied units in the Development 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 unrestricted manager's units.

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 $20,000,000 in tax-exempt multifamily housing revenue bonds to finance the construction of the Project. On February 23, 2004, the Mayor approved Certificate No. 2004-4, 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 $20,000,000 in private activity bonds. On July 7, 2004, the City submitted a request to CDLAC for an allocation of $19,379,000. On September 15, 2004, the City received an allocation from CDLAC for this amount.

Total Project financing requirements are estimated to be $39,310,000. The sources of funds are different during the construction period and at permanent financing. During construction, it is estimated that the costs of the Project will be funded with: (1) $19,379,000 of Bond proceeds, consisting of $13,780,000 of the Series 2004C-1 Bonds and $5,599,000 of the Series 2004C-2 Bonds; (2) City loans, grants and fee waivers in the aggregate amount of approximately $12,972,000 to the Borrower; (3) a County of Santa Clara loan in the amount of $260,000; (4) tax credit equity of approximately $4,700,000; and (5) approximately $2,000,000 in deferred developer fee.

After completion of the Project, it is estimated that the Development costs will be funded with: (1) $13,780,000 of Bond proceeds; (2) City loans, grants and fee waivers in the aggregate amount of approximately $12,972,000; (3) a County of Santa Clara loan in the amount of $260,000; (4) tax credit equity of approximately $11,914,000; and (5) approximately $384,000 in deferred developer fee. A portion of the tax credit equity payments received at completion will be used to retire the Series 2004C-2 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 December 14, 2004. It is anticipated that the Bonds will close on or about September 30, 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 – 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 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, 54% of the occupied units will be rented to families with incomes that do not exceed 50% of the area median income (including 21% of the units to be rented to families with incomes that do not exceed 30% of area median income) and 46% 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 in an aggregate amount not to exceed $19,379,000. The Series 2004C-1 Bonds are expected to be issued in the amount of $13,780,000 for a term of approximately 42.3 years and the Series 2004C-2 Bonds are expected to be issued in the amount of $5,599,000 for a term of approximately 3.5 years.

Interest Rate During the construction period, the Bonds will pay interest only at a variable rate equal to the prime rate less one-half percent (1/2%). Once the Project is completed, the interest rate will be fixed at 6.40%. Amortization is expected to commence on 40 year basis in January 2007.

Private Placement Structure Because the Bonds will be non-rated and not credit-enhanced, they will be structured as a private placement. Bank of America will be the initial private placement purchaser and will sign an Investor's Letter acknowledging that it is an "accredited investor." If the Bank wishes to transfer the Bonds, the new bondholder must sign and deliver a similar Investor Letter to the Bond Trustee. In addition, the Bonds have a minimum denomination of $250,000.

Charter Mac, a statutory trust, has agreed to purchase the 2004C-1 Bonds upon completion of the Project. The Series 2004C-2 Bonds will be retired at Project completion from the proceeds of tax credit equity.

Draw Down Bond Structure The Bonds are structured as draw down bonds. Only a small amount of Bond proceeds will be released to and held by the Trustee at closing. Bank of America will fund the Bonds incrementally as the Project is constructed, in an aggregate amount not to exceed $19,379,000.

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 September 21, 2004.

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 Indenture obligates the Borrower to compensate the Trustee for services rendered under the Indenture.

Loan 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 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 interest of the City in receiving payments under the Loan Agreement and enforcing the receipt of such payments under the Loan Agreement has 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 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. 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.

Subordination Agreements There are two Subordination Agreements: one among the City, the Trustee, the Borrower and the County of Santa Clara (the "County") and the other among the City, the Trustee, the Bank and the Borrower (collectively, the "Subordination Agreements"). These Agreements are executed by the City Manager or other authorized officer on behalf of the City. The Subordination Agreements prioritize certain rights and remedies of the City, Trustee, Bank and the County in the event that the Borrower defaults under either of its subordinate loan agreements with the City, Bank or County.

Bond Purchase Agreement The Bond Purchase Agreement (the "Purchase Agreement") is a contract between the City, the Borrower and Bank of America (the "Private Placement Purchaser"), and is executed by the City Manager or other authorized officer on behalf of the City. The Purchase Agreement specifies the representations and warranties of the City, the Borrower and the Private Placement Purchaser, the documents to be executed at closing, and the conditions that allow the Private Placement Purchaser to terminate the Purchase Agreement.

City Housing Loans and Grants

The Housing Department will provide a loan and grant to the Borrower in an amount not to exceed $11,506,605, including a retail grant of $1,500,000 on behalf of the Redevelopment Agency. In addition, there is expected to be a waiver of the Redevelopment Agency's impact fee in the amount of $1,291,500. The funding commitment for items was approved by the City Council on June 29, 2004, Resolution No. 72252.

Financing Team Participants

The financing team participants consist of:

- City's Financial Advisor: Ross Financial
- Bond Counsel: Quint & Thimmig LLP
- 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, City loan proceeds and/or Borrower equity.

Financing Schedule

The current proposed schedule is as follows:

• Council Approval of Bond Documents	September 28, 2004
• Pre-Close and Close Bonds	September 29-30, 2004
• CDLAC Deadline for Bond Closing	December 14, 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, City loan or Borrower equity. The Bonds are tax-exempt obligations secured by mortgage loans 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 approximately $73,447.50 and an annual fee equal to one-eighth of a point (0.125%) of the original principal amount of the Bonds, approximately $24,223.75, 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, 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, City loan 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

Downtown Strategy Plan EIR and addenda thereto, Resolution No. 64273 and 68839, File No. PDC03-016.

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