COUNCIL AGENDA: 02/05/19
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ITEM: 4.1

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Julia H. Cooper
Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: January 23, 2019

Approved D. DSyL Date 1/25/19

COUNCIL DISTRICT: 7

SUBJECT: TEFRA HEARING FOR CALIFORNIA STATEWIDE COMMUNITIES DEVELOPMENT AUTHORITY'S ISSUANCE OF TAX-EXEMPT MULTIFAMILY REVENUE BONDS TO ACQUIRE AND REHABILITATE THE VALLEY PALMS 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 Statewide Community Development Authority to issue private-activity bonds for the acquisition and rehabilitation of the Valley Palms Apartments, a 354-unit apartment complex located at 2155 and 2245 Lanai Avenue in San José.

(b) Hold a Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") public hearing for the issuance not to exceed $120,000,000 in tax-exempt private-activity bonds by the California Statewide Community Development Authority to finance the Project and to pay certain expenses incurred in connection with the issuance of the bonds.

(c) Adopt a resolution approving the issuance of Tax-Exempt Revenue Bonds by CSCDA in a principal amount not to exceed $120,000,000 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 the California Statewide Community Development Authority ("CSCDA") to issue tax-exempt bonds to permit the acquisition and rehabilitation of the Valley Palms Apartments, an existing apartment property with no City funding, providing 352 affordable apartments located at 2155 and 2245 Lanai Avenue. It will also result in lengthened affordability restrictions, preserving the supply of affordable housing in San José.

BACKGROUND

The description of the project, acquisition and rehabilitation is provided by CSCDA. CSCDA has requested that the City of San José ("City") consent to its issuance of an amount not to exceed $120,000,000 in tax-exempt private activity bonds ("Bonds") for the Valley Palms Apartments (the "Property"), located at 2155 and 2245 Lanai Avenue (the "Project") in San José. 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.

CSCDA is a statewide Joint Powers Authority, of which the City is a member. For CSCDA to issue bonds in San José, it must request permission pursuant to its membership agreement. City staff then determines whether the issuance comports with the City's Policy. The proposed issuance is consistent with the City's current policy for Issuance of Multifamily Revenue Bonds ("the Policy"), under Section I. B, as discussed in the Analysis section, and CSCDA requests that the City Council permit CSCDA's bond issuance and hold a public TEFRA hearing on the forthcoming issuance.

Property Owner

KDF Valley Palms, L.P., an affiliate of KDF Communities ("KDF"), is the existing project owner. KDF purchased the property in 2002 and is now seeking funding to recapitalize the Property.

Property Overview

The Property was built in 1966, last renovated in 2002, and already offers restricted affordable rents.

The current restricted rents are enforced by CSCDA's bond regulatory agreement from 2002, in which the City is a third-party beneficiary, and the 2002 TCAC regulatory agreement. The restrictions will continue substantially the same as they are now:

- 106 apartments (30%) will continue to be rent restricted serving tenants with maximum incomes of 50% of the area median income ("AMI"), with current incomes up to $49,875 for a two-person family in a one-bedroom apartment, with the limit varying by household size. Rents are initially expected to range from $1,247 for a one bedroom to $1,496 for a two bedroom;

- 246 apartments (70%) will continue to be rent restricted serving tenants with maximum incomes of 60% of the AMI with current incomes up to $59,850 for a two-person family in a one-bedroom apartment, with the limit varying by household size. Rents are initially expected to range from $1,496 for a one bedroom to $1,796 for a two bedroom; and
- Two two-bedroom apartments for resident managers will remain unrestricted.

The Project is located in a desirable location within a mixed-use neighborhood with major shopping, schools, and recreational amenities located within a short distance. Access to groceries, pharmacy and shopping is convenient and is within reasonable walking distance. Located on a large 17-acre lot, the Project also offer a clubhouse, tennis court, basketball court, two swimming pools, two playgrounds, laundry facilities and covered parking.

Borrower

The Borrower of the proposed Project, is Valley Palms 2018 LP ("VP 2018") a new limited partnership that has been formed to purchase the property. VP 2018 is a California limited partnership. VP 2018 will purchase the Project from KDF and become the new project owner.

The to be formed, new partnership will consist of Affordable Housing Access, Inc. ("AHA"), as the general partner. AHA is an existing California nonprofit public benefit corporation. The limited partner for VP 2018 is to be determined.

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 Projects tax credit compliance period of 15 years has ended, it is allowable under federal IRS 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, KDF requested that CSCDA apply to the CDLAC for a bond allocation for the Project. In addition, KDF also 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 $14,900,000 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 arms-length acquisition of the property by a new legal entity, pay for hard and soft transaction costs, pay any relocation costs and initially capitalize reserves.

Scope of Work

The scope of rehabilitation will address health and safety issues, accessibility requirements, deferred maintenance, and energy efficiency enhancements. The rehabilitation includes exterior upgrades such as: repainting of exterior, retrofit of windows and sliding doors, new landscaping and irrigation system repair, new LED lighting, new outdoor furniture, new signage, address trip hazards, and site drainage issues. Interior upgrades will include improvements to the: laundry room, unit repairs as needed to the heating, mechanical or electrical systems, ADA improvements on selected units, new appliances, painting, cabinetry, and new flooring.

Work is expected to start in April 2019 and conclude in April 2020. While it is possible that some residents may need to stay briefly in another location so that their apartments can be renovated, most of the rehabilitation is expected to take place with the tenants in place. No significant permanent displacement of residents is anticipated from the rehabilitation or the financial restructuring.

TEFRA

As a pre-condition for the exclusion from gross income for federal income tax purposes of interest on all qualified private activity bonds, the TEFRA requires, among other things, that the proposed bond issue be approved (a "TEFRA approval") either by an elected official or body of elected officials of the applicable governmental entity after a public hearing (a "TEFRA hearing") following reasonable public notice (a "TEFRA notice"). A qualified private activity bond is a bond issued to fund a project for a private entity, which must meet certain requirements under the Internal Revenue Code (the "Code") in order for the interest received by the bondholder to be excluded from gross income for federal income tax purposes. TEFRA hearings provide interested individuals or parties the opportunity to comment on any matters related to such potential bond issues, including the nature and location of the project.

ANALYSIS

City Council Policy for the Issuance of Multifamily Housing Revenue Bonds

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, CSCDA to issue bonds if two conditions are met: 1) the City is not making a loan or grant to the project; and 2) the project is one of multiple projects 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 and/or City staff have approved developers' use of an alternate issuer pursuant to the Policy.

This proposed transaction meets the conditions for approving, CSCDA as the conduit issuers under Section I.B of the City's Policy. The first of the Policy's conditions is met, there is no prior, existing, or future City loan or grant on the Apartments. In addition, the second of the Policy’s conditions regarding multiple concurrent issuances is also met: KDF is submitting three separate projects to be approved in the forthcoming CDLAC allocation round. KDF is able to achieve significant time and cost savings, economies of issuance, by utilizing the same finance team for the projects.

The Project also has an existing bond regulatory agreement from CSCDA's 2002 bond issuance. CSCDA must continue to report to CDLAC for the next 55 years from the Closing date, as required by CDLAC conditions. The City is currently listed as a third-party beneficiary to the regulatory agreement, which provides the City the right, but not the obligation) to enforce, separately or jointly with the Issuer and/or the Trustee, or to cause the Issuer or Trustee to enforce, the terms of the bond regulatory agreement. As the Issuer, the City has greater control over the Project. However, when the City is not the Issuer, the reduction of control for this Project is mitigated when the City is a third party beneficiary to the regulatory agreement. Because this proposed transaction meets Section I.B of the City's Policy and because the City will be named a third-party beneficiary, the City staff recommends CSCDA request to be the Issuer for this Project acceptable.

The City intends to monitor the compliance and operating status of the property. The City will negotiate with CSCDA regarding implementation of fees to reimburse the City for its monitoring. It is intended that these fees will be negotiated and documented prior to the issuance of the bonds by CSCDA.

TEFRA Hearing

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. Pursuant to the Code, the issuance of the Bonds by CSCDA requires the City's approval because the Project is located within the territorial limits of the City. In order for the interest on the Bonds to be excluded from the gross income of the owner of the Bonds (i.e. tax-exempt), an "applicable elected representative" of the government unit must approve the issuance of the Bonds after the TEFRA hearing; The form of government approval is the resolution. The City Council's approval of CSCDA's issuance of the Bonds and the use of the proceeds serve to meet the applicable Code requirements. The City Council's approval of this action is not approval of the Apartments for any other purpose.

Pursuant to the Policy, in situations in which the City allows an external agency such as CSCDA to issue the bonds, the City Council must hold the TEFRA hearing. The Director of Finance's delegation of authority under Chapter 5.06 of the Municipal Code is limited in allowing staff level TEFRAs to be held to those cases where the City will be the issuer. Therefore, as part of this action, a specially-noticed public hearing will be held to satisfy the TEFRA requirements.

EVALUATION AND FOLLOW-UP

There is no planned City Council follow-up anticipated as part of this action; however, staff will seek confirmation of the bond issuance and obtain the new CSCDA bond regulatory agreement in its work to track all restricted affordable housing in San José.

POLICY ALTERNATIVES

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

Alternative #1:	***Deny CSCDA's bond issuance request.***
Pros:	The City would receive its usual upfront and annual issuer fees that would add to the City's resources.
Cons:	Given the short notification to the City, the City would be unable to meet CSCDA's application deadline for the California Debt Allocation Committee ("CDLAC") and Tax Credit Allocation Committee ("TCAC"). The City would be unable to match the issuance pricing offered by CSCDA, as a result of multiple simultaneous bond transactions with the borrower. With little staff work, the CSCDA issuance will result in an additional 17 years of affordability.
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 CSCDA's bond issuance.

PUBLIC OUTREACH

A public hearing notice regarding the TEFRA hearing to be held as part of the actions recommended in this report is scheduled to be published in the Post-Record on or about January 22, 2019. This report will be posted to the agenda website for the City Council's February 5, 2019 meeting.

COORDINATION

This memorandum has been prepared in coordination with the City Attorney's Office and the City Manager's 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.

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. The typical fees collected by the City when acting as the bond issuer include an issuance fee of approximately $325,000 and annual ongoing fees of $78,000. However, as consideration for this request, the City will receive its $5,000 TEFRA hearing fee for non-City bond issuances. There are no other fiscal impacts to the City as there are no City funds allocated to the Apartments. Repayment of the tax-exempt bonds issued by CSCDA 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/	/s/
JULIA H. COOPER	JACKY MORALES-FERRAND
Director, Finance Department	Director, Housing Department

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