COUNCIL AGENDA: 10/03/17
ITEM: 4-5

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: September 12, 2017

Approved D. DSyL Date 9/21/17

COUNCIL DISTRICT: 6

SUBJECT: APPROVAL OF THE ISSUANCE OF MULTIFAMILY HOUSING REVENUE BONDS, THE LOAN OF BOND PROCEEDS AND RELATED DOCUMENTS FOR THE CATALONIA APARTMENTS

RECOMMENDATION

Adopt a resolution:

a. Authorizing the issuance of tax-exempt multifamily housing revenue bonds designated as "City of San José Multifamily Housing Revenue Bonds (Catalonia Apartments), Series 2017C (the "Bonds") in a principal amount not to exceed $17,713,027;

b. Approving a loan of Bond proceeds to Catalonia Two, L.P., a California limited partnership created by Eden Housing, Inc., a California nonprofit corporation, to finance the acquisition and rehabilitation of the Catalonia Apartments located at 2036 Evans Lane, in San José (the "Property");

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

d. Authorizing and directing the City Manager, Director of Finance and Director of Housing, or their designees, to execute and, deliver the Bond Documents and related documents as necessary; and

e. Authorizing the Director of Housing to negotiate and execute amendments to existing City loan documents relating to the Catalonia Apartments consistent with the terms described below.

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 an existing 50-apartment rental property, all of which are and will continue to be affordable for an additional period of at least 55 years, except for one manager's unit. This Property serves and will continue to serve low- and very low-income families with current annual incomes up to $83,160 for an assumed family size of up to six people.

EXECUTIVE SUMMARY

Catalonia Apartments, is an existing affordable housing development that was completed in 1996 by Eden Housing with financing assistance from the City. The City has an outstanding total balance of $3,513,439 of which $2,250,000 is principal balance and $1,263,439 is accrued interest. Eden Housing, Inc., a California nonprofit corporation (the "Developer"), has requested that the City issue tax-exempt multifamily housing revenue bonds ("Bonds") in an amount not to exceed $17,713,027. The Bonds will be purchased initially by J.P. Morgan Chase Bank, N.A. ("JPM Chase") and, after completion and lease-up, will be transferred to California Community Reinvestment Corporation ("CCRC").

The proceeds of the Bonds will be loaned to Catalonia Two, L.P., 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 of the existing 50-apartment rental housing property (the "Project") known as Catalonia Apartments (the "Property").

This financing is intended to ensure the Property's long-term physical and economic viability and, in so doing, enable it to lengthen the period for which it will be an affordable housing resource for the City's residents. **The Bonds will not be paid from or secured by the general taxing power of the City or any other City asset.**

The City's total outstanding loan balance will be recast as a new loan at Bond closing. The City will amend and restate the loan documents with respect to the Property incorporating the amended terms discussed below. Full repayment of the total outstanding City debt from residual receipts is not anticipated in the next 50 years. However, the useful life of the project is being extended via the rehabilitation, and the terms of affordability will increase another 55 years.

BACKGROUND

Catalonia Apartments, is an existing affordable housing development that was completed in 1996 by Eden Housing with financing assistance from the City. The site is a three story, 50-unit development with attached two-car garages, located on Evans Lane. Of the 50 units, 11 are designated for very low income and 38 units are designated as low-income. There is one unrestricted manager's unit. The City has an outstanding total balance amount of $3,513,439 of which $2,250,000 is principal balance and $1,263,439 is accrued interest.

The Developer has requested that the City issue the Bonds for the purpose of lending Bond proceeds to the Borrower. The Borrower is a California limited partnership. The Borrower will consist of: (1) Catalonia Two LLC, a limited liability company created by the Developer, as General Partner and (2) RBC Tax Equity LLC, or an affiliate thereof, as the tax credit investor limited partner.

The proceeds of the Bonds, together with other funds, will be used by the Borrower to finance the acquisition and rehabilitation of the Property. The current scope of Property rehabilitation is intended to improve the Property's safety and security, code compliance, waterproofing, and energy and water efficiency.

A summary of the project is provided below.

Borrower. The Borrower is a California limited partnership. The Borrower will consist of: (1) Catalonia Two LLC, a limited liability company created by the Developer, as General Partner and (2) RBC Tax Equity LLC, or an affiliate thereof, as the tax credit investor limited partner.

The Developer has requested that the City issue the Bonds for the purpose of lending Bond proceeds 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 Property.

Property Overview. The transaction involves the acquisition and rehabilitation of 50 three-and four-bedroom rental apartments, including one manager's unit. Upon completion of the Property's rehabilitation, apartments will continue to be rented as shown in the following table:

- 11 apartments of three to four bedrooms (approximately 22 percent) will continue to be rented to households with incomes up to 50 percent of the area median income ("AMI"), with current incomes up to $69,300 for a six-person family in a four-bedroom apartment, with the limit varying by apartment and household size;
- 38 apartments of three to four bedrooms (approximately 78 percent) will continue to be rented to households with incomes up to 60 percent of AMI, with current incomes up to $83,160 for a six-person family in a four-bedroom apartment, with the limit varying by apartment and household size; and
- One apartment will continue to be an unrestricted manager's unit.

The Property is currently owned by Catalonia Associates, L.P., a California limited partnership created by the Developer. The Property, originally constructed in 1995 by the Developer, consists of nine residential buildings and one community building. The Borrower will be acquiring the Property to recapitalize it and to provide funds for its rehabilitation. The Borrower can qualify for new tax-exempt financing and a new allocation of Low Income Housing Tax

Credits – the major sources of funding for acquisition and rehabilitation of existing affordable multifamily properties.

Scope of Work. The current scope of Property rehabilitation is intended to improve the Property's safety and security, code compliance, waterproofing, and energy and water efficiency. The goal is to ensure the Property continues to perform as high-quality affordable housing over the coming decades. Improvements include:

- Safety and Security – upgrade site and building lighting; extend height of perimeter fencing; add security cameras; upgrade signage; plant barrier-type landscape materials behind trash enclosures; make mobility improvements.
- Building Envelope – replace roofs, building skins and windows; address water intrusion and pest damage; and repair the stairway, balcony decks and landing in one building.
- Energy Efficiency – improve site energy efficiency by at least 10%; install solar photovoltaics; upgrade HVAC, mechanical and electrical systems, as needed.
- Water Conservation – retrofit irrigation system; replace lawn with drought-resistant landscaping.
- Unit Interiors – new flooring, painting and cabinetry for certain units.
- Accessibility Upgrades to Two Units – reconfiguration of bath and kitchen.
- Common Area/On-site Amenities – repair landscaping, paving and drainage; expand maintenance space.
- Other Improvements – complete seismic upgrades to tuck-under garages; replace patio enclosures.

This rehabilitation work will take approximately 12 months in total. The work will require the temporary relocation of three units to allow rehabilitation to occur in an orderly and safe manner. Those units include the two units receiving accessibility upgrades and one unit affected by the stairwell replacement. These units will be completed in three phases, one unit at a time, with each phase requiring the household to be out of their unit for approximately 30 days. The remaining units will experience no interruption in service during the rehabilitation; the tenants in those units will not need to relocate. The total relocation budget for the Property is $60,000.

City Loan for the Property. In May 10, 1996, the City made a loan of $2,250,000 in connection with the original acquisition and construction of the Property by Catalonia Associates, L.P. The loan was funded from 20% MF funds and currently has an outstanding principal amount of $2,250,000 and $1,263,439 in accrued interest. Total outstanding City debt is $3,513,439.

City as Issuer of Multifamily Housing Bonds. The City's Policy for Issuance of Multifamily Housing Revenue Bonds (the "City's Policy") is that it shall be issuer of any tax-exempt multifamily housing bond for affordable housing projects for which it has made or will be making a loan.

Sources of Project Funding. The proceeds of the Bonds will fund a portion of the total project costs during the rehabilitation and permanent phases. JPM Chase will purchase the Bonds initially in the expected amount of $16,349,953[1]. Following the rehabilitation of the Property, and its lease-up and stabilization ("at permanent"), CCRC will purchase the Bonds from JPM Chase in the approximate amount of $6,119,000, with the remaining portion repaid from low income tax credit proceeds. The Bonds will have a 19-year nominal maturity, with a 35-year amortization, subject to repayment in approximately 17 years after issuance.

During the acquisition and rehabilitation period (approximately 24 months), the Bonds will be variable rate. At permanent, the Bonds will be fixed rate.

The sources of funding for the Property's acquisition and rehabilitation phase and permanent phase are estimated as shown in the table below.

City of San José
Catalonia Apartments
Plan of Finance – Sources of Funding[2]

Source	Acquisition-Rehabilitation	Permanent
Bond Proceeds	$ 16,349,953	$ 6,119,000
Bay Area MF Capital Advance Loan	0	250,000
City of San Jose Loan and Accrued Interest	3,513,439	3,513,439
Seller Financing and Accrued Interest	5,997,415	5,997,415
Existing Reserves and Income from Operations	325,394	860,855
Sponsor Loan	0	1,000,000
General Partner Capital Contribution	1,094,278	1,094,278
Deferred Costs	881,146	0
Tax Credit Equity	1,036,293	10,362,931
Deferred Developer Fee	1,094,278	1,094,278
Total	$ 30,292,196	$ 30,292,196

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

- February 22, 2017 – The Director of Finance held a TEFRA hearing regarding the issuance of tax-exempt multifamily housing revenue bonds in an amount not to exceed $30,600,000 to finance the acquisition and rehabilitation of the Property.
- March 3, 2017 – The Mayor certified the actions of the Director of Finance.

[1] While a bond issuance in the amount of not to exceed $17,713,027 is requested to be authorized, consistent with the private activity bond allocation from CDLAC, the expectation is that a smaller amount will be issued.
[2] Estimated as of the date of this report. The actual amounts may vary from these estimates.

- March 17, 2017 – The City on behalf of the Borrower applied to the California Debt Limit Allocation Committee ("CDLAC") for a private activity bond allocation of $17,713,027.
- May 17, 2017 – The City received a private activity bond allocation in the requested amount of $17,713,027.
- May 17, 2017 – The Project received from the California Tax Credit Allocation Committee ("CTCAC") an allocation of federal tax credits in the requested amount of $1,066,271 per year, which credits will be sold in exchange for Tax Credit Equity.

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 Property. These sections describe the financing structure, financing documents, financing team participants, and financing schedule.

Financing Structure

Overview of the Multifamily Housing Financing

General. Multifamily housing financing historically has involved the issuance of tax-exempt bonds on behalf of private developers of qualifying affordable rental apartment properties. The City would issue tax-exempt bonds and loan the proceeds to the borrower, generally a limited partnership formed by the developer. The advantages of tax-exempt financing to developers include below-market interest rates and an entitlement to federal low income housing tax credits – features that are not available with a conventional multifamily housing mortgage loan.

The Bonds use a portion of the State's federal tax-exempt private activity cap allocated by CDLAC. The Bonds also allow the Borrower to qualify the Property for tax credits provided through 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.

Requirements for Tax-Exemption. For a multifamily housing revenue bond 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. The second restriction will be incorporated into the Regulatory Agreement for the Bonds.

Structure of the Bonds

Direct Purchase/Funding Structure. The Bonds will be structured as non-rated and non-credit-enhanced obligations that are directly purchased and funded by JPM Chase as the initial purchaser. Pursuant to the City's policies regarding non-credit-enhanced Bonds, JPM Chase will sign an Investor Letter acknowledging that it is a "qualified institutional buyer" or an "accredited investor" – that is, a large institutional investor who understands and accepts the risks associated with unrated bonds secured solely by the Property rents. Upon transfer of the Bonds to CCRC after the Conversion Date (defined below), CCRC will need to sign and deliver a similar Investor Letter to Wilmington Trust, N.A. as the Trustee. An executed Investor Letter filed with the Trustee must accompany all transfers of the Bonds. It is anticipated that the Bond can be transferred only in whole.

Principal Amounts and Terms. Based on current projections, the Bonds are anticipated to be issued in the amount of $16,349,953. After the Property is rehabilitated and leased up, and conversion to the permanent loan phase occurs (the "Conversion Date"), the principal balance of the Bonds is expected to be paid down to $6,119,000 from tax credit equity funds. The Conversion Date is anticipated to be 24 months after Bond closing.

The maturity of the Bonds is anticipated to be 19 years after the Closing Date. Bond principal remaining on the Conversion Date will amortize on a 35-year basis commencing on the Conversion Date. The Bonds will be subject to mandatory prepayment in 17 years. At such point, the Borrower will need to refinance the remaining balance of the Bonds or repay it from another funding source.

Interest Rates. During the acquisition and rehabilitation period, the Bonds will pay interest only at a variable rate equal to 30-day LIBOR plus a margin of 1.35%.

After the Conversion Date, interest on the Bonds will be paid at a fixed rate that will be set prior to the Closing Date based on a formula[3] and is estimated to be 4.76% based on current market conditions plus a cushion of 0.50%.

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 September 12, 2017.

Indenture of Trust. The Bonds will be issued under an Indenture of Trust (the "Indenture") between the City and Wilmington Trust, N.A., as 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

[3] The formula is equal to the 15-year municipal bond index plus a spread of 1.90%.

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 owners; and to pursue remedies on behalf of the Bond owners. The Indenture sets forth the guidelines for the administration, investment and treatment of investment earnings generated by each fund and account, and restrictions relating to any subsequent transfer of the Bonds. The Loan Agreement (described below) obligates the Borrower to compensate the Trustee for services rendered under the Indenture.

Loan Agreement. This document (the "Loan Agreement") is between the City and the Borrower. 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 Bond proceeds to the Borrower for the acquisition-rehabilitation and permanent financing of the Property, and for the repayment of such loan by the Borrower. The loan will be evidenced by a note (the "Note") in an amount and with terms that mirror the terms of the Bonds. The City's rights to receive payments under the Note will be assigned to the Trustee, along with certain other rights under the Indenture, the Loan Agreement, and the Bonds; however, the City has retained certain reserved rights, such as the City's right to indemnification.

Regulatory Agreement and Declaration of Restrictive Covenants. This agreement (the "Regulatory Agreement") is among the City and the Borrower. The Regulatory Agreement contains certain covenants and restrictions regarding the Property 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 49 of the Property's apartments to low-income and very low-income residents for a period of at least 55 years.

Financing Team Participants

The financing team participants for the Series 2017 Obligations consist of:

• City's Financial Advisor:	Ross Financial
• Bond Counsel:	Quint & Thimmig LLP
• Trustee:	Wilmington Trust, N.A.
• Bond Purchaser:	J.P. Morgan Chase Bank, N.A.

All costs associated with the Financial Advisor, Bond Counsel, and Trustee 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 Bond Documents	October 3, 2017
• Pre-close Bonds	October 10, 2017
• Close Bonds	October 12, 2017
• CDLAC Allocation Lapses	November 21, 2017

City Funding

The City currently has an outstanding loan with respect to the Property in the amount of $2,250,000, as well as existing affordability restrictions (in aggregate, "City Loan"). At closing of the Bonds, the City Loan terms will be amended and restated as follows:

1. Affordability Restrictions – The term of the City's Affordability Restriction will be extended to start a new 55-year period commencing at the date of the Notice of Completion for the rehabilitation work, expected in 2018. This new affordability period represents a net increase of 55 remaining term years to the existing City affordability period.

2. Interest Rate – The compounded interest rate will be the greater of 2.43% compounding annually or the Applicable Federal Rate ("AFR") at the time of closing, as is required for affordable properties that do not pay off existing City financing at the time of obtaining new tax credits. The current loan interest rate is 5% simple per annum.

3. Loan Term – The amended and restated City Loan term will start at the close of financing and will mature in 55 years. The amended City Note will mature in 2072. This new period represents an increase of 55 remaining term years to the existing loan term. The loan term is being extended beyond 30 years to meet the Borrowers Tax Counsel true debt test. Accrued interest on the Loan is due annually on or before the first day of June to the extent of the availability of 50% of excess/distributable cash. During the rehabilitation period spanning calendar year 2017-2018, projected uses of net operating income as a permanent source of funding is approximately $101,690 and $433,771 respectively. There will be no excess/distributable cash during this time.

4. Subordination –The City's Deed of Trust will be subordinated to the new Bond loan. The City will also subordinate its Affordability Restrictions to the new Senior Lender, in the event of a foreclosure. Rents will not be allowed to exceed 60% AMI.

5. Other – The City will incorporate additional provisions in the Affordability Restriction that provide for City loan monitoring and loan servicing fees, Borrower operating and reporting covenants, and certain City approval rights. Also, together with the senior lender, the City will oversee rehabilitation using the assistance of an external construction consultant, to ensure the quality of rehabilitation.

The proposed 4% tax credit re-syndication with tax-exempt bonds proceeds will pay off the current senior hard debt - Berkadia Commercial Mortgage in the original loan amount of $2,400,000. The current senior note has simple annual interest rate of 4.53%, with a maturity due of August 1, 2018. The resyndication includes paying off the Berkadia loan in the amount of $2,377,410 the current total outstanding loan amount.

The greatest benefit to the City is the renovation of the property and further extending the use of the property with continued affordability for 55 years to 2072.

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 early October 2017, and the acquisition and rehabilitation of the Property 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 February 22, 2017 before the Director of Finance. The public hearing notice for the February 22, 2017 hearing was published in the *San José Post - Record* on January 23, 2017.

This memorandum and the Bond Documents will be posted on the City's website for the October 3, 2017 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

All issuance costs will be paid from proceeds of the 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.

City Fees

Under the City's Policy, the City charges an upfront issuance fee based on the total amount of tax-exempt and taxable obligations issued: 0.50% of the first $10 million principal amount of such obligations and 0.25% of the remaining principal amount. Based on the currently estimated aggregate initial size of $16,349,953 for the Bonds, the City will receive an upfront issuance fee of $65,875.

The City will also receive an annual fee for monitoring the Property and reporting its compliance to CDLAC. Bond fees will be deposited into Fund 440.

Under the City's Policy, nonprofit sponsors such as Eden Housing are allowed a lower annual fee after the Conversion Date than before the Conversion Date. Before the Conversion Date, the annual fee is equal to one-eighth of a point (0.125%) of the initial principal amount of the bonds; after the Conversion Date, the annual fee is equal to one-eighth of a point (0.125%) of the principal amount of the bonds on the Conversion Date, with a minimum fee of $7,500. Based on this formula, an initial $16,349,953 principal amount of Bonds prior to the Conversion Date and an expected $6,119,000 principal amount of Bonds to be outstanding on the Conversion Date, the annual fee will be $20,437 prior to the Conversion Date and $7,649 after the Conversion Date.

The Borrower is obligated to pay this 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.

CEQA

Exempt, File No. PP17-019, CEQA Guidelines Section 15301 for existing facilities.

/s/
JULIA H. COOPER
Director of Finance

/s/
JACKY MORALES- FERRAND
Director, Housing Department

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

Attachment A: Site Map

<u>**Attachment A**</u>
<u>**SITE MAP**</u>

2036 Evans Lane, San José
Council District 6