COUNCIL AGENDA: 04/27/21
FILE: 21-884
ITEM: 3.6

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: April 13, 2021

Approved D. DSyL   Date 04/15/21

COUNCIL DISTRICT: 7

SUBJECT: APPROVAL OF THE ISSUANCE OF TAX-EXEMPT MULTIFAMILY HOUSING REVENUE BONDS AND THE LOAN OF THE PROCEEDS THEREOF AND APPROVAL OF RELATED DOCUMENTS AND CHANGES TO EXISTING LOAN AND GRANT TERMS FOR THE MARKHAM PLAZA II DEVELOPMENT

RECOMMENDATION

1. Adopt a resolution:

   a. Authorizing the issuance of (a) tax-exempt multifamily housing revenue bonds designated as “City of San José Multifamily Housing Revenue Bonds (Markham Plaza II), Series 2021C-1” (the “Series 2021C-1 Bonds”) and “City of San José Multifamily Housing Revenue Bonds (Markham Plaza II), Subordinate Series 2021C-2” (the “Series 2021C-2 Bonds” and with the “Series 2021C-1 Bonds, the “2021C Bonds”) in an aggregate principal amount not to exceed $25,000,000;

   b. Approving the loan of the proceeds of the Series 2021C Bonds to Markham Plaza II, LP, a California limited partnership created by Core Development, Inc., a California corporation, to finance the acquisition and rehabilitation of a 152-unit multifamily development known as the Markham Plaza II apartments (formerly known as Tully Gardens II) located at 2010 Monterey Road, in San José (the “Development”);

   c. Approving in substantially final form the Indenture of Trust, the Subordinate Indenture of Trust, the Loan Agreement, the Subordinate Loan Agreement and the Regulatory Agreement and Declaration of Restrictive Covenants (the “Series 2021C Bond Documents”);

d. Authorizing and directing the City Manager, Director of Housing, Director of Finance, the Assistant Director of Finance, the Deputy Director of Finance, Debt & Treasury Management, or their designees, to execute and deliver the Series 2021C Bond Documents together with any documents ancillary to the Series 2021C Bond Documents; and

2. Adopt a resolution approving changes in terms for the City's outstanding $5,491,858.38 loan and outstanding $3,781,000 grant for the Development, approving a loan-to-value ratio in excess of 100% and authorizing the Director of Housing to negotiate and execute documents and amendments related to those changes.

OUTCOME

Approval of the recommended actions will enable the issuance of multifamily housing revenue bonds for the purpose of financing a portion of the costs to acquire and rehabilitate the Development, an existing 152-unit affordable rental apartment project, with 151 apartments restricted to very low and extremely low-income households and remaining affordable for a period of at least 55 years. Approval of the recommended actions will also enable the City to re-cast its existing loan on the Development with new terms, including a loan rate that will be lower than the existing 4.77%, an extended loan term and a loan-to-value ratio that exceeds one hundred percent.

The Development will serve residents with current maximum annual incomes between 30% and 35% of the area median income.

EXECUTIVE SUMMARY

In accordance with the City's Policy for Issuance of Multifamily Housing Revenue Bonds, Core Affordable Housing, a California corporation (the "Developer") and an affiliate of Core Development, Inc. (the "Project Sponsor"), has requested that the City issue tax-exempt multifamily housing revenue bonds in two series. The Series 2021C-1 Bonds will be purchased by U.S. Bank National Association ("US Bank"); the Series 2021C-2 Bonds will be purchased by Tully Gardens Phase II, L.P., the current owner of the Development, in the form of tax-exempt seller carry back financing. Tully Gardens Phase II, L.P. is a California limited partnership created by the Project Sponsor (the "Seller").

The proceeds of the 2021C Bonds will be loaned to Markham Plaza II, LP, a California limited partnership (the "Borrower") formed by the Project Sponsor. These proceeds, together with other funds, will be used by the Borrower to finance the acquisition and rehabilitation of the Development.
These actions are intended to ensure the Development's long-term physical and economic viability and to preserve an affordable housing resource for the City.

The 2021C Bonds will not be paid from or secured by the general taxing power of the City or any other City asset.

BACKGROUND

Borrower. The Borrower will be a California limited partnership consisting of the following entities:

(1) **Administrative General Partner**: CORE Markham II, LLC, a California limited liability corporation, the sole member of which is Core Affordable Housing, LLC, an affiliate of the Project Sponsor.
(2) **Managing General Partner**: EAH Markham II, LLC, a California limited liability corporation, the sole member of which is EAH Housing, a California nonprofit public benefit corporation.
(3) **Limited Partner**: Core Affordable Housing, LLC, a California limited liability company, to be replaced by an entity to be formed by Enterprise Housing Credit Investments, LLC.

The Developer has requested that the City issue the Series 2021C Bonds for the purpose of lending the proceeds thereof to the Borrower. The proceeds of the Series 2021C Bonds, 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 149 studios and 3 two-bedroom rental apartments. Currently, the unit mix pursuant to the City's affordability restrictions is as follows:

Markham Plaza II	**Apartments**	**30% AMI***	**Unrestricted Manager's Unit**
Studio/1 Bath	149	149	0
2 Bedroom/1 Bath	3	2	1
Total Apartments	**152**	**151**	**1**

*Area median income

Upon completion of the rehabilitation of the Development, the previously approved unit mix pursuant to the amended City's affordability restrictions will be as follows:

Markham Plaza II	**Apartments**	**30% AMI***	**35% AMI***	**Unrestricted Manager's Unit**
Studio/1 Bath	149	75	74	0
2 Bedroom/1 Bath	3	1	1	1
Total Apartments	**152**	**76**	**75**	**1**

*Area median income

The increase in the allowed incomes will raise additional revenue for the financial viability of the Development and support resident services. The City's affordability restrictions for the Development will remain for a period of 55 years from the closing of the bond financing.

The Development, originally constructed in 2004, is currently owned by Tully Gardens Phase II, L.P. The Development consists of one four-story residential building with a wood frame structure, slab on grade foundation, and stucco exterior. The overall building size totals 64,444 square feet of living and community space. Site amenities include community areas, laundry, gated access, security, recreational area, a pool, fitness center, and computer room. There is an adjacent 3-story above-grade concrete parking garage. The Development represents the second phase of a two-phase development. The first phase, known as Markham Plaza I, was constructed by an affiliate of the Project Sponsor in 2003 and is located next to the Development.

The Development is subject to low-income housing tax credit ("LIHTC") restrictions. 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 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 Santa Clara County Housing Authority ("HACSC") will provide 20 project-based VASH Vouchers under the Housing and Urban Development Veterans Affairs Supportive Housing Program (HUD-VASH Program). These vouchers will provide additional cash flow to the Development. This will result in a minimum of 50 apartments which will be set-aside for special needs, homeless or veterans housing.

Following the rehabilitation of the Development, all the apartments will remain LIHTC-restricted.

Scope of Work. The current scope of Development rehabilitation will address health and safety issues, ADA, deferred maintenance, and energy efficiencies. The scope encompasses improvements/repairs to the building's exterior, interior, individual units, and the site. Building exterior renovations will include wood siding and stucco repair, new roof, repairs to stairs and landings, wall insulation replacement, and fresh paint. Interior renovations will include elevator improvements, new plumbing fixtures, HVAC system repairs, and upgrades to the fire suppression system. Individual units will be updated with new Energy Star appliances (refrigerator, range, exhaust hood), kitchen and bathroom countertops, and cabinets, doors, lighting, flooring, window blinds, smoke detectors, and fresh paint. Site renovations will include concrete repairs, asphalt repaving and parking lot re-striping, new fencing and gates, new signs and mailboxes, lighting, and upgrades to drainage and landscaping. Thirteen apartments will be remodeled for ADA compliance. ***The rehabilitation work is estimated to take approximately 18 months.***

Temporary Relocation of Tenants. According to the Borrower's relocation plan, the rehabilitation of the Development will involve temporary relocation of existing tenants, with no households expected to be relocated permanently. Each apartment will be rehabilitated. Apartments will be vacated for approximately five to six weeks during the rehabilitation process. The Borrower has identified available units at Extended Stay America locations in San José, and expects to require eight to nine units per phase. Tenants have received advisory services and will be provided advance notice as required by state relocation law. The Borrower has budgeted $1,660,000 for temporary relocation, which is expected to occur in as few as 14 phases.

City Loan and Grant for the Project. The City has an existing loan to the Development with an outstanding balance as of March 21, 2021 in the amount of $5,526,594.59, consisting of $2,766,794.19 in principal from the HOME Investment Partnership Program implemented by the Department of Housing Urban Development ("HOME") and $2,759,800.40 in accrued unpaid interest. The interest on the City loan will be capitalized, and the accrued interest and outstanding principal will be re-cast into a new City loan (the "City Loan") to be assumed by the Borrower. The outstanding City loan was accompanied by 55 Year Affordability Restrictions and Rider (the "City's Affordability Restrictions").

In addition to the City Loan, the City made a conditional grant of $3,781,000 in tax increment funds for the original purchase and pre-development costs to enable the use of the Development for extremely low-income units: $2,444,309 was disbursed to the current owner of the Development for the purchase of the site and $1,336,691 was disbursed to Emergency Housing Consortium (now "Home First"). The obligations under the grant are secured by a conditional grant deed of trust in favor of the City and recorded against the property. The grant agreement and grant deed of trust will be amended and restated as part of this transaction.

TEFRA Meeting. September 15, 2020[1] City Council Meeting – A Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") public hearing was held for the issuance, not to exceed $25,000,000, of tax-exempt private-activity bonds by the City to finance the acquisition 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.

Key summary points from that meeting include:

- 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;
  An increase to rents and income up to 60% AMI (low-income) for all units in the event of foreclosure or for 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;
- 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;
- 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;

Tax Credit Equity Update. The Markham II project was awarded a Bond Allocation from the California Debt Limit Allocation Committee (CDLAC) of $25,000,000 on December 9, 2020 and on December 27, 2020, a massive Stimulus package for coronavirus aid of nearly $900 billion was signed by the President. Due to the Stimulus Act being passed in December of 2020, the Development was able to generate increased funding from its tax credit equity by $4,100,000. The Stimulus Act included a provision that allows the Low Income Housing Tax Credit (LIHTC) rate on bond deals to be set at 4% permanently. Prior to the change, this rate was previously subject to fluctuation on a monthly basis at approximately 3.07%.

On April 9, 2021, the California Debt Allocation Committee ("CDLAC") and the California Tax Credit Allocation Committee ("TCAC") approved the Borrower's request to modify CDLAC's original approval resolution to reflect the additional $4,100,000 in tax credit equity funding for this Development. It is anticipated that the Director of Housing

[1] https://www.sanjoseca.gov/home/showpublisheddocument?id=63759

under her Delegation of Authority can add more terms in addition to the existing negotiated terms of the City Loan.

The additional $4,100,000 of tax equity funds will be spent to reduce the County Loan by $2,100,000, from $5,000,000 to $3,800,000, fund a negative cash flow reserve in the amount of $500,000 during the lease-up period, and fund a tenant services and security reserve in the amount of $1,500,000 to provide 24/7 security services and fund additional tenant services as necessary to benefit the residents. Additionally, the Borrower is allocating $100,000 a year from project operations to provide one full time security personnel. As described in the attached September 15, 2021 [2]Staff Supplemental Memo from Council Member Esparza, the Borrower will include a security plan to ensure onsite security resources 24 hours, 7 days a week.

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 or refinancing of affordable rental housing projects for which it has provided, or will be providing, a loan.

Prevailing Wages. On February 7, 1989 and October 10, 1989 adopted Resolutions No. 61144 and 61716, requiring the payment of prevailing wages to privately-owned housing projects receiving acquisition financing, construction financing or commitment of such financing by the City's Department of Housing, except projects (a) with fewer than eight (8) dwelling units and (b) the portion of projects involving non-contracted volunteer or self-help construction. In 2005, the Council adopted Resolution No. 72518 which extended those requirements to privately-owned projects receiving City permanent funding or commitment of such financing.

When no additional City money is disbursed to a project and all City construction funds have already been spent, payment of prevailing wages is not required for rehabilitation projects. In addition, City prevailing wage requirements have not been applied to projects on which the permanent loan was extended for a new 55-year period, which is the equivalent of making a new permanent loan.

Sources of Development Funding. The Series 2021C Bonds will fund a portion of the total Development costs, which are currently estimated to be $49,616,033. During the acquisition and rehabilitation period, the Series 2021C Bonds will be outstanding in an estimated aggregate amount of $25,000,000, consisting of an estimated $19,000,000 for the Series 2021 C-1 Bonds and an estimated $6,000,000 par for the Series 2021C-2 Bonds. Following the rehabilitation of the Development and its lease-up ("at permanent"), Series 2021C-1 Bonds will be repaid in full and only the Series 2021C-2 Bonds will remain

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[2] http://sanjose.legistar.com/gateway.aspx?M=F&ID=79b35c1a-97c1-4625-be35-11515ca9ff34.pdf

outstanding. The Series 2021C-1 Bonds will be variable rate and purchased/funded by US Bank; the Series 2021C-2 Bonds will be a fixed rate, residual receipts obligation purchased by the Seller of the Development. The Series 2021C-1 Bonds are anticipated to be repaid at permanent from low-income housing tax credits and the proceeds of a $5,900,000 loan from the County of Santa Clara under its 2016 Measure A Affordable Housing Bond program.

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

City of San José
Markham Plaza II
Plan of Finance – Sources of Funding[3]

Source	Acquisition-Rehabilitation	Permanent
Series 2021C-1 Bonds	$ 19,000,000	$ 0
Series 2021C-2 Bonds	6,000,000	6,000,000
Seller Note	13,818,967	13,818,967
City of San Jose	5,491,858	5,491,858
County of Santa Clara Loan	0	5,900,000
Home First Re-Cast Loan	1,668,520	1,668,520
Tax Credit Equity	2,051,751	15,929,495
Purchased Reserves	0	806,993
General Partner Equity	200	200
Total	$ 48,031,296	$ 49,616,033

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

- May 1, 2020 - the Director of Finance and the Director of Housing declared the City's intent to issue up to $25,000,000 in tax-exempt bonds for the Markham Phase II.
- June 11, 2020 - The City submitted an initial joint application to CDLAC and CTCAC for a private activity allocation in the amount of $25,000,000 (CDLAC) and $2,015,782 in annual 4% Federal tax credits (CTCAC).
- September 15, 2020 - The City Council held a TEFRA hearing and approved the issuance of tax-exempt multifamily housing revenue bonds in an amount not to exceed $25,000,000 to finance the acquisition and rehabilitation of the Development.
- December 9, 2020 - The City received a private activity bond allocation from CDLAC and a reservation of 4% Federal tax credits in the requested amounts.

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

ANALYSIS

Markham Plaza II Apartments was built and occupied in 2004 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 lowest income households living within the high-cost Bay Area. A one-person household living at Markham Plaza II Apartments earns less than $2,329 per month (before taxes) and pays $699 to rent an 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 55 of the 152 tenant households are rent-burdened paying greater than 50% of their incomes in rent, with average incomes of $12,224 per year. Some tenants earn less than $10,000, the lowest annual income reported is $7,316 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 SCCHA have worked together to establish a model for creating permanent supportive housing to permanently house the formerly homeless population. This model not only provides funding for the construction of new housing, but also for the resident services necessary to support households with the lowest incomes. Markham Plaza II will have 30 apartments dedicated to chronically homeless individuals referred to by the County's Office of Supportive Housing and 20 apartments for homeless veterans referred to by the Veterans Affairs office. Proposed resident services will include County services such as case management, health care, behavioral health, and streamlined benefit access. Additionally, the onsite property management will increase the current staffing by 2.5 additional positions to oversee program activities for residents, interface with public agencies, community volunteer groups, and provider agencies. The service coordinators will also collaborate with County case managers and assist residents with individualized needs and provide referrals. Furthermore, the Developer has presented a detailed security plan that includes increasing site lighting to eliminate all low visibility areas, 24-hour security officer presence on-site seven days a week and adding, adding 18 new live cameras in addition to the existing 122 cameras and live camera monitoring to assist the on-site security officer. The restructuring of the finances for this development will provide 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; and exterior repairs and upgrades including paving, sidewalks, landscaping, and paint.

The proposed restructuring will allow for the investment of Measure A funds, while not requiring any additional investment from the City. The City's original investment of over

$7.6 million will be preserved by this action and the length of the affordability restriction will be extended.

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.

Bond Financing Structure

Overview of the Multifamily Housing Revenue Bond Financing

General. Multifamily housing revenue bond financing typically involves the issuance of tax-exempt bonds on behalf of private developers of qualifying affordable rental apartment projects. The City issues tax-exempt bonds and loans bond proceeds to the developer/borrower. The advantages of tax-exempt financing to developers include: lower interest cost than for taxable financing and access to 4% federal low-income housing tax credits – features that are not available with a conventional multifamily housing mortgage loan.

Multifamily housing revenue bonds are limited obligations of the City, payable solely from loan repayments by the borrower from the affordable rental project and related sources. Such bonds are not secured by the general taxing power of the City or any other asset of the City.

Requirements for Tax-Exemption. For a private activity multifamily housing revenue bond to qualify for tax-exemption, federal law requires, among other matters, that one of two restrictions 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. While this second restriction will be incorporated into the Regulatory Agreement for the 2021C Bonds, the Development will also be subject to additional restrictions.

Public Disclosure Report Relating to Conduit Revenue Obligations

The Borrower, through its financial consultant Veloce Partners, has prepared a public disclosures report pursuant to California Government Code Section 5852.1, providing good faith estimates of certain costs associated with the issuance of the Note. ***See attachment B for Public Disclosure Report.***

Structure of the Series 2021C Bonds

As noted the Series 2021C Bonds will be issued in two series: Series 2021C-1 Bonds and Series 2021C-2 Bonds.

The Series 2021C-1 Bonds

Direct Purchase/Funding Structure. The Series 2021C-1 Bonds will be structured as non-rated and non-credit-enhanced obligations that are directly purchased by US Bank. Pursuant to the City's policies regarding non-credit-enhanced bonds, US Bank will sign an Investor Letter acknowledging that it is a "qualified institutional buyer" or "accredited investor" that is, a sophisticated investor, as required under the City's Policy for the Issuance of Multifamily Housing Revenue Bonds, who understands and accepts the risks associated with unrated bonds secured solely by the Development rents. If US Bank wishes to transfer the Series 2021C-1 Bonds, the new holder must sign and deliver a similar Investor Letter to the Trustee. The Series 2021C-1 Bonds may only be transferred in whole.

Principal Amounts and Terms. Based on current projections, the estimated par of the Series 2021C-1 Bonds is $19,000,000 but in no event shall the aggregate amount of the Series 2021C-1 Bonds and Series 2021C-2 Bonds exceed $25,000,000. After the Development is rehabilitated and leased up, and conversion to the permanent loan phase occurs (the "Conversion Date"), the Series 2021C-1 Bonds are expected to be repaid in full with tax credit equity funds and County loan proceeds. The Conversion Date is anticipated to occur between 18-24 months after Bond closing.

The stated maturity of the Series 2021C-1 Bonds is expected to be approximately three years.

Interest Rates. During construction, the interest rate on the 2021 Note will be variable and based on one-month LIBOR[4] plus a spread, subject to mandatory redemption 21 months after closing with the option of a 6-month extension. It is expected that bank documents will include acceptable LIBOR succession language.

[4] Acronym for "London Interbank Offered Rate," which represents the average rate at which a leading bank can obtain unsecured funding in the London interbank market. LIBOR serves as a benchmark for various interest rates. Obligations of parties to such transactions are typically expressed as a spread to LIBOR. Most LIBOR settings are expected to end in 2023 as the world financial markets transition to other rate indices.

<u>The Series 2021C-2 Bonds</u>

<u>Direct Purchase/Funding Structure.</u> The Series 2021C-2 Bonds will be structured as non-rated and non-credit-enhanced obligations that are directly purchased by the Seller. The Series 2021C-2 Bonds will be repaid from a portion of the Borrower's share of the Development's residual cash flow after repayment of the County Loan. The Series 2021C-2 Bonds will be subject to an Investor Letter requirement and similar transfer restrictions applicable to the Series 2021C-1 Bonds.

<u>Principal Amounts and Terms.</u> Based on current projections, the estimated par of the Series 2021C-2 Bonds is $6,000,000 but in no event shall the aggregate amount of the Series 2021C-1 Bonds and Series 2021C-2 Bonds exceed $25,000,000.

The stated maturity of the Series 2021C-2 Bonds will not exceed 45 years, as required under State law.

<u>Interest Rates.</u> The interest rate on the Series 2021C-2 Bonds will be fixed at a rate equal to the Applicable Federal Rate, which is reset monthly. The Applicable Federal Rate for April 2021 is 1.98%.

Financing Documents

The City Council is being asked to approve and authorize the execution of the following documents described below. Copies of these documents will be available in the City Clerk's Office on or about April 16, 2021.

<u>Indentures.</u> There will be two Indentures of Trust for the Series 2021C Bonds, each between the City and U.S. Bank, National Association as trustee (the "Trustee"): The Series 2021C-1 Bonds will be issued under an Indenture of Trust (the "Senior Indenture") and the Series 2021C-2 Bonds will be issued under a Subordinate Indenture of Trust (the "Subordinate Indenture" and with the Senior Indenture, the "Indentures"). The Senior and Subordinate Indentures will be executed by the Director of Finance, or another authorized officer, on behalf of the City. Pursuant to the Indentures, the Trustee is authorized to receive, hold, invest, and disburse the Series 2021C Bond proceeds and other funds established under the respective Indentures; to authenticate the Series 2021C Bonds; to apply and disburse payments to the Bondholders; and to pursue remedies on behalf of the Bondholders. The Indentures 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 the Series 2021C Bonds. The Loan Agreements (described below) obligate the Borrower to compensate the Trustee for services rendered under the Indentures.

<u>Loan Agreements.</u> There will be two Loan Agreements between the City and Borrower (the "Loan Agreements"): one with respect to the Series 2021C-1 Bonds (the "Senior

Loan Agreement") and the other with respect to the Series 2021C-2 Bonds (the "Subordinate Loan Agreement" and, with the Senior Loan Agreement, the "Loan Agreements"). 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 2021C-1 Bond and Series 2021C-2 Bond proceeds to the Borrower for the acquisition and rehabilitation of the Development, and for the repayment of such loans by the Borrower. The loan of Bond proceeds will be evidenced by separate notes that correspond to the par of Series 2021C-1 Bonds and the Series 2021C-2 Bonds (the "Notes"). The City's rights to receive payments under the Notes will be assigned to the Trustee, along with certain other rights under 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 Trustee, 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 and Chapter 7 of Part 5 of Division 31 of the California Health and Safety Code. 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 and very low-income residents for a period of at least 55 years.

Financing Team Participants

The financing team participants for the 2021C Bonds consist of:

- **City's Municipal Advisor**: CSG Advisors
- **Bond Counsel**: Jones Hall, A Professional Law Corporation
- **Trustee**: U.S. Bank National Association
- **Series 2021C-1 Bond Purchaser**: U.S. Bank National Association
- **Series 2021C-2 Bonds Purchaser**: Tully Gardens Phase II, L.P.

All costs associated with the Municipal Advisor, Bond Counsel and Trustee are contingent upon the sale of the 2021C Bonds and will be paid from Bond proceeds, tax credit equity and/or Borrower funds.

Financing Schedule

The proposed financing schedule is as follows:

- Council Approval of 2021C Bonds/Bond Documents — April 27, 2021
- Pre-Close 2021C Bonds — Week of May 3, 2021
- Close 2021C Bonds — Week of May 3, 2021

- CDLAC Deadline for 2021C Bond Closing June 9, 2021

Variances from the August 2018 City adopted Underwriting Guidelines

- **Project Cost Savings**: Under the August 2018 City-adopted Underwriting Guidelines, project cost savings, if any are used to reduce the balance of the City loan. The County is funding 100% of the project's costs and the permanent loan. Because of the County's commitment to invest in the Development such as, among other things, providing a zero interest permanent loan and supportive housing services to special needs tenants, the City staff has agreed to allow the County to receive any project cost savings. The County will then split the Project Cost Savings 50/50 with the Developer to pay for a portion of its developer fee not to exceed $500,000 while the County's share will reduce its permanent loan. The reduction in the County loan amount will reduce the debt that the City loan will be subordinate to.

- **Developer Fee**: Under the August 2018 City-adopted Underwriting Guidelines, the City allows up to a maximum amount of $2,500,000 developer fee on rehab or acquisition and resyndication transactions, which mirrors Tax Credit Allocation Committee regulations of projects up to 100 units. Any amount over $2,500,000 for additional units is subject to the City's approval. Deferred developer fee shall be paid from the developer's share of the net cash flow. The Borrower is receiving a developer fee in the amount of $3,000,000 and shall be payable as follows: (a) $2.5 million during construction and (b) up to $500,000 from Project Cost Savings shared by the County with the Developer. Any unpaid Developer Fee shall be deferred at permanent phase and shall be paid from Borrower's share of the net cash flow. City staff recognizes that the Development consists of 151 extremely low income restricted units, therefore staff determined that the $3,000,000 developer fee is reasonable.

- **Loan-to-Value:** An appraisal prepared by James G. Palmer Appraisals, Inc. on October 1, 2019 valued the Property at $27,000,000. The total debt on the Property, including the City Loan, will result in a combined loan-to-value ratio ("LTV") that significantly exceeds 100%, which is the City's LTV policy threshold. The 100% LTV policy was intended to reduce the City's risk of loss associated with its loans; however, the deep affordability of the development increases the need for public subsidies, while decreasing the project's market value, leading to an increased LTV. An elevated LTV is not uncommon for public lenders in the affordable housing industry. Projects that have a high LTV are considered acceptable by City staff, as the Property's projected operating income is expected to be at least 1.15 times the permanent mortgage debt service payments. This standard is a common standard for assessing the financial feasibility of affordable housing developments.

The proposed 4% tax credit re-syndication with multi-family housing revenue bonds will pay off the existing $995,000 bridge loan provided by the Silicon Valley Housing Trust, fund the rehabilitation/construction, improve cash flow in order to increase resident services to the existing tenants and financially stabilize the Property. The benefit to the City is the renovation of the Property without providing additional City funds, increasing resident services, and further extending the use of the Property with continued affordability for 55 years.

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.

- Annual Fee, except for nonprofit borrowers, is an amount equal to 0.125% of the par issued through the term of the regulatory period.

Based on an aggregate Bond par of $25,000,000, the City's Policy would require an issuance fee projected to be a maximum of $87,500 and an annual monitoring fee of $31,250.

The Borrower is obligated to pay the City's annual fee throughout the 55-year Regulatory Agreement term; if the Series 2021C 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.

EVALUATION AND FOLLOW-UP

This Memorandum presents the set of recommendations related to the City Council's approval of the issuance of the 2021C Bonds and requires no follow-up to the City Council. Once the 2021C Bonds close, anticipated in May 2021, and the acquisition and rehabilitation of the Development commences, the Housing Department will provide updates in its periodic reports posted at www.sjhousing.org under "Reports & Data."

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/INTEREST

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 September 15, 2020 before the City Council. The public hearing notice for this hearing was published in the *San José Post - Record* on September 4, 2020. There were no public comments made at the TEFRA hearing.

This Memorandum and the Bond Documents will be posted on the City's website for the April 27, 2021 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

The Borrower will pay all issuance costs from proceeds of 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.

The City is expected to receive a maximum of $87,500 as a one-time revenue from the issuance fee and an annual monitoring fee of $31,250. All issuance costs will be paid from proceeds of the Series 2021C Bonds, tax credit equity and/or Borrower funds. The outstanding City loan of $5.5 million on the property will be assumed by the Borrower, with repayments to the Low and Moderate Income Housing Asset Fund as with the current terms of the loan. The conditional grant of $3.78 million will start a new affordability period of 55 years, and would require repayment to the City in the event the 55-year affordability restrictions are not met.

There will be no additional investment made by the City in this transaction.

CEQA

Categorically Exempt, File No. ER21-023, CEQA Guidelines Section 15301, Existing Facilities.

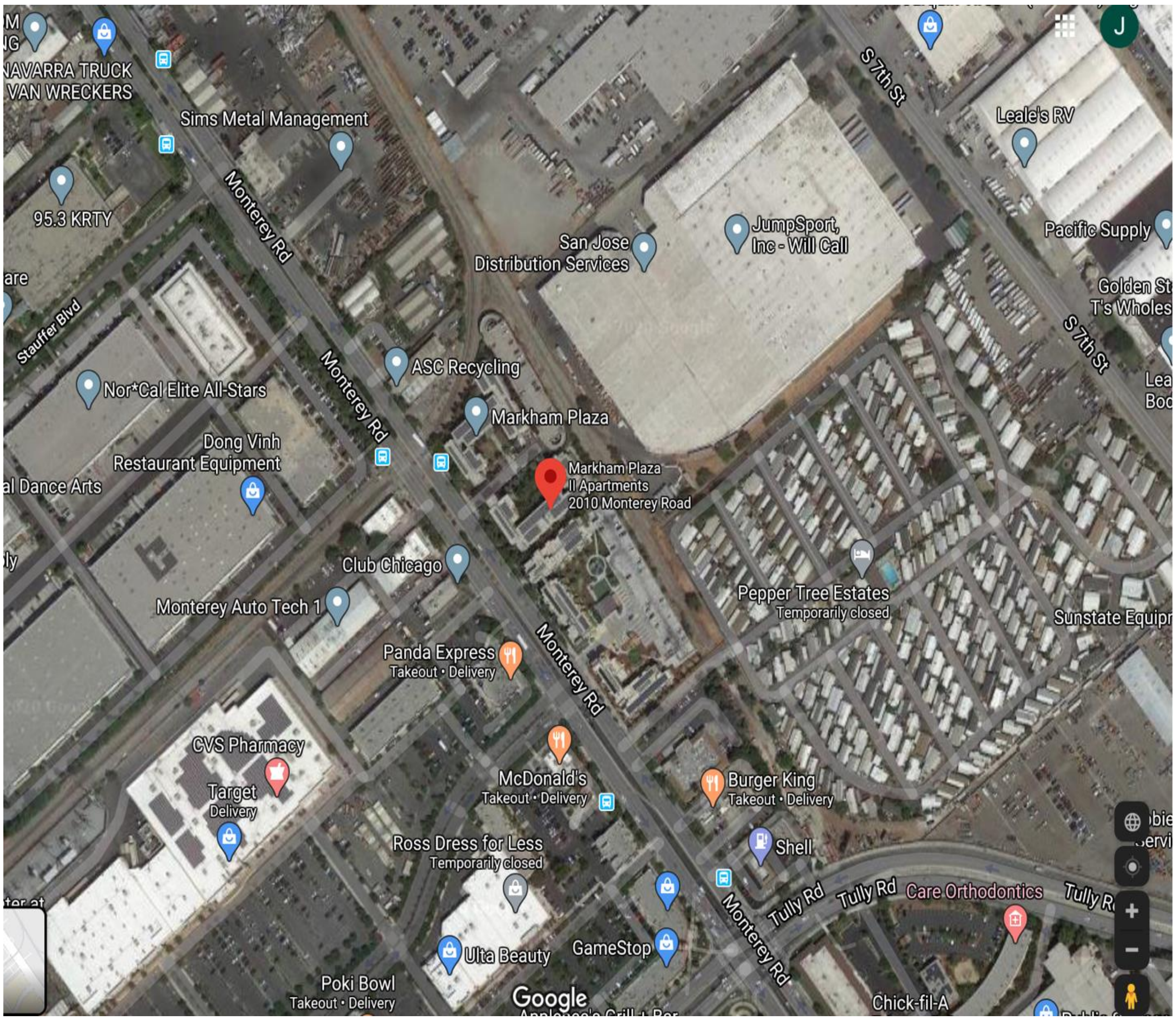
/s/	*/s/*
JULIA H. COOPER	JACKY MORALES-FERRAND
Director of Finance	Director of Housing

For questions, please contact Nikolai Sklaroff, Deputy Director of Finance, Debt & Treasury Management at (408) 535-7832 or Rachel VanderVeen, Deputy Director of the Housing Department at (408) 535-8231.

Attachment A: Location Map
Attachment B: Public Disclosure Report

ATTACHMENT A – LOCATION MAP

2010 Monterey Road San Jose, CA



ATTACHMENT B – PUBLIC DISCLOSURE REPORT

Markham Plaza II Apartments

PUBLIC DISCLOSURES RELATING TO CONDUIT REVENUE OBLIGATIONS

Pursuant to California Government Code Section 5852.1, the borrower (the "Borrower") identified below has provided the following required information to the City of San José (the "City") prior to the City's regular meeting (the "Meeting") of its City Council (the "City Council") at which Meeting the City Council will consider the authorization of conduit revenue bonds as identified below.

1. Name of Borrower: **Markham Plaza II, LP, a California limited partnership**.

2. City Council Meeting Date: **April 27, 2021**.

3. Name of Bond Issue / Conduit Revenue Obligations: **City of San José Multifamily Housing Revenue Bonds (Markham Plaza II Apartments) Series 2021C-1 (the "2021C-1 Bonds") and Multifamily Housing Revenue Bonds (Markham Plaza II Apartments) Subordinate Series 2021C-2 (the "2021C-2 Bonds" and with the 2021C-1 Bonds, the "Bonds").**

4. __Private Placement Lender or Bond Purchaser, __Underwriter or **_X_**Financial Advisor (mark one) engaged by the Borrower from which the Borrower obtained the following required good faith estimates relating to the Bonds:

   (A) The true interest cost of the Bonds, which means the rate necessary to discount the amounts payable on the respective principal and interest payment dates to the purchase price received for the new issue of the Bonds (to the nearest ten-thousandth of one percent): **(a) for the 2019C-1 Bonds: 4.00% (estimated as of 3/30/21 – interest rate is variable) and (b) for the 2021C-2 Bonds: 1.98% (as of 4/1/21 – rate to be known in the month of closing.**

   (B) The estimated finance charges of the Bonds, which mean the sum of all fees and charges paid to third parties: collectively, **$1,991,250 ($272,500 paid at closing per the costs of issuance budget, $62,500 paid during the term of the Bonds and $1,656,250 paid from Bonds maturity through the end of the 55-year compliance period in the Regulatory Agreement)**.

(C) The amount of proceeds received, or deemed received, by the public body for sale of the Bonds less the finance charges of such Bonds described in subparagraph (B) and any reserves or capitalized interest paid or funded with proceeds of such Bonds: an estimated **$17,008,750 from the 2021C-1 Bonds (subject to change based on final underwriting) and an estimated $6,000,000 from the 2021C-2 Bonds. (All finance and interest charges funded from a source other than the proceeds of the Bonds).**

(D) The total payment amount, which means the sum total of all payments the Borrower will make to pay debt service on the Bonds plus the finance charges of the Bonds described in subparagraph (B) not paid with the proceeds of such Bonds (which total payment amount shall be calculated to the final maturity of such Bonds): **$30,041,376 (consisting of: (a) estimated principal of $19,000,000 and interest payments of $497,687 with respect to the 2021C-1 Bonds, (b) estimated principal of $6,000,000 and interest payments of $4,543,689 with respect to the 2021C-2 Bonds, and (c) estimated finance charges identified in (B)**.

This document has been made available to the public at the Meeting of the City Council.
Dated: April 27, 2021.