COUNCIL AGENDA: 09-27-11
ITEM: 4.3

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Leslye Corsiglia
Julia H. Cooper

SUBJECT: SEE BELOW

DATE: September 14, 2011

Approved

Date 9-15-11

COUNCIL DISTRICT: 3
SNI AREA: RINCON DE LOS ESTEROS

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

RECOMMENDATION

Adopt a resolution of the Council:

a. Authorizing the issuance of a tax-exempt multifamily housing revenue note designated as "City of San José Multifamily Housing Revenue Note (First and Rosemary Family Apartments), Series 2011B" in an aggregate principal amount not to exceed $30,700,000 (the "Governmental Lender Note" or "Note");

b. Approving a loan of Note proceeds to 1st and Rosemary Family Housing, L.P., a California limited partnership created by ROEM Apartments Communities, LLC, to finance the construction of the First and Rosemary Apartments located at 34, 66, 80 East Rosemary Street 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");

d. Authorizing and directing the City Manager, Acting Director of Finance, Assistant Director of Finance, Treasury Division Manager, Debt Administrator, and Director of Housing, or their designees, to execute and, deliver these Documents and other related Note documents as necessary; and

e. Declaring its intent to use the proceeds of the notes to reimburse project expenditures.

OUTCOME

Approval of the recommended actions will enable the issuance of a multifamily housing revenue note for the purpose of constructing a 184 unit rental apartment project, composed of 182 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 $17,460 and $50,940.

EXECUTIVE SUMMARY

In accordance with the requirements under the City's Policy for Issuance of Multifamily Housing Revenue Bonds, ROEM Apartment Communities, LLC (the "Developer") has requested that the City issue a tax-exempt multifamily housing revenue note, which will be sold to generate proceeds to be loaned to 1st and Rosemary Family Housing, L.P., a California limited partnership (the "Borrower") in an amount not to exceed $30,700,000. 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 184 unit rental apartment housing project to be known as First and Rosemary Family Apartments (the "Project"). The Project will consist of 182 units that will be affordable for at least 55 years and two (2) manager's units that will be unrestricted. The affordable units are comprised of 55 one-bedroom units, 97 two-bedroom units, and 30 three-bedroom units.

Additionally, the Housing Department will convert a $6,300,000 acquisition loan that was approved by the Council on December 16, 2008, and funded by the Housing Department on February 20, 2009 from 20% tax increment funds, to a construction/permanent loan in the same amount. This loan represents a conversion of the $6,300,000 acquisition loan. It is anticipated that the conversion of the acquisition loan to a construction/permanent will close in early October 2011.

BACKGROUND

Borrower. The Borrower, First and Rosemary Apartments, L.P., is a California limited partnership. The Borrower will consist of: (1) Pacific Housing, Inc., a California non-profit affordable housing developer, as the Managing General Partner; (2) the Developer, as General Partner; and (3) Alliant Capital, or an affiliate thereof, as the tax credit investor limited partner.

The Developer has requested that the City issue the Note for the purpose of lending the Note proceeds to the Borrower. The proceeds of the Note, together with other funds, will be used by the Borrower to finance the construction of the Project.

Project Overview. The Project involves the construction of 184 one-bedroom, two-bedroom and three-bedroom apartment units. Upon completion of the Project, 10 percent of the units (19 units) will be initially rented to individuals and families with incomes that do not exceed 30 percent of the area median income ("AMI"); 25 percent of the units (46 units) will be rented to individuals and families with incomes that do not exceed 45 percent of AMI; 40 percent of the units (73 units) will be rented to families with incomes that do not exceed 50 percent of AMI; and 24 percent of the units (44 units) will be rented to families with incomes that do not exceed 60 percent of AMI[1]. Two of the Project's 184 units are unrestricted manager's units. The rental restrictions for the Project will remain for a period of 55 years and conform to the City's rental affordability requirements.

City Loan for the Project. On December 16, 2008, the Council adopted Resolution No. 74374 approving a funding commitment for a site acquisition loan (the "Acquisition Loan") in the amount of $6,300,000 for the development of the Project. The funding source of Acquisition Loan was 20% housing set-aside tax increment funds. On February 20, 2009, the Developer used $6,300,000 in loan proceeds to acquire the site. On June 24, 2011, the Council adopted Resolution No. 75932 approving the conversion of the Acquisition Loan to a construction/ permanent loan for the Project. A Commitment Letter for the construction/permanent loan was executed on June 28, 2011, by the Developer and the Director of Housing.

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. As the Note is the equivalent of a multifamily housing bond, the Policy applies.

Sources of Project Funding. The Note will be structured as a fixed rate obligation in the principal amount of $30,700,000. Note proceeds will fund a portion of the total Project costs, which are estimated to be $52,856,567. The estimated sources of funding for the Project's construction phase and after completion and lease-up (the "permanent phase") are as follows:

[1] Percentages of units by income restriction do not add to 100% due to individual rounding.

City of San José
First and Rosemary Family Apartments
Plan of Finance – Sources of Funding(1)

Source	Construction	Permanent
Note Proceeds	$ 30,700,000	$ 18,916,000
City Loan	6,300,000	6,300,000
State of California Proposition IC Funds (Infill Grant)	7,883,968	7,883,968
Tax Credit Equity	8,335,415	17,470,576
Lease-up Income	422,128	729,026
Interim Bond Paydown	(3,743,000)	0
Deferred Fees and Reserves	2,958,056	1,556,997
Total	$ 52,856,567	$ 52,856,567

(1) Estimated as of the date of this report. The actual amounts may vary from these estimates.

Financing History of Project – Key Dates. On December 9, 2008, the City's Director of Finance, pursuant to Municipal Code Section 5.06.430, held a TEFRA Hearing to receive public comment regarding the issuance of bonds by the City for the Project. On March 10, 2011, the Director of Finance held a second TEFRA hearing regarding the issuance of tax-exempt multifamily housing revenue bonds in an amount not to exceed $33,000,000 to finance the construction of the Project. On March 18, 2011, the Director of Housing submitted an application to the California Debt Limit Allocation Committee ("CDLAC") for an allocation of up to $30,700,000 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 May 18, 2011, the City received a private activity bond allocation of $30,700,000 from CDLAC as requested. The City is requesting a 60-day extension from CDLAC in order to accommodate the anticipated bond closing.

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 Multifamily housing financing typically involves the issuance of bonds on behalf of private developers of qualifying affordable rental apartment projects. The bonds are issued by the City with the proceeds loaned 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.

The Notes operate in a very similar manner to multifamily housing bonds. The Notes 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 cap allocated by CDLAC. The Notes also allow the Project to qualify for tax credits provided through the California Tax Credit Allocation Commission (TCAC). The Notes are limited obligations of the City, payable solely from loan repayments by the Borrower.

The Note structure is being utilized because of a recent ruling of the Office of the Comptroller of the Currency ("OCC") that distinguished loans from bonds for purposes of counting maximum Community Reinvestment Act ("CRA") credit. The change occurred when the regulatory compliance of Citibank, N.A., the lender for the Project, was shifted to OCC from the Office of Thrift Supervision ("OTS"). OTS had viewed tax-exempt financing activity as lending and not as an investment, whether structured as a bond or note, since proceeds of the financing were loaned to the borrower. However, OCC will only treat tax-exempt bond financing activity as an investment, which is considerably less beneficial to Citibank N.A. than a loan. Citibank N.A. believes that the Note financing approach 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 or bond 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 second 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 Note, the new Note holder 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 variable rate tax-exempt note in an aggregate amount of approximately $30,700,000. Upon completion of the Project and its lease-up and conversion to the permanent loan phase, a portion of the tax credit equity funds will be used to pay the Note down to an estimated remaining outstanding balance of approximately $18,916,000. 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 with a maturity of approximately 18 years after the Conversion Date. After the Conversion Date, the Note will amortize on a 35 year basis and will be prepayable after 15 years. The remaining balance will be due at maturity to be repaid either from a refinancing or another funding source to be identified by the Borrower at that time.

Interest Rates During the construction period, the Note will accrue interest-only at a variable rate equal to the Securities Industry and Financial Markets Association ("SIFMA") Index plus a margin of 2.95% per year.

During the permanent period, after the Project is completed and after the Conversion Date, the interest will accrue at a fixed rate that is estimated to be approximately 6.1% based on current market conditions.

Financing Documents

The following is a brief description of each document the 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 September 14, 2011.

Funding Loan Agreement The Note will be issued under a Funding Loan Agreement (the "Agreement") between the City, Citibank, N.A., as funding lender, and Wells Fargo Bank, National Association, as the fiscal agent (the "Fiscal Agent"). The Agreement is executed by the Acting Director of Finance, 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 Acting Director of Finance, 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 Acting Director of Finance, 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 Note will be payments from the Borrower with respect to 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:	Ross Financial
• Bond Counsel:	Orrick, Herrington & Sutcliffe 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	September 27, 2011
• Pre-Close	September 28, 2011
• Close Note (Week of)	October 24, 2011
• Anticipated CDLAC Deadline for Note Closing	November 27, 2011

As the Bond closing will be contingent on the conversion of the outstanding City acquisition loan to a construction/permanent loan, it is possible that these closing dates may change. In that case, an extension of CDLAC's deadline to complete the transaction may need to authorized by the CDLAC board.

City Subordinate Funding

The Housing Department will convert its existing acquisition loan to a construction/permanent loan to the Borrower in an amount up to $6,300,000. This loan will represent a conversion of an existing acquisition loan approved by the Council on December 16, 2008, and funded on February 20, 2009. No new funds will be added to the City loan.

EVALUATION AND FOLLOW-UP

This Memorandum presents the set of recommendations related to the Council's approval of the issuance of the Note for the First and Rosemary Apartments and requires no follow-up to the Council. Once the Note closes which is anticipated to be in early October 2011, and the construction of the Project commences, the Housing Department will provide updates in its Quarterly Construction Reports to the 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 Council to hold a Tax Equity and Fiscal Responsibility Act (TEFRA) Hearing. TEFRA Hearings were held on December 9, 2008 and March 10, 2011, by the Assistant Director of Finance. The public hearing notice for the March 10, 2011 hearing was published in the *San José Mercury News* on February 18, 2011. This Memorandum will also be posted on the City's website in advance of the September 27, 2011 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 Council on June 12, 2007, to increase the supply of affordable housing, and with the City's *Consolidated Plan 2010-2015* to provide housing units for very low- and extremely low-income households.

COST SUMMARY/IMPLICATIONS

All issuance costs will be paid from Note proceeds and/or Borrower equity. The Note is a tax-exempt obligation secured by a mortgage loan 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. Based on an initial Note size of $30,700,000, the City will receive an upfront issuance fee of approximately $101,750. 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 original principal amount of the Note or a minimum fee of $7,500. Based on the formula and an initial Note size of $30,700,000, the annual fee will be $38,375.

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: EIR resolution 72768 adopted June 21, 2005, file number PDC07-101

Julia H Cooper
JULIA H. COOPER
Acting Director of Finance

LESLYE CORSIGLIA
Director, Housing Department

For questions, please contact Arn Andrews, Acting Assistant Director of Finance at (408) 535-7041.