COUNCIL AGENDA: 11-10-09
ITEM: SJFA #3

SUPPLEMENTAL

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL
CITY OF SAN JOSE FINANCING AUTHORITY BOARD

FROM: Julia H. Cooper
Leslye Krutko

SUBJECT: **SEE BELOW**

DATE: November 6, 2009

Approved

Date 11/6/09

COUNCIL DISTRICT: 7
SNI AREA: N/A

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

SUPPLEMENTAL MEMORANDUM

REASON FOR SUPPLEMENTAL

This Supplemental Memorandum provides an updated status on financing for the Orvieto Family Apartments Project, details of which were learned subsequent to submission of the October 22, 2009 staff report.

Updated Status of Financing

On October 20, 2009, the U.S. Department of the Treasury announced through a series of webinars a new Federal housing program that could provide significant economic and structural benefits to the Orvieto Family Apartments Project. If the City is able to implement the new "Multifamily Credit Enhancement Bond Product" (the "New Federal Program"), the approach will entail the same financing parties as described in the October 22, 2009 staff report, however, the existing draft bond documents would need to be modified. The authorizing resolution now provides the flexibility for the City either to proceed under the approach described in the October 22, 2009 staff report or under the New Federal Program described in this report and modify the bond documents accordingly.

Description of the Program

The New Federal Program provides for the direct purchase by the U.S. Department of the Treasury of new construction multifamily housing bonds that are guaranteed by Fannie Mae or Freddie Mac. During the construction period, the bonds will bear a variable interest rate equal to SIFMA (the national tax-exempt index that is reset weekly) plus 0.50%. The permanent rate will be established at the time of bond issuance at a rate equal to the 10-year Treasury rate, plus a spread of 1.15% as well as various fees, including the customary and standard Freddie Mac guarantee and servicing fees.

During the construction period, the bonds will be interest only and a letter of credit will run to Freddie Mac. At permanent financing, the bonds will convert to a fixed rate, which will amortize on a 30-year schedule with a mandatory tender 18 years after issuance.

Economic Benefits to the Project

Citi Community Capital, the servicer for Freddie Mac with respect to the Project, has estimated the following benefits and costs of the New Federal Program compared with the traditional Freddie Mac approach described in the October 22, 2009 staff report:

Comparison of Rates and Costs between Structures	New Federal Program	Traditional Freddie Mac Program
Construction Interest Rate	3.98%	3.275%
Construction Interest Cost	$1,602,650	1,367,675
Permanent Interest Rate	6.008%	6.848%
Permanent Loan Proceeds	$8,350,000	$7,590,000

The New Federal Program increases the amount of permanent loan proceeds to the project, and would result in a savings of more than $525,000 to the project. As interest rates are tied to indices that continue to move until closing of the bonds, the sources and uses continue to fluctuate. This financial benefit will help the project; however, the financing gap discussed in the main Memorandum continues to exist and must be filled in order to close the bonds.

Structural Benefits of the Program

The New Federal Program has some distinct advantages over the Freddie Mac bond financing as described in the October 22, 2009 staff report. The primary benefits are as follows:

- There is no need for weekly remarketing of bonds. The bonds will be placed directly with the Treasury Department with the rate reset weekly by reference to the national SIFMA index. This approach eliminates the liquidity risks associated with public remarketings of variable rate bonds.
- The need to transition the security for the bonds from a J.P. Morgan Chase letter of credit to a Freddie Mac credit enhancement agreement is eliminated. Freddie Mac will credit enhance

the bonds from issuance. The J.P. Morgan Chase letter of credit will be for the benefit of Freddie Mac during construction rather than securing the bonds directly.

- During the permanent financing period, the bond rate will be fixed. By contrast, the variable rate Freddie Mac bond program requires with the mortgage loan rate to be synthetically fixed through an interest rate swap. The New Federal Program eliminates the need for the swap. Removing the need for a derivative product and locking the permanent rate directly also reduces some of the transaction's underwriting complexity and eliminates risk to the involved parties.

Anticipated Changes to the Bond Documents

If the New Federal Program is implemented, staff anticipates the following changes to the documents scheduled for approval on November 10, 2009:

- **Indenture.** The Indenture will be modified by eliminating all of the provisions relating to variable rate demand bonds (e.g., mechanism to set interest rates, conversion to fixed rate, optional and mandatory purchase/redemption of bonds, remarketing agent references and related provisions). Instead, the Indenture will reflect that the bond interest rate will be set during construction by reference to the weekly SIFMA rate. At the time of permanent financing, the bond rate will be fixed, subject to a fixed amortization schedule.
- **Purchase Agreement.** The Purchase Agreement will include the Treasury Department and is expected to be modified to reflect the new terms of bonds.
- **Official Statement.** The Official Statement will eliminate the references to variable rate demand bonds (e.g., mechanism to set interest rates, conversion to fixed rate, optional and mandatory purchase/redemption of bonds, remarketing agent references and related provisions). Instead, it will reflect a variable interest rate during construction and a fixed rate during the permanent financing period, subject to a fixed sinking fund schedule.

No other documents will need to be changed if the project uses the New Federal Program.

Financing Schedule

The financing team will make every effort to adhere to the financing schedule described in the October 22, 2009 staff report. However, the financing team cannot revise the applicable documentation until additional details relating to the New Federal Program are released. While a term sheet and financing document templates are expected imminently, there is no guarantee that the Treasury Department will be able to meet this timeline or that the additional Program details may reduce the economic benefit of the Program to the Project.

CDLAC currently requires the bonds to close by November 30, 2009. On November 4, 2009, staff submitted a letter to CDLAC for an extension which must be approved by the CDLAC board at its meeting on November 18, 2009. CDLAC staff has indicated that it should know the

Board's direction well before the meeting date. If the extension request is granted, the bonds would need to close by December 31, 2009 under the New Federal Program.

Conclusion

The New Federal Program released by the U.S. Department of the Treasury would bring structural and economic benefits to the project. Therefore, staff is requesting permission to proceed with this alternate structure.

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