COUNCIL AGENDA: 09/13/19
FILE: 19-796
ITEM: 4.2

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Jacky Morales-Ferrand
Julia H. Cooper

SUBJECT: SEE BELOW

DATE: August 26, 2019

Approved D. DSyk Date 9/5/19

COUNCIL DISTRICT: 7

SUBJECT: APPROVAL OF THE ISSUANCE OF TAX-EXEMPT MULTIFAMILY HOUSING REVENUE BONDS AND THE LOAN OF THE PROCEEDS THEREOF AND APPROVAL OF RELATED DOCUMENTS AND CHANGES TO EXISTING LOAN AND GRANT TERMS FOR THE MARKHAM PLAZA I PROJECT

RECOMMENDATION

(a) Adopt a resolution:
   (1) Authorizing the issuance of (a) tax-exempt multifamily housing revenue bonds designated as "City of San José Multifamily Housing Revenue Bonds (Markham Plaza I), Series 2019B-1" (the "Series 2019B-1 Bonds") and "City of San José Multifamily Housing Revenue Bonds (Markham Plaza I), Subordinate Series 2019B-2" (the "Series 2019B-2 Bonds" and with the "Series 2019B-1 Bonds, the "2019B Bonds") in an aggregate principal amount not to exceed $23,000,000;
   (2) Approving the loan of the proceeds of the 2019B Bonds to Markham Plaza I, L.P. a California limited partnership created by Core Development, Inc., a California corporation, to finance the acquisition and rehabilitation of a 153-unit multifamily project known as the Markham Plaza I apartments (formerly known as Tully Gardens I) located at 2000 Monterey Road, in San José (the "Development");
   (3) Approving in substantially final form the Indenture of Trust, Subordinate Indenture of Trust, the Loan Agreement, the Subordinate Loan Agreement and Regulatory Agreement, and Declaration of Restrictive Covenants (the "Series 2019B Bond Documents");
   (4) Authorizing and directing the City Manager, Director of Housing, Director of Finance or the Assistant Director of Finance, or their designees, to execute and deliver the Series 2019B Bond Documents together with any documents ancillary to the Series 2019B Bond Documents; and

(b) Adopt a resolution approving changes in terms for the City's outstanding $4,836,559 loan and outstanding $4,866,000 grant for the Development, approving a loan to value ratio in excess of 100% and authorizing the Director of Housing to negotiate and execute documents and amendments related to those changes.

OUTCOME

Approval of the recommended actions will enable the issuance of multifamily housing revenue bonds for the purpose of financing a portion of the costs to acquire and rehabilitate the Development located at 2000 Monterey Road, San Jose, CA 95112, an existing 153-unit affordable rental apartment project, with 152 apartments restricted to very low and extremely low income households and remaining affordable for a period of at least 55 years. Approval of the recommended actions will also enable the City to re-cast its existing loan on the Development with new terms, including a loan rate that will be lower than the existing 4.76%, an extended loan term and a loan to value ratio that exceeds one hundred percent.

The Development will serve residents with current maximum annual incomes between 30% and 35% of the area median income as adjusted for family size in accordance with the procedures set forth in the table contained in 25 Cal. Code Regulation 6932, as may be amended from time to time.

EXECUTIVE SUMMARY

In accordance with the City's Policy for Issuance of Multifamily Housing Revenue Bonds, Core Affordable Housing, a California corporation (the "Developer") and an affiliate of Core Development, Inc. (the "Project Sponsor"), has requested that the City issue tax-exempt multifamily housing revenue bonds in two series (the "Series 2019B-1 Bonds" and the "Series 2019B-2 Bonds" and, collectively, the "2019B Bonds") in an aggregate amount not to exceed $23,000,000. The Series 2019B-1 Bonds will be purchased by U.S. Bank National Association ("US Bank"); the Series 2019B-2 Bonds will be purchased by Tully Gardens, L.P., the current owner of the Development, in the form of tax-exempt seller carry back financing. Tully Gardens, L.P. is a California limited partnership created by the Project Sponsor (the "Seller").

The proceeds of the 2019B Bonds will be loaned to Markham Plaza I, LP, a California limited partnership (the "Borrower") formed by the Project Sponsor. These proceeds, together with other funds, will be used by the Borrower to finance the acquisition and rehabilitation of an existing 153-unit rental housing rental project known as Markham Plaza I (the "Development").

These actions are intended to ensure the Development's long-term physical and economic viability and to preserve an affordable housing resource for the City.

The 2019B Bonds will not be paid from or secured by the general taxing power of the City or any other City asset.

BACKGROUND

Borrower. The Borrower is a California limited partnership consisting of the following entities:

(1) Administrative General Partner: CORE Markham I, LLC, a California limited liability corporation, the sole member of which is Core Affordable Housing, LLC, an affiliate of the Project Sponsor.
(2) Managing General Partner: EAH Markham I, LLC, a California limited liability corporation, the sole member of which is EAH Housing, a California nonprofit public benefit corporation.
(3) Limited Partner: Core Affordable Housing, LLC, a California limited liability company, to be replaced by an entity to be formed by Enterprise Housing Credit Investments, LLC.

The Developer has requested that the City issue the 2019B Bonds for the purpose of lending the proceeds thereof to the Borrower. The proceeds of the 2019B Bonds, together with other funds, will be used by the Borrower to finance the acquisition and rehabilitation of the Development.

Development Overview. The Development involves the acquisition and rehabilitation of 150 studios and 3 two-bedroom rental apartments. Currently, the unit mix pursuant to the City's affordability restrictions is as follows:

Markham Plaza I	Apartments	30% AMI**
Studio/1 Bath	150	150
2 Bedroom/1 Bath	3*	2
Total Apartments	**153**	**152**

* Includes one unrestricted manager's unit
**Area median income

Upon completion of the rehabilitation of the Development, the unit mix pursuant to the amended City's affordability restrictions will be as follows:

Markham Plaza I	Apartments	30% AMI**	35% AMI**
Studio/1 Bath	150	75	75
2 Bedroom/1 Bath	3*	1	1
Total Apartments	**153**	**76**	**76**

* Includes one unrestricted manager's unit
**Area median income

The increase in the allowed incomes will raise additional revenue for the financial viability of the Development, allow tenant incomes to increase and still remain in the building, and will support resident services. The City's affordability restrictions for the Development will remain for a period of 55 years from the closing of the bond financing.

The Development, originally constructed in 2003, is currently owned by Tully Gardens, L.P. The Development consists of one four-story residential building with a wood frame structure, slab on grade foundation, and stucco exterior. The overall building size totals 63,844 square feet of living and community space. Site amenities include community areas, laundry, gated access, security, recreational area, a pool, fitness center, and computer room. There is an adjacent 3-story above-grade concrete parking garage. The Development represents the first phase of a two-phase project. The second phase, known as Markham Plaza II, was constructed by an affiliate of the Project Sponsor in 2004 and is located next to the Development.

The Development is subject to low income housing tax credit ("LIHTC") restrictions. Twenty of the apartments are currently assisted by a Section 8 Project-Based Voucher Housing Assistance Payment ("HAP") contract, which will be extended by the Housing Authority of the County of Santa Clara County ("HACSC"), and assigned to and assumed by the new ownership. HACSC will also provide a new HAP contract for an additional 20 apartments and will enter into an additional agreement to continuously refer 10 households holding tenant-based vouchers under a Santa Clara County supportive/homeless housing initiative. Twenty of the vouchers will be allocated to formerly homeless veterans under HUD's Veterans Affairs Supportive Housing Program. This will result in a minimum of 50 apartments which will be set-aside for special needs, homeless or veterans housing.

Following the rehabilitation of the Development, all the apartments will remain LIHTC-restricted.

Scope of Work. The current scope of Project rehabilitation will address health and safety issues, ADA, deferred maintenance, and energy efficiencies. The scope encompasses improvements/repairs to the building's exterior, its interior, individual units, and the site. Building exterior renovations will include wood siding and stucco repair, new roof, repairs to stairs and landings, wall insulation replacement, and fresh paint. Interior renovations will include elevator improvements, new plumbing fixtures, a new HVAC system, and upgrades to the fire suppression system. Individual units will be updated with new Energy Star appliances (refrigerator, range, exhaust hood), kitchen and bathroom countertops, and cabinets, doors, lighting, flooring, window blinds, smoke detectors, and fresh paint. Site renovations will include concrete repairs, asphalt repaving and parking lot re-striping, new fencing and gates, new signs and mailboxes, lighting, and upgrades to drainage and landscaping. Thirteen apartments will be remodeled for ADA compliance.

The rehabilitation work is estimated to take approximately 12 to 14 months.

Temporary Relocation of Tenants. According to the Borrower's relocation plan, the rehabilitation of the Development will involve temporary relocation of existing tenants, with no households expected to be relocated permanently. Each apartment will be rehabilitated. Apartments will be vacated for approximately four weeks during the rehabilitation process. The Borrower is holding approximately 5 to 10 apartments vacant for temporary relocation purposes and has secured temporary lodging at Extended Stay America, 1560 N. First Street, San Jose, CA. Tenants have received advisory services and will be provided advance notice as required by state relocation law. The Borrower has budgeted $1,984,000 for temporary relocation, which is expected to occur in 19 phases.

City Loan and Grant for the Project. As discussed in detail under the City Subordinate Financing section, the City has a loan on the Development with an outstanding balance as of September 10, 2019 in the amount of $4,836,559, consisting of $2,745,588 in principal from the HOME Investment Partnership Program implemented by the Department of Housing Urban Development ("HOME") and $2,090,971 in accrued unpaid interest. The interest on the City loan will be capitalized, and the accrued interest and outstanding principal will be re-cast into a new City loan (the "City Loan") to be assumed by the Borrower. The outstanding City loan was accompanied by 55 Year Affordability Restrictions and Rider (the "City's Affordability Restrictions"). The City's Affordability Restrictions as amended and restated will be extended to 2074, 55 years from the closing of the bond financing. Additionally, a separate HOME affordability restriction will be recorded in connection with this transaction.

In addition to the City Loan, the City made a conditional grant of $4,866,000 in tax increment funds for the original purchase and pre-development costs to enable the use of the Development for extremely low income units: $2,718,206.55 was disbursed to the current owner of the Development for the purchase of the site and $2,147,793.45 was disbursed to Emergency Housing Consortium (now "Home First"). The obligations under the grant are secured by a conditional grant deed of trust in favor of the City and recorded against the property. The grant agreement and grant deed of trust will be amended and restated as part of this transaction.

City as Issuer of Multifamily Housing Bonds. The City's Policy for Issuance of Multifamily Housing Revenue Bonds requires the City to be the issuer of tax-exempt multifamily housing revenue bonds in connection with the financing or refinancing of affordable rental housing projects for which it has provided, or will be providing, a loan.

Prevailing Wages. On February 7, 1989 and October 10, 1989 adopted Resolutions No. 61144 and 61716, requiring the payment of prevailing wages to privately-owned housing projects receiving acquisition financing, construction financing or commitment of such financing by the City's Department of Housing, except projects (a) with fewer than eight (8) dwelling units and (b) the portion of projects involving non-contracted volunteer or self-help construction. In 2005, the Council adopted Resolution No. 72518 which extended those requirements to privately-owned projects receiving City permanent funding or commitment of such financing.

Historically, when no additional City money is disbursed to a project and all City construction funds have already been spent, prevailing wages have not been required for rehabilitation projects. In addition, City prevailing wage requirements have not been applied to projects on which the permanent loan was extended for a new 55-year period, which is the equivalent of making a new permanent loan.

Sources of Project Funding. The 2019B Bonds will fund a portion of the total Development costs, which are currently estimated to be $47,579,033. During the acquisition and rehabilitation period, the 2019B Bonds will be outstanding in an estimated aggregate amount of $23,000,000, consisting of an estimated $18,000,000 for the Series B-1 Bonds and an estimated $5,000,000 par for the Series 2019B-2 Bonds. Following the rehabilitation of the Development and its lease-up ("at permanent"), Series 2019B-1 Bonds will be repaid in full and only the Series 2019B-2 Bonds will remain outstanding. The Series 2019B-1 Bonds will be variable rate and purchased/funded by US Bank; the Series 2019B-2 Bonds will be a fixed rate, residual receipts obligation purchased by the Seller of the Development. The Series 2019B-1 Bonds are anticipated to be repaid at permanent from low income housing tax credits and the proceeds of a $5,000,000 loan from the County of Santa Clara under its 2016 Measure A Affordable Housing Bond program.

The sources of funding for the Development's acquisition and rehabilitation phase and permanent phase currently are estimated as follows:

City of San José
Markham Plaza I
Plan of Finance – Sources of Funding[1]

Source	Acquisition-Rehabilitation	Permanent
Series 2019B-1 Bonds	$ 18,000,000	$ 0
Series 2019B-2 Bonds	5,000,000	5,000,000
Seller Carry Back	10,398,431	10,398,431
City of San Jose	4,829,193	4,829,193
County of Santa Clara Loan	0	5,000,000
Home First Re-cast Loan	4,467,904	4,467,904
AHP Re-cast Loan	936,000	936,000
Tax Credit Equity	1,586,026	15,860,261
Deferred Developer Fee	0	32,239
Income from Operations and Other	1,055,005	1,055,005
Total	$ 46,272,559	$ 47,579,033

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

Financing History of the Project – Key Dates. The following are the key dates relating to the financing history of the Project:

- March 6, 2019 - The Director of Finance held a TEFRA hearing regarding the issuance of tax-exempt multifamily housing revenue bonds in an amount not to exceed $26,000,000 to finance the acquisition and rehabilitation of the Project.
- March 15, 2019 - The City submitted a joint application to CDLAC and CTCAC for a private activity allocation in the amount of $23,000,000 (CDLAC) and $1,634,997 in annual 4% Federal tax credits (CTCAC).
- March 25, 2019 - The Mayor certified the actions of the Director of Finance.
- May 15, 2019 - The City received a private activity bond allocation from CDLAC and a reservation of 4% Federal tax credits in the requested amounts.

ANALYSIS

Markham Plaza I Apartments was built and occupied in 2002 and was one of the first developments dedicated to serving only extremely-low income households. Tenants who qualify to live in the development face challenges typical for the lowest income households living within the high-cost Bay Area. A one-person household living at Markham Plaza I Apartments earns less than $2,329 per month (before taxes) and pays $699 to rent an efficiency apartment. Many extremely-low income tenants do not have options to move to other apartments when rents increase or life circumstances change. As a result, tenants pay more than 50% of their income on rent in an effort to maintain their housing. The most recent rent roll for Markham Plaza I Apartments indicates that 46 of the 152 tenant households are rent-burdened paying greater than 50% of their incomes in rent, with average incomes of $18,000 per year. Some tenants earn less than $10,000, the lowest annual income reported is $1,800 per year. Tenants living in these income ranges are often left with insufficient income to support all of their basis needs such as food, transportation and clothing.

Over the past few years, the City, County, and Housing Authority have worked together to establish a model for creating permanent supportive housing to permanently house the formerly homeless population. This model not only provides funding for the construction of new housing, but also for the resident services necessary to support households with the lowest incomes. Markham Plaza I will have 30 apartments dedicated to chronically homeless individuals referred to by the County's Office of Supportive Housing and 20 apartments for homeless veterans referred to by the Veterans Affairs office. Proposed resident services will include County services such as case management, health care, behavioral health, and streamlined benefit access. Additionally, the onsite property management will increase the current staffing by 2.5 additional positions to oversee program activities for residents, interface with public agencies, community volunteer groups, and provider agencies. The service coordinators will also collaborate with County case managers and assist residents with individualized needs and provide referrals. The restructuring of the finances for this development will provide funding for services for the tenants and for rehabilitation of the existing building.

The scope of services for the building rehabilitation includes repairs to the interiors of the apartments; retrofitting apartments to make them accessible to individuals with disabilities; repairs and upgrades to building systems including electrical, mechanical and plumbing; and exterior repairs and upgrades including paving, sidewalks, landscaping, and paint.

The proposed restructuring will allow for the investment of Measure A funds, while not requiring any additional investment from the City. The City's original investment of over $7.6 million will be preserved by this action and the length of the affordability restriction will be extended.

This portion of the report is divided into several sections to address the items in staff's recommendation to proceed with the financing for the Development. These sections describe the financing structure, financing documents, financing team participants, and financing schedule.

Bond Financing Structure

Overview of the Multifamily Housing Revenue Bond Financing

General. Multifamily housing revenue bond financing typically involves the issuance of tax-exempt bonds on behalf of private developers of qualifying affordable rental apartment projects. The City issues tax-exempt bonds and loans bond proceeds to the developer/borrower. The advantages of tax-exempt financing to developers include: below-market interest rates and federal low-income housing tax credits – features that are not available with a conventional multifamily housing mortgage loan.

Multifamily housing revenue bonds are limited obligations of the City, payable solely from loan repayments by the borrower from the affordable rental project and related sources. Such bonds are not secured by the general taxing power of the City or any other asset of the City.

Requirements for Tax-Exemption. For a private activity multifamily housing revenue bond to qualify for tax-exemption, federal law requires, among other matters, 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 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. While this second restriction will be incorporated into the Regulatory Agreement for the 2019B Bonds, the Development will also be subject to additional restrictions.

Structure of the 2019B Bonds

As noted the 2019B Bonds will be issued in two series: Series 2019B-1 Bonds and Series 2019B-2 Bonds.

The Series 2019B-1 Bonds

Direct Purchase/Funding Structure. The Series 2019B-1 Bonds will be structured as non-rated and non-credit-enhanced obligations that are directly purchased by US Bank. Pursuant to the City's policies regarding non-credit-enhanced bonds, US Bank will sign an Investor Letter acknowledging that it is a "qualified institutional buyer" or "accredited investor" that is, a sophisticated investor, as required under the City's Policy for the Issuance of Multifamily Housing Revenue Bonds, who understands and accepts the risks associated with unrated bonds secured solely by the Development rents. If US Bank wishes to transfer the Series 2019B-1 Bonds, the new holder must sign and deliver a similar Investor Letter to the Trustee. The Series 2019B-1 Bonds may only be transferred in whole.

Principal Amounts and Terms. Based on current projections, the estimated par of the Series 2019B-1 Bonds is $18,000,000 but in no event shall the aggregate amount of the Series 2019B-1 Bonds and Series 2019B-2 Bonds exceed $23,000,000. After the Development is rehabilitated and leased up, and conversion to the permanent loan phase occurs (the "Conversion Date"), the Series 2019B-1 Bonds are expected to be repaid in full with tax credit equity funds and County loan proceeds. The Conversion Date is anticipated to occur between 18-24 months after Bond closing.

The stated maturity of the Series 2019B-1 Bonds is expected to be approximately 3 years.

Interest Rates. The interest rate on the Series 2019B-1 Bonds will be variable and based on one-month LIBOR plus a spread.

The Series 2019B-2 Bonds

Direct Purchase/Funding Structure. The Series 2019B-2 Bonds will be structured as non-rated and non-credit-enhanced obligations that are directly purchased by the Seller. The Series 2019B-2 Bonds will be repaid from a portion of the Borrower's share of the Development's residual cash flow after repayment of the County Loan. Series 2019B-2 Bonds will be subject to an Investor Letter requirement and similar transfer restrictions applicable to the Series 2019B-1 Bonds.

Principal Amounts and Terms. Based on current projections, the estimated par of the Series 2019B-2 Bonds is $5,000,000 but in no event shall the aggregate amount of the Series 2019B-1 Bonds and Series 2019B-2 Bonds exceed $23,000,000.

The stated maturity of the Series 2019B-2 Bonds will not exceed 45 years, as required under State law.

Interest Rates. The interest rate on the Series 2019B-2 Bonds will be fixed at a rate equal to the Applicable Federal Rate, which is reset monthly. The Applicable Federal Rate for August 2019 is 2.33%.

Financing Documents

The following is a brief description of the documents the City Council is being asked to approve and authorize its execution. Copies of these documents will be available in the City Clerk's Office on or about September 6, 2019.

Indentures. There will be two Indentures of Trust for the 2019B Bonds, each between the City and U.S. Bank, National Association as trustee (the "Trustee"): The Series 2019B-1 Bonds will be issued under an Indenture of Trust (the "Senior Indenture") and the Series 2019B-2 Bonds will be issued under a Subordinate Indenture of Trust (the "Subordinate Indenture" and with the Senior Indenture, the "Indentures"). The Senior and Subordinate Indentures will be executed by the Director of Finance, or another authorized officer, on behalf of the City, and attested by the City Clerk. Pursuant to the Indentures, the Trustee is authorized to receive, hold, invest, and disburse 2019B Bond proceeds and other funds established under the respective Indentures; to authenticate the 2019B Bonds; to apply and disburse payments to the Bondholders; and to pursue remedies on behalf of the Bondholders. The Indentures set 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 2019B Bonds. The Loan Agreements (described below) obligate the Borrower to compensate the Trustee for services rendered under the Indentures.

Loan Agreements. There will be two Loan Agreements between the City and Borrower (the "Loan Agreements"): one with respect to the Series 2019B-1 Bonds (the "Senior Loan Agreement") and the other with respect to the Series 2019B-2 Bonds (the "Subordinate Loan Agreement" and, with the Senior Loan Agreement, the "Loan Agreements"). Each of the Loan Agreements will be executed by the Director of Finance, or another authorized officer, on behalf of the City. The Loan Agreements provide for the loan of Series 2019B-1 Bond and Series 2019B-2 Bond proceeds to the Borrower for the acquisition and rehabilitation of the Development, and for the repayment of such loans by the Borrower. The loan of Bond proceeds will be evidenced by separate notes that correspond to the par of Series 2019B-1 Bonds and the Series 2019B-2 Bonds (the "Notes"). The City's rights to receive payments under the Notes will be assigned to the Trustee, along with certain other rights under the Loan Agreements and the Notes; 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. There will also be a regulatory agreement (the "Regulatory Agreement") among the City, the Trustee, and the Borrower. The Regulatory Agreement contains certain covenants and restrictions regarding the Development and its operations intended to assure compliance with the Internal Revenue Code of 1986. The Regulatory Agreement is executed by the Director of Finance and Director of Housing, or other authorized officers, on behalf of the City. The Regulatory Agreement restricts the rental of Development units to low and very low-income residents for a period of at least 55 years.

Financing Team Participants

The financing team participants for the 2019B Bonds consist of:

- City's Municipal Advisor: Ross Financial
- Bond Counsel: Jones Hall, A Professional Law Corporation
- Trustee: U.S. Bank National Association
- Series 2019B-1 Bond Purchaser: U.S. Bank, National Association
- Series 2019B-2 Bonds Purchaser: Tully Gardens, L.P.

All costs associated with the Municipal Advisor, Bond Counsel and Trustee are contingent upon the sale of the 2019B Bonds and will be paid from Bond proceeds, tax credit equity and/or Borrower funds.

Financing Schedule

The current proposed schedule is as follows:

- Council Approval of 2019B Bonds/Bond Documents September 17, 2019
- Pre-Close 2019B Bonds September 27, 2019
- Close 2019B Bonds September 29, 2019
- CDLAC Deadline for 2019B Bond Closing November 25, 2019

City Subordinate Financing

The City currently has an outstanding loan with respect to the Development consisting of $2,745,588 in principal and $2,043,079 in accrued, unpaid interest as of June 25, 2019. The City intends to re-recast the outstanding principal and unpaid accrued interest into a new City loan of approximately $4,836,559 as of September 2019 that will be assumed by the Borrower. Staff anticipates amending and restating all the 2002 Loan and Grant documents in connection with this transaction. As authorized by the recommended actions and under her Delegation of Authority, the Director of Housing will negotiate and execute amendments to the City loan documents to include the following terms:

- Interest Rate: The fixed interest rate on the City Loan will be equal to the AFR long-term rate as of the month of closing, compounded annually. The AFR for August 2019 is 2.33%. This represents a reduction in the existing rate of 4.76% for the outstanding loan.
- Loan Term: The loan term will be extended approximately 15 years to 55 years from the closing of the bond financing.
- Residual Receipts: 50% of the Development's net operating income, after payment of the County's loan, will be shared 50% to the City and 50% to the Borrower.
- Affordability Restrictions: These will be amended as previously authorized to be affordable at 30% area median income and for new tenants, 35% of area median income. The City's maximum income limit for a one-person household, at 30% AMI is $30,750; and at 35% AMI the maximum income limit is $35,875. Fast food cooks, restaurant workers and cashiers earn wages within these income levels. The term of the City's Affordability Restriction will be extended to start a new 55-year period commencing from closing of the bond financing. Additionally, a separate HOME affordability restriction, expiring on September 22, 2026 will be recorded in connection with this transaction to ensure all funding requirements are met. The City will not subordinate these restrictions to the new senior lender.
- Loan to Value: The loan to value ratio of the Property will exceed 100% after consideration of all new debt. Approval of the excess of 100% loan to value ratio is needed to ensure consistency with Municipal Code Chapter 5.06. An appraisal prepared by James G. Palmer Appraisals, Inc. on January 3, 2019 valued the Property at $26,000,000. The total debt on the Property including the City Loan will result in a combined loan-to-value ratio ("LTV") that significantly exceeds 100%, which is the City's LTV policy threshold. The 100% LTV policy was intended to reduce the City's risk of loss associated with its loans; however, the deep affordability of the development increases the need for public subsidies, while decreasing the project's market value, leading to an increased LTV. An elevated LTV is not uncommon for public lenders in the affordable housing industry. Projects that have a high LTV are considered acceptable by City staff, as the Property's projected operating income is expected to be at least 1.15 times the permanent mortgage debt service payments. This standard is a common standard for assessing the financial feasibility of affordable housing developments.
- Prevailing Wage: As discussed above, no new City funds are being loaned or granted to the Borrower, the City's Prevailing Wage policy will not apply.

Variances from the City's Underwriting Guidelines

- Project Cost Savings: Typically, the City would be funding a portion of the rehabilitation. The County is funding 100% of the project's costs and the permanent loan. Because of the County's commitment to invest in the Development such as, among other things, providing a zero interest permanent loan and supportive housing services to special needs tenants, the City staff has agreed to allow the County to receive any project cost savings to reduce its permanent loan. Under the City's current Underwriting Guidelines, project cost savings, if any are used to reduce the balance of the City loan. The reduced County loan amount will result in a lower debt that the City loan will be subordinate to.

- Developer Fee: The Borrower is receiving a developer fee in the amount of $3,000,000. Under the City's current Underwriting Guidelines, the City allows up to a maximum amount of $2,500,000 developer fee on rehab or acquisition and resyndication transactions, which mirrors Tax Credit Allocation Committee regulations, of projects up to 100 units. Any amount over $2,500,000 for additional units is subject to the City's approval. City staff recognizes that the Development consists of 152 restricted units, therefore staff determined that the $3,000,000 developer fee is reasonable.

The proposed 4% tax credit resyndication with multi-family housing revenue bonds will pay off the existing $1,300,000 bridge loan provided by the Silicon Valley Housing Trust, fund the rehabilitation/construction, improve cash flow in order to increase resident services to the existing tenants and financially stabilize the Property. The benefit to the City is the renovation of the Property without providing additional City funds, increasing resident services, and further extending the use of the Property with continued affordability for 55 years.

City Issuance and Monitoring Fees

The City's Policy for Issuance of Multifamily Housing Revenue Bonds requires that the issuance fee and annual monitoring fee be calculated as follows:

- Issuance Fee is an amount equal to the sum of (a) 0.50% of the first $10,000,000 issued and (b) 0.25% of the remaining par issued.
- Annual Fee, except for nonprofit borrowers, is an amount equal to 0.125% of the par issued through the term of the regulatory period.

Based on an aggregate Bond par of $23,000,000, the City's Policy would require an issuance fee projected to be a maximum of $82,500 and an annual monitoring fee of $28,750.

The Borrower is obligated to pay the City's annual fee throughout the 55-year Regulatory Agreement term; if the 2019B Bonds mature or are redeemed prior to maturity, the City has the option to require the Borrower to prepay the annual fee due for the remainder of the Regulatory Agreement term.

EVALUATION AND FOLLOW-UP

This Memorandum presents the set of recommendations related to the City Council's approval of the issuance of the 2019B Bonds and requires no follow-up to the City Council. Once the 2019B Bonds close, anticipated in September 2019, and the acquisition and rehabilitation of the Development commences, the Housing Department will provide updates in its Quarterly Construction Reports posted at www.sjhousing.org under "Reports & Data."

PUBLIC OUTREACH/INTEREST

The method of notifying the community of the City's intent to issue the tax-exempt private activity Bonds is the Tax Equity and Fiscal Responsibility Act (TEFRA) Hearing. The TEFRA Hearing was held on March 6, 2019 before the Director of Finance. The public hearing notice for this hearing was published in the *San José Post - Record* on February 20, 2019. There were no public comments made at the TEFRA hearing.

This Memorandum and the Bond Documents will be posted on the City's website for the September 17, 2019 meeting.

COORDINATION

This report has been prepared by the Finance Department and the Housing Department in coordination with the City Attorney's Office and the Budget Office.

COMMISSION RECOMMENDATION / INPUT

This item was not heard by the Housing and Community Development Commission, as approvals of affordable development financing do not fall under the functions, powers and duties of the Commission delineated in Section 2.08.2840 of the San José Municipal Code.

FISCAL/POLICY ALIGNMENT

This action is consistent with the City's *Consolidated Plan 2015-2020,* adopted by City Council on May 5, 2015, to provide homes for very low- and extremely low-income households; and with Goal H-2 of the City's *Housing Element 2014-2023,* adopted by City Council on January 27, 2015, to "increase, preserve, and improve San José's affordable housing stock."

COST SUMMARY/IMPLICATIONS

The borrower will pay all issuance costs from proceeds of Bonds, tax credit equity and/or Borrower funds. The Bonds will not be paid from, nor secured by, the general taxing power of the City or any other City asset.

The City is expected to receive a maximum of $82,500 as a one-time revenue from the issuance fee and an annual monitoring fee of $28,750. All issuance costs will be paid from proceeds of 2019B Bonds, tax credit equity and/or Borrower funds. The outstanding City loan of $4.8 million on the property will be assumed by Markham Plaza I, LP, the borrower, with repayments to the Low and Moderate Income Housing Asset Fund as with the current terms of the loan. The conditional grant of $4.9 million will start a new affordability stipulation of 55 years, and would require repayment to the City in the event the 55-year affordability restrictions are not met.

There will be no additional investment made by the City in this transaction.

CEQA

Categorically Exempt, CEQA Guideline Section 15301, Existing Facilities, File No. PP19-057.

/s/
JULIA H. COOPER
Director of Finance

/s/
JACKY MORALES-FERRAND
Director of Housing

For questions, please contact Lisa Taitano, Assistant Director of Finance, at (408) 535-7041.

Attachment A: Location Map

ATTACHMENT A – LOCATION MAP

2000 Monterey Road San Jose, CA