CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: MAKING GOVERNMENT WORK BETTER COMMITTEE

FROM: Scott P. Johnson

SUBJECT: **FY 2005-06 FIRST QUARTER DEBT REPORT AND AMENDMENTS TO THE MULTIFAMILY HOUSING POLICY**

DATE: November 3, 2005

Approved | Date

COUNCIL DISTRICT: City-Wide

RECOMMENDATIONS

1. Accept the FY 2005-06 First Quarter Debt Report.

2. Recommend City Council to approve the following changes to the City's Policy for the Issuance of Multifamily Housing Revenue Bonds:

   (a) Addition of a new Tax Equity and Fiscal Responsibility Act ("TEFRA") Hearing fee of $5,000 to be paid by project sponsors of multifamily housing projects located in San José in circumstances where the City is not the bond issuer; and

   (b) Amendment of the City's Annual Monitoring Fee policy by permitting a one-time reduction in the annual monitoring fee for nonprofit and governmental agency developers under certain circumstances following project completion and lease-up, subject to an annual minimum monitoring fee of $7,500.

DISCUSSION

As part of the preparation of Quarterly Debt Reports, the Finance Department reviews the City's Adopted Debt Policies to identify areas which amendments to the policies would be beneficial to the City. As part of the FY 2005-06 First Quarter Debt Report, Finance staff in coordination with the Housing Department is recommending two minor amendments to the *"Policy for the Issuance of Multifamily Housing Revenue Bonds"*. These amendments are discussed in detail in the attached memorandum.

Additionally, attached is a copy of the FY 2005-06 First Quarter Debt Report focusing on:

- Completed financings and current portfolio through September 30, 2005
- Debt issuance and management activities currently in progress
- Current long-term interest rate environment
- Performance of City's variable rate debt

Staff from the Finance Department will make a formal presentation to the Making Government Work Better Committee at the November 17, 2005 meeting.

SCOTT P. JOHNSON
Director, Finance Department

Attachments (2)

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO:	MAKING GOVERNMENT WORK COMMITTEE	**FROM:**	Scott P. Johnson Leslye Krutko
SUBJECT:	**AMENDMENTS TO THE POLICY FOR THE ISSUANCE OF MULTIFAMILY HOUSING REVENUE BONDS**	**DATE:**	November 7, 2005

Approved Date

COUNCIL DISTRICT: City-wide
SNI AREA: N/A

RECOMMENDATION

Recommend City Council to approve the following changes to the City's Policy for the Issuance of Multifamily Housing Revenue Bonds:

(a) Addition of a new Tax Equity and Fiscal Responsibility Act ("TEFRA") Hearing fee of $5,000 to be paid by project sponsors of multifamily housing projects located in San José in circumstances where the City is not the bond issuer; and

(b) Amendment of the City's Annual Monitoring Fee policy by permitting a one-time reduction in the annual monitoring fee for nonprofit and governmental agency developers under certain circumstances following project completion and lease-up, subject to an annual minimum monitoring fee of $7,500.

BACKGROUND

On June 11, 2002, the City Council adopted Resolution #71023 approving a Policy for the Issuance of Multifamily Housing Revenue Bonds (the "Policy"). The Policy addressed such matters relating to permitted issuers of bonds for multifamily housing projects located in the City of San José, the financing process, California Debt Limit Allocation Committee ("CDLAC") applications, City Council approval, bond sale, City fees, credit considerations and refunding/ restructuring/remarketing of bonds.

Consistent with the City's Debt Management Policy, approved by Resolution #70977 on May 21, 2002, Finance and Housing staff reviews the Policy at least annually to ensure consistency with the City's debt management objectives and industry developments relating to the issuance of multifamily housing revenue bonds. Since the adoption of the Policy, the City has experienced two situations currently not addressed in the Policy.

First, the City has been asked from time to time by project sponsors to hold TEFRA hearings (required by Federal law) for projects located in San José under circumstances where the City is not the bond issuer. (A description of the TEFRA Hearing requirement is discussed below.) While the Policy provides that the City shall be the issuer of all bonds for multifamily housing rental projects located in the City, bonds may be issued through other issuers (such as California Statewide Community Development Authority ("CSCDA") or Association of Bay Area Governments ("ABAG")) under limited instances. In those instances, the City is nonetheless asked to conduct a TEFRA hearing with respect to that project. The proposed addition to the Policy would allow the City to charge a fee of $5,000 for costs associated with the TEFRA hearing process in such circumstances.

Second, the City has issued bonds on behalf of nonprofit project sponsors in which State of California Department of Housing and Community Development Multifamily Housing Program ("MHP") funds, tax credit investor equity and other sources of funds are used to repay a significant amount of bond principal after project completion and lease-up[1]. The Policy currently provides that the City charge an annual monitoring fee to ensure on-going compliance with Federal tax law requirements applicable to tax-exempt multifamily rental housing revenue bonds. The existing Policy establishes the annual monitoring fee at an amount equal to the original principal amount of the bonds issued multiplied by 0.125%; the Policy currently does not permit a reduction of the City's annual fee under any circumstance. The proposed change to the Policy would allow a one-time reduction in the City's annual monitoring fee for nonprofit and governmental agency developers under circumstances where bond principal is reduced from other sources of funds following project completion and lease-up. The proposed change would include establishment of a minimum annual monitoring fee of $7,500, to cover ongoing costs for regulatory oversight.

ANALYSIS

This portion of the report is divided into two sections to address each of the proposed amendments to the Policy; the TEFRA Hearing Fee and Annual Monitoring Fee. A copy of the policy with changes noted is attached. Amendments are only being recommended in the City Fees section on pages 5 and 6 of the Policy.

[1] Period of time during construction and lease-up is often referred to as the *construction financing stage*. At the completion of the construction and lease-up the transition is often referred to as conversion to *permanent financing stage.*

TEFRA Hearing Fee

TEFRA Hearing Requirement The Federal Tax Equity & Fiscal Responsibility Act ("TEFRA") of 1986 specifies that a government agency cannot issue tax-exempt multifamily rental housing bonds unless the multifamily housing project is approved at a public hearing, called a TEFRA hearing, held by the legislative body of the jurisdiction in which the development is located. Even if a statewide bond issuer is used (except for California Housing Finance Agency ("CalHFA")), the project still must be approved at a TEFRA hearing held at the local level. TEFRA hearings require published notice (the "TEFRA Notice") in a newspaper of general circulation. A TEFRA hearing provides interested individuals or parties the opportunity to testify on any matters related to a potential bond issue, including the nature and location of the proposed project.

In the City, through City Council delegation, TEFRA hearings are typically held before the Director of Finance on the date specified on the TEFRA Notice. Evidence of the TEFRA hearing, including an affidavit of publication, is required by the California Debt Limit Allocation Committee ("CDLAC") as a condition for reviewing applications for private activity bond allocation needed to issue tax-exempt multifamily rental housing bonds. In order to conduct a TEFRA hearing, City staff undertakes the following activities:

- Prepares and publishes the TEFRA Notice
- Prepares and posts the agenda for the Public Hearing
- Prepares the necessary background and procedural documentation for the Director of Finance in order for the hearing to be conducted in accordance with federal tax law,
- Prepares the inducement declaration and the Mayor's Certificate (if the City or the Redevelopment Agency issues the bonds)
- Obtains required signatures from the Mayor, City Clerk and Directors of Finance and Housing
- Provides certification of hearing and copies of the required documentation to CDLAC
- Files the minutes and required documentation of the Public Hearing with the City Clerk's Office

When necessary, staff also researches the project to see whether or not it entails an exception to the Policy. If it does, staff works with the developer to discover why an exception is being requested and reviews the request in connection with the exceptions outlined in the Council adopted policy. If exceptions are granted, they are included in the Quarterly Delegation of Authority Informational Memorandum sent to the Mayor and City Council and they are additionally included in the Comprehensive Annual Debt Report.

Current Multifamily Rental Housing Bond Policy The Policy provides that the City be the issuer of multifamily rental housing bonds except in limited circumstances. One of those circumstances is to permit the Association of Bay Area Governments (”ABAG”), California Statewide Community Development Authority (“CSCDA”) or other similar conduit agencies to issue bonds where the City is not providing a subsidy to the project *and* the project is one of multiple projects being financed by the project sponsor through such conduit under a similar financing program so as to result in economies of scale. Nonetheless, under those circumstances, the project sponsor and the conduit issuer will request that the City hold a TEFRA Hearing for projects located in the City.

Proposed Policy Change The proposed Policy change is to charge project sponsors, when the City or Redevelopment Agency is not the issuer, a TEFRA hearing fee to compensate the City for the staff and administrative expenses associated with analyzing whether the project meets the exception provided in the Policy; holding the TEFRA hearing; producing and maintaining the necessary records, and coordinating with the project sponsor and issuing agency. The TEFRA hearing fee is waived if the City or Redevelopment Agency is the bond issuer, since the existing Policy provides for an upfront issuance fee to compensate for the staff and administrative expenses associated with the financing, including conducting the TEFRA hearing.

Annual Monitoring Fee

Federal Tax Law For multifamily housing revenue bonds to qualify for tax-exemption, generally, one of two 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). To maintain the tax-exemption, the bond documents require the annual monitoring of these restrictions.

Current Multifamily Rental Housing Bond Policy The Policy provides that the City will monitor multifamily rental housing projects for tax compliance where it is the bond issuer. The annual monitoring fee is established by Policy at an amount equal to the original bond amount multiplied by 0.125%. The annual fee stays constant through bond maturity.

The City recently has participated in several bond issues in which a significant portion of the bonds issued to finance the acquisition and construction of a project is repaid after completion and lease-up from various sources of funds (e.g., tax credit equity or MHP funds). In other words, the tax-exempt bond amount at the start of the permanent financing phase is lower than during the construction financing phase of a project. Under the current policy, the City’s annual fee would not decline. For example, if the City issued $20,000,000 in multifamily rental housing bonds for the initial financing to fund construction and other related costs of the project, and upon completion of the project, $10,000,000 of such bonds were to be repaid from State Multifamily Housing Program (“MHP”) funds and other sources, the City’s annual monitoring fee would remain $25,000 ($20,000,000 times 0.125%). The implementation of the recommendation would, in this case, result in a reduction of the fee to $12,500. The potential impact of maintaining the higher annual fee is to lower the amount of permanent financing available to a project.

As part of the evaluation of this proposed change, a survey of other active issuers of multifamily housing revenue bonds was conducted related to the fees charged in conjunction with services provided, such as holding a TEFRA Hearing, issuing the bonds, and monitoring for regulatory compliance after the bonds are issued. Several other jurisdictions, including the San Diego Housing Commission and the City of Los Angeles charge fees for holding a TEFRA hearing when they are not the issuer of the debt.

Proposed Policy Change The proposed Policy change would allow a reduction in the City's annual monitoring fee for nonprofit and governmental agency developers under circumstances where bond principal is reduced from other sources of funds at conversion to permanent financing. The City's annual monitoring fee would then be an amount equal to the bond size at the start of the permanent financing phase multiplied by 0.125%, subject to a minimum annual monitoring fee of $7,500. The fee would not be reduced as principal is amortized. A fee reduction is only contemplated for nonprofit and governmental agency developers because those types of entities construct projects with deeper affordability restrictions than for-profit developers. A higher annual fee means less cash flow available to service debt on the property. A lower debt capacity translates into lower loan amounts, which results in smaller projects [and fewer additional services offered to tenants such as homework help or English as a Second Language (ESL) classes]. By assisting nonprofit developers through the reduction of the City's annual monitoring fee, more cash flow is available to the developer for providing affordable housing.

OUTCOMES

Acceptance of the recommended policy amendments will allow the City to be more flexible and responsive to the City's affordable housing program.

PUBLIC OUTREACH

Not applicable.

COORDINATION

This report has been coordinated with the City Attorney's Office.

COST IMPLICATIONS

The proposed change to the Policy would result in the City receiving a fee of $5,000 for holding a TEFRA hearing with respect to a multifamily rental housing project. The proposed policy change could also reduce the City's annual fee for monitoring multifamily rental housing projects involving nonprofit or governmental agency project sponsors. The amount of reduction will depend on the extent to which bonds are repaid prior to the permanent phase of the multifamily rental housing bond financing.

In Fiscal Year 2004-05, the City held six TEFRA hearings. Of these hearings, two were exceptions to the policy where the bonds were issued by agencies other than the City or the Redevelopment Agency (ABAG and CSCDA were the bond issuers). These two projects would have been subject to the TEFRA fee, resulting in the City receiving a total fee of $10,000.

CEQA

Not applicable. Not a project.

SCOTT P. JOHNSON Director, Finance Department	LESLYE KRUTKO Director, Housing Department

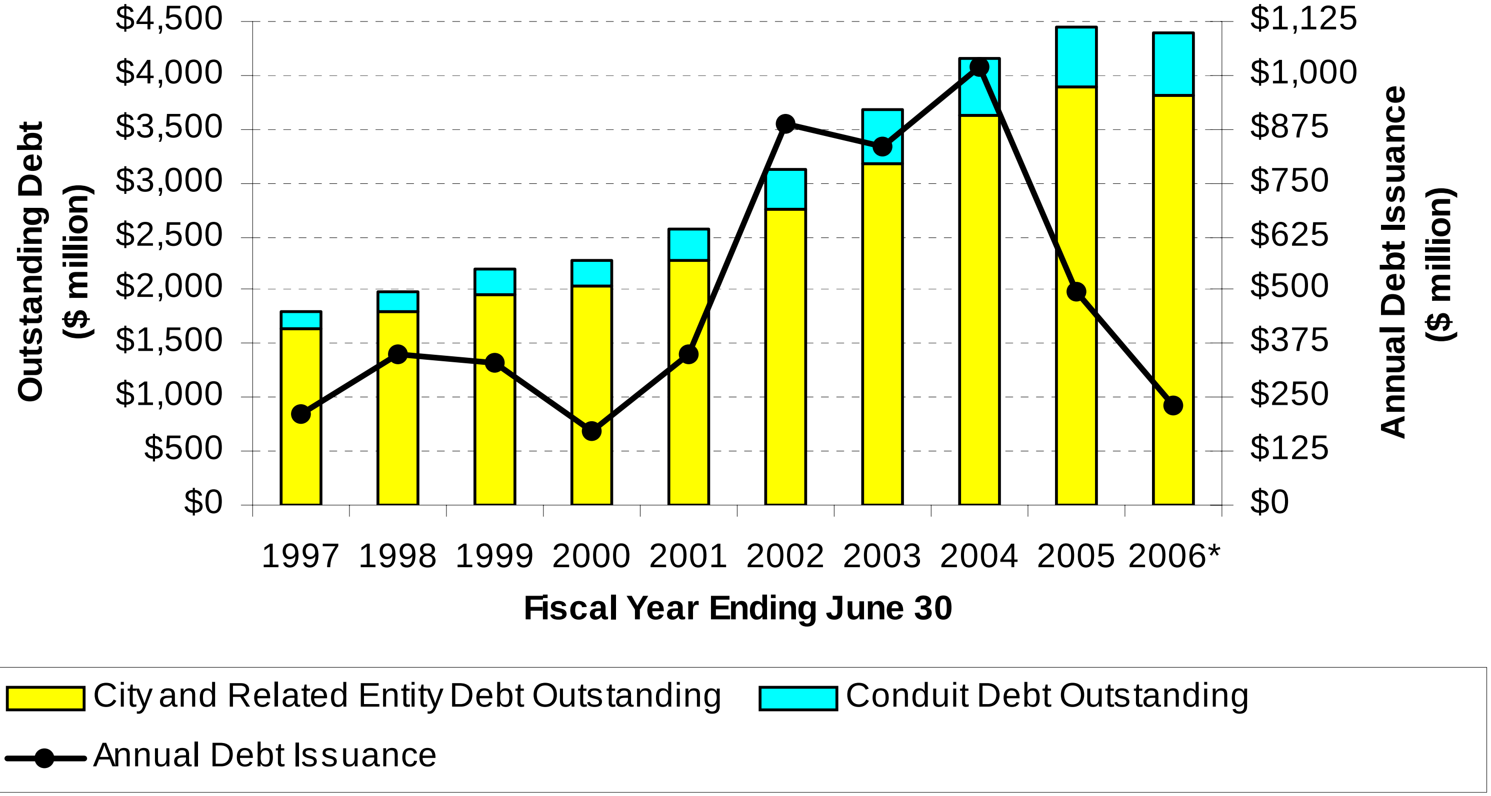
Attachment

FY 2005-06 First Quarter Debt Report

Making Government Work Better Committee

Finance Department
Debt Management Program
November 17, 2005

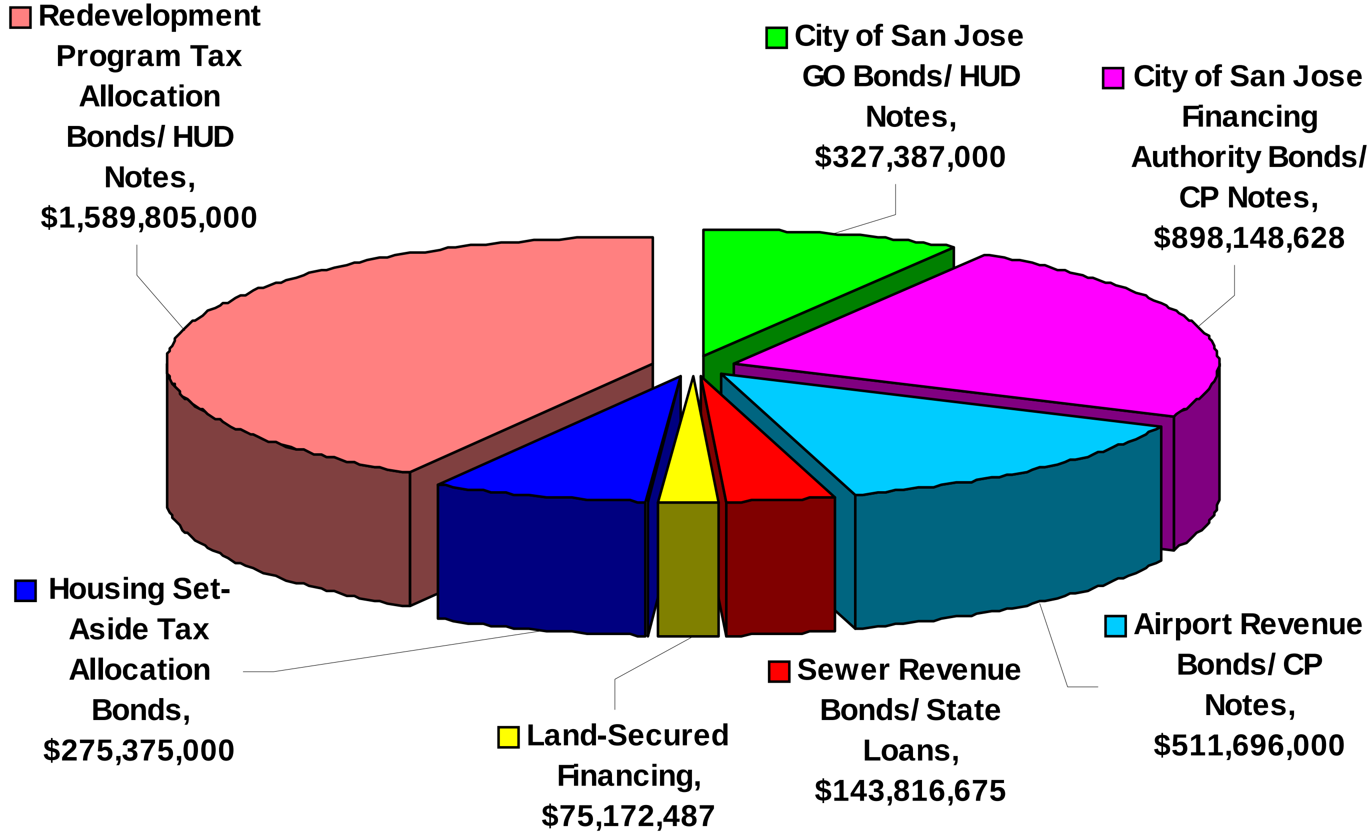
City Debt Portfolio and Issuance History



* Through September 30, 2005.

Outstanding Bonds Issued by All Agencies

Outstanding Debt as of September 30, 2005: $3,821,400,790



CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY
10th Largest U.S. City

Debt Issuance and Debt Management Activities during 1st Quarter and in Progress

- Redevelopment Tax Allocation Bonds (2 Series)
  - Refund Existing Agency Debt
  - $220,080,000, Closed July 25, 2005
    - Generated $6,870,000 of present value debt service savings
- Sewer Revenue Bonds (2 Series)
  - Refund Existing Wastewater System Debt
  - $81,150,000, Closed October 5, 2005
    - Generated $8,901,079 of present value debt service savings
- Lease Revenue Commercial Paper Program Expansion
  - Central Service Yard Phase II Project Interim Financing
  - $18,000,000, expected to close November 17, 2005
- Multifamily Housing Revenue Bonds (2 Series)
  - Paseo Senter I
    - $29,947,600, anticipated to close December 15, 2005
  - Paseo Senter II
    - $24,679,400, anticipated to close December 15, 2005
- Annual Reporting -- SEC Continuing Disclosure Requirements

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City of San Jose – Credit Rating

- Rating presentations in late May, early June 2005
- Aa1/AA+/AA+, confirmed in June 2005
- Demonstrates City's overall strong credit worthiness
- Remain highest rated City with populations of over 250,000 in California
- Ranked higher than State of California (A2/A/A) and County of Santa Clara (Aa2/AA+/--)

CITY OF SAN JOSE
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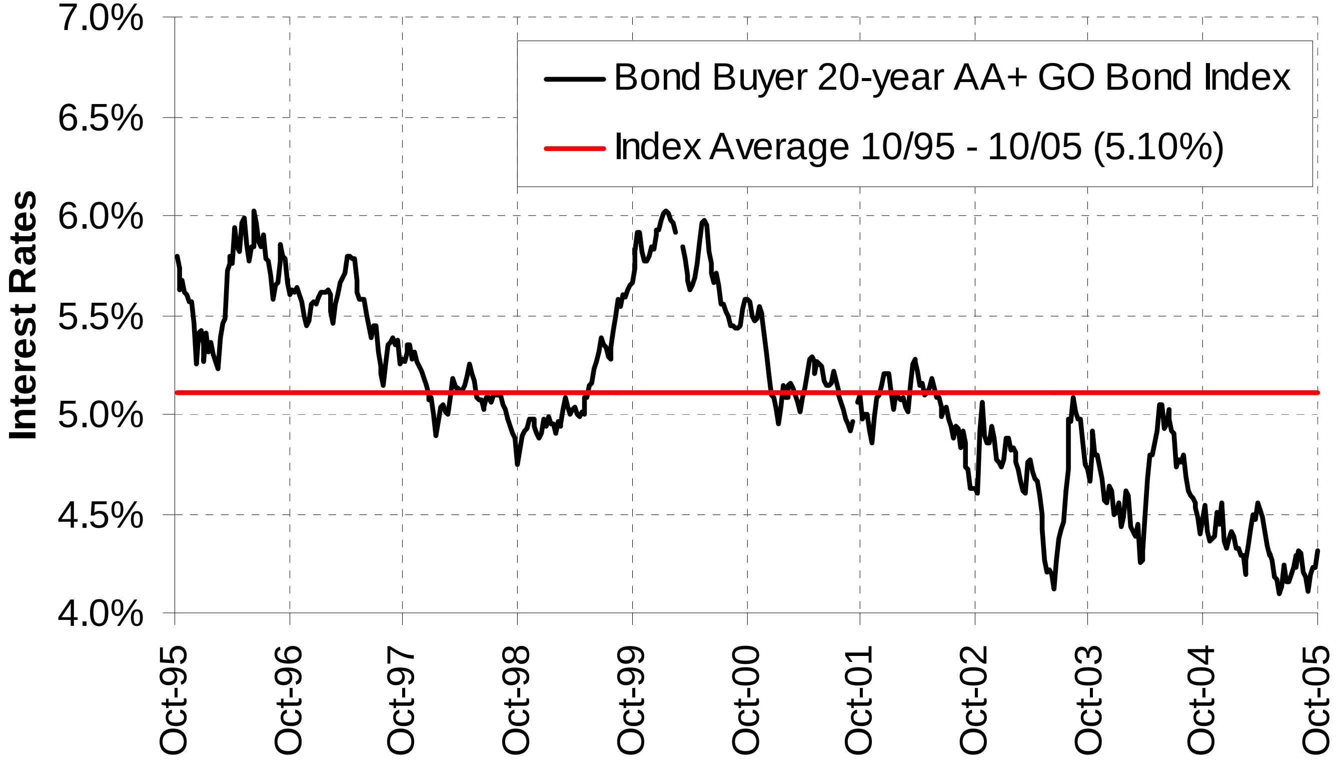
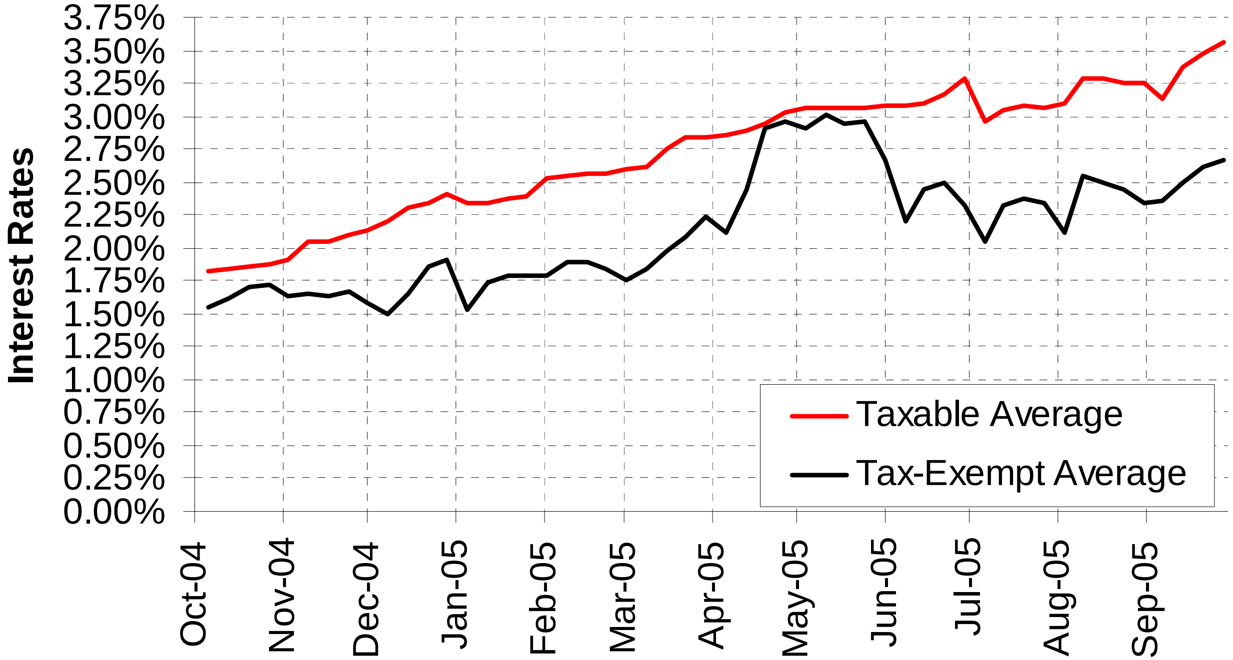
Average Fixed Tax-Exempt Rates

- Tax-exempt long-term interest rates increased by 15 basis points during the first quarter of 2005-06. Current rates (4.55% as of 11/03/05) remain below their ten-year average.



Average Variable Taxable and Tax-Exempt Interest Rates

- Tax-exempt weekly interest rates paid by the City have averaged 2.46% in fiscal year 2005-06, and are currently at 2.60% (as of 11/8/05)
  - 35 basis point increase from July 1, 2005 to September 30, 2005
- Taxable weekly interest rates paid by the City have averaged 3.31% in fiscal year 2005-06, and are currently at 3.67% (as of 11/8/05)
  - 28 basis point increase from July 1, 2005 to September 30, 2005



Recommended Amendments to Policy for Multifamily Housing Bond Issuance

- Addition of new TEFRA Hearing fee of $5,000 to be paid by project sponsors for projects located in San Jose where the City is not the bond issuer.

- Amendment to City's Annual Monitoring Fee by permitting one-time reduction, in certain circumstances, subject to annual minimum fee of $7,500.

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO:	Making Government Work Better Committee	**FROM:**	Scott P. Johnson
SUBJECT:	**QUARTERLY SUMMARY - CITY'S INVESTMENT REPORT**	**DATE:**	November 4, 2005

Approved Date

RECOMMENDATION

It is recommended that the Making Government Work Better Committee accept the City's Investment Report for the quarter ended September 30, 2005.

BACKGROUND

As part of the Making Government Work Better (MGWB) Committee's workplan, the Finance Department will present a quarterly report on the City's investment activity. Under separate cover, the MGWB Committee and City Council has received a comprehensive quarterly report for the period ended September 30, 2005. The report is posted to the City's website at www2.csjfinance.org and a hard copy is on file at the City Clerk's Office. It should be noted that due to the success of the electronic report distribution, beginning with the report for the quarter ended June 30, 2005, staff no longer distributed hard copy quarterly investment reports and will continue the electronic distribution through the internet consistent with the monthly distribution process. Staff will continue to provide a hard copy to the City Clerk for public access. This report includes a summary of investment activity for the quarter ended September 30, 2005.

ANALYSIS

Summary of Investment Activity – Quarter Ending September 30, 2005

The information presented on the following page highlights the investment activity for the quarter ending September 30, 2005. Information is also provided for the immediately preceding quarter as well as the same quarter in the previous year, for comparison purposes for quarters ending June 30, 2005 and September 30, 2004, respectively.

For the quarter ended:	**September 2005**	**June 2005**	**September 2004**
Total Portfolio:			
Portfolio value[1] [2] as of end of the quarter	$1,093,010,774.93	$1,255,508,050.56	$1,283,592,576.10
Earned interest yield	3.167%	3.141%	2.335%
Portfolio effective yield	3.166%	3.164%	2.381%
Dollar-weighted average days to maturity	400	417	441
Portfolio Fund 1:			
Portfolio value[1] as of end of quarter	$1,004,385,812.55	$1,147,336,909.83	$1,018,563,015.59
Earned interest yield	3.125%	3.096%	2.519%
Portfolio effective yield	3.128%	3.128%	2.558%
Dollar-weighted average days to maturity	435	455	551
Total Portfolio Income Recognized:			
Net interest earnings	$ 9,446,482.84	$ 9,287,038.51	$ 7,808,369.64
Fiscal year-to-date Interest earnings	$ 9,446,482.84	$32,758,644.48	$ 7,808,369.64

[1] Reflects book value (principal plus any purchased interest costs).

[2] The total as of the quarter ending September 2005 excludes $660,952,969 in bond proceeds held by trustees for the City of San Jose ($602,340,254) and the Redevelopment Agency ($58,612,715).

Portfolio Performance

The total investment portfolio as of September 30, 2005 was $1.093 billion. This is an decrease of approximately $162.5 million from June 30, 2005, primarily due to the accounts payable and payroll related disbursements including transfers to trustees and escrow agents and litigation settlement payments. For the quarter ended September 30, 2005, the earned interest yield was 3.167% which was an increase of 0.026% from the quarter ended June 30, 2005, reflecting the continued overall increase in market yields and purchases of repurchase agreements. The weighted average days to maturity as of September 30, 2005 was 400 days, representing a decrease of 17 days from 417 days as of June 30, 2005.

From the quarter ended September 2004 to the quarter ended September 2005, the investment portfolio earned interest yield increased 0.832%. The increase is reflective of the maturity of investments purchased in prior periods of lower market yields and the subsequent replacement by investments purchased in the current market of rising yields. On September 30, 2005, the Federal Open Market Committee (FOMC) raised the federal funds rate to 3.75%. The Fed action was the eleventh consecutive quarter-point increase since June 30, 2004. The Federal Reserve expects the impact of Hurricane Katrina to be only temporary and will not pose a more persistent threat to long-run economic growth and productivity. Most market analysts expect the Federal Reserve to continue raising interest rates to slow the economy and maintain low and stable inflation. Some economists expect the federal funds will be at 4.25% by year-end and increasing to 4.75% in 2006. (NOTE: Subsequent to the issuance of the Investment Report for the quarter ending September 30, 2005, the Federal Reserve increased the federal funds rate to 4.00% on November 1, 2005 to contain inflationary pressures and also raised expectations for additional increases in the future.)

Interest Earnings

Actual General Fund interest earnings were $1,317,261 for the quarter ended September 2005 and for the fiscal year-to-date. Interest earnings were greater than budgeted earnings estimates by $413,025 for the quarter ended September 2005 and for the fiscal year-to-date.

Cash Flows by Major Funds

The monthly comparison of cash balances as reported in the City's Financial Management System reveals the cyclical changes in balances which over time are reflected in the investment portfolio balances. The monthly balances for the Airport, Capital Projects and Redevelopment Agency reflect the influx of bond sale proceeds and the subsequent expenditures reducing balances over time. Fluctuations in the monthly balances for the General Fund reflect impacts of State budget actions, specifically the "triple flip", whereby monthly receipts of Motor Vehicle License Fees and a portion of the Sales Tax receipts which were previously received on a monthly basis from the State and were are replaced by property-tax in-lieu payments received semi-annually in January and May.

Based on the Treasury Division cash flow projection of September 30, 2005, the total portfolio is expected to have approximately $274 million in maturities and interest during the next six months, plus approximately $765 million in revenues. These amounts are more than sufficient to cover the projected expenditures during the next six months.

PUBLIC OUTREACH

N/A

COORDINATION

This report has been coordinated with the City Manager's Office.

CEQA

Not a project.

SCOTT P. JOHNSON
Director, Department of Finance