

COUNCIL AGENDA: 05-04-10
ITEM: 3.2

Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Lee Price, MMC
City Clerk

**SUBJECT: CITY OF SAN JOSE EXECUTIVE
HOME LOAN PROGRAM**

DATE: 04-28-10

RECOMMENDATION

As recommended by the Public Safety, Finance and Strategic Support Committee on April 15, 2010 and outlined in the attached memo previously submitted to the Public Safety, Finance and Strategic Support Committee, accept the report containing recommended changes to the City of San José Executive Home Loan Program.



Memorandum

TO: PUBLIC SAFETY, FINANCE AND
STRATEGIC SUPPORT COMMITTEE

FROM: Debra Figone

SUBJECT: CITY OF SAN JOSE
EXECUTIVE HOME LOAN

DATE: April 14, 2010

REPLACEMENT

REASON FOR REPLACEMENT

Due to an administrative oversight, an incorrect memo was distributed and posted. This memo provides further clarification related to program requirements including the definition of a borrower's commute and factors in determining principal residence.

RECOMMENDATION

It is recommended that the Public Safety, Finance and Strategic Support Committee (PSFSS) accept this report containing recommended changes to the City of San Jose Executive Home Loan Program (the Program) and forward it to City Council for acceptance and approval.

BACKGROUND

The Executive Home Loan Program was established on April 4, 2000, by City Council Resolution #69478. The Program is administered by the City Manager, the Finance Department and the City Attorney's Office. Administration of the Program includes the review of the financing structure of home purchases and all required documentation necessary to close transactions.

The recruitment and hiring of top quality executive management is essential to the efficient operation of the City. This Program provides a valuable recruiting tool used to attract desirable talent to the City. The Program also requires that loan participants live within the city limits of San Jose allowing them to gain a better perspective of the needs of the residents that they serve. City Council has directed staff to provide recommendations that improve the Program and allow the Council to thoroughly review the Program and ensure that taxpayer funds are preserved for essential city services.

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EXECUTIVE SUMMARY

During the August 4, 2009 Council meeting in which the Program was discussed, Council raised questions and discussed potential modifications to the Program. Based on the feedback from Council, the discussion focused on four main elements of the Program as follows:

- ✓ Establish an objective analysis and criteria for offering home loan assistance to executive candidates.
- ✓ Establish criteria that can be used to evaluate the qualifications of the Program.
- ✓ Establish a definition of principal residence.
- ✓ Provide alternatives to mitigate market risk.

Staff conducted relevant analyses and formulated modifications outlined in Attachment A. Based on Council feedback, the objective of the modifications is to align the City's Executive Home Loan program (the Program) with the following guiding principles:

- The Program provides a recruitment tool that does not constitute a benefit to which the new executive is entitled:
- The City is not overly zealous in their efforts to attract qualified executive candidates while still remaining competitive.
- The Program provides reasonable housing assistance when San Jose's housing costs far exceed the area from which the new executive would be relocating.
- The Program encourages new executives to live in San Jose and become connected to the community they will serve.

ANALYSIS

During the August 4, 2009 Council meeting in which the Program was discussed, Council raised questions and discussed potential modifications to the Program. The discussion focused on four main elements of the Program as follows:

- ✓ Establish an objective analysis and criteria for offering home loan assistance to executive candidates.
- ✓ Establish criteria that can be used to evaluate the qualifications of the Program.
- ✓ Establish a definition of principal residence.
- ✓ Provide alternatives to mitigate market risk.

In order to provide a comprehensive analysis and approach to respond to Council's comments and questions, a multi-departmental team was formed to discuss and provide input. The team consisted of staff from the City Manager's Office, the Office of Employee Relations and the departments of Finance, Housing and Human Resources. Staff discussed each element at length and considered the following guiding principles in their deliberations:

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- The Program provides a recruitment tool that does not constitute a benefit to which the new executive is entitled.
- The City is not overly zealous in their efforts to attract qualified executive candidates while still remaining competitive.
- The Program provides reasonable housing assistance when San Jose's housing costs far exceed the area from which the new executive would be relocating.
- The Program encourages new executives to live in San Jose and become connected to the community they will serve.

Following are staff's recommendations and the analysis performed:

- **Establish an objective analysis and criteria for offering home loan assistance to executive candidates.**

Resolution 69478 states, "interests of the City of San Jose would best be served by encouraging such Council appointed officers and members of the City Manager's Senior Staff to live within the San Jose corporate limits to ensure their ready availability and familiarity with the community." Since its inception, the Program has proven to be a key factor in our ability to attract senior executives to relocate to the City of San Jose. Despite the current downturn in home values, the median home cost in San Jose is higher than it was at the inception of the Program and continues to be higher than most areas across the country. Therefore, the Program is anticipated to continue to be vital in the City's ability to attract and retain top quality talent.

Staff recommendation:

Maintain the existing Program under the discretion of the City Council (for Council Appointees) and the City Manager (for members of the City Manager's Senior Staff) with qualification criteria as outlined below to enable continued attraction of talented executive candidates to the City.

- **Establish criteria that can be used to evaluate the qualifications of the Program.**

The City should establish criteria to ensure the Program loan is only offered to executive candidates whose circumstances show that offering the below-market-rate loan would enhance the employment offer.

Staff recommendations:

Three methods will be used jointly to establish the threshold criteria to offer an Executive Home Loan as follows:

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- 1) **Borrowers Commute** – The driving distance from the executive’s former place of employment to their new place of employment with the City of San Jose must be longer than 50 miles.
- 2) **Establish a definition of principal residence** -- One concern raised by the Council was how the Program was utilized by participants for property that did not appear to be the principal residence of the participant in the Program.

Staff reviewed the IRS guidelines and definitions for principal place of residence. To confirm their interpretation of the guidelines, staff also reviewed professional literature from The CPA Journal. The CPA Journal stated, “Treasury Regulations section 1.121-1(b) (2) states that when a taxpayer uses more than one residence, the determination of the principal residence depends upon all the facts and circumstances. If a taxpayer alternates between two homes and uses each one as a residence, the principal residence would generally be the one the taxpayer uses the majority of the time during the year”. If there is a question as to whether or not a residence is a principal residence, additional factors that can be used to determine if a home is a principal residence are the location of family member’s main home, mailing addresses for bills and correspondence, the address listed on federal and state returns, homeowner’s exemption as applied to property tax assessment, driver’s license, car registration and voter registration card, the location of the banks used and the location of recreational clubs and religious organizations borrower is a member of. A principal residence cannot be rented, vacant and unoccupied, or be a vacation or secondary home.

In the existing program, when signing the City Loan Note, the borrower acknowledges that failure to occupy the property as their principal residence will accelerate repayment of the loan. To ensure acknowledgement of this requirement prior to loan approval, the executive will complete a loan application (new document requirement of the Program) that notifies executive that failure to occupy the property as their principal residence will accelerate repayment of the loan. In the loan application, Principal Residence will be defined as the residence the borrower uses the majority of the time of the year. The provision will also remain in the City Loan Note.

It should be noted that participants in the Program are responsible in determining that they are in compliance with the Principal Residence criteria and staff will not be expected to verify or monitor the factors noted above for each participant in the Program. In addition, the participant is responsible to determine any tax implications regarding compliance with the Income Tax Regulations. The City does not provide tax advice and recommends that Participants consult with their income tax preparers or advisors.

- 3) **Housing Cost Differential** -- The City will require that the cost differential in median home prices between the Metropolitan Statistical Area (MSA) the candidate will be relocating from and the San Jose MSA be at least 30% using statistics published by the National Association of Realtors. According to the National Association of Realtors, in

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Q2 of 2009, the western US region's median home price exceeded the national median home price by 23%. The same statistics showed that the San Jose-Sunnyvale-Santa Clara MSA had the second highest median home price in the US at \$500,000 with Honolulu being the highest. To alleviate these large disparities, the 30% threshold would allow the Program loan to be offered to candidates expected to relocate from MSAs having median home prices equal to or less than \$350,000 in today's market.

- **Provide alternatives to mitigate market risk**

The usual method of financing real property purchases is to record a lien on the property. One hundred percent financing, therefore, exposes the City to market risk. Down payments could be required, particularly in a declining real estate market. In addition, the Program currently requires interest-only payments. An alternative that could be considered is to fully amortize the loan and require interest and principal payments thereby developing systematic reduction in loan-to-value ratios over time and protecting the City from declining property values.

Staff recommendation:

Limit the loan-to-value (LTV) ratio to a maximum of 95% (minimum 5% down payment) at close of escrow. This requirement would be subject to the City Manager's and the Council's (with respect to the Council Appointees) discretion to require a larger down payment (lower LTV). The loan would also not exceed 50% of the purchase price of the home. Should the purchase transaction require an additional loan in first position (before the City loan), the City loan would not exceed the principal amount of the first loan or \$250,000, whichever is lower.

Other revisions to program provisions could also assist in reducing risk to the City; such as making payroll deductions of payments mandatory; not allowing refinancing of any loans against the property unless such refinancing results in a principal reduction on the City loan; and charging administrative fees for refinancing requests to assist the City in recouping staffing costs associated with the transactions. It should be noted that the amount of the administrative fees will be dependent upon the amount of time that City staff spends on the refinancing transaction, with the goal of full-cost recovery to the City.

In the event a participant in the Program subsequently becomes ineligible for the City Loan per the terms and conditions of the loan (such as cessation of employment or change in use of property) and the property is "under water" (total loans against the property are greater than the market value of the property), the City would consider:

- Modifying the six-month repayment requirement;
- Increasing the interest rate to market level and fully amortizing (principal and interest) over 30 years with a possible balloon payment requirement, and/or;
- Allowing borrower to convert property from a principal residence to rental property.

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EVALUATION AND FOLLOW-UP

The Finance Department will propose revisions to Council Resolution #69478 for City Council consideration based on the recommendations of this Committee. Finance will finalize draft procedures for the Program and update all working documents related to the Program as directed by City Council.

COORDINATION

This report was prepared in coordination with the City Attorney's Office, the Office of Employee Relations and the departments of Finance, Housing and Human Resources.

FISCAL/POLICY ALIGNMENT

The Program aligns with Council Resolution #69478 adopted on April 4, 2000.

CEQA

Not a project.



DEBRA FIGONE
City Manager

Attachment: A – Proposed Program Changes

For questions, please contact Scott P. Johnson, Director of Finance, at (408) 535-7001.

Executive Home Loan Program – Proposed Program Changes

PROGRAM ELEMENT	EXISTING PROGRAM	PROPOSED CHANGE
Eligible Executive Positions	Council appointed officers and members of the City Manager's Senior Staff (Assistant City Manager, Deputy City Managers, Department Directors, and other senior members of the City Manager's Office as designated by the City Manager) are eligible for this program.	No change
Qualifying Criteria	For Senior Staff, the City Manager will determine whether housing assistance will be used as a recruiting tool in Senior Staff recruitments.	Candidate must satisfy three criteria in order to qualify for the loan: <ul style="list-style-type: none"> ▪ Driving distance from former place of employment to new place of employment with the City of San Jose must be longer than 50 miles; and ▪ New home purchased must be candidate's principal residence; and ▪ The cost differential in median home prices between MSA of former residence to San Jose MSA must be at least 30%¹.
Principal Residence	When signing the City Loan Note, borrower acknowledges that failure to occupy the property as their principal residence will accelerate repayment of the loan.	Borrower will certify in the loan application (new document requirement) that they will occupy the property as their principal residence and acknowledge that failure to do so will accelerate repayment of the loan. Principal Residence will be defined as the residence borrower uses the majority of the time of the year ² . The certification will be placed in the City Loan Note.
Loan Amount and Term	Appraised value of the property must meet or exceed the purchase price. Any loan made under the Program shall not exceed \$250,000, for a term not to exceed 30 years.	Appraised value of the property must meet or exceed the purchase price. The total loan-to-value ratio of the purchase cannot exceed 95% (minimum 5% down payment required); and the loan shall not : <ul style="list-style-type: none"> ▪ Exceed 50% of the purchase price, or ▪ Exceed the principal amount of the loan in 1st position or \$250,000, whichever is lower.

¹ The cost differential in median home prices between the Metropolitan Statistical Area (MSA) the candidate will be relocating from and the San Jose MSA will be determined using statistics published by the National Association of Realtors.

² Although "principal residence," is defined as the residence the borrower uses the majority of the time of the year, additional factors that can be used to determine if a home is a principal residence are the location of family members' main home, mailing addresses for bills and correspondence, the address listed on federal and state returns, homeowner's exemption as applied to property tax assessment, driver's license, car registration and voter registration card, the location of the banks used and the location of recreational clubs and religious organizations borrower is a member of. A principal residence cannot be rented, vacant and unoccupied, or be a vacation or secondary home.

Executive Home Loan Program – Proposed Program Changes

PROGRAM ELEMENT	EXISTING PROGRAM	PROPOSED CHANGE
Interest Rate	The interest rate of the loan shall be no lower than the City's current average annual earnings rate on its investment portfolio as of June 30 of the previous fiscal year.	The interest rate of the loan shall be no lower than the City's current average annual earnings rate on its investment portfolio as of June 30 of the previous fiscal year, with the application of an interest rate floor.
Cost	The employee is responsible for all costs associated with the purchase and sale of the residence, including, but not limited to, any costs of a title insurance policy naming the City as a beneficiary.	The employee is responsible for all costs associated with the purchase and sale of the residence, including, but not limited to, any costs of a title insurance policy naming the City as a beneficiary and all costs associated with subsequent refinancing of the City Loan, if refinancing request is approved.
Loan Repayment	The employee shall repay the promissory note through bi-monthly or monthly interest only payments.	The employee shall repay the promissory note through mandatory bi-weekly payroll deductions of interest only payments.
Property Location	The loan is limited to residential property within the City of San José, and must be the employee's principal residence.	No change.
Repayment Acceleration	If the property is in default, sold or transferred; if the employee's employment is terminated; or if the property ceases to be used as the employee's principal residence, the loan will be due and payable in full within six months of the date of such event.	Depending upon the unique circumstances of the borrower and the economic environment, the following alternatives would be considered individually or in various combinations on a case-by-case basis: <ul style="list-style-type: none"> ▪ Modification of existing six-month repayment requirement, ▪ Increase interest rate to current market rate, ▪ Require full amortization (not interest only), ▪ Add a balloon payment requirement; ▪ Allow borrower to convert property to rental property.

Executive Home Loan Program

City of San José

PSFSS Committee Meeting
April 15, 2010
Agenda Item #7

City of San José
Executive Home Loan Program



Council Directives

August 4, 2009, Council Meeting

- Objective Analysis for Offering Program ✓
- Criteria to Evaluate Qualification ✓
- Definition of Principal Residence ✓
- Alternatives to Mitigate Market Risk ✓

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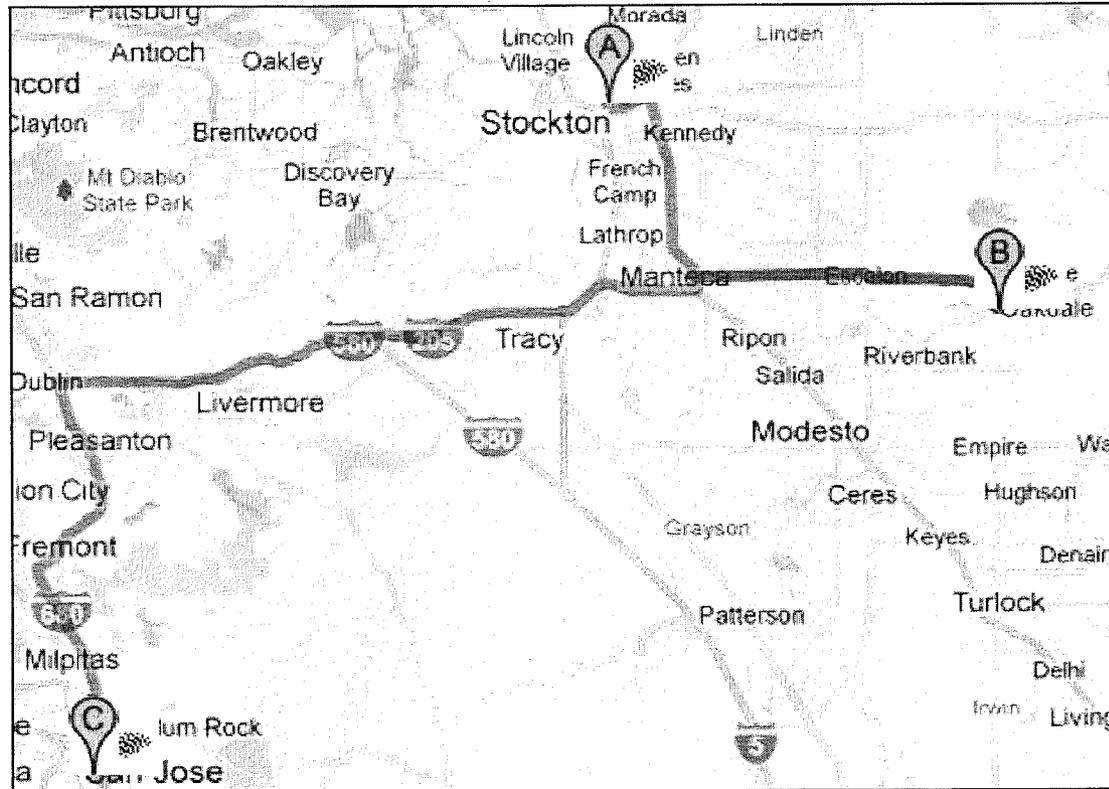
Proposed Changes

PROGRAM ELEMENT	PROPOSED CHANGE
Eligible Executive Positions	No change
Principal Residence	<ul style="list-style-type: none"> ▪ Borrower certifies in loan application (new requirement) ▪ Used the majority of the year ▪ Other factors established to determine principal residence
Loan Amount and Term	<ul style="list-style-type: none"> ▪ LTV < or equal to 95% of purchase price ▪ City loan < or equal to 50% of purchase price ▪ City loan < or equal to first loan or \$250k (whichever is lower)
Qualifying Criteria	<ul style="list-style-type: none"> ▪ Commute distance (IRS guidelines) ▪ Principal residence ▪ Cost differential in median home prices

Commuter Distance

A – Previous Work, Stockton **B** – Home, Oakdale **C** – City Hall, San Jose

If driving distance from B to C is more than 50 miles longer than B to A, the distance criteria is met.



Proposed Changes (cont.)

PROGRAM ELEMENT	PROPOSED CHANGE
Interest Rate	No change
Cost	Cost recovery fees will be imposed for any refinancing, if approved
Loan Repayment	Mandatory payroll deductions
Property Location	No change.
Repayment Acceleration	<ul style="list-style-type: none"> ▪ Modify existing 6-month repayment requirement ▪ Increase interest rate to current market (rate floor and ceiling established for case-by-case modifications) ▪ Require full amortization ▪ Add a balloon payment requirement ▪ Allow borrower to convert to rental property
Documentation	New application form

Recommendation

The Committee accept this report containing recommended changes to the City of San Jose Executive Home Loan Program and forward it to City Council for acceptance and approval.

Contributors

Prepared in coordination with:

City Manager's Office
Finance Department
City Attorney's Office
Employee Relations
Human Resources Department
Housing Department

Questions?

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