COUNCIL AGENDA: 12-06-05
ITEM: 4.4(a)

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Leslye Krutko
Julia H. Cooper

SUBJECT: SEE BELOW

DATE: November 14, 2005

Approved

Date 11/17/05

COUNCIL DISTRICT: 7
SNI AREA: Tully/Senter

SUBJECT: APPROVAL OF THE ISSUANCE OF BONDS, LOAN OF BOND PROCEEDS AND RELATED DOCUMENTS FOR THE PASEO SENTER I 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 (Paseo Senter I) Series 2005B-1 and Series 2005B-2" in an aggregate principal amount not to exceed $29,947,600 (collectively, the "Bonds");

(b) Approving a loan of Bond proceeds to Paseo Senter, L.P., a California limited partnership, for financing the construction of the Paseo Senter I project located at 1896, 1900 and 1970 Senter Road 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.

(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; and

(e) Authorizing the City Manager to negotiate and execute an amendment to the general financial advisory agreement with Ross Financial, increasing the scope of service to include bond-specific work related to the Paseo Senter I and Paseo Senter II projects, and increasing compensation by $60,000 for the two projects combined for a total amount not to exceed $225,000 for financial advisory fees.

BACKGROUND

Charities Housing Development Corporation and CORE Development Inc. (collectively, the "Developer") have requested that the City issue tax-exempt multifamily housing revenue bonds for the purpose of lending the bond proceeds to Paseo Senter, 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 117 units of family rental apartment housing to be known as Paseo Senter I Apartments (the "Project"). Upon completion of the Project, 10% of the occupied units in the Project will be rented to families with incomes that do not exceed 15% of the area median income, 20% of the occupied units will be rented to families with incomes that do not exceed 25% of the area median income and 68% of the occupied units in the Project will be rented to families with incomes that do not exceed 50% of the area median income. These restrictions will remain for a period of 55 years. Two of the Project's units are unrestricted manager's units.

On July 18, 2005, 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 $32,000,000 in tax-exempt multifamily housing revenue bonds to finance the construction of the Project. On July 18, 2005, the Mayor approved Certificate No. 2005-3, 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 $32,000,000 in private activity bonds. On July 27, 2005, the City submitted a request to CDLAC for an allocation of $29,947,600. On September 21, 2005, the City received an allocation from CDLAC for this amount.

Total costs for the Project are still being finalized but are estimated at $43,365,697. The final breakdown of funding sources will be presented in a supplemental staff report. The sources of funds are different during the construction period and at permanent financing. During construction, the Project will be funded from several different sources: (1) Bond proceeds, (2) City loans and grants, (3) Federal Home Loan Bank Affordable Housing Program ("AHP") funds, (4) a Housing and Urban Development McKinney-Vento Homeless Assistance Supportive Housing ("SHP") grant; (5) tax credit equity; and (6) developer equity, lease-up income, and certain other deferred costs.

After completion of the Project, the Project costs will be funded with: (1) Bond proceeds; (2) City loans and grants; (3) California Housing and Community Development's Multifamily Housing Program ("MHP") funds; (4) Federal Home Loan Bank AHP funds; (5) a Housing Trust of Santa Clara County loan; (6) a County of Santa Clara Affordable Housing Fund loan; (7) HOME Investment Partnership Act funds through the County of Santa Clara; (8) a Housing and Urban Development McKinney-Vento Homeless Assistance Supportive Housing ("SHP") grant; (9) tax credit equity; and (10) developer equity and lease-up income.

The California Housing and Community Development Multifamily Housing Program (MHP) funds, County of Santa Clara funds and a portion of the tax credit equity funds received at completion of construction will be used to retire the Series 2005B-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 20, 2005. It is anticipated that the Bonds will close on or about December 15, 2005.

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 and any credit enhancement.

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: 10% of the occupied units in the Project will be rented to families with incomes that do not exceed 15% of the area median income, 20% of the occupied units will be rented to families with incomes that do not exceed 25% of the area median income and 70% of the occupied units in the Project will be rented to families with incomes that do not exceed 45% of the area median income. The two manager's units 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 the Project rents. 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 a two series of tax-exempt bonds in an aggregate amount not to exceed $29,947,600. The final maturity of the Bonds is estimated to be approximately 33 years. The Series 2005B-1 Bonds are expected to be issued in the amount of $6,197,200 and the Series 2005B-2 Bonds are expected to be issued in the amount of $23,750,400. It is expected that the Series 2005B-2 Bonds will be repaid in approximately 3 years, after completion of the Project, from California Housing and Community Development Multifamily Housing Program (MHP) funds, County of Santa Clara loan funds and a portion of tax credit equity funds.

Interest Rate During the construction period, the Bonds will pay interest only at a variable rate. The variable rate on the Series 2005B-1 Bonds will be the U.S. Bank prime rate plus fifty basis points (0.5%) multiplied by a tax-exempt conversion factor (currently, 75.218%). The variable rate on the Series 2005B-2 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.

Once the Project is completed, the interest rate on the Series 2005B-1 Bonds will be fixed through a period of approximately 15 years after the completion and lease-up of the Project (approximately January 1, 2024) (the "Repricing Date"). The fixed rate will be based on the following formula: U.S. Bank's Community Investment Pricing Index plus a spread of 1.75% multiplied by a tax-exempt conversion factor. After the Repricing Date, the interest rate will be fixed in a manner similar to the initial fixed rate. Amortization of the Series 2005B-1 Bonds is expected to commence on a 30-year basis in January 2008.

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 $29,947,600.

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 November 28, 2005.

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 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 Series 2005B-1 and 2005B-2 Bonds, respectively. 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 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.

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 and grant to the Borrower in an aggregate amount not to exceed $7,143,800. The funding commitment for items was approved by the City Council on June 29, 2004, Resolution No. 72231.

Financing Team Participants

The financing team participants consist of:

- City's Financial Advisor: Ross Financial
- Bond Counsel: Jones Hall LLP
- Trustee: Wells Fargo Bank, National Association
- Private Placement Purchaser U.S. Bank, National Association

Ross Financial currently serves as the Housing Department's general financial advisor. The existing agreement was entered into in April 2001 for an original term of four years with two one-year extension options. Both options have been exercised and the final expiration date is June 30, 2006.

The scope of services of the existing contract does not include bond-specific work. The pool for financial advisors for specific bond issues expired in June 2005 and a new pool has not yet been established. Although staff is in the process of requesting proposals from potential pool participants, it is not practicable to complete the RFQ and selection process by December 20, 2005, the latest date on which the bonds can close. Consequently, staff is recommending that Council approve an amendment to expand the scope of services to include serving as financial advisor in connection with the issuance of multifamily housing revenue bonds for the Paseo Senter I and Paseo Senter II projects, and increase total compensation by $60,000 to a not-to-exceed amount of $225,000. The compensation will include a flat fee of $30,000 for Paseo Senter I and a flat fee of $30,000 for Paseo Senter II, contingent on the sale of bonds.

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 December 6, 2005
- Pre-Close and Close Bonds December 13-15, 2005
- CDLAC Deadline for Bond Closing December 20, 2005

OUTCOMES

Approval of the recommended actions will allow for the issuance of multifamily housing revenue bonds for the purpose of constructing 117 housing units, 115 of which will be affordable for 55 years.

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 July 18, 2005 by the Director of Finance. The public hearing notice was published in the *San José Post Record* on July 1, 2005.

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 proceeds 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 issuance fee of approximately $99,869. 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 $37,434.50).

On November 17, 2005, a recommended amendment to the "Policy of the Issuance of Multifamily Housing Revenue Bonds" will be presented to the Making Government Work Better Committee, which proposes a revised methodology of calculating the annual monitoring fee. If this change is approved by Council on November 29, 2005, the annual monitoring fee will be reduced to $7,746.50 (i.e., the greater of one-eighth of a point (0.125%) of the amount of permanent bonds outstanding following completion and lease-up of the Project (approximately $7,746.50) or $7,500). The fee will not be reduced as the bonds amortize.

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.

CEQA

Mitigated Negative Declaration file number PDC03-057.

Julia H Cooper
JULIA H. COOPER
Deputy Director of Finance

Leslye Krutko
LESLYE KRUTKO
Director, Housing Department