COUNCIL AGENDA: 03/17/20
FILE: 20-263
ITEM: 8.1

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

# Memorandum

**TO:** HONORABLE MAYOR
AND CITY COUNCIL

**FROM:** Jacky Morales-Ferrand

**SUBJECT: SEE BELOW**

**DATE:** March 3, 2020

Approved D. DSyL    Date 3/4/2020

**COUNCIL DISTRICT: 10**

**SUBJECT: TAX EQUITY AND FISCAL RESPONSIBILITY ACT HEARING FOR CALIFORNIA MUNICIPAL FINANCE AUTHORITY'S ISSUANCE OF TAX-EXEMPT MULTIFAMILY REVENUE BONDS TO FINANCE THE ACQUISITION AND REHABILITATION OF VISTA PARK II APARTMENTS**

## RECOMMENDATION

(a) Allow under Section I, B. of the City Council Policy 1-16, Policy for the Issuance of Multifamily Housing Revenue Bonds, to permit the California Municipal Finance Authority ("CMFA") to issue private activity bonds for the acquisition and rehabilitation of the Vista Park II, an 83-unit affordable apartment complex located at 3975 Vistapark Dr. in San José by Vista Park II, L.P. a California limited partnership (the "Project");

(b) Hold a Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") public hearing for the issuance not to exceed $20,000,000 in tax-exempt private activity bonds by CMFA to finance the acquisition and rehabilitation of the Project and to pay certain expenses incurred in connection with the issuance of the bonds; and

(c) Adopt a resolution approving the issuance of Tax-Exempt Revenue Bonds by CMFA in a principal amount not to exceed $20,000,000 to be used to finance the Project and to pay certain expenses incurred in connection with the issuance of the tax-exempt private activity bonds.

## OUTCOME

Approval of the recommended action will authorize CMFA to issue tax-exempt bonds to finance the acquisition and rehabilitation of the Vista Park II Apartments, an existing rental apartment property with no new City funding, providing 82 affordable apartment units for senior households and one unrestricted manager's unit located 3975 Vistapark Drive ("Project"). It will also result in lengthened affordability restrictions, preserving the supply of affordable housing in San José.

## BACKGROUND

CMFA has requested that the City of San José ("City") consent to its issuance of an amount not to $20,000,000 in tax-exempt bonds for the Vista Park II Apartments, located at 3975 Vistapark Avenue in San José ("Development" or "Project"). The bond proceeds and other sources, including low income housing tax credit equity, will finance the acquisition and rehabilitation of the existing restricted affordable apartments.

The Project was built in 2000, financed in part by the City with 20% Redevelopment Agency Funds in the amount of $2,368,000. The City has an existing recorded Affordability Restrictions restricting use of the Project to 82 very low-income senior households with an expiration date of June 28, 2055 ("City Restrictions"). In addition to the City Restrictions, the Project is subject to an existing 2000 low income housing tax credit ("LIHTC") regulatory agreement. Following the rehabilitation, all 82 units of the Project will continue to be LIHTC-restricted.

The Borrower of the Project is Vista Park II, L.P. a new limited partnership that has been formed to purchase the property. Vista Park II, L.P. will purchase the Project from Vista Park Associates II, L.P. and become the new project owner. The developer will be EAH Inc., a non-profit housing developer and an affiliate of Vista Park II, L.P. and Vista Park Associates II, L.P.

The recapitalization involving financial restructuring and improvements being made to the Project is a typical action of existing low-income housing tax credit properties which is to be expected at certain periods in a low-income housing properties' lifecycle. As the Project's tax credit compliance period of 15 years has ended, it is allowable under Federal Internal Revenue Service rules for the Project to receive a new tax credit allocation to rehabilitate the property. A concurrent change in ownership will also result, as tax credit equity investors are typically 99% owners of tax credit financed properties.

For the purposes of this financial recapitalization, Vista Park II, L.P requested that CMFA apply to the California Debt Limit Allocation Committee ("CDLAC") for a bond allocation for the Project. In addition, Vista Park II, L.P. is seeking 4% low income housing tax credits and a potential tax credit equity investor.

A portion of tax-exempt bond proceeds must be spent on physical improvements; therefore, approximately $5,500,000 in property improvements will be made in conjunction with this transaction. The remainder of the Bond proceeds and tax credit equity will be used to finance the acquisition of the property by Vista Park II, L.P., repay the City Loan in full that has a current outstanding balance of $2,917,000, pay for hard and soft transaction costs, pay for temporary relocation costs and capitalize reserves. This financing will preserve 82 units of affordable housing in the City of San José by extending the restrictions for the next 55 years.

## ANALYSIS

The Vista Park II affordable housing development currently provides housing for 82 senior households (plus one manager's apartment) with incomes no greater than 50% of the AMI (currently $51,250 for a one-person family in the City of San José). The approval of the recommendations for this Development will provide funds in the rehabilitation of the existing building. The financing of this development will result for the repayment of the existing City loan of $2,917,000. Upon completion of the Development's rehabilitation, 82 one-bedroom apartments will be preserved and rented to seniors with incomes no greater than 50% AMI for an additional 55 years.

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 City Council Bond Issuance Policy and the TEFRA Hearing.

<u>City Council Policy for the Issuance of Multifamily Housing Revenue Bonds</u>

The City Policy requires that the City be the issuer of tax-exempt private-activity bonds for housing developments located within the City of San José. When the City is not the issuer, of the Policy, under Section I B., allows the City to authorize another conduit bond issuer, in this case, CMFA to issue bonds if two conditions are met: 1) the City is not making a loan or grant to the project, and the existing loan will be paid off and 2) the project is one of multiple projects of the developer seeking awards in the same round of CDLAC allocations under a similar financing program so as to result in economies of the costs of issuance. Although it is the City's practice to require that the City be the issuer of bonds for all projects in San José, on rare occasions, the City Council has approved developers' use of an alternate issuer pursuant to the Policy.

This proposed transaction meets the conditions for approving CMFA as the conduit issuer under Section I. B. of the City's Policy. The City affordability restriction will remain on the Project after the repayment of the City Loan. Additionally, when the CMFA issues the bonds a bond regulatory agreement will be recorded against the property for 55 years. During such compliance period, the CMFA will be responsible for all aspects of the bond related compliance and reporting to the Federal, State and Local agencies.

The Board of Directors of the California Foundation for Stronger Communities ("CFSC"), a California non-profit public benefit corporation, acts as the Board of Directors for CMFA. CMFA shares a portion of its issuance fees with its member communities and donates a portion of issuance fees to the Foundation for the support of local charities. It is expected that 25% of the issuance fee will be contributed by CMFA to the City to be used for any lawful purpose. The Borrower will be the beneficiary of a CFSC charitable donation through a 25% reduction in issuance fees.

Pursuant to Section 147(f) of the Internal Revenue Code of 1986 (the "Code"), the issuance of the Bonds by CMFA requires the City's approval because the projects are located within the territorial limits of the City. The proposed bond issuance by CMFA is classified as a private activity for purposes of the Code. A qualified private activity bond is a bond issued to fund a project for a private entity which meets certain requirements under the Internal Revenue Code in order for the interest received by the bondholder to be excluded from gross income for federal income tax purposes.

TEFRA Hearing

The Code provides that a governmental unit with elected representatives and jurisdiction over the area in which the project to be financed is located, in this case, the City Council, is an "applicable elected representative" with respect to the bond issue. Where the City is not the issuer of bonds for a Project, it shall be the City's policy to require the issuer to assume full responsibility for issuance and on-going compliance of the bond issue with federal tax and state laws. Where feasible, however, the City shall seek to hold The Equity and Fiscal Responsibility Act of 1986 Hearing, better known as the "TEFRA" Hearing for such Project. The City Council's approval of the action items is not approval of the Project for any other purpose. The City has no obligation for the repayment of the bonds to be issued by CMFA.

A TEFRA hearing is mandated by the IRS to provide a reasonable opportunity for interested individuals to express their views, either orally or in writing, on the issuance of bonds and the nature of the improvements and projects for which the bond funds will be allocated. Federal tax law limits the types of projects that may be funded with tax-exempt bond proceeds since the interest earned on such bonds is exempt from federal taxation. The purpose of a TEFRA public hearing is to identify a project which may subsequently receive funding from the sale of private activity tax-exempt bonds.

The public hearing is required to have a 7-day public notice, and such public notice has been published in accordance with the Code.

## CONCLUSION

Staff supports this action of holding the TEFRA hearing and allowing CMFA to issue bonds for the Vista Park II affordable housing development. This action will result in the preservation of 83 affordable apartments through rehabilitation, pay off of the existing City loan and a new bond regulatory agreement that will require an addition 55 years of affordability. The City affordability restriction will remain on the Project after the repayment of the City Loan.

## EVALUATION AND FOLLOW-UP

This action will facilitate the issuance of tax-exempt revenue bonds by CMFA and requires no follow-up with the City Council.

## CLIMATE SMART SAN JOSE

The recommendation in this memo has no effect on Climate Smart San José energy, water, or mobility goals.

## POLICY ALTERNATIVES

To arrive at this proposal, staff considered the following options:

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| *Alternative #1:* | ***Deny CMFA's bond issuance request.*** |
| ***Pros:*** | The City would issue the bonds and receive its usual upfront and annual issuer fees that would add to the City's resources. |
| ***Cons:*** | The City would be unable to match the issuance pricing offered by CMFA, as a result of multiple simultaneous bond transactions with the borrower. |
| **Reason for not recommending:** | To promote efficient use of scarce City staff resources, however staff does not support this alternative and instead recommends approval of CMFA's bond issuance. |

## PUBLIC OUTREACH

The TEFRA hearing to be held as part of the action items on the March 3, 2020 Council Agenda is a method of notifying the community of CMFA's intent to issue tax-exempt private activity bonds for this Project. This memorandum will be posted on the City's Council Agenda website by February 21, 2020 for the March 3, 2020 Council Meeting.

## COORDINATION

This memorandum has been coordinated with the City Attorney's Office, the City Manager's Budget Office and Finance Department.

## 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

## COST SUMMARY/IMPLICATIONS

By not exercising its option to be the bond issuer, the City will forego its standard issuance fees and the annual fees associated with the bond monitoring obligation. However, as consideration for this request, the City can charge its $5,000 TEFRA hearing fee for non-City bond issuances. Additionally, it is expected that 25% of the CMFA issuance fee, or $18,000, will be contributed by CMFA to the City. There are no other fiscal impacts to the City as there are no City funds allocated to the Project after the existing City Loan is fully repaid at closing of the bonds. Repayment of the tax-exempt bonds issued by CMFA will be secured solely by the Project's revenues.

## FISCAL/POLICY ALIGNMENT

This action is consistent with the City's Consolidated Plan 2015-2020, adopted by the City Council on May 5, 2015, and with the City's Adopted Housing Element 2014-2023 in that the action preserves existing homes for very low-income households.

## CEQA

Not a Project, File No. PP17-004, Government Funding Mechanism or Fiscal Activity with no commitment to a specific project which may result in a potentially significant physical impact on the environment.

/s/
JACKY MORALES-FERRAND
Director of Housing

For questions, please contact Rachel VanderVeen, Deputy Director, at (408) 535-8231.