COUNCIL AGENDA: 10-27-09
ITEM: 4.2

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: October 5, 2009

Approved

Date 10-13-09

COUNCIL DISTRICT: 3
SNI AREA: N/A

SUBJECT: APPROVAL OF THE ISSUANCE OF BONDS, LOAN OF BOND PROCEEDS, RELATED DOCUMENTS, AND CHANGE IN INCOME RESTRICTIONS FOR THE BELOVIDA AT NEWBURY PARK SENIOR 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 (Belovida at Newbury Park Senior Apartments), Series 2009A" in an aggregate principal amount not to exceed $26,200,000 (the "Bonds");

b. Approving a loan of Bond proceeds to Belovida at Newbury Park, L.P., a California limited partnership created by CORE Affordable Housing, LLC and EAH, Inc., to finance the construction of the Belovida at Newbury Park Senior Apartments located at 1777 Newbury Park Drive in San José;

c. Approving in substantially final form the Bonds, Trust Indenture, Loan Agreement, and Regulatory Agreement and Declaration of Restrictive Covenants;

d. Authorizing the City Manager, Director of Finance, Assistant Director of Finance, Treasury Division Manager, Debt Administrator, and Director of Housing, or their designees, to execute and, as appropriate, to negotiate, execute and deliver these Bond documents and other related Bond documents as necessary; and

e. Approving a change in the project's income restrictions, related to units restricted to extremely low-income and very low-income households, to 48 units restricted to households at or below 30% of Area Median Income ("AMI"), 136 units restricted to households at or below 50% of AMI, and one unrestricted manager's unit.

OUTCOME

Approval of the recommended actions will allow for the issuance of multifamily housing revenue bonds for the purpose of constructing 185 apartments of senior housing, composed of 184 units that will be affordable for a period of at least 55 years and one manager's unit that is unrestricted. These apartments will serve senior residents with current annual incomes between $22,300 and $42,450.

EXECUTIVE SUMMARY

CORE Affordable Housing, LLC and EAH, 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 Belovida at Newbury Park, L.P., a California limited partnership (the "Borrower"), created by the Developer. The Bonds will be non-rated and not credit-enhanced and will be structured as a private placement with Bank of America as the initial purchaser. The proceeds of the loan, together with other funds, will be used by the Borrower to finance the construction of 185 units of senior rental apartment housing to be known as Belovida at Newbury Park Senior Apartments (the "Project").

Additionally, the Housing Department will provide a loan to the Borrower for this Project in an amount not to exceed $21,491,607, as approved by the City Council on February 25, 2008 and on May 19, 2009. The City Council also approved a loan commitment to serve as a backstop for the previously awarded 1C Infill Grant in the amount of $3,123,330 in the event that the State of California cannot fund this during construction. These funds, if used, are temporary, with the City's funds being reimbursed by Developer from the actual 1C Infill Grant funds they become available to the Project. This report further provides an update on the Project's combined Loan-to-Value ratio, as well as information detailing the Project's economic development benefits.

BACKGROUND

EAH, Inc. and CORE Affordable Housing, LLC, have requested that the City issue tax-exempt multifamily housing revenue bonds for the purpose of lending the Bond proceeds to Belovida at Newbury Park, L.P., a California limited partnership, created by the Developer. The proceeds of the loan, together with other funds, will be used by the Borrower to finance the construction of 185 units of senior rental apartment housing to be known as Belovida at Newbury Park Senior Apartments. Upon completion of the Project, 100% of the occupied units in the Project will be rented to seniors with incomes that do not exceed 50% of the Area Median Income ("AMI").

These restrictions will remain for a period of at least 55 years. One of the Project's units is an unrestricted manager's unit.

On March 13, 2009, the Deputy 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 $26,200,000 in tax-exempt multifamily housing revenue bonds to finance the construction of the Project. On March 24, 2009, the Mayor approved Certificate No. 2009-1, 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 $26,200,000 in private activity bonds. On May 20, 2009 the City submitted a request to CDLAC for an allocation of $26,200,000. On July 22, 2009, the City received an allocation from CDLAC for this amount.

The Bonds will be structured as a single series in an amount currently estimated to be $24,170,000. Bond proceeds will fund a portion of the total Project costs, which are estimated at approximately $49,156,633. The estimated sources of funding differ during construction and following completion and lease-up ("permanent"), as shown in the following table:

City of San José
Belovida at Newbury Park Senior Apartments
Plan of Finance – Sources of Funding

Source	Construction	Permanent
Bonds Proceeds	$ 24,170,000	$ 10,970,000
City Loans	20,421,919	20,491,607
State of California – 1C Infill Grant(1)	3,123,330	3,123,330
Tax Credit Equity	0	12,654,978
Developer Equity/Lease-up Income/Deposits	0	153,000
New Solar Home Partnership – Solar Incentive Funds	0	337,095
FHLB AHP Funds(2)	0	0
Deferred Costs	1,220,241	1,205,480
Total	$ 48,935,490	$ 48,935,490

(1) City Council approved a loan commitment to serve as a backstop for the previously awarded 1C Infill Grant in the amount of $3,123,330 in the event that the State of California cannot fund this during construction. These funds, if used, are temporary and will be replaced by the actual 1C Infill Grant when it is available to the Project.

(2) The Developer has also applied for Federal Home Loan Bank Affordable Housing Program Funds ("AHP Funds"). If the Developer is awarded AHP Funds, these funds will assist in financing the Project.

A portion of the tax credit equity funds received at completion of construction will be used to retire a portion of the Bonds with the resulting amount of outstanding Bonds at no more than $11,210,000. One of CDLAC's requirements is that the Bond closing must occur within the time period set by CDLAC. The Bond closing for this Project must occur by November 9, 2009. It is anticipated that the Bonds will close on or about November 5, 2009.

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 modification to the affordability targeting, Bond financing structure, Bond financing documents, 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 Borrower. The bonds are typically issued as tax-exempt securities. The advantages of tax-exempt bonds to the Borrower 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% of the units in the housing development must be reserved for occupancy by individuals and families whose income is 50% or less of area median income or (2) at least 40% of the units must be reserved for occupancy by individuals and families whose income is 60% or less 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 seniors with incomes that do not exceed 50% of the area median income. 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 Bank of America ("Bank of America" or "Private Placement Purchaser") as the initial private placement purchaser. Pursuant to the City's policies regarding non-credit enhanced bonds, the Private Placement Purchaser will sign an Investor's Letter acknowledging that it is a "qualified institutional buyer" or an "accredited investor", that is, a large institutional investor who understands and accepts the risks associated with unrated bonds secured solely by the Project rents. If the Private Placement

Purchaser wishes to transfer the Bonds, the new bondholder must sign and deliver a similar Investor's Letter to the 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. Minimum denominations of the Bonds will be at least $250,000.

Principal Amount and Term Initially, the Bonds will be issued as interest-only floating rate tax-exempt bonds in an aggregate amount not to exceed $26,200,000. Upon completion of the Project and after lease-up and conversion of the Project, a portion of the tax credit equity funds will be used to payoff a portion of the Bonds with the remaining outstanding amount of the Bonds equal to no more than $11,210,000. At that time (the "Conversion Date"), which is estimated to be 30 months after the issuance of the Bonds, the Bonds will convert to a fixed-rate tax-exempt bond fully amortized over 30 years with a 17-year reset date.

Interest Rate During the construction period, the Bonds will pay interest only at a variable rate. The interest rate will be equal to the greater of: a) three percent (3.0%), or b) 30-day LIBOR plus 2.57% as determined on an actual/360-day basis, which results in more interest than if a 365-day year were used.

Once the Project is completed and at the Conversion Date, the interest will accrue at a fixed rate calculated on a 30/360-day basis and that rate will remain in effect for 17 years (the "Fixed Rate Period"). The fixed rate will be determined immediately prior to Bond closing based upon then applicable market rates for similar bonds. Bank of America estimates that were the rate determined today, the rate would be approximately 6.6%. Interest is paid monthly during the Fixed Rate Period.

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 October 16, 2009.

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, Bank of America, and the Borrower. The Loan Agreement 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 note (the "Note") in an amount that corresponds to the principal amount of the Bonds. The City's rights to receive payments under the Note will be assigned to the Trustee, along with certain other rights under the Indenture, the Loan Agreement and the Note; 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. The Regulatory Agreement 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 (except for the one manager's units) to low-income seniors for a period of at least 55 years as previously described.

Financing Team Participants

The financing team participants consist of:

- City's Financial Advisor: E. Wagner & Associates, Inc.
- Bond Counsel: Orrick, Herrington & Sutcliffe LLP
- Trustee: Wells Fargo Bank, National Association
- Private Placement Purchaser Bank of America

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 October 27, 2009
- Pre-Close and Close Bonds November 3-5, 2009
- CDLAC Deadline for Bond Closing November 9, 2009

City Subordinate Funding

The Housing Department will provide a loan to the Borrower in an amount not to exceed \$21,491,607. The funding commitment was approved by the City Council on February 25, 2008 and on May 19, 2009, Resolutions No. 74289 and No. 74911, respectively. The City Council also approved a loan commitment to serve as a backstop for the previously awarded 1C Infill Grant in the amount of $3,123,330 in the event that the State of California cannot fund this during construction. These funds, if used, are temporary, with the City's funds being reimbursed by Developer from the actual 1C Infill Grant funds they become available to the Project.

Modification to the Affordability Targeting

On March 18, 2008, the City Council approved a funding commitment for the Belovida at Newbury Park affordable housing project to be made available to extremely low-income ("ELI") and very low-income ("VLI") senior households. At the time of the City funding commitment, the Project contemplated 180 total units, which included 45 units affordable to households earning up to 30% of AMI, 93 units affordable to households earning up to 45% of AMI, 40 units affordable to households earning up to 50% of AMI, and two unrestricted managers' units.

Subsequently, the Developer redesigned the Project to include 185 total units and now must adjust the Project's unit affordability mix due to the need for a technical correction. The proposed unit mix will be 48 units at 30% of AMI, 136 units at 50% of AMI, and one unrestricted manager's unit. The change in the Project's affordability mix is needed because of Internal Revenue Service ("IRS") regulations. In accordance with the Housing and Economic Recovery Act of 2009 ("HERA"), HUD published "HERA special income limits" for 2007 and 2008 to determine allowable project rents. The IRS has not made a determination of 2009 rents, so the Developer has opted not to use the "HERA special income limits" and has been advised to use the non-special income limits. This requires a corresponding adjustment to the Project's affordability mix, as rent levels for 45% AMI under HERA limits are equivalent to 48% AMI under non-special income limits. The City plans to restrict the units for households at or below 50% AMI income levels while rents charged are expected to be appropriate for residents at the 48% AMI level.

As consideration for making the requested change to the unit affordability mix, the City is receiving three additional units at 30% of AMI.

Loan-to-Value Update

The City Council action approved on May 19, 2009 included the waiver of the 100% combined Loan-to-Value (LTV) policy. The senior lender has shared with City staff an appraisal from The Fillmore Group dated September 2009 that indicates a combined LTV for senior and City debt of 162%. This is overstated given that the City restrictions will be at 50% AMI rather than 48% AMI, as the appraiser used intended rents rather than slightly higher allowable maximum rents. However, the high combined LTV is mitigated by the fact that the senior lender's first mortgage amount represents less than 75% of appraised value with a 15% cushion over the expected senior loan mortgage payments. Senior debt LTV and debt service coverage ratio (1.15) are considered a better test of the City's risk, as both indicate a high likelihood that the Project will be completed according to schedule.

Economic Development Benefits

By enabling the Project to start construction, San Josė will benefit economically. First, the Developer will pay City fees of approximately $1,164,560 and an additional $90,880 in school district fees in order to proceed with the development process. The Developer will additionally pay approximately $75,000 in City fees for the related offsite improvements in the new neighborhood created at King and Dobbin. The total of these up-front fees exceeds $1.33 million.

Second, total local impacts for communities in the area are defined as benefits of the direct construction activity itself as well as the impact of local residents who earn money from the construction activity and spend part of it within the area. According to a 2009 study on the economic benefits to local areas for multifamily construction by the National Association of Homebuilders (NAHB), 185 units of senior housing are estimated to generate over $18 million of local benefits in the first year and approximately $6.5 million each year thereafter.

Third, according to the NAHB metrics, it is also anticipated that proceeding with and completing the development of the Project will create 400 local jobs in San Josė in the first year, directly and indirectly, and 124 local jobs each year thereafter. For example, CORE Affordable Housing, LLC and EAH Inc., the Developers, will target building material suppliers in Santa Clara County for competitive bids. Support for CORE Affordable Housing is also support for a local business, as CORE Affordable Housing is headquartered in San Josė and has built approximately 95% of their over 1,500 units in projects in San Josė. CORE Affordable Housing is an important part of the local affordable housing development and delivery network and their continued organizational viability is important to the City of San Josė.

EVALUATION AND FOLLOW-UP

This memorandum presents the set of recommendations related to the City Council's approval of the issuance of the Bonds for the Belovida at Newbury Park Senior Apartments and requires no follow-up to the City Council. Once the Bonds close, anticipated to be on November 5, 2009, and the construction of the Project commences, the Housing Department will provide updates in its Quarterly Production Updates to the City Council.

PUBLIC OUTREACH/INTEREST

☑ **Criterion 1:** Requires Council action on the use of public funds equal to $1 million or greater. **(Required: Website Posting)**

☐ **Criterion 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)**

- ☐ **Criterion 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 and Notice in appropriate newspapers)**

This action meets Criterion 1: Requires Council action on the use of public funds equal to $1 million or more. 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 March 13, 2009 by the Deputy Director of Finance. The public hearing notice was published in the *San José Mercury News* on February 19, 2009.

COORDINATION

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

FISCAL/POLICY ALIGNMENT

This action is consistent with the City's *2007-2012 Five-Year Housing Investment Plan*, adopted by City Council on June 12, 2007, to increase the supply of affordable housing, and with the City's *Consolidated Plan 2005-2010* to provide housing units for very low- and extremely low-income households.

COST SUMMARY/IMPLICATIONS

All issuance costs will be paid from Bond proceeds, City loan proceeds, and/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 $90,500. The City will also receive an annual fee for monitoring the Bonds and the Regulatory Agreement. Under the City's Policy for the Issuance of Multifamily Housing Revenue Bonds, the annual fee is equal to 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 $11,210,000 of permanent bonds, which results in an annual fee of approximately $14,000) with a minimum of $7,500.

No appropriation of funds is required at this time. Compensation for the financing team participants (financial advisor, bond counsel, and trustee), 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

CEQA: Mitigated Negative Declaration No. PDC07-015.

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For questions, please contact Julia Cooper, Assistant Director of Finance at (408) 535-7011.