COUNCIL AGENDA: 8-23-11
ITEM: 2.10

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Julia H. Cooper
Leslye Corsiglia

SUBJECT: SEE BELOW

DATE: August 1, 2011

Approved

Date 8/8/11

COUNCIL DISTRICT: 5
SNI AREA: East Valley/680 Communities

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

RECOMMENDATION

Adopt of a resolution:

(a) Authorizing the issuance of tax-exempt multifamily housing revenue bonds in two series designated as "City of San José Multifamily Housing Revenue Bonds (Taylor Oaks Apartments), Series 2011A-1 and Series 2011A-2, in the aggregate principal amount not to exceed $7,000,000 and sale of the Bonds to Citigroup Global Markets by negotiated sale;

(b) Approving a loan of bond proceeds to Taylor Oaks Apartments Investors, L.P., a California limited partnership, for financing a portion of the costs of acquiring and rehabilitating the Taylor Oaks Apartments located at 2726 – 2738 Kollmar Avenue in the City of San José;

(c) Approving in substantially final form the following documents: (1) Trust Indenture, (2) Financing Agreement, (3) Regulatory Agreement and Declaration of Restrictive Covenants, (4) Intercreditor Agreement, (5) Purchase Contract, and (5) Official Statement; and

(d) Authorizing the City Manager, Assistant Director of Finance, Director of Housing or their designees to execute and, as appropriate, to negotiate, execute and deliver these bond documents and other related documents as necessary.

OUTCOME

Approval of the recommended actions will allow for the issuance of multifamily housing revenue bonds for the purpose of financing a portion of the costs of acquiring and rehabilitating 59 studio, one-and two- bedroom family apartment units, 58 of which will be affordable for 55 years, with one unrestricted manager's unit.

EXECUTIVE SUMMARY

In accordance with the requirements under the City's Policy for Issuance of Multifamily Housing Revenue Bonds, For the Future Housing Inc. (the "Developer") has requested that the City issue tax-exempt multifamily housing revenue bonds for the purpose of lending the bond proceeds to Taylor Oaks Apartments Investors, L.P. (the "Borrower") in an aggregate amount not to exceed $7,000,000. These proceeds, together with other funds, will finance a portion of the costs of acquiring and rehabilitating the Taylor Oaks Apartments (the "Project"), consisting of 59 studio, one- and two-bedroom apartment units. The incomes of residents are expected to range from $21,750 to $46,600.

The City will issue the City of San José Multifamily Housing Revenue Bonds (Taylor Oaks Apartments), Series 2011A-1 and Series 2011A-2 (the "Bonds") as publicly-offered fixed rate bonds in an expected aggregate amount of $6,300,000[1]. The Series 2011A-1 Bonds, in an estimated amount of $3,700,000, are expected to have a final maturity of not more than 19 years; the Series 2011A-2 Bonds, in an estimated amount of $2,600,000, are expected to have a maturity of not more than three years and will be repaid in full from tax credit investor equity proceeds prior to conversion of construction financing to permanent loan. The Bonds will be credit enhanced by Freddie Mac.

To secure Freddie Mac during the Project's rehabilitation and lease-up period, Citibank, N.A. ("Citi"), as Construction Lender, initially will advance proceeds of a separate conventional construction loan to the Borrower to fund a cash collateral account for Freddie Mac's benefit. During the rehabilitation/lease up period, Citi will replace the cash collateral with an unconditional, irrevocable standby letter of credit in favor of Freddie Mac.

BACKGROUND

Borrower. The Project's borrower, Taylor Oaks Apartments Investors, L.P., is a California limited partnership (the "Borrower"). The Borrower will consist of: (1) Pacific Housing Inc., a California non-profit affordable housing developer, or an affiliate thereof, as the Managing General Partner, (2) For the Future Housing Inc. (the "Developer"), or an affiliate thereof, as

[1] The Developer requested a higher bond authorization amount than the expected bond size to provide flexibility in the event rehabilitation costs increase prior to bond issuance.

General Partner and (3) Churchill Stateside Group, or an affiliate thereof, as the tax credit investor limited partner.

Project Overview. The Project involves the acquisition and rehabilitation of the Taylor Oaks Apartments, consisting of 59 studio, one- and two-bedroom apartment units (the "Project"). Upon completion of the Project's rehabilitation, 10 percent of the units (6 units) in the Project will be initially rented to individuals and families with incomes that do not exceed 30 percent of the area median income ("AMI"); 17 percent of the units (10 units) will be rented to individuals and families with incomes that do not exceed 45 percent of AMI; and 72 percent of the units (42 units) will be rented to families with incomes that do not exceed 50 percent of AMI. One of the Project's 59 units will be an unrestricted manager's unit. The rental restrictions for the Project will remain for a period of 55 years.

City Loan for the Project. On May 17, 2011, the City Council approved an acquisition/construction and permanent loan in the amount of $5,250,000 to acquire and rehabilitate the Project. This loan will be funded under the Neighborhood Stabilization Program 2 ("NSP2") by the U.S. Department of Housing and Urban Development. No portion of the City loan will be funded from 20% housing set-aside tax increment.

City as Issuer of Multifamily Housing Bonds. The City's Policy for Issuance of Multifamily Housing Revenue Bonds requires that if the Housing Department makes a project loan, the City must be the issuer of tax-exempt multifamily housing revenue bonds for the purpose of lending the bond proceeds to the project.

Sources of Project Funding. The Bonds will be structured in two series in an expected aggregate principal amount of $6,300,000. Bond proceeds will fund a portion of the total Project costs, which are estimated to be $12,931,823. The estimated sources of funding for the Project's rehabilitation/lease-up period and its permanent period are as follows:

Source	Constr./Rehab.	Permanent
Bond Proceeds	$6,300,000	$3,700,000
City Loan (NSP2)	5,250,000	5,250,000
Accrued Interest (City Loan)	250,963	250,963
Tax Credit Equity	631,800	3,158,998
Deferred Funding of Reserves	292,602	--
Interim Bond Repayment	(576,689)	--
Lease-Up Income	--	376,782
Interest Income	--	17,415
Deferred Developer Fee	783,147	177,665
Total	**$12,931,823**	**$12,931,823**

Tax credit equity funds received pursuant to a limited partnership agreement between the Borrower and Churchill Stateside Group (or an affiliated entity) are anticipated to repay the

Series 2011A-2 Bonds ($2.6 million). Following completion of the Project's rehabilitation and lease-up, only the Series 2011A-1 Bonds ($3.7 million) will remain outstanding.

Financing History of Project – Key Dates. On May 17, 2011, the Council approved a funding commitment, from NSP2 funds, of $5,250,000 for an acquisition/rehabilitation/ permanent loan to be made to the Developer or its designated affiliate for the Project. On May 18, 2011, the 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 an amount not to exceed $7,500,000 in tax-exempt multifamily housing revenue bonds to finance the acquisition and rehabilitation of the Project. On May 20, 2011, the Director of Housing submitted an application to CDLAC for an allocation of up to $7,000,000 in private activity bonds for the Project, pursuant to the Joint Authority of the Directors of Housing and Finance under San José Municipal Code Section 5.06.425. On July 20, 2011, the City received a private activity bond allocation of $7,000,000 from CDLAC as requested.

CDLAC will require that the bond closing for the Project occur by October 18, 2011. It is anticipated that the Bonds will close on or about September 22, 2011.

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 brief descriptions of the Bond financing structure, Bond financing documents, the City funding, financing team participants and financing schedule.

Bond Financing Structure

Overview of Multifamily Bond Financing

General Multifamily housing revenue bonds are issued to finance qualifying rental apartment projects to be constructed or rehabilitated by private developers. The City issues the bonds and then loans the proceeds to the developer/borrower. The bonds are typically issued as tax-exempt obligations. The advantages of tax-exempt financing to developers include: below-market interest rates and low-income housing tax credits – features not available with a conventional multifamily housing mortgage loan. The bonds are limited obligations of the City, payable solely from loan repayments by the borrower.

Requirements for Tax-Exemption For multifamily housing revenue bonds to qualify for tax-exemption, Federal law generally requires that one of two affordability restrictions must apply: either (1) at least 20 percent of the units in the housing development must be reserved for occupancy by individuals and families of very-low income (50% of area median income) or (2) at least 40 percent of the units must be reserved for occupancy by individuals and families of low income (60% of area median income). The Regulatory Agreement and

Declaration of Restrictive Covenants for the Project is expected to contain the restriction in clause (1).

Structure of the Bonds

Issuance in Two Series The Bonds will be issued in two series. The Series 2011A-1 Bonds will provide both construction/rehabilitation and permanent financing. The Series 2011A-2 Bonds will provide on financing for the Project only during the rehabilitation period.

Public Offering/Credit Enhancement The Bonds will be publicly-offered and credit enhanced by Freddie Mac. As Freddie Mac does not take rehabilitation/construction and lease-up risk, the Borrower has arranged for its construction lender, Citi, to provide the following security to Freddie Mac during the Project's rehabilitation and lease-up period: initially, a cash collateral account will be funded with the proceeds of a conventional taxable loan which will be replaced by a Citi letter of credit in favor of Freddie Mac. The Bonds are expected to be rated "AAA" by Standard & Poor's based on its current assessment of Freddie Mac. The rating is expected to be received on or about August 29, 2011. Citigroup Global Markets Inc. will underwrite and market the Bonds.

Principal Amount and Term The Bonds will be issued as tax-exempt bonds in an expected aggregate amount of $6,300,000. The expected par sizes of the Series 2011A-1 Bonds and Series 2011A-2 Bonds are $3,700,000 and $2,600,000, respectively. In no event may the aggregate par of the Bonds exceed $7,000,000.

The Series 2011A-1 Bonds are expected to mature by 2030. Starting in 2013 or 2014, the Series 2011A-1 Bonds will repay principal annually on the basis of a 35-year amortization. At maturity, the Series 2011A-1 Bonds will have a "balloon" balance, which will need to be refinanced through a new series of bonds and/or paid from another source. The Freddie Mac credit enhancement guaranties the repayment of the balloon payment at maturity.

The Series 2011A-2 Bonds are expected to mature by 2014 and will be repaid from tax credit investor equity funds.

The final dates, principal amounts and other financial terms for the Bonds are subject to change based on final pricing information prior to the bond closing.

Interest Rate The Bonds are expected to pay a fixed interest rate of approximately 5.0% based the current market through maturity. The resolution authorizing the issuance of the Bonds, however, will authorize an interest rate not to exceed 12%, the maximum permitted by State law to ensure sufficient flexibility to meet changing market conditions.

Bond Financing Documents

The following are brief descriptions of each document the Council is being asked to approve and authorize the execution of. Copies of these documents will be posted to the City's agenda website on or about August 11, 2011. Staff recommends that the City's Assistant Director of Finance, Director of Housing, or other authorized officer of the City be authorized to execute the agreements on behalf of the City as described below ("Authorized Officers"). As modifications may be required prior to the closing, staff also recommends that the Authorized Officers each be authorized to execute the final version of each of these agreements and to approve changes to the Official Statement upon consultation with the City Attorney's Office.

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 Assistant Director of Finance or other authorized officer on behalf of the City and attested by the City Clerk. The Indenture set forth the terms of the Bonds, including the interest rates, final maturity, and redemption provisions applicable to each series. The Indenture establishes various funds and accounts for the deposit of bond proceeds and repayment sources. Pursuant to the Indenture, the Trustee is given the authority to receive, hold, invest and disburse the bond proceeds and other funds; 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. The Indenture provides that the Borrower will compensate the Trustee for services rendered thereunder.

Financing Agreement This agreement (the "Financing Agreement") is among the City, the Trustee, and the Borrower. The Financing Agreement is executed by the Assistant Director of Finance or other authorized officer on behalf of the City. The Financing Agreement provides for the loan of the bond proceeds to the Borrower for the acquisition and rehabilitation of the Project and for the repayment of such loan by the Borrower. The City's rights to receive payments under the Financing Agreement will be assigned to the Trustee along with certain other rights under the Indenture and Intercreditor Agreement; 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 Assistant Director of Finance and the Director of Housing or other authorized officers on behalf of the City. The Regulatory Agreement contains certain covenants and restrictions regarding the Project and its operations needed to assure continued compliance with Federal tax and State bond law requirements. The Regulatory Agreement restricts the rental of Project units (excepting one manager's unit) to low- or very-low income families for a period of 55 years.

Intercreditor Agreement This agreement (the "Intercreditor Agreement") is among the City, the Trustee, the Borrower, Freddie Mac, and Citi. This document is executed by the Assistant Director of Finance or other authorized officer on behalf of the City. The Intercreditor Agreement assigns the exclusive right to exercise all rights and remedies (other than the City's reserved rights) under the Financing Agreement and the Borrower's loan documents (1) to Citi during the Project's rehabilitation and lease-up period and (2) to Freddie Mac during the Project's permanent phase.

Bond Purchase Agreement This agreement ("Purchase Agreement") is among the City, the Borrower, and Citigroup Global Markets Inc. (the "Underwriter"). The Purchase Agreement sets forth the conditions under which the Underwriter will purchase the Bonds. It contains certain representations and warranties of the City and the Borrower, the documents to be executed at closing, and the conditions that may allow the Underwriter to cancel its purchase of the Bonds. This document is executed by the Assistant Director of Finance or other authorized officer on behalf of the City.

Official Statement This document is the public offering statement relating to the Bonds. This document is executed by an authorized officer of the Borrower. The City does not execute the Official Statement. This document, prepared by the Underwriter's counsel, describes the terms and structure of the Bonds, the flow of funds, the Project, and the security for the Bonds. The City will not circulate the Official Statement until Citi and Freddie Mac have issued their final credit approvals. During the marketing period for the Bonds, the Official Statement will be issued in preliminary form. After the Bonds are sold, the final pricing information will be included and the Official Statement will become "final".

A copy of the draft preliminary Official Statement, in substantially final form, will be posted on the agenda website on or about August 11, 2011. As a conduit Issuer, the only portions of the Official Statement that the City is certifying as to accuracy are the sections entitled "The Issuer" and "Absence of Litigation – The Issuer". If any Councilmember has any personal knowledge that any of the material information in these sections of the Official Statement is false or misleading, he or she should promptly advise City staff of the matter; City staff, bond counsel and the financial advisor will be available at the Council meeting on August 23, 2011, to address any questions, issues and/or concerns.

Financing Team Participants

The financing team participants consist of:

• City's Financial Advisor	Ross Financial
• Bond Counsel	Jones Hall, A Professional Law Corporation
• Trustee	Wells Fargo Bank, National Association
• Underwriter	Citigroup Global Markets Inc.

All costs associated with the Financial Advisor, Bond Counsel, Trustee, and Underwriter are contingent on the sale of the Bonds and are expected to be paid from tax credit equity funds advanced at Bond closing, or another available funding source.

Financing Schedule

The current proposed schedule is as follows:

• Council approval of bond documents	August 23, 2011
• Distribute Preliminary Official Statement	August 25, 2011
• Price the Bonds	September 8, 2011
• Pre-close and close Bonds	September 20 and 22, 2011
• CDLAC deadline for bond closing	October 18, 2011

City Loan Commitment

On May 17, 2011, via Resolution No. 75800, the Council approved a loan to the Borrower of up to $5,250,000 to finance a portion of the costs of acquiring and rehabilitating the Project and to provide a permanent mortgage. The source of loan proceeds is a NSP2 grant from the U.S. Department of Housing and Urban Development. No portion of the City loan will be funded from 20% housing set-aside tax increment.

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 Taylor Oaks Apartments and requires no follow-up to the City Council. Once the Bonds close, anticipated in mid to late September 2011 and the rehabilitation of the Project commences, the Housing Department will provide updates in its Quarterly Production Updates to the Council.

PUBLIC OUTREACH

☐ **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, Notice in appropriate newspapers)**

This request does not meet any of the above criteria. Instead, the method of notifying the community of the City's intent to issue tax-exempt private activity bonds is for the City's Finance Department to hold a Tax Equity and Fiscal Responsibility Act (TEFRA) Hearing. The TEFRA Hearing was held on May 18, 2011, before the Director of Finance. The public hearing notice was published in the *San José Mercury News* on April 26, 2011.

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 Council on June 12, 2007, to increase the supply of affordable housing. This action is also consistent with the City's Policy 1-16, Policy for the Issuance of Multifamily Bonds, which requires the City to issue tax-exempt multifamily housing revenue bonds for projects within the City limits that also have a City loan or grant commitment, with certain limited exceptions.

COST IMPLICATIONS

All costs of the Project will be paid from bond proceeds, City loan proceeds, tax credit equity, income from operations, and deferred developer fee. Compensation for the financing team participants (financial advisor, bond counsel, underwriter and trustee), as well as the other costs of the financing, are contingent on the sale of the Bonds and will be paid most likely from tax credit equity at bond closing.

The Bonds are tax-exempt obligations secured by a first priority lien against the Borrower's fee interest in the 59-unit Taylor Oaks Apartments and a Freddie Mac credit enhancement agreement. No payment of the Bonds will be paid from or guaranteed through the general taxing power of the City or any other City asset.

From this bond issuance, the City will receive an issuance fee of $31,500 based on an initial bond size of $6,300,000. The City also will receive an annual fee for monitoring the Bonds and the Regulatory Agreement. Under current City policy, the annual fee is equal to one-eighth of a point (0.125%) of the original principal amount of the Bonds ($7,875 per year based on an initial Bond size of $6,300,000). The total bond fees to be paid to the City will be approximately $181,125 over the life of the Bonds, assuming a 19-year maturity. The actual amount of annual fee collect will depend on the final maturity of the bonds.

CEQA

Exempt, File No. PP11-022.

/s/

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/s/

LESLYE CORSIGLIA
Director, Housing Department

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