COUNCIL AGENDA: 08-07-18
FILE: 18-1022
ITEM: 4.1

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 16, 2018

Approved [signature] Date 7-24-18

COUNCIL DISTRICT: 3

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 EL RANCHO VERDE APARTMENTS PROJECT

RECOMMENDATION

Adopt a resolution:

a. Authorizing the issuance of (a) tax-exempt multifamily housing revenue notes designated as "City of San José Multifamily Housing Revenue Note (El Rancho Verde Apartments), Series 2018A" (the "Series 2018A Note") and "City of San José Multifamily Housing Revenue Note (El Rancho Verde Apartments), Series 2018B" (the "Series 2018B Note" and with the "Series 2018A Note, the "Notes") in an aggregate principal amount not to exceed $318,000,000;

b. Approving the loan of the proceeds of the Notes to ERV 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 the El Rancho Verde Apartments located at 300 and 303 Checkers Drive, in San José (the "Development");

c. Approving in substantially final form the Funding Loan Agreements, Borrower Loan Agreements and Regulatory Agreement and Declaration of Restrictive Covenants (the "Series 2018 Note Documents");

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 Series

2018 Note Documents together with any other documents required in connection with this transaction, including any documents ancillary to the 2018 Note Documents; and

e. Authorizing an increase in the issuance fee and a reduction in annual monitoring fees, notwithstanding the requirements of the City's Policy for Issuance of Multifamily Housing Revenue Bonds, as provided below.

OUTCOME

Approval of the recommended actions will enable the issuance of multifamily housing revenue notes for the purpose of financing the acquisition and rehabilitation of El Rancho Verde Apartments, an existing 700-unit rental apartment project. The Affordability Restrictions at the project, which are restricted to low and very low income households, will be extended for an additional 19 years, which is expected to terminate in the year 2075. The Development will continue to serve low- and very low-income residents with current maximum annual incomes between 60% and 50% 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, a California limited liability corporation formed by WNC & Associates, Inc., a California corporation (the "Developer"), has requested that the City issue tax-exempt multifamily housing revenue notes in two series (the "Series 2018A Notes" and the "Series 2018B Notes" and, collectively, the "Notes") in an aggregate amount not to exceed $318,000,000. The Notes will be initially purchased and funded by Citibank, N.A. ("Citibank").

The proceeds of the Notes will be loaned to ERV 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 of an existing 700-unit rental housing rental project known as El Rancho Verde Apartments (the "Development").

The Notes 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. The Borrower will consist of the following entities:

(1) Administrative General Partner: ERV Partners, LLC, a California limited liability corporation of which WNC-ERV Partners, LLC (an affiliate of the Developer) and L&M Rancho Verde LLC are each 50% members;
(2) Managing General Partner: FFAH V El Rancho Verde LLC, an affiliate of Foundation for Affordable Housing, a California nonprofit public benefit corporation, and;
(3) Limited Partner: An entity formed by Wells Fargo Bank.

The Developer has requested that the City issue the Notes for the purpose of lending the proceeds thereof to the Borrower. The proceeds of the Notes, 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 700 two-bedroom and three-bedroom rental apartments. Currently, and upon completion of the rehabilitation of the Development, the unit mix and affordability restrictions will be as follows:

El Rancho Verde Apartments	Unit Mix
Very Low Income (50% of AMI)	557
Low Income (60% of AMI)	139
Unrestricted Managers Unit	4
Total Units	**700**

The City's maximum income limit for a 2-person household, at 50% AMI is $53,200; for a 4-person household at 60% AMI the maximum income limit is $79,800. However, incomes at the property tend to be significantly lower given that approximately 80% of the total units at the property, are occupied by tenants with Section 8 project based vouchers.

The Development is currently restricted to low and very low income households and has an existing Affordability Restriction with an expiration of September 21, 2056. With this transaction, the Affordability Restrictions will be extended an additional 19 years from the anticipated date of permanent loan conversion and are expected to terminate in the year 2075.

The Development is currently owned by El Rancho Verde Apartments L.P. (the "Seller"), a California limited partnership, which acquired the Development in December 2012. The Development was originally built in two phases in 1969 and 1971-72, completely remodeled in 2001 and underwent a $6 million renovation from 2011 through 2015. The Development consists of 49 two and three story residential buildings. The residential buildings are wood-frame construction on concrete slab foundations with stucco exteriors. The site also includes a community building, two swimming pools, five playgrounds, picnic areas, 11 laundry room buildings, a storage building, an unoccupied daycare center and 1,170 parking spaces.

In addition to the City's Affordability Restrictions, the Development is subject to low income housing tax credit ("LIHTC") restrictions, with the occupants of 557 apartments being recipients of project-based Section 8 rental subsidies. The existing Section 8 Housing Assistance Payment ("HAP") contract will be assigned and transferred to the new Borrower and Owner of the Development. 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 address health and safety issues, ADA, deferred maintenance and energy efficiencies. The Borrower is planning full interior upgrades, including new kitchen cabinetry, counters 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, install solar, upgrade building systems and install drought-tolerant landscaping.

The rehabilitation work, estimated to take approximately fifteen months, does not call for any demolition or modification to the footprints of existing units. All work is anticipated to be completed with the tenants in place. Any vacant units will be rehabilitated first, allowing tenants from within the Development to move into these units while their units are being rehabilitated. The Developer has budgeted $700,000 for temporary relocation.

No Outstanding City Loan for the Project. The City does not have an outstanding loan on the Development. However, on July 27, 2000 the City made a loan of $5,500,000 (the "City Loan") to El Rancho Verde Preservation, LP ("ERVP"), a prior owner which, along with bonds issued by the California Housing Finance Agency, financed a portion of ERVP's cost of acquiring and rehabilitating the Development. The City Loan was accompanied by a 55 Year Affordability Restrictions and Rider (the "City's Affordability Restrictions"). The City Loan was repaid on December 27, 2012 when El Rancho Verde Apartments LP, the current owner, purchased the Development. The City's current Affordability Restrictions remain in place, and will be extended for 19 years from the date of permanent conversion of the 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 of affordable rental housing projects in its jurisdiction subject to certain limited exceptions. The Notes are the equivalent of multifamily housing revenue bonds.

Sources of Project Funding. The Notes will fund a portion of the total Development costs, which are currently estimated to be $512,468,559. During the acquisition and rehabilitation period, the Notes will be outstanding in an estimated aggregate amount of $318,000,000, consisting of an estimated $278,000,000 par for the Series 2018A Note and $40,000,000 par for the Series 2018B Note. Following the rehabilitation of the Development and its lease-up ("at permanent"), Series 2018B Note will be repaid in full and only the Series 2018A Note will remain outstanding. The Notes will be fixed rate and purchased/funded by Citibank.

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

City of San José
El Rancho Verde Apartments
Plan of Finance – Sources of Funding[1]

Source	Acquisition-Rehabilitation	Permanent
Note Proceeds	$ 318,000,000	$ 278,000,000
Citibank Taxable Loan	17,000,000	0
Tax Credit Equity	103,461,024	160,461,024
Deferred Developer Fee	54,767,535	54,767,535
Seller Credit	4,500,000	4,500,000
Income from Operations and Other	14,740,000	14,740,000
Total	$ 512,468,559	$ 512,468,559

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

- May 17, 2018 - The City submitted an application to CDLAC for a private activity allocation in the amount of $318,000,000.
- June 11, 2018 - The Director of Finance held a TEFRA hearing regarding the issuance of tax-exempt multifamily housing revenue bonds in an amount not to exceed $350,000,000 to finance the acquisition and rehabilitation of the Project.
- June 13, 2018 - The Mayor certified the actions of the Director of Finance.
- July 18, 2018 - The City received a private activity bond allocation from CDLAC in the amount of $318,000,000 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.

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

Note Financing Structure

Overview of the Multifamily Note 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 low-income housing tax credits – features that are not available with a conventional multifamily housing mortgage loan.

The Notes operate in a similar manner to tax-exempt multifamily housing bonds. The City Charter provides that the City may issue revenue bonds and execute and deliver revenue notes pursuant to California law. The City is authorized to issue the Notes 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 revenues notes 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 notes for purposes of the Act. The Notes use a portion of the State's federal tax-exempt private activity cap allocated by CDLAC.

The Notes also allow the Project to qualify for tax credits provided through the California Tax Credit Allocation Commission (CTCAC). The Notes 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 note 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 note 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 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. This second restriction will be incorporated into the Regulatory Agreement for the Notes.

Structure of the Notes

Direct Purchase/Funding Structure. The Notes will be structured as non-rated and non-credit-enhanced obligations that are directly purchased/funded by Citibank. Pursuant to the City's policies regarding non-credit-enhanced Notes, Citibank 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 notes secured solely by the Development rents. If Citibank wishes to transfer either of the Notes, the new holder must sign and deliver a similar Investor Letter to the Fiscal Agent. The minimum transfer amount is no less than 15% of the outstanding principal amount of the Series 2018A Note or Series 2018B Notes, as the case may be.

Principal Amounts and Terms. Based on current projections, the estimated par of the Series 2018A Note is $278,000,000 and the estimated par of the Series 2018B Note is $40,000,000 but in no event shall the aggregate amount of the Notes exceed $318,000,000. After the Project is rehabilitated and leased up, and conversion to the permanent loan phase occurs (the "Conversion Date"), the Series 2018B Note is expected to be repaid in full with tax credit equity funds. The Conversion Date is anticipated to be between 24 to 30 months after Note closing.

The stated maturity of the Series 2018A Note is anticipated to be 30 years after the Conversion Date. Principal of the Series 2018A Note will amortize on a 35-year basis following Conversion. Citibank has an option to require the Borrower to prepay the Series 2018A Note in full 17 years after Note closing, with six month's prior notice. Assuming the exercise of such mandatory prepayment option, the Borrower will need to refinance the remaining balance of the Series 2018A Note or to repay the remaining balance from another funding source.

The maturity of the Series 2018B Note is anticipated to be approximately 3 years.

Interest Rates. The interest rate on the Notes has been locked at 4.62%.

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 July 27, 2018.

Funding Loan Agreements. The Series 2018A Note and Series 2018B Note will be issued under separate Funding Loan Agreements (the "Funding Loan Agreements") among the City, Citibank, as funding lender, and U.S. Bank National Association as the fiscal agent (the "Fiscal Agent"). Each of the Funding Loan Agreements 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 Funding Loan Agreements, the Fiscal Agent is authorized to receive, hold, invest, and disburse Note proceeds and other funds established under the respective Funding Loan Agreement; to authenticate the Notes; to apply and disburse payments to the Note holders; and to pursue remedies on behalf of the Note holders. The Funding Loan Agreements 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 a Series 2018A Note or Series 2018B Note, as the case may be. The Borrower Loan Agreements (described below) obligate the Borrower to compensate the Fiscal Agent for services rendered under the Funding Loan Agreements.

Borrower Loan Agreements. There will be two Borrower Loan Agreements between the City and Borrower (the "Loan Agreements"), each corresponding to a Funding Loan Agreement. 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 2018A Note or Series 2018B Note proceeds, as the case may be, 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 2018A Note proceeds will be evidenced by a note that corresponds to the amount of Series 2018A Note (the "Series 2018A Loan Note"). The loan of Series 2018B Note proceeds will be evidenced by a note that corresponds to the amount of Series 2018B Note (the "Series 2018B Loan Note" and, with the Series 2018A Loan Note, the "Loan Notes"). The City's rights to receive payments under the Loan Notes will be assigned to the Fiscal Agent, along with certain other rights under the Funding Loan Agreements, 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 Fiscal Agent 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 Notes consist of:

• City's Municipal Advisor:	Ross Financial
• Bond Counsel:	Jones Hall, A Professional Law Corporation
• Fiscal Agent:	U.S. Bank National Association
• Funding Lender:	Citibank, N.A.

All costs associated with the Municipal Advisor, Bond Counsel and Fiscal Agent are contingent upon the sale of the Notes and will be paid from Note proceeds, tax credit equity and/or Borrower funds.

Financing Schedule

The current proposed schedule is as follows:

• Council Approval of Notes/Note Documents	August 7, 2018
• Pre-Close Notes	August 10, 2018
• Close Notes	August 14, 2018
• CDLAC Deadline for Note Closing	January 14, 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 19 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 of $820,000.
- 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 of $397,500.

Housing department staff, at the request of the Developer, reviewed the issuance fee and annual monitoring fee that would be required for this bond issuance and, notwithstanding the City's Policy, recommend that the City Council authorize an overall reduction in bond fees. The City's policy did not envision an issuance of obligations in the estimated par amount of the Notes for this project. The typical bond or note issued by the City for multifamily housing developments is in the $15 to $40 million range with projects of 100 to 200 units. City staff therefore is recommending a lower overall fee for this transaction approximately half), in part, to remain competitive with other conduit issuers of multifamily housing bonds within California, and in part to be more sustainable within the operating projections and underwriting for the property. The reduction in fees will not impact City operations.

Staff has recommended up front and annual fees as follows:

- An upfront issuance fee of $900,000, which represents an increase in the amount that otherwise would be due, in part, to offset the effect of the lower annual monitoring fee.

- An annual monitoring fee of $50,000 for the first year, increasing 5% per year through the 15th year; beginning in year 16, the fee will be $250,000 per year for the remainder of the 55-year Regulatory Agreement term.

This fee structure with a higher upfront fee and an escalating annual fee will result in a new present value equivalent to an upfront fee of $400,000 and an annual fee of $187,500.

The Borrower is obligated to pay the City's annual fee throughout the 55-year Regulatory Agreement term; if the Notes 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 Notes and requires no follow-up to the City Council. Once the Notes close, anticipated in mid-August 2018, 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 June 11, 2018 before the Director of Finance. The public hearing notice for the June 11, 2018 hearing was published in the *San José Post - Record* on May 24, 2018.

This memorandum and the Note Documents will be posted on the City's website for the August 7, 2018 Council 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 Notes, tax credit equity and/or Borrower funds. The Notes are tax-exempt obligations secured by a mortgage loan payable from the Development. The Notes will not be paid from, nor secured by, the general taxing power of the City or any other City asset.

CEQA

Categorically Exempt, CEQA Guideline Section 15301, Existing Facilities, File No. PP18-069.

/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 Leif Regvall, Acting Division Manager, Housing Department, at (408) 535-8232.

Attachment A: Site Map

ATTACHMENT A
SITEMAP

El Rancho Verde Apartments – 700 Unit Family Property
300 and 303 Checkers Drive, San Jose, CA