COUNCIL AGENDA: 08-28-12
ITEM: 4.2

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 6, 2012

Approved

Date 8/14/12

COUNCIL DISTRICT: 2

SUBJECT: APPROVAL OF THE ISSUANCE OF TAX-EXEMPT MULTIFAMILY HOUSING REVENUE BONDS, LOAN OF BOND PROCEEDS AND RELATED DOCUMENTS FOR THE LA MORAGA APARTMENTS

RECOMMENDATION

Adopt of a resolution of the City Council in connection with the issuance of multifamily housing revenue bonds:

a. Authorizing the issuance of tax-exempt multifamily housing revenue bonds designated as "City of San José Multifamily Housing Revenue Bonds, Series 2012E (La Moraga Apartments)" in an aggregate principal amount not to exceed $52,440,000 (the "Bonds");

b. Approving a loan of bond proceeds to La Moraga San Jose, L.P, a California limited partnership created by St. Anton Capital to finance the construction of the La Moraga Apartments located at the corner of Charlotte Drive and Raleigh Road in San José (the "Project");

c. Approving in substantially final form an Indenture of Trust, a Loan Agreement and Regulatory Agreement and Declaration of Restrictive Covenants (the "Documents");

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

OUTCOME

Approval of the recommended actions will enable the issuance of multifamily housing revenue bonds for the purpose of constructing a 275-unit rental apartment project, composed of 90 units that will be affordable for a period of at least 55 years, 182 units that will be rented at market rates and three manager's units. The restricted apartments will serve very low- and low-income households with current annual incomes between $42,000 and $75,700 in addition to market-rate units serving all income ranges.

EXECUTIVE SUMMARY

Consistent with the City's Policy for Issuance of Multifamily Housing Revenue Bonds, St. Anton Capital (the "Developer") has requested that the City issue tax-exempt multifamily housing revenue bonds, in an aggregate amount not to exceed $52,440,000, the proceeds of which will be loaned to La Moraga San Jose L.P., a California limited partnership (the "Borrower"). The Bonds will be non-rated; non-credit enhanced, and structured as a private placement with U.S. Bank National Association ("U.S. Bank") and Mechanics Bank, as the initial purchasers. The proceeds of the loan, together with other funds, will be used by the Borrower to finance the construction of the Project. The Project will consist of 275 units, 90 of which will be affordable for at least 55 years, 182 of which will be rented at market rates and three of which will be managers' units. The affordable units are comprised of 40 one-bedroom units, 39 two-bedroom units and 11 three-bedroom units.

BACKGROUND

Borrower. The Borrower, La Moraga San Jose L.P., is a California limited partnership. The Borrower will consist of: (1) Anton La Moraga, LLC, an affiliate of the Developer, as Administrative General Partner, (2) Pacific Housing, Inc. or an affiliate, a California nonprofit public benefit corporation, as Managing General Partner, and (3) St. Anton Investors, LLC as the tax credit investor limited partner.

The Developer has requested that the City issue the Bonds for the purpose of loaning bond proceeds to the Borrower. The proceeds of the Bonds, 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 275 one-bedroom, two-bedroom and three-bedroom apartment units. Upon completion of the Project, 21 percent of the affordable units (57 units) will be initially rented to individuals and families with incomes that do not exceed 50 percent of the area median income ("AMI"); and 12 percent of the affordable units (33 units) will be rented to individuals and families with incomes that do not exceed 80 percent of AMI. Three of the Project's 275 units are unrestricted managers' units and the remaining 182 units will be rented at market rates. The rental restrictions for the Project will remain for a period of 55 years.

Proposed Rents	50%	80%	Market Rate
1 Bedroom	$ 945	$ 1,476	$ 1,925
2 Bedroom	$ 1,130	$ 1,653	$ 2,500
3 Bedroom	$ 1,251	$ 1,831	$ 3,000

Negotiated Affordable Housing Requirements. The Project is to be developed on a parcel known as Lot 9, formerly owned by Hitachi Global Storage Technologies, Inc. ("HGST"). The Development Agreement by and among the City of San José, The Redevelopment Agency of the City of San José and HGST (the "Development Agreement"), dated December 20, 2005, governs the development of all the real property owned by HGST and includes an Affordable Housing Plan. On December 14, 2011, La Moraga San Jose, LLC, a California limited liability company ("La Moraga"), an affiliate of the Developer, acquired Lot 9 from HGST. Lot 9 is subject to the affordable housing requirements of the Development Agreement, which requirements were assumed by La Moraga under an Assignment and Assumption Agreement dated December 14, 2011 with HGST. Based on the proposed Project as set forth in Planned Development Permit PD12-002, the affordable housing requirement for the Project would be: 22 Very Low Income units (affordable to households earning no more than 50% of average area median income) and 33 Low Income units (affordable to households earning no more than 80% of average area median income)(collectively, the "Existing Affordable Housing Requirement").

On July 31, 2012, La Moraga and the Borrower entered into an Agreement Regarding the Transfer of Development Rights, Affordable Housing Obligations and Other Property Interests (the "Transfer Agreement") with ICS Transit Village Property Owner LLC, a California limited liability company ("ICS"), the owner of Lot 8. Lot 8 is also subject to the affordable housing requirements of the Development Agreement, including the requirement to provide 35 Very Low Income units (the "Lot 8 VLI Units"). Under the Transfer Agreement, ICS transferred the obligation to provide the Lot 8 VLI Units to La Moraga, and the Borrower agreed to develop the Lot 8 VLI units as part of the Project in addition to the Existing Affordable Housing Requirement.

The Borrower's total affordable housing obligation will be to provide 57 Very Low Income units and 33 Low Income units. Affordability Restrictions setting forth this obligation will be recorded against Lot 9 at the time of Bond closing, expected in early September 2012. The Affordability Restrictions shall not be subordinated to senior permanent financing security. The total affordable housing obligation will be recorded on the site in the form of an Affordability Agreement, separate from the bond Regulatory Agreement, which will conform to the City's rental affordability requirements.

No City Loan for the Project. There is no City loan for the Project.

City as Issuer of Multifamily Housing Bonds. The City's Policy for Issuance of Multifamily Housing Revenue Bonds (the "City Policy") encourages developers of multifamily housing projects in the City to utilize the City as the bond issuer. As with other rental projects being developed under the Development Agreement for the Hitachi lots seeking tax-exempt financing, the City negotiated to be the bond issuer.

Sources of Project Funding. The Bonds will be issued in the anticipated amount of $52,440,000. During construction, the Bonds will be structured as a variable rate draw-down obligation. After construction and lease-up (the "permanent phase"), the Bonds will be converted to fixed-rate obligations. Bond proceeds will fund a portion of the total Project costs, which are estimated to be $65,529,000. The estimated sources of funding for the Project's construction phase and permanent phase are as follows:

City of San José
La Moraga Apartments
Plan of Finance – Sources of Funding(1)

Source	Construction	Permanent
Bond Proceeds	$ 52,440,000	$ 52,440,000
Net Operating Income	2,300,000	5,307,000
Borrower Equity	8,639,000	5,882,000
Deferred Developer Fee	2,150,000	1,900,000
Total	$ 65,529,000	$ 65,529,000

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

Financing History of Project – Key Dates. On February 2, 2012, the City's Director of Finance held a TEFRA Hearing, pursuant to Municipal Code Section 5.06.430, regarding the issuance of tax-exempt multifamily housing revenue bonds by the City in an amount not to exceed $53,500,000 to finance the construction of the Project. On May 16, 2012, the Director of Housing submitted an application to CDLAC for an allocation of up to $52,440,000 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 18, 2012, the City received a private activity bond allocation of $52,440,000 from CDLAC as requested.

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.

Bond Financing Structure

Overview of the Multifamily Bond Financing

General Multifamily housing financing typically involves the issuance of tax-exempt bonds on behalf of private developers of qualifying affordable rental apartment projects. The City issues the bonds and loans the proceeds to the developer/borrower. 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 a multifamily housing revenue bond to qualify for tax-exemption, federal law generally requires that one of two restrictions apply: either (1) at least 20% of the units in the housing development must be reserved for occupancy by individuals and families with incomes of 50% or less of area median income or (2) at least 40% of the units must be reserved for occupancy by individuals and families with incomes of 60% or less of area median income. The first restriction will be incorporated into the Regulatory Agreement for the Bonds. Further, in consideration of the applicable Negotiated Affordable Housing requirements, the Project will be subject to the deeper affordability requirements described in the Background section above, which additional requirements will be included in the separate Affordability Restrictions to be recorded against Lot 9 at the time of the closing of the Bonds.

Structure of the Bonds

Private Placement Structure The Bonds will be non-rated; non-credit enhanced, and structured as a private placement with US Bank and Mechanics Bank as the initial private placement purchasers (the "Initial Purchasers"). Following construction and lease-up of the Project ("Conversion"), Massachusetts Mutual Life Insurance Company ("MassMutual" and, with the Initial Purchasers, the "Bondowners") will purchase the Bonds from the Initial Purchasers. Pursuant to the City's policies regarding non-credit enhanced notes, the Bondowners will sign an Investor 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 Bonds secured solely by the Project rents. If a Bondowner wishes to transfer its Bonds, the new Bondowner must sign and deliver a similar Investor Letter to the Trustee. The Bonds can only be transferred in minimum denominations of $250,000 and there may be no more than 35 Bondowners.

Principal Amounts and Terms The Bonds will be issued in a single series in an estimated initial principal amount of $52,440,000. The Bonds are anticipated to have a final maturity of approximately 13 years. The Bonds will be subject to prepayment at the option of the Borrower (a) in full or in part at any time prior to the Conversion Date, (b) after five years following the Conversion Date, subject to a prepayment premium of the greater of: (i) 1% or (ii) the present value of remaining monthly interest payments to the maturity date, discounted by the Treasury rate for a maturity comparable to the remaining term of the Bonds and (c) within 90 days of the final maturity without premium..

The Bonds will amortize on a 35-year basis. At final maturity in approximately 13 years, the Borrower will need to refinance or otherwise pay off the remaining obligation. That risk is borne by the Bondowners.

Interest Rates During the construction period, the Bonds will pay interest-only at a variable rate equal to one-month LIBOR index plus a margin of 2.75%. After the Conversion Date, the interest on the Bonds will convert to a fixed rate that is estimated to be approximately 4.63% based on current market conditions.

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 16, 2012.

Indenture of Trust The Bonds will be issued under an Indenture of Trust (the "Indenture") between the City and Wells Fargo Bank, N.A., as trustee (the "Trustee"). The Indenture is executed by the Acting Director of Finance, Acting Assistant Director of Finance, or other authorized officers on behalf of the City, and attested by the City Clerk. Pursuant to the Indenture, the Trustee is given the authority to receive, hold, invest, and disburse the bond proceeds and other funds established under the Indenture; to authenticate the Bonds; to apply and disburse payments to the Bondholder; and to pursue remedies on behalf of the Bondholder. The Indenture 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 Bonds. The Loan Agreement (described below) obligates the Borrower to compensate the Trustee for services rendered under the Indenture.

Loan Agreement There is also a loan agreement (the "Loan Agreement") among the City, US Bank and the Borrower. The Loan Agreement is executed by the Acting Director of Finance, Acting Assistant Director of Finance or other authorized officer on behalf of the City. The Loan Agreement provides for the loan of the Bond 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 "Note") in the same principal amount as the Bonds. The City's right to receive payments under the Note will be assigned to the Trustee, along with certain other rights under the Indenture, Loan Agreement and Bonds; 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 Trustee, 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, Acting Assistant Director of Finance, and Director of Housing or other authorized officers on behalf of the City. The Regulatory Agreement restricts the rental of 20% of Project units to very low-income residents for a period of at least 55 years as previously described.

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, N.A.
- Private Placement Purchaser: U.S. Bank National Association

All costs associated with the financial advisor, bond counsel and trustee are contingent upon the sale of the Bond and will be paid from Borrower equity.

Financing Schedule

The current proposed schedule is as follows:

- Council Approval of Bond Documents August 28, 2012
- Bond Pre-Closing September 4, 2012
- Bond Closing September 6, 2012
- Anticipated CDLAC Deadline for Bond Closing October 17, 2012

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 La Moraga Apartments and requires no follow-up to the City Council. Once the Bonds close, which is anticipated to occur in early September 2012, and the construction of the Project commences, the Housing Department will provide updates in its periodic project-related reports published on the Housing Department website.

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 February 2, 2012, before the Acting Director of Finance. The public hearing notice for this hearing was published in the *San José Mercury News* on January 13, 2012. This Memorandum will also be posted on the City's website in advance of the August 28, 2012 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 2010-2015* to provide housing units for very low- and extremely low-income households.

COST SUMMARY/IMPLICATIONS

All issuance costs will be paid from Bond proceeds and/or Borrower equity. The Bonds are tax-exempt obligations secured by a mortgage loan payable from Project revenues. No payment of the Bonds will be made from, or guaranteed through, the general taxing power of the City or any other City asset. Based on an aggregate initial Bond par of $52,440,000, the City will receive an upfront issuance fee of approximately $156,100. The City will also receive an annual fee for monitoring the Bonds 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 Bonds or a minimum fee of $7,500. Based on the formula and an initial Bond size of $52,440,000, the annual fee will be $65,550. This annual fee will be paid by the Borrower on parity with the repayment of the loan that funds debt service on the Bonds.

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

CEQA

CEQA: EIR resolution no. 72772 adopted June 21, 2005, file number PDC04-031, as cited in the Project's Planned Development Permit, PD12-002.

/s/
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/s/

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