COUNCIL AGENDA: 08-31-10
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: August 9, 2010

Approved: Deanna Santana

Date: 8/17/10

SUBJECT: APPROVAL OF THE ISSUANCE OF A TAX-EXEMPT MULTIFAMILY HOUSING REVENUE NOTE AND LOAN OF REVENUE NOTE PROCEEDS AND RELATED DOCUMENTS FOR THE KINGS CROSSING APARTMENTS

RECOMMENDATION

Adoption of a resolution of the City Council:

a. Authorizing the issuance of a tax-exempt multifamily housing revenue note designated as "City of San José Multifamily Housing Revenue Note (Kings Crossing Apartments), Series 2010C" in an aggregate principal amount not to exceed $25,380,000 (the "Governmental Lender Note" or "Note");

b. Approving a loan of Note proceeds to Kings Crossing, L.P., a California limited partnership created by Charities Housing Development Corporation to finance the construction of the Kings Crossing Apartments located at the corner of N. King Road and Dobbin Drive in San José;

c. Approving in substantially final form the Borrower Loan Agreement, Funding Loan Agreement, Assignment of Deed of Trust, and Regulatory Agreement and Declaration of Restrictive Covenants (the "Documents") and;

d. Authorizing the 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 Documents and other related Note documents as necessary.

OUTCOME

Approval of the recommended actions will allow for the issuance of a multifamily housing revenue note for the purpose of constructing a 94 unit rental apartment project, composed of 92 units that will be affordable for a period of at least 55 years and two managers' units that will be unrestricted. These apartments will serve low- and extremely low-income residents with current annual incomes between $10,875 and $64,200.

EXECUTIVE SUMMARY

Charities Housing Development Corporation (the "Developer") has requested that the City issue a tax-exempt multifamily housing revenue note, which will be sold in order to generate proceeds that will be loaned to Kings Crossing, L.P., a California limited partnership (the "Borrower") created by the Developer. The Note will be non-rated and not credit enhanced and will be structured as a private placement with Citibank, N.A. as the initial purchaser. The proceeds of the loan, together with other funds, will be used by the Borrower to finance the construction of 94 unit rental apartment housing composed of 92 units, consisting of 33 one-bedroom units, 33 two-bedroom units, and 26 three-bedroom units, that will be affordable for a period of at least 55 years and two (2) manager's units that will be unrestricted to be known as Kings Crossing Apartments (the "Project").

Additionally, the Housing Department will provide a loan to the Borrower for this Project in the amount of $10,145,275. This amount is within the maximum loan amount of $10,565,700 approved by City Council for the Project on March 18, 2008.

BACKGROUND

Charities Housing Development Corporation ("Charities") has requested that the City issue the Note for the purpose of lending the Note proceeds to Kings Crossing, 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 the Project: 100% of the 92 affordable units in the Project will be rented to residents with incomes between 15% and 50% of the Area Median Income ("AMI"). These restrictions will remain for a period of at least 55 years. Two of the Project's units are unrestricted managers' units.

On September 23, 2009, the City was awarded a private activity bond allocation of $25,380,000 from California Debt Limit Allocation Committee ("CDLAC"). On June 1, 2010, the Assistant 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 $25,380,000 in tax-exempt multifamily housing revenue bonds to provide construction and permanent funding for the Project. On June 7, 2010, the Mayor approved Certificate No. 2010-2, which authorized the City to issue up to $25,380,000 in multifamily housing revenue bonds for the Project.
The Note will be structured as a single series note in an amount currently estimated to be $24,901,618. Note proceeds will fund a portion of the total Project costs, which are estimated at this time to be approximately $44,232,612. The following table provides the estimated breakdowns of the sources of funding during the construction phase, and after completion of the project and lease up phase (permanent):

City of San José
Kings Crossing Apartments
Plan of Finance – Sources of Funding[1]

Source	Construction	Permanent
Note Proceeds	$ 24,901,618	$ 2,820,000
City Loans	6,748,465	10,145,275
State of California – 1C Infill Grant	4,495,840	4,495,840
Tax Credit Equity	1,711,748	11,411,652
Developer Equity/Lease-up Income/Deposits	1,300,000	1,300,000
American Recovery and Reinvestment Act (ARRA) 1602 Funds	2,076,901	2,076,901
Federal Home Loan Bank Affordable Housing Program Funds	0	460,000
County of Santa Clara Mental Health Services Act (MHSA) Funds	1,200,000	1,200,000
County of Santa Clara Home Investment Partnerships Program	0	350,994
State of California Housing and Community Development Multifamily Housing Program	0	9,971,950
Deferred Costs	1,798,040	0
Total	$ 44,232,612	$ 44,232,612

[1] The dollar amount of each source is estimated as of the date of this report. The actual amounts may vary slightly from these estimates.

A portion of the tax credit equity funds received at completion of construction will be used to retire a portion of the Note with the resulting amount of outstanding Note to be approximately $2,820,000.

One of CDLAC's requirements is that the Note closing must occur within the time period set by CDLAC. The City has requested an extension of the CDLAC deadline to September 22, 2010. It is anticipated that the Note will close on or about September 2, 2010.

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 financing structure, financing documents, existing City funding commitment, financing team participants, and financing schedule.

Note Financing Structure

Overview of the Multifamily Note Financing

General As a brief summary, multifamily housing revenue notes are issued to finance the development by private developers of certain affordable rental apartment projects. These notes operate in a very similar manner to the more familiar multifamily housing bonds. They are issued pursuant to the same provisions of state law (California Health and Safety Code Section 52075 -52098) and use a portion of the State's federal tax-exempt private activity allocation which are allocated by CDLAC procedures. The Notes also work in connection with tax credits provided through the California Tax Credit Allocation Commission (TCAC). The City issues revenues notes as tax-exempt securities which are then sold and the City then loans the proceeds to the Borrower. The notes are limited obligations of the City, payable solely from loan repayments by the Borrower.

Citibank, N.A. is requiring that the issuance be structured as a note rather than a bond because of a recent ruling of the Office of the Comptroller of the Currency ("OCC") that distinguishes loans from bonds for purposes of counting maximum Community Reinvestment Act ("CRA") credit. The change occurred when Citibank's regulatory compliance was shifted to OCC from the Office of Thrift Supervision ("OTS"). OTS had always viewed tax-exempt financing activity as lending and not as an investment, whether structured as a bond or private placement, since proceeds of the financing were loaned to the borrower. However, OCC will only treat bond tax-exempt financing activity as an investment that is considerably less beneficial than a loan to Citibank N.A. Citibank N.A. is satisfied that the private placement back-to-back structure of the issuance meets OCC's definition of a CRA loan as well as CDLAC's requirements for tax-exempt financing.

Requirements for Tax-Exemption For a multifamily housing revenue note 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 Note. Further, in consideration of the City loans, the Project will be subject to the deeper affordability requirements described in the Background section above.

Structure of the Note

Private Placement Structure The Note will be non-rated and not credit enhanced and will be structured as a private placement with Citibank, N.A. ("Citibank, N.A." or "Private Placement Purchaser") as the initial private placement purchaser. Pursuant to the City's policies regarding non-credit enhanced notes, 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 note secured solely by the Project rents. If the Private Placement Purchaser wishes to transfer the Revenue Note, the new noteholder must sign and deliver a similar Investor's Letter to the Fiscal Agent. Minimum denominations of the Note will be at least $100,000.

Principal Amounts and Terms Initially, the Note will be issued as interest-only fixed rate tax-exempt note in an aggregate amount of approximately $24,901,618. 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 Note with the remaining outstanding amount of the Note equal to approximately $2,820,000. At that time (the "Conversion Date"), which is estimated to be no later than 30 months after the issuance of the Note, the Note will convert to a fixed-rate tax-exempt note to be fully amortized as follows:

Tranche	Principal	Term
A	$1,516,000	30 years
B	1,304,000	15 years
	$2,820,000	

Interest Rates During the construction period, the Note will pay interest-only at a maximum fixed rate of 6.25%.

During the permanent period, after the Project is completed and after the Conversion Date, the interest will accrue at a fixed rate calculated on a 30/360-day basis. The maximum interest rate during the permanent period is set at Note closing but will not exceed:

Tranche	Principal	Term	Interest Rate
A	$1,516,000	30 years	7.75% fixed
B	1,304,000	15 years	7.25% fixed
	$2,820,000		

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 August 12, 2010.

Funding Loan Agreement The Note will be issued under a Funding Loan Agreement (the "Agreement") between the City and Wells Fargo Bank, National Association, as the fiscal agent (the "Fiscal Agent"). The Agreement is executed by the Assistant Director of Finance, or other authorized officers on behalf of the City, and attested by the City Clerk. Pursuant to the Agreement, the Fiscal Agent is given the authority to receive, hold, invest, and disburse the Note proceeds and other funds established under the Agreement; to authenticate the Note; to apply and disburse payments to the Noteholder(s); and to pursue remedies on behalf of the Noteholder(s). The Agreement 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 Note. The Borrower Loan Agreement (described below) obligates the Borrower to compensate the Fiscal Agent for services rendered under the Agreement.

Borrower Loan Agreement There is also a loan agreement (the "Loan Agreement") among the City, Citibank, N.A., and the Borrower. The Loan Agreement is executed by the Assistant Director of Finance or other authorized officer on behalf of the City. The Loan Agreement provides for the loan of the Note proceeds to the Borrower for construction and permanent financing for the Project and for the repayment of such loan by the Borrower. The loan is evidenced by a note (the "Loan Note") in an amount that corresponds to the principal amount of the Note. The City's rights to receive payments under the Note will be assigned to the Fiscal Agent, along with certain other rights under the Agreement, 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 Additionally, there is an agreement (the "Regulatory Agreement") among the City, the Fiscal Agent, and the Borrower that 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 is executed by the Assistant Director of Finance and Director of Housing, or other authorized officers on behalf of the City. The Regulatory Agreement restricts the rental of Project units (except for the two manager's units) to low-income residents for a period of at least 55 years as previously described.

Assignment of Deed of Trust The Borrower's loan repayment obligations to the City will be secured by a Deed of Trust, of which the City is the beneficiary. The sole source of funds for the City's repayment of the Revenue Note will be payments from the Borrower in respect of such loan from the City. Therefore, at closing the City will assign (without recourse) its rights as beneficiary under the Deed of Trust, thereby permitting the holder(s) of the Note to pursue the remedies set forth in the Deed of Trust against the Borrower directly.

Financing Team Participants

The financing team participants consist of:

• City's Financial Advisor:	E. Wagner & Associates, Inc.
• Bond Counsel:	Hawkins, Delafield & Wood, LLP
• Fiscal Agent:	Wells Fargo Bank, National Association
• Private Placement Purchaser:	Citibank, N.A.

All costs associated with the financial advisor, bond counsel and fiscal agent are contingent upon the sale of the Note and will be paid from Note proceeds, City loan proceeds, and/or Borrower equity.

Financing Schedule

The current proposed schedule is as follows:

• Council Approval of Note Documents	August 24, 2010
• Pre-Close	August 31, 2010
• Close Note	September 2, 2010
• Anticipated CDLAC Deadline for Note Closing	September 22, 2010

As the tax credit syndicator, senior lender, and City all require California Housing Finance Agency's closing of ARRA and MHSA funds concurrent with the other funding sources, it is possible that these closing dates will move slightly.

City Subordinate Funding

The Housing Department will provide a loan to the Borrower in an amount up to $10,145,275. The funding commitment was approved by the City Council on March 18, 2008 via Resolutions No. 74291, 74292 and 74293.

EVALUATION AND FOLLOW-UP

This Memorandum presents the set of recommendations related to the City Council's approval of the issuance of the Note for the Kings Crossing Apartments and requires no follow-up to the City Council. Once the Note closes which is anticipated to be on September 2, 2010, and the construction of the Project commences, the Housing Department will provide updates in its Quarterly Construction Reports 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 does not meet any of the above Criteria. The method of notifying the community of the City's intent to issue a tax-exempt private activity note is for the City Council to hold a Tax Equity and Fiscal Responsibility Act (TEFRA) Hearing. The TEFRA Hearing was held on June 1, 2010 by the Assistant Director of Finance. The public hearing notice was published in the *San José Mercury News* on May 10, 2010. This Memorandum will also be posted on the City's website in advance of the August 24, 2010 meeting.

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 Note proceeds, City loan proceeds, and/or Borrower equity. The Note is a tax-exempt obligation secured by mortgage loans payable from Project revenues. No payment of the Note will be paid from, or guaranteed through, the general taxing power of the City or any other City asset. The City will receive an upfront issuance fee of approximately $87,765. The City will also receive an annual fee for monitoring the Note 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 the construction Note and permanent Note outstanding following completion and lease-up of the Project or a minimum fee of $7,500 Although this execution proposes to use tax-exempt Notes rather than issue tax-exempt bonds, the same policy applies. Based on the formula, during construction the annual fee will be approximately $31,382 and following completion and lease-up $7,500 per annum.

No appropriation of funds is required at this time. Compensation for the financing team participants (financial advisor, bond counsel, and fiscal agent), as well as the costs of the financing, are contingent on the sale of the Note and will be paid from Note proceeds, City loan proceeds, and/or Borrower equity.

CEQA

CEQA: Mitigated Negative Declaration No. PDC07-015.

/s/
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/s/
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Director, Housing Department

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