COUNCIL AGENDA: 12-15-09
ITEM: 4.7

SUPPLEMENTAL

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: December 11, 2009

Approved [signature] Date 12-11-09

COUNCIL DISTRICT: 3
SNI AREA: Five Wounds/Brookwood Terrace

SUBJECT: APPROVAL OF SUPPLEMENTING RESOLUTION RELATING TO BROOKWOOD TERRACE FAMILY APARTMENTS AND APPROVAL TO DISBURSE UP TO $600,000 OF THE APPROVED CONSTRUCTION LOAN PROCEEDS FOR BOND CLOSING COSTS

SUPPLEMENTAL MEMORANDUM

REASON FOR SUPPLEMENTAL

This Supplemental Memorandum provides an updated status on the financing for the Brookwood Terrace Family Apartments Project. In order to access federal American Reinvestment and Recovery Act ("ARRA") funds that decrease the cost of this Project, the bond issue must close by the end of December 2009. Therefore, this Memorandum adds a Recommendation requesting authority to disburse up to $600,000 of the existing City construction/permanent loan funding commitment as needed for bond closing costs.

RECOMMENDATIONS

Adoption of resolutions by the City Council:

a) Supplementing the authority previously granted to issue not to exceed $13,600,000 of City of San José Multifamily Housing Revenue Bonds (Brookwood Terrace Family Apartments), Series 2009B (the "Bonds") to allow such issuance in two series, with (i) the Series B-1 Bonds (the "Series B-1 Bonds") issued fixed rate bonds directly placed with the U.S. Treasury Department (the "Treasury"), and (ii) the Series B-2 Bonds (the

"Series B-2 Bonds") issued either as a publicly offered variable rate demand bonds credit enhanced by a letter of credit from JP Morgan Chase (the "Bank") or as variable rate bonds directly placed with the Bank; and authorizing the Assistant Director of Finance to negotiate and approve changes to the Bond Documents previously approved by the City Council and to negotiate and approve other documents necessary to enable to the issuance of the Bonds in two series.

b) Approving a request for disbursement of up to $600,000 of the existing City construction/permanent loan funding commitment; and, authorizing the Director of Housing to negotiate and execute all documents to effectuate this early disbursement.

BOND ISSUANCE TIMING

On December 7, 2009, the City received confirmation of an allocation award under the new federal program (the "Federal Program") allowing for the direct purchase of new construction multifamily housing bonds by the Treasury Department. Under the Federal Program guidelines announced on November 24, 2009, bonds must be issued on December 23, 2009. This timing is allowable under an extension that has been obtained from the California Debt Limit Allocation Committee.

The amount of multifamily housing revenue bonds to be issued for the Project is anticipated to be $13,225,000 (the "Bonds"), with $7,780,000 to be issued under the Federal Program and $5,445,000 to be issued as variable rate demand bonds secured by a direct pay letter of credit from JP Morgan Chase Bank ("JPMC"). This funding approach is estimated to save approximately $585,000 in total project financing costs and avoid another $250,000 in potential new costs as compared to the alternative of issuing bonds through a traditional Freddie Mac credit enhancement as originally planned.

The tax credit syndicator, Hudson Housing ("Hudson"), has indicated that it will not have a funding commitment from its tax credit investor, which is expected to be JPMC (or an affiliate), in time for the December 23 closing deadline. To demonstrate its confidence that JPMC or another investor will enter the partnership, Hudson has agreed to pay $400,000 towards bond issuance costs at closing.

JPMC's internal credit approval is scheduled at the end of January 2010. Assuming JPMC approves the transaction, Hudson expects JPMC's admission to the partnership to be finalized in the first quarter of 2010. If JPMC does not commit to the transaction, Hudson will seek another investor to enter the transaction. If that is not possible, Hudson would exit the deal and replaced by another investor.

BOND CLOSING PROCEDURES AND FUNDING THE CLOSING COSTS

The plan is for the bonds to be issued on December 23 with Bond proceeds held by the trustee and not disbursed for construction until JPMC or another an investor is admitted to the partnership. If another investor's commitment could not be obtained, the full amount of the Bonds would be collapsed prior to the commencement of construction. In this worst-case scenario, as the full amount of Bond proceeds would be unspent and redeemed, there is no financial exposure for the bondholders, credit enhancers, or the City as issuer.

In order to close the Bonds, approximately $1 million is needed to fund transaction costs, which include expenses such as lender fees, interest during a portion of construction, title costs, and attorney fees. These costs are usually funded with a combination of sources at closing. Hudson's $400,000 will be used for transaction costs, leaving the closing budget short by approximately $600,000.

Staff recommends that the Housing Department make an early disbursement of up to $600,000 of its committed construction loan funds to help to cover transaction costs. This amount is not an increase to the City's total obligation; it is part of the City's existing $10,893,000 construction/ permanent loan commitment that was already anticipated to be disbursed in December. The City would document its construction/permanent loan and close in December. The loan agreement would stipulate the condition of disbursement of any additional construction funds would be the entrance of the equity investor to the partnership.

RATIONALE FOR PROCEEDING AND BOND CLOSING REQUIREMENTS

Staff and its advisors believe that final approval of the equity investment should be a requirement to disburse the remainder of the City's construction loan proceeds and to disburse bond proceeds to start construction. While in prior years it was not uncommon for an equity investor to enter the financing post-bond closing, given the uncertainty in the financial and real estate markets, the prudent approach at this time must be to ensure the equity investor is in place prior to disbursement of any additional City construction loan proceeds or bond proceeds.

There are several reasons staff believes the Bond issuance can proceed under the conditions described above:

- A short delay in commencement of construction will not disrupt the construction timeline; the construction bond enhancement period of up to 30 months would continue to be a sufficient time period to build and lease the buildings.

- Staff believes that it is highly likely that JPMC will approve the transaction and enter the partnership. Hudson's $400,000 payment indicates its confidence that JPMC will approve the transaction. Hudson and JPMC have a lengthy history of working together on similar transactions dating back two decades. Additionally, JPMC is also the letter of credit provider for the variable rate Bonds and the dual role creates additional financial incentive for JPMC to consummate the transaction.

- City assumes no risk on the repayment of the Bonds. If it appears that neither JPMC nor another investor would be admitted in time to meet federal tax rules, e.g., there is no longer an expectation to commence expenditure of the bond proceeds within six months following issuance, the City may need to collapse the transaction. The full amount of the Bonds would be redeemed because construction would not have yet started, so there is no bond repayment risk from this structure.

- The Bonds are callable at any time and under no circumstances would the City be liable for payment on the Bonds.

- The Bond issuance costs are eligible costs to be paid from the City's construction loan, and there is no other financing source in this transaction that could cover the Bond issuance costs. ROEM does not have another $600,000 available to disburse for the Bond closing costs, as it already has expended approximately $500,000 related to the Project. Staff already had budgeted for a larger disbursement than $600,000 to pay project costs in December so the funds are available.

- ROEM and its principal, Robert Emami, will provide a payment guaranty to the City to cover the City's advance of approximately $600,000 of the construction loan in the event that Bonds are redeemed prior to construction. In addition, ROEM and Robert Emami will cover any interest payments due on the Bonds that are not funded from the City's advance at Bond closing.

- The site will be conveyed to the City of San Jose Financing Authority at the as previously approved by the City/Authority Board to commence the ground lease structure so the City/Authority will own the land in December as originally planned.

- Eden Housing, a 40-year old nonprofit housing development company based in Hayward, is replacing Pacific Housing, Inc., as ROEM's nonprofit partner. Eden, which has built several projects in San José, will become part of the borrowing entity and will add further financial strength and experience to the team, which will benefit the City.

The impacts of not proceeding are significant as summarized below.

- Federal Program is authorized by ARRA and creates a one-time opportunity. If the City does not agree to disburse $600,000 from the construction loan at closing, the chance to use the new Federal Program is lost. The lost savings to the Project plus the new costs to change the documentation and close under a regular Freddie Mac enhancement structure is estimated at $835,000. Interest rate increases in the next month could further add to the gap. Given the State's Redevelopment "take" of redevelopment funds, the City does not have the resources available to fund this potential gap under the alternate structure and neither does the borrower.

- Long-term affordability restrictions are already recorded on the site and the only permitted use of the site is for an affordable housing project. Commencing the development of the site promptly is important to the neighborhood. The previous use of the site was a junkyard and an affordable housing project will improve the neighborhood. Having the site remain vacant for the near future is an undesirable outcome.

CONCLUSION

Given the deadlines imposed on this transaction from the time-limited Federal Program and the opportunity to realize substantial savings from participating in the Federal program, Brookwood Terrace has a unique set of circumstances. The reasons to proceed with the bond closing outweigh the downside of not proceeding. Staff recommends approval of the early disbursement of construction loan proceeds under the conditions outlined below:

1) No bond proceeds or additional City loan funds will be disbursed until the equity investor is admitted to the partnership.
2) Borrower agrees to commence their obligation to make all bond payments from the time of bond issuance.
3) ROEM and Robert Emami will provide the City a payment guaranty in the event that the City loses its early-disbursed funds in the worst-case scenario that bonds are redeemed prior to the start of construction.
4) Land will be transferred to the City/Authority as planned at the closing on December 23, 2009.

LESLYE KRUTKO
Director, Housing Department

JULIA H. COOPER
Assistant Director of Finance

For questions, please contact Leslye Krutko, Director of Housing at 408-535-3581.