COUNCIL AGENDA: 8-13-19
FILE: 19-626
ITEM: 4.3

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: July 22, 2019

Approved D.DSyC Date 8/2/19

COUNCIL DISTRICT: 6

SUBJECT: APPROVAL OF THE ISSUANCE OF TAX-EXEMPT MULTIFAMILY HOUSING REVENUE BONDS AND THE LOAN OF THE BOND PROCEEDS THEREOF AND APPROVAL OF RELATED DOCUMENTS FOR THE LENZEN SQUARE APARTMENTS PROJECT

RECOMMENDATION

Adopt a resolution:

(a) Authorizing the issuance of (a) tax-exempt multifamily housing revenue bonds designated as "City of San José Multifamily Housing Revenue Bonds (Lenzen Square Apartments), Series 2019A-1" (the "2019A-1 Bonds"), and the "City of San José Multifamily Housing Revenue Bonds (Lenzen Square Apartments) Series 2019A-2" (the "2019A-2 Bonds") in an aggregate principal amount not to exceed $23,000,000;

(b) Approving the loan of the proceeds of the Bonds to Lenzen Square Community Partners, LP, a California limited partnership created by Community Preservation Partners, LLC, a California limited liability corporation, to finance the acquisition and rehabilitation of an existing 88-unit rental housing project known as the Lenzen Square Apartments located at 790 Lenzen Avenue, in San José (the "Development");

(c) Approving in substantially final form the Indenture, Borrower Loan Agreements and Regulatory Agreement and Declaration of Restrictive Covenants (the "2019A-1 Bond Documents" and "2019A-2 Bond Documents"); and

(d) 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 2019A Bond Documents together with any other documents required in connection with this transaction, including any documents ancillary to the 2019A Bond Documents.

OUTCOME

Approval of the recommended actions will enable the issuance of multifamily housing revenue bonds for the purpose of financing the acquisition and rehabilitation of Lenzen Square Apartments, located at 790 Lenzen Avenue, an existing 88-unit rental apartment project. The outcome of the bond issuance is a new 55-year bond regulatory agreement, also the City Affordability Restriction will be extended for an additional 8 years with a new termination date in the year 2075.

The Development will continue to serve low and very low income residents with maximum income limits between 50% and 60% of area median income as adjusted for family size in accordance with the requirements set forth in the table contained in 25 Cal. Code Regulation 6932, as amended from time to time.

EXECUTIVE SUMMARY

In accordance with the City's Policy for Issuance of Multifamily Housing Revenue Bonds, Community Preservation Partners, LLC (the "Developer"), a California limited liability corporation formed by WNC & Associates, Inc., a California corporation, has requested that the City issue tax-exempt multifamily housing revenue bonds in two series (the "Series 2019A-1 Bonds" and the "Series 2019A-2 Bonds" and, collectively, the "2019A Bonds") in an aggregate amount not to exceed $23,000,000. The Bonds will be initially purchased and funded by Red Stone ("the Lender").

The proceeds of the 2019A Bonds will be loaned to Lenzen Square Community Partners, LP, a California limited partnership (the "Borrower") formed by the Developer. These proceeds, together with other funds, will be used by the Borrower to finance the acquisition and rehabilitation the Development.

The 2019A 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, Lenzen Square Community Partners, LP, is a California limited partnership. The Borrower will consist of the following entities:

(1) Administrative General Partner: WNC – Lenzen Square Community Partners, LLC, a California liability company. Its manager is, WNC Development Partners, LLC.
(2) Managing General Partner: FFAH V Lenzen Square LLC, a California limited liability company. Its sole member is, Foundation for Affordable Housing V., a California nonprofit public benefit corporation.

(3) Limited Partner: WNC California Holding, LLC

The Developer has requested that the City issue the 2019A Bonds for the purpose of lending the proceeds thereof to the Borrower. The proceeds of the 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 88 studios, one-bedroom, and two-bedroom rental apartments. Currently, and upon completion of the rehabilitation of the Development, the unit mix and affordability restrictions will be as follows:

Lenzen Square Apartments	**Unit Mix**
Very Low Income (50% of AMI)	23
Low Income (60% of AMI)	64
Unrestricted Managers Unit	1
Total Apartments	**88**

The City's maximum income limit for a 2-person household, at 50% AMI is $58,550; for a 3-person household at 60% AMI the maximum income limit is $79,020.

The Development is currently restricted to low and very low income households and has an existing Affordability Restriction with an expiration of November 2, 2067. The Affordability Restrictions will be extended an additional 8 years with a new termination date in the year 2075.

The Development is currently owned by Lenzen Square Community Partners, LP which acquired the Development in February 2019. The Development was originally built in 2002, and consists of two three-story buildings with a shared elevator and is constructed from masonry and wood frame construction with a stucco and wood siding trim over parking structures. The site is also improved with 142 garage parking spaces, as well as a swimming pool, and picnic area. Within the buildings there is also a community room with computer for tenant use, exercise room, leasing office, and laundry facilities.

In addition to the City's Affordability Restrictions, the Development is subject to an existing 2002 low income housing tax credit ("LIHTC") regulatory agreement and a 2001 bond regulatory agreement. Following the rehabilitation of the Development, all residential apartments will continue to be LIHTC-restricted.

Scope of Work. The current scope of Project rehabilitation will include upgrades to interior units and exterior site work, including ADA upgrades. The Borrower is planning interior upgrades, including new kitchen countertops and appliances, bathroom countertops and cabinetry, resealed tubs, window replacement, repainting, and stair replacement. In addition, the Borrower intends to perform exterior repainting, address parking lot deferred maintenance, upgrade building systems and install drought-tolerant landscaping.

The rehabilitation work, estimated to take approximately six months, does not call for any demolition or modification to the footprints of existing apartments. The rehabilitation will be phased and completed with the tenants in place. Any vacant apartments will be rehabilitated first, allowing tenants from within the Development to move into these apartments while their apartments are being rehabilitated. The temporary relocation budget is $75,000. Community Preservation Partners, LLC ("the Developer") has provided a temporary relocation plan which will be reviewed and requires approval by City staff prior to start of relocations.

No Outstanding City Loan for the Project. The City does not have an outstanding loan on the Development. The City Loan in the original amount of up to $4,161,000 made on August 1, 2001 to Lenzen Housing, L.P. was for the purpose of developing and constructing 88 residential apartments with 69 apartments available to low-income persons and families and 18 apartments available to very low income households and 1 unrestricted manager's unit, with improvements including but not limited to sidewalks and landscaping. This City loan was paid off in full in 2019 as part of the acquisition of the improvements by Lenzen Square Community Partners, LP from Lenzen Housing, L.P.

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 of affordable rental housing projects in its jurisdiction subject to certain limited exceptions.

Sources of Project Funding. The 2019A Bonds will fund a portion of the total Development costs, which are currently estimated to be $32,659,401. During the acquisition and rehabilitation period, the 2019A Bonds will be outstanding in an estimated aggregate amount of $21,500,000, consisting of an estimated $18,500,000 par for the Series 2019A-1 Bonds and $3,000,000 par for the Series 2019A-2 Bonds. Following the rehabilitation of the Development, a portion of the Series 2019A-1 Bonds will be repaid using tax credit equity. The 2019A Bonds will be fixed rate and purchased/funded by Red Stone.

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

City of San José
Lenzen Square Apartments
Plan of Finance – Sources of Funding[1]

Source	Acquisition-Rehabilitation	Permanent
Bond Proceeds	$ 21,500,000	$ 19,250,000
Net Income from Operations during Construction	2,089,330	2,186,863
Tax Credit Equity	4,746,312	9,686,351
Deferred Developer Fee	3,814,087	1,026,515
Net Income from Operations during the interim bridge period (Acquisition through August Closing)	509,672	509,672
Total	$ 32,659,401	$ 32,659,401

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 $23,000,000 to finance the acquisition and rehabilitation of the Project.
- March 15, 2019 - The City submitted an application to CDLAC for a private activity allocation in the amount of $23,000,000.
- June 15, 2019 - The City received a private activity bond allocation from CDLAC in the amount of $23,000,000 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 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 Bond Financing

General. Multifamily housing financing historically has involved the issuance of tax-exempt bonds on behalf of private developers of qualifying affordable rental apartment projects. The City would issue tax-exempt bonds and loan the proceeds to the developer/borrower. The advantages of tax-exempt financing to developers include: below-market interest rates and

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

low-income housing tax credits – features that are not available with a conventional multifamily housing mortgage loan. This transaction will preserve the 88 affordable apartments for an additional 55 years (bond regulatory agreement) and the City's affordability restriction will be extended for an additional eight years. The investment of $3.3 million in rehabilitation of these apartments will ensure quality housing for the low-income families living in the development for the long term.

The City Charter provides that the City may issue revenue bonds and execute and deliver revenue bonds pursuant to California law. The City is authorized to issue the Bonds pursuant to California Health and Safety Code Sections 52075-52098, as amended (the "Act"), which authorize cities to issue revenue bonds and execute and deliver revenue bonds for the purpose of financing the acquisition and rehabilitation of multifamily rental housing. Section 52011 of the California Health and Safety Code defines "Bonds" to include bonds for purposes of the Act. The Bonds use a portion of the State's federal tax-exempt private activity cap allocated by CDLAC.

The Bonds also allow the Project to qualify for tax credits provided through the California Tax Credit Allocation Commission (CTCAC). The Bonds are limited obligations of the City, payable solely from loan repayments by the Borrower and are not secured by the general taxing power of the City or any other asset of the City.

The bond financing structure is being utilized because of a ruling of the Office of the Comptroller of the Currency ("OCC") that distinguished loans from bonds for purposes of Community Reinvestment Act ("CRA") credit. For the past several years, banks have been utilizing the bond financing approach on the belief that it meets OCC's definition of a CRA loan as well as CDLAC's requirements for tax-exempt financing.

Requirements for Tax-Exemption. For a private activity multifamily housing revenue obligation to qualify for tax-exemption, federal law generally requires that one of two restrictions must apply: either (1) at least 20% of the apartments 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 apartments must be reserved for occupancy by individuals and families whose income is 60% or less of area median income. This second restriction will be incorporated into the Regulatory Agreement for the Bonds.

Structure of the Bonds

Direct Purchase/Funding Structure. The 2019A Bonds will be structured as non-rated and non-credit-enhanced obligations that are directly purchased/funded by Red Stone. Pursuant to the City's policies regarding non-credit-enhanced bonds, Red Stone will sign an Investor Letter acknowledging that it is a "qualified institutional buyer", that is, a large institutional investor who understands and accepts the risks associated with unrated bonds secured solely by the Development rents. If Red Stone wishes to transfer the 2019A Bonds, the new holder must sign and deliver a similar Investor Letter to the Fiscal Agent.

Principal Amounts and Terms. Based on current projections, the estimated par of the Series 2019A-1 Bonds is $18,500,000 and the estimated par of the Series 2019A-2 Bonds is $3,000,000 but in no event shall the aggregate amount of the 2019A Bonds exceed $23,000,000. After the Project is rehabilitated and leased up, and conversion to the permanent loan phase occurs (the "Conversion Date"), a portion of the Series 2019A-1 Bonds will be repaid using tax credit equity. The Conversion Date is estimated to occur 24 months after closing.

The stated maturity of the 2019A-1 Bonds is anticipated to be approximately 40 years after closing. Principal of the 2019A-1 Bonds will amortize on a 40-year schedule. Red Stone has an option to require the Borrower to prepay the 2019A-1 Bonds in full beginning 16 years after closing, with six months prior notice. In the event of the exercise of such mandatory prepayment option, the Borrower would need to refinance the remaining balance of the 2019A-1 Bonds or to repay the remaining balance from another funding source.

The maturity of the Series 2019A-2 Bonds is anticipated to be approximately 40 years after closing.

Interest Rates. The interest rate on the Series 2019A-1 Bonds is estimated at 5.00% with a 40-year amortization schedule and the interest rate on the Series 2019A-2 Bonds is estimated at 8.00% with a 40-year amortization schedule.

Financing Documents

The following is a brief description of each document 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 August 2, 2019.

Indenture. The Series 2019A-1 Bonds and Series 2019A-2 Bonds will be issued under the same Indenture (the "Indenture") among the City and U.S. Bank Global Corporate Trust as the trustee (the "Trustee"). The Indenture 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 Indenture, the Trustee is authorized to receive, hold, invest, and disburse Bond proceeds and other funds established under the Indenture; to authenticate the Bonds; to apply and disburse payments to the Bond holder(s); and to pursue remedies on behalf of the Bond holder(s). 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 Series 2019A Bonds. The Loan Agreement (described below) obligates the Borrower to compensate the Trustee for services rendered under the Indenture.

Loan Agreement. There will be a Loan Agreement between the City and Borrower (the "Loan Agreement"), corresponding to the Indenture. The Loan Agreement will be executed by the Director of Finance, or another authorized officer, on behalf of the City. The Loan Agreement provides for the loan of Series 2019A Bond proceeds to the Borrower for the acquisition-rehabilitation and permanent financing of the Development, and for the repayment of such loans by the Borrower. The loan of Series 2019A-1 Bond proceeds will be evidenced by bonds that correspond to the amount of Series 2019A-1 Bonds (the "Series 2019A-1 Promissory Note"). The loan of Series 2019A-2 Bond proceeds will be evidenced by a note that corresponds to the amount of Series 2019A-2 Bonds (the "Series 2019A-2 Promissory Note" and, with the Series 2019A-1 Promissory Note, the "Promissory Notes"). The City's rights to receive payments under the Promissory Notes will be assigned to the Fiscal Agent, along with certain other rights under the Indenture, the Loan Agreement and the Promissory 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-income and very low-income residents for a period of at least 55 years.

Financing Team Participants

The financing team participants for both the Bonds consist of:

• City's Municipal Advisor:	PFM Financial Advisors LLC
• Bond Counsel:	Stradling Yocca Carlson & Rauth
• Trustee:	U.S. Bank Global Corporate Trust
• Funding Lender:	Red Stone

All costs associated with the Municipal Advisor, Bond Counsel and Fiscal Agent are contingent upon the sale of the 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 Bonds/Bond Documents	August 13, 2019
• Pre-Close Bonds	August 20, 2019
• Close Bonds	August 22, 2019
• CDLAC Deadline for Bond Closing	November 7, 2019

City Affordability Restrictions

The City has existing affordability restrictions (the "City Affordability Restrictions") recorded against the Development. The Affordability Restrictions will be extended an additional 8 years from the anticipated date of permanent loan conversion with the new Affordability Restrictions expected to terminate in the year 2075.

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. This would result in an upfront issuance not to exceed $82,500.
- Annual Fee, except for nonprofit borrowers, is an amount equal to 0.125% of the par issued through the term of the regulatory period, resulting in an annual fee not to exceed $28,750.

The Borrower is obligated to pay the City's annual fee throughout the 55-year Regulatory Agreement term; if the 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 Bonds and requires no follow-up to the City Council. Once the Bonds close, anticipated in mid-August 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

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 the March 6, 2019 hearing was published in the *San José Post - Record* on March 20, 2019. The hearing was held and no members of the public attended.

This Memorandum and the Bond Documents will be posted on the City's website for the August 13, 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 City will receive an estimated one-time issuance fee of $82,500 and $28,750 ongoing for the bond monitoring obligation in the Housing Trust Fund. The borrower will pay all issuance costs from proceeds of Bonds, tax credit equity and/or Borrower funds. The Bonds are tax-exempt obligations secured by a mortgage loan payable from the Development. The Bonds will not be paid from, nor secured by, the general taxing power of the City or any other City asset.

CEQA

Categorically Exempt, File No. PP19-054, CEQA Guidelines Section 15301, Existing Facilities.

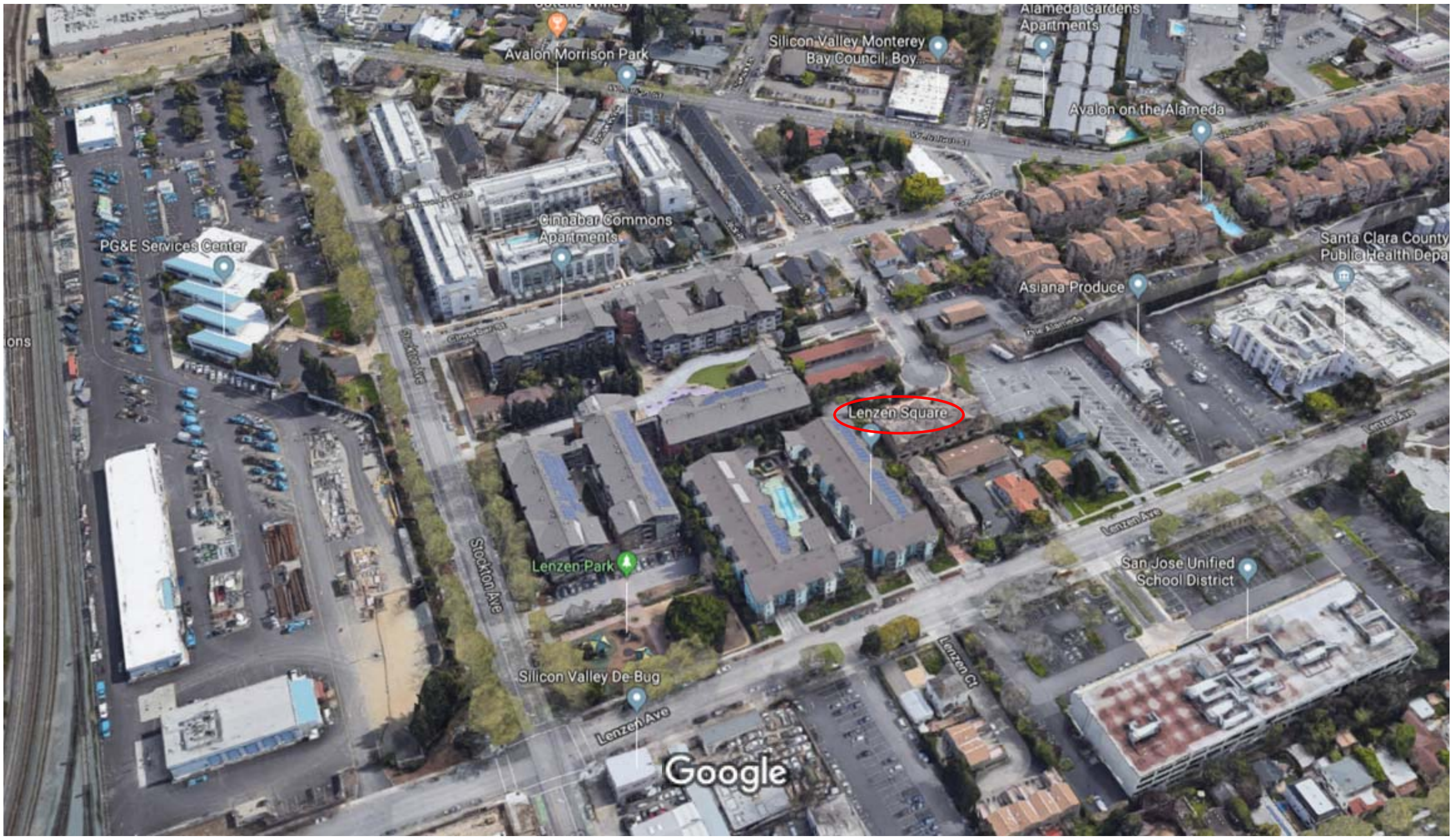
/s/	/s/
JULIA H. COOPER	JACKY MORALES-FERRAND
Director of Finance	Director, Housing Department

For questions, please contact Lisa Taitano, Assistant Director of Finance, at (408) 535-7041 or Rachel VanderVeen, Deputy Director, Housing Department, at (408) 535-8231.

Attachment A: Location Map

Attachment A

Location Map: 790 Lenzen Avenue, San Jose, CA



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