COUNCIL AGENDA: 2/5/2019
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ITEM: 4.2

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: 3

SUBJECT: TEFRA HEARING FOR CALIFORNIA STATEWIDE COMMUNITIES DEVELOPMENT AUTHORITY'S ISSUANCE OF TAX-EXEMPT MULTIFAMILY REVENUE BONDS TO ACQUIRE AND REHABILITATE THE PARKSIDE TERRACE APARTMENTS

RECOMMENDATION

(a) Allow under Section I. C. of the City Council policy 1-16, Policy for the Issuance of Multifamily Housing Revenue Bonds ("Policy"), the California Statewide Communities Development Authority to issue private-activity bonds for the acquisition and rehabilitation of the Parkside Terrace Apartments, a 201-apartment complex located at 463 Wooster Avenue in San José (the "Project").

(b) Hold a Tax Equity and Fiscal Responsibility Act ("TEFRA") public hearing for the issuance of up to $85,000,000 in tax-exempt private-activity bonds by CSCDA to finance the Project.

(c) Adopt a resolution approving the issuance of Tax-Exempt Revenue Bonds by CSCDA in an aggregate principal amount not to exceed $85,000,000 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 CSCDA to issue tax-exempt private activity bonds ("Bonds") to permit the acquisition and rehabilitation of the Parkside Terrace Apartments (formerly known as Hidden Brooks Apartments), an existing apartment property with no City funding providing 200 affordable apartments located at 463 Wooster Avenue, built in 1972. The action will also result in lengthened affordability restrictions on 200 apartments, preserving the supply of affordable housing in San José; the new restrictions will expire in 2074, rather than 2056.

BACKGROUND

The California Statewide Communities Development Authority ("CSCDA") has requested that the City of San José ("City") consent to its issuance of up to $85,000,000 in tax-exempt bonds ("Bonds") for the Parkside Terrace Apartments ("Property"), located at 463 Wooster Avenue 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 Property.

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 the City's permission pursuant to its membership agreement. City staff then determines whether the issuance is allowed under the City's Policy for the Issuance of Multifamily Housing Revenue Bonds ("Policy"). Given that this issuance does not comport with Section I. B of the Policy for conduit issuers, as discussed in the Analysis section, CSCDA has requested that the City Council allow, under Section I.C of the Policy, Special Circumstances, CSCDA to issue the bonds for this Project and for the City to hold a TEFRA public hearing on the forthcoming issuance.

Ownership

Wooster Ave, LLC a Delaware limited liability company, is the current project owner. Community HousingWorks ("CHW"), an existing, California nonprofit public benefit corporation, is the current sponsor and current guarantor to Wooster Ave, LLC.

Property Overview

The Property, formerly known as Hidden Brooks Apartments, were built in 1972, last renovated in 2001, and already offers restricted affordable rents.

The current restricted rents are enforced by CSCDA's bond regulatory agreement from 2001, as amended and restated in 2008. The restrictions will continue as they are now:

- 40 apartments (20%) will offer restricted rents serving tenants with maximum incomes of 50% of the area median income ("AMI"). $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;
- 160 apartments (80%) will offer restricted rents for tenants at or below 60% 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
- One two-bedroom apartment for a resident manager will remain unrestricted.

The Property 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 7-acre lot, the Property also offer a clubhouse, fitness center, a grilling area, a playground, laundry facilities and a computer center for residents' use.

Borrower

The Borrower of the proposed Project, a new partnership (will be formed, Tripp Avenue Housing Associates, LP ("Tripp Ave LP"). Tripp Ave LP is a California Limited Partnership and will be the borrower of bond proceeds for the purpose of purchasing the Project from Wooster Ave, LLC. Tripp Ave LP would then become the new project owner.

Tripp Ave LP, the to be formed, new partnership will consist of Tripp Avenue Community Housing Development, LLC ("Tripp Ave LLC"), a to be formed, general partner, and a limited partner that will be an entity that invests in tax credits. CHW will be the Manager and Sole Member of Tripp Ave LLC.

CHW specializes in developing and operating affordable rental apartments throughout California and has completed more than 3,300 units within 35 projects. Wooster Ave, LLC. purchased the property in 2017 and is now seeking to sell to an affiliate entity in order to recapitalize the Property. Recapitalization involving financial restructuring and improvements being made to a property, is an action on existing low-income housing tax credit properties which is typical and is to be expected at certain periods in properties' lifecycles. As the Property's tax credit compliance period of 15 years has ended, it is allowable under federal IRS rules for the Property 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, CHW requested that CSCDA apply to the California Debt Limit Allocation Committee ("CDLAC") for an allocation of bond allocation for the Apartments. In addition, CHW 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 $9,000,000 in property improvements will be made in conjunction with this transaction. According to CHW, the remainder of the Bond proceeds and tax credit equity will be used to finance the arms-length acquisition of the property by the Borrower, pay for hard and soft transaction costs (including any costs for relocation), 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. Currently, CHW is planning on replacing all countertops and cabinetry in units, replacing the windows, painting the kitchen and baths, installing energy efficiency appliances, and upgrading building systems as necessary. Work is expected to start in October, 2019 and conclude in November, 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 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 Tax Equity and Fiscal Responsibility Act of 1982 ("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 Council's Policy for the Issuance of Multifamily Housing Revenue Bonds ("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, the Section I.B of the Policy allows the City to authorize another conduit bond issuer 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.

This proposed transaction does not meet the requirements of Section I.B of the Policy which describes the ABAG, CSCDA, Other Conduit conditions for approving conduit issuers under the Policy. While the first requirement of Section I.B of the Policy is met, there is no prior, existing, or future City loan or grant on the Property, however the second part regarding multiple concurrent issuances is not met: CHW only has a single bond issuance anticipated to be approved in the forthcoming CDLAC allocation round.

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 where the conditions required under Section I.B were not met. However, under Section I.C., Special Circumstances, the City may approve an alternate issuer when "merited by special circumstances of the Project and the financing".

CHW has two additional bond issuances with CSCDA that were just approved by CDLAC in the last round. As such, CHW is able to achieve significant time and cost savings by utilizing the same finance team for all of these projects. CHW requests that City Council, under the Special Circumstances, section I.C. of the Policy permit CSCDA to issue the bonds for this Project. The special circumstances of the Project and financing that merit this authorization are:

- The Project has a CDLAC and California Tax Credit Allocation Committee "TCAC" funding application deadline of January 18th. Given the short notice provided to the City, the City would be unable to induce the bond in a public hearing prior to the January 18th deadline, potentially resulting in a delay of funding to the project. Additionally, CSCDA is able to achieve cost savings to the borrower, by utilizing the same finance team they are using on multiple projects with CHW.

- The Project has an existing bond regulatory agreement from CSCDA's 2001 bond issuance and as amended and restated in 2008. CSCDA must continue to report to CDLAC for 55 years from the date of issuance, until 2056. 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 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 will be named a third party beneficiary to the regulatory agreement. 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.

Staff recommends approval of the request, by means of the Special Circumstances clause of the Policy, thereby enabling CSCDA to issue the bonds for the Project in time for the California Tax Credit Allocation Committee and Debt Allocation Committee January deadlines, and cost savings garnered from CHW use of CSCDA on multiple bond deals. The Project has an existing CSCDA regulatory bond agreement which requires CSCDA to continue to monitor the project affordability of the Apartments and report to CDLAC until 2056—regardless of whether those original bonds remain outstanding. Under the current CSCDA regulatory agreement, the City is listed as a third-party beneficiary to the regulatory agreement. The City shall have the right (but not the obligation) to enforce, separately or jointly with the Issuer and/or the Trustee or to cause the Issuer or the Trustee to enforce, the terms of the Regulatory Agreement and to pursue an action for specific performance or other available remedy at law or in equity in accordance with Section 27 of the Regulatory Agreement. The Property' rent restrictions will remain unchanged under the original issuance.

The proposed issuance of bonds will result in a new 55-year bond regulatory agreement that will ensure restricted rents for an additional 18 years over the current bond regulatory agreement. By enabling CSCDA to issue bonds, City staff will spend a minimal amount of work but the community will enjoy the positive benefits of longer affordability. Recapitalizations similar to this transaction promotes the City's goals stated in its current Housing Element to extend restrictions for existing affordable properties as a preservation strategy. Therefore, the Finance and Housing Departments jointly recommend the City Council to approve the issuance under Section I.C of the Policy.

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 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.

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 TEFRA hearings 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 notice, the City would be unable to meet CHW's aggressive January 18th application timeline deadlines for the California Debt Allocation Committee and Tax Credit Allocation Committee. The City would be unable to match the pricing offered by CSCDA, as a result of the multiple deals with CHW. With little staff work, the CSCDA issuance will result in an additional 18 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 14, 2018. 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/
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/s/
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For questions, please contact Rachel VanderVeen, Deputy Director, at (408) 535-8231.