COUNCIL AGENDA: 9/15/20
FILE: 20-1050
ITEM: 8.1

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Julia Cooper
Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: September 1, 2020

Approved D. DSyL

Date 9/4/2020

COUNCIL DISTRICT: 7

SUBJECT: HOLD A TAX EQUITY AND FISCAL RESPONSIBILITY ACT ("TEFRA") HEARING AND APPROVE, FOR TEFRA PURPOSES, THE CITY OF SAN JOSE'S ISSUANCE OF UP TO $25,000,000 IN TAX-EXEMPT MULTIFAMILY REVENUE BONDS TO FINANCE AN 152-UNIT MULTIFAMILY RENTAL HOUSING FACILITY FOR THE BENEFIT OF MARKHAM PLAZA II, LP, A CALIFORNIA LIMITED PARTNERSHIP, OR AN ENTITY TO BE CREATED BY CORE AFFORDABLE HOUSING, LLC, FOR THE ACQUISITION AND REHABILITATION OF THE 152-UNIT MARKHAM PLAZA II APARTMENTS LOCATED AT 2010 MONTEREY ROAD, APPROVAL OF A CITY LOAN TERM EXTENSION, REDUCTION IN INTEREST RATE, SUBORDINATION TO A COUNTY OPTION TO PURCHASE THE PROPERTY AND INCREASES IN THE INCOME LIMITS AND RENTS TO 35% OF AREA MEDIAN INCOME FOR UP TO 75 UNITS

RECOMMENDATION

(a) Hold a Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") public hearing for the issuance not to exceed $25,000,000 in tax-exempt private-activity bonds by City to finance the acquisition by Markham Plaza II, L.P (the "Borrower") and rehabilitation of the Markham Plaza II Apartments, formerly Tully Gardens II Apartments, a 152-unit apartment complex located at 2010 Monterey Road in San José (the "Development");

(b) Adopt a resolution approving the issuance of Revenue Bonds by the City in an aggregate principal amount not to exceed $25,000,000 to finance the acquisition and rehabilitation of a 152-unit multifamily rental housing facility for the benefit of Markham Plaza II, LP, a California limited partnership, or an entity to be created by Core Affordable Housing, LLC (or an affiliate), and certain other matters relating thereto; and

(c) Adopt a resolution authorizing:

(1) A change in the existing affordability restriction for Markham Plaza II Apartments (formerly Tully Gardens II Apartments) to allow a change from 151 units affordable to extremely low-income ("ELI") households at up to 30% of Area Median Income ("AMI") and one unrestricted manager's unit to 76 units affordable to ELI households at up to 30% of AMI and 75 units to be restricted affordable to very low-income households ("VLI") for new or over income tenants only at up to 35% of AMI;

(2) An increase to rents and income up to 60% AMI (low-income) for all units in the event of foreclosure or for new tenants in subsidized units in the event of the expiration or involuntary termination of subsidy contracts, provided the City has determined the increase is needed for feasibility of the development and allowed by other funds;

(3) The extension of the existing City's loan term by an additional 17 years; until the 55th anniversary of the closing of the bond financing, and a decrease in the City's loan interest rate from 4.77% fixed, compounded annually to 3% fixed, compounded annually;

(4) The subordination of the City's Deeds of Trust to a County option to purchase the land, provided that the City shall have a right of first refusal to purchase the land; and

(5) The Director of Housing to negotiate and execute any City loan documents, grant documents, amendments, and all other documents related to these actions.

OUTCOME

Approval of the recommended actions will enable the Borrower to apply to the California Debt Allocation Committee ("CDLAC") allocation of $25,000,000 in tax-exempt multifamily housing revenue bonds to finance, to acquire, and rehabilitate the Development to preserve the units and continue serving the extremely low- and very low-income households in San José.

BACKGROUND

On October 31, 2000, the City made a $3,781,000 grant ("Grant") from the Redevelopment Agency's ELI Supplemental funds to subsidize the 151 ELI units. In addition to the Grant, on September 30, 2002 the City made a $2,825,295 HOME loan ("Loan"), together, to fund the acquisition and development of Markham Plaza II Apartments.

Adjacent to the Development is Markham Plaza I, a 152-unit affordable housing development that is under rehabilitation. The rehabilitation and acquisition of Markham Plaza I was funded by City-issued bond financing, a City loan, a City grant and a loan from the County of Santa Clara's Measure A bonds and is currently under construction.

In January 2019, CORE applied to the Housing Department in connection with its proposed resyndication and rehabilitation transaction for the Development.

On June 11, 2020, CORE and the City submitted a joint application to the CDLAC for allocation of $25,000,000 in tax-exempt multifamily housing revenue bonds to finance the acquisition and rehabilitation of the Development. In addition to the CDLAC application, CORE submitted an application to Tax Credit Allocation Committee (“TCAC”) to be considered for low-income housing tax credits for the Development. Awards for both applications are anticipated to be announced by TCAC sometime in September 2020.

Under a commitment letter dated February 20, 2020, the Santa Clara County Office of Supportive Housing (“County”) approved a permanent loan in the amount of $5,900,000 in Measure A funds for as a part of the financial restructure of the Development. The loan is zero percent interest with annual amortizing payments payable in 30 years. The zero-interest feature of the County loan enables the Development to provide cash flow to pay for the much-needed supportive services to existing and future tenants. Additionally, the County (in coordination with the Santa Clara County Housing Authority) will provide a total of 30 tenant-based vouchers restricted to households or individuals formerly homeless or experiencing homelessness and shall be rented to households referred through the County’s Coordinated Entry System or such other equivalent County direct referral program while the Housing Authority of Santa Clara County (“HACSC”) will provide 20 project-based VASH Vouchers under the Housing and Urban Development Veterans Affairs Supportive Housing (HUD-VASH Program). These vouchers will provide additional cash flow to the Development.

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.

The Council meeting date on September 15, 2020 will include the TEFRA Hearing. Under normal circumstances, the Finance Director is authorized under Chapter 5.06 of the Municipal Code to hold TEFRA hearings for City issued multifamily revenue bonds in City Hall in which the public can attend. Due to the COVID-19 crisis, the City decided to close the City Hall doors to the public for the safety of its citizens and employees.

Therefore, the Finance and Housing Departments jointly recommend that the City Council hold the TEFRA hearing and approve of the above request, thereby enabling the TEFRA hearing for the bonds for be held within 30 days of the California Tax Credit Allocation Committee and CDLAC September 16, 2020 allocation award date.

The TEFRA hearing is required to have a 7-day public notice period. In compliance with the notice period, the public hearing notice will be posted on the City's website as part of the September 15 2020 Council meeting agenda and published in the *San José Post Record* no later than September 7, 2020 announcing the time and location of the public hearing.

ANALYSIS

Markham Plaza II Apartments was built and occupied in 2003 and was one of the first developments dedicated to serving only extremely-low income households. Tenants who qualify to live in the Development face challenges typical for the poorest households living within the high-cost Bay Area. An individual living at Markham Plaza II Apartments earns less than $2,329 per month (before taxes) and pays $699 to rent a single-room-efficiency apartment. Many extremely-low income tenants do not have options to move to other apartments when rents increase or life circumstances change. As a result, tenants pay more than 50% of their income on rent in an effort to maintain their housing. The most recent rent roll for Markham Plaza II Apartments indicates that 66 of the 152 tenant households are rent-burdened paying greater than 50% of their incomes in rent, with average incomes of $17,537 per year. Some tenants earn less than $10,000, the lowest annual income reported is $1,232 per year. Tenants living in these income ranges are often left with insufficient income to support all of their basic needs such as food, transportation and clothing.

Over the past few years, the City, County and Housing Authority have worked together to establish a model for funding supportive housing for extremely low-income households. Not only is funding now made available for the construction of new housing, but also for the services necessary to support households with the lowest incomes. The restructuring of the finances for this development will provide increase funding for services for the tenants and for rehabilitation of the existing building. The scope of services for the building rehabilitation includes repairs to the interiors of the apartments; retrofitting apartments to make them accessible to individuals with disabilities; repairs and upgrades to building systems including electrical, mechanical and plumbing; installation of security cameras and exterior repairs and upgrades including paving, sidewalks, landscaping and paint.

The proposed restructuring will allow for the investment of County Measure A funds, while not requiring any additional investment from the City. The City's original investment of over $6.6 million will be preserved by this action and the length of the affordability restriction will be extended.

Changes to the Affordability Limits

Since the opening of the Markham Plaza II Apartments, all of the apartments have been restricted to 30% AMI. These affordability restrictions create housing opportunities for the lowest incomes in our community. However, at the same time, the rents do not produce the revenue necessary to provide the level of services necessary to serve the residents. Staff is requesting an increase of the AMI level for up to half of the apartments in the Development from 30% AMI to 35% AMI. This change would only be allowed for new tenants and over-income tenants so that there is no impact on the current eligible tenants. This requested change in affordability is intended to improve cash flow to pay for enhanced services for the existing tenants and financially stabilize the Development. The Sponsor, CORE Affordable Housing Inc. ("CORE") also plans to seek Veterans Affairs Supportive Housing ("VASH") vouchers for new tenants to bring more revenue into the project and has indicated that those vouchers require the City to allow incomes up to 35% AMI. The Sponsor has indicated that allowing the change in the affordability levels will enable the Sponsor to attract prospective lenders and investors for the resyndication as they may be reluctant to commit with the existing 30% AMI rents. While 50% of the units will be allowed to change to 35% AMI upon turn over, the remaining 50% of the units will stay at 30% AMI to avoid displacing or creating economic hardship for the current residents. The requested action will gradually create more economic diversity in the Development and will provide added flexibility without compromising the program's intent.

Additional Changes to Existing Loan and Grant Documents

The Sponsor has also requested that the City allow an increase to 60% AMI in the event of foreclosure or for units with subsidies in the event of expiration or involuntary termination of subsidy contracts. This is reasonable provided the City has first determined the extent of the increase needed for feasibility of the Development and that any increases are limited to the extent necessary to achieve feasibility.

The City Affordability Restriction which has a current termination date of December 23, 2058 will be extended to 2075 (55 years from the closing of the bond financing). The City Affordability Restriction will be amended to reflect the new termination date and other covenants.

As noted above, the Sponsor applied to CDLAC for a tax-exempt multifamily housing revenue bond allocation and has been successful in securing approval of an allocation of Measure A funding from Santa Clara County for the Development. The City's current Loan and Grant will remain in place, secured as liens on the Property. The City Affordability Restriction will not be subordinated to any senior lender.

Staff has brought these specific requests to Council for consideration because the authorization for affordability changes to more than 10% of the units are not included within the scope of Director's authority for amendments to loan documents that is provided in Chapter 5.06 of the Municipal Code.

Subordination of the City Deeds of Trust to the County of Santa Clara Option to Purchase

The Sponsor has also requested that the City consent to the execution and recording of County's Option to Purchase the land, and to the subordination of the City's Deed of Trust to the County Option to Purchase. As with the previous project, Markham Plaza I, City staff recommends that the City Council authorize this subordination, but since the City provided significant acquisition funding for the project, the subordination is only recommended if the City is granted a right of first refusal to purchase the land prior to the County's exercise of the option.

Changes in City Loan Terms

The City's current loan term is 55 years and will mature on October 1, 2059. The City's current interest rate is 4.77%, fixed, compounded annually. The Sponsor has requested the City to extend the existing term of the loan by an additional 17 years to 55 years from the closing of the bond funding and reduce its interest rate from 4.77% fixed, compounded annually to 3% fixed, compounded annually. The extension of the City loan term and the interest rate reduction are necessary to meet the Internal Revenue Service's ("IRS") true debt test requirements.

Operational Challenges

The property has been experiencing among other things, a need for increased staffing, bouts of trespassing and other petty disturbances that impact operations and residents. To address these issues, the Developer has presented a detailed security plan which will be discussed in a supplemental memorandum. As noted above, the restructuring of the financing allows for an increase in services and security to address the operational challenges.

Prevailing Wage Does Not Apply

As discussed above, no new City funds are being loaned or granted to the Borrower, the City's Prevailing Wage policy will not apply. The County of Santa Clara will require its own Prevailing Wage policy.

CONCLUSION

Staff supports these actions of holding the TEFRA hearing, allowing the City to issue allocation of $25,000,000 in tax-exempt multifamily housing revenue bonds, and amending the existing terms of the City loan. These actions will result in the preservation of 151 affordable apartments through rehabilitation and extension of the City Affordability Restriction by 17 years.

EVALUATION AND FOLLOW-UP

Staff is anticipated to return to City Council in fall 2020 after the Development receives its bond allocation from CDLAC for further City action authorizing the issuance of bonds.

The Housing Department produces a quarterly Information Memorandum regarding the use of the Director of Housing's Delegation of Authority under the Municipal Code. Final amended Loan and Grant business terms would be summarized in those memos. In addition, the Housing Department posts a Quarterly Production report on the status of its affordable properties undergoing rehabilitation or construction to its website, www.sjhousing.org. If the recommended actions are approved and Markham Plaza II Apartments successfully closes financing, it would be included in the production report.

CLIMATE SMART SAN JOSE

The recommendation in this memo has no effect on Climate Smart San José energy, water, or mobility goals.

POLICY ALTERNATIVES

To arrive at this proposal, Housing Department staff considered the following option:

Alternative:	***The City Council could deny the Housing Department's recommendation to modify the Development's AMI levels***
Pros:	100% of the Development's units would be income-restricted to ELI households for the term of the Affordability Restrictions.
Cons:	The City will lose an opportunity to provide long-term services to the tenants.
Reason for not recommending:	The proposed action will help to meet the continuing demand for deep affordable housing that is affordable to the lowest income households.

PUBLIC OUTREACH

The public will be notified of the proposed financing structure of the Markham Plaza II Apartments consistent with the City's standard public outreach requirements for the issuance of tax-exempt private activity Bonds in the form of a Tax Equity and Fiscal Responsibility Act (TEFRA) Hearing. The public hearing notice for the September 15, 2020 will be published in the *San Jose Post - Record* on or before September 7, 2020.

This memorandum will be posted on the City's Council Agenda website for the September 15, 2020 Council Meeting.

COORDINATION

Preparation of this report was coordinated with the Office of the City Attorney 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.

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 Jose's affordable housing stock."

CEQA

Not a Project, PP17-003, Agreements/Contracts (New or Amended) resulting in no physical changes to the environment.

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

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

Attachment

ATTACHMENT

Site Location