CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: December 11, 2017

Approved D.DSyL Date 12/11/17

COUNCIL DISTRICT: 6

SUBJECT: LEIGH AVENUE SENIOR APARTMENTS

RECOMMENDATION

Adopt a resolution:

1. Authorizing an exception to the City's Policy for the issuance of Multifamily Housing Revenue Bonds for the Leigh Avenue Senior Apartments project, thereby allowing issuance by the California Housing Finance Agency; and
2. Authorizing the Director of Housing to negotiate and execute such documents, and to take the other necessary actions to facilitate First Community Housing's participation in a limited-time opportunity to obtain tax credit financing for the Leigh Avenue Senior Apartments project.

OUTCOME

Approval of these actions will allow California Housing Finance Agency ("CalHFA") to issue bonds for the Leigh Avenue Seniors development. This will eliminate the risk of the project being unable to secure private activity housing bonds and 4% tax credit financing, caused by the potential elimination of the program as contained in the proposed federal tax bill.

BACKGROUND

Leigh Avenue Senior Apartments

On June 20, 2017, the City Council approved up to $9,000,000, including a construction-permanent loan of up to $8,000,000 in Low and Moderate Income Housing Asset Funds ("LMIHAF"), to First Community Housing or an affiliated development entity ("FCH" or "Developer") for the Leigh Avenue Senior Apartments. This is a new, senior affordable development to be located at 1030 Leigh Avenue ("Site") offering rent- and income-restricted apartments for 63 extremely low-income ("ELI") and very low-income ("VLI") households ("Project"). Twenty of the apartments are set-aside for chronically homeless residents. When the Council initially approved funds for the Project, the Developer anticipated applying for 4% Low Income Housing Tax Credits in March 2018. Leigh Avenue Senior Apartments was underwritten and approved with the assumption that development would receive tax-exempt bond financing and 4% LIHTC funding.

Low Income Housing Tax Credits

Low Income Housing Tax Credits ("LIHTC" or "tax credits") are federal tax credits that fund the production and preservation of restricted affordable rental housing. The LIHTC program, operated by the U.S. Treasury, has produced more than 28,000 developments and 2.2 million rent- and income-restricted apartments since 1995. Approximately 200 of the 234 affordably-restricted apartment complexes in San José have used LIHTC funding. Federal tax credits are allocated to states based on population size. Each state administers its allocation of federal credits.

The LIHTC program provides two types of tax credits for developers to build affordable housing: the 9% credit and the 4% credit. Investors then provide a capital contribution to the development in exchange for the tax credits. The 4% credit can only be awarded to the development if 50% or more of the project is funded using Tax-Exempt Private-Activity Bonds ("PABs"). It is estimated that PABs contribute to 60% or more of the affordable rental housing built or renovated each year.

Federal Tax Bill Implications

On October 26, 2017, the U. S. House of Representatives ("House") introduced Bill H.R. 1, which eliminates PABs including multifamily housing bonds. The House passed Bill H.R. 1 on November 16, 2017, by a vote of 227-205. On November 3, 2017, the U. S. Senate ("Senate") introduced the Senate Tax Cuts and Jobs Act bill which retains the tax-exempt PABs program. The Senate voted 51-49 to approve the bill on December 1, 2017.

The differences between the tax bills passed by the House and Senate must be reconciled and a final piece of legislation voted on by both chambers, and signed by the President, in order to be implemented in 2018. The House and Senate intend to prepare legislation for the President to sign before December 25, 2017. If a bill that includes the elimination of tax-exempt bond financing is signed, developers of affordable housing will no longer be able to apply for tax-exempt housing bonds and 4% tax credit financing.

Although the Senate version of the tax bill preserved the tax-exempt PABs program that supports 4% LIHTC funding for affordable housing, the final version of the bill has yet to be negotiated between House and Senate. As such, there is a reasonable risk that the final version may eliminate or reduce the funding available for affordable housing development.

The State's Response

Due to the uncertainty around the elimination of PABs proposed in the federal tax reform legislation, several California State agencies involved in the issuance of PABs and LIHTCs have taken actions to prepare for the potential impacts of the tax bill on affordable housing developments. On November 21, 2017, the California Debt Limit Allocation Committee ("CDLAC"), who sets and allocates California's annual debt ceiling and administers the State's tax-exempt bond program to issue the debt, set the date for an emergency allocation committee meeting, to be held on December 13, 2017. The intent of this meeting is to allocate bond capacity so that a number of projects can secure a tax credit allocation before the bonds are swept as a result of the tax bill. This action requires that developers apply and participate in a conduit issuer program to access PABs to develop their affordable housing projects.

The California Housing Finance Agency announced a special opportunity for developers to apply for tax-exempt bonds, with a deadline of November 27, 2017. Due to the implications surrounding federal tax bill and a restricted timeframe, CalHFA used a streamlined application and waived some elements of their standard processes, including review by local agencies. The special statewide application period yielded 10 project applications for roughly $319 million in bond authority. The Tax Equity and Fiscal Responsibility Act ("TEFRA") hearing for the 10 projects will be held on December 22, 2017.

The California Tax Credit Allocation Committee ("TCAC"), which allocates federal and state tax credits to developers of affordable housing projects, has committed to awarding tax credits to qualifying projects that receive and close bond issuances by the end of 2017.

First Community Housing's Actions

On November 27, 2017, FCH submitted an application and $100,000 performance deposit to CalHFA to be the bond issuer for the Project. On December 5, 2017, CalHFA forwarded the application to CDLAC to confirm that the Project qualifies for consideration in the emergency PABs allocation process. As noted above, CalHFA will hold the TEFRA hearing on December 22, 2017.

<u>ANALYSIS</u>

The Developer, FCH, has a unique opportunity to seek tax-exempt housing bonds and receive tax credits prior to the end of the calendar year. This ensures that Project is not jeopardized in the event that new federal tax law eliminates the PAB program and the project could not receive LIHTC 4% tax credits. If FCH was unable to participate in this program, the project would be significantly delayed as the availability of 9% tax credits is extremely limited in Santa Clara County.

City Council Policy for the Issuance of Multifamily Housing Revenue Bonds

The City Council's 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 Bonds Policy allows the City to authorize another conduit bond issuer ("Issuer") to issue bonds. 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 has approved developers' use of an alternate issuer pursuant to the Bonds Policy.

Section I. C of the Bonds Policy states:

> "Another agency may issue bonds when merited by special circumstances of the Project and the financing. Where the City is not the issuer of bonds for a Project, it shall be the City's policy to require the issuer to assume full responsibility of issuance and on-going compliance of the bond issue with federal tax and state laws."

The Housing Department recommends that the City Council authorize an exception to allow CalHFA to issue bonds for the Project to eliminate the risk of the Project failing to secure tax-exempt bonds and 4% tax credits, due to the special circumstance caused by the pending federal tax bill.

Expedited Process to Ensure LIHTCs are Reserved for the Project

After CalHFA's TEFRA hearing on December 22, but prior to December 31, the Project's bond financing will need to be finalized via an expedited process. Through this process, bond proceeds are drawn down in full and held by a trustee or fiscal agent. The bond proceeds will not be expended for any purpose until several conditions are met, including, but not limited to the following:

- The low-income housing tax credit investor (the "LIHTC Investor") is admitted to the partnership;
- The loan is sized and fully underwritten following a review of the appraisal, other third-party reports, and a cost review; and
- The real estate and security documents are negotiated, executed, and recorded.

The conditions for closing typically include:

- Adoption of a resolution by the issuer approving the transaction and the execution of bond documents (trust indenture, loan agreement, bond regulatory agreement, and, if applicable, a bond purchase agreement); and
- Execution of those bond documents.

Bond counsel will likely also require:

- Evidence to support the borrower's reasonable expectation that the Project will proceed in a reasonable period of time, a factual assessment based on the work that has occurred to date, e.g., existence of a purchase and sale agreement, status of entitlements, drawings, etc.;
- Letter of intent with the LIHTC Investor;
- Financing commitment(s) from the construction and permanent lenders; and
- The borrower to pay all transaction costs from a source other than bond proceeds.

The lender will likely require that the borrower fund an interest reserve to address "negative arbitrage" i.e., the cost of carry arising from the likelihood of reinvesting bond proceeds at a lower interest rate than the borrowing rate on the bonds.

The Housing Department is recommending that the City Council authorize the Director of Housing to negotiate and execute legal documents, and to take the other necessary actions to facilitate FCH's participation in the time limited opportunity to ensure the Project receives its bond funding. The expedited process described above will not require that the City's loan documents be executed prior to December 31, 2017. Therefore, the City maintains the ability to ensure that any City funds be expended in a manner consistent with established due diligence processes for traditionally financed projects.

EVALUATION AND FOLLOW-UP

The Housing Department produces a quarterly Information Memoranda regarding the use of the Director of Housing's Delegation of Authority under the Municipal Code; therefore, final loan business terms would be summarized in those memos. In addition, the Housing Department posts periodic reports on the status of its affordable properties undergoing rehabilitation or construction to its website, www.sjhousing.org. If the recommended actions are approved and Leigh Avenue Senior Apartments successfully closes construction financing, it would be included in these Quarterly Production Reports.

POLICY ALTERNATIVES

Alternative:	***The City Council could deny the request to grant an exception to the Bonds Policy, thus not allowing CalHFA to be the bond issuer for the Project.***
Pros:	The City could potentially receive bond fees if the City were to issue the bonds for the Project.
Cons:	Due to the restricted timeline, the City would not be able to issue bonds in time to take advantage of the CDLC and TCAC special allocation process. The City will lose an opportunity to provide affordable housing for

individuals and families, including homeless individuals, currently residing in San José.

Reason for not recommending: Effectuation of this Project will help the City fulfill its affordable housing goals. Pending federal tax bill revisions potentially pose a significant risk to the ability of the Developer to achieve full funding for the Project..

PUBLIC OUTREACH

This memorandum will be posted on the City's Council Agenda for December 19, 2017.

COORDINATION

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

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 IMPLICATIONS

By allowing CalHFA issue the bonds, the City will forgo approximately $20,000 in annual bond monitoring fees paid by the project for the monitoring service.

CEQA

PD07-083/PD07-089, Mitigated Negative Declaration and PDA07-089-01, Determination of Consistency with the MND.

/s/
JACKY MORALES-FERRAND
Director, Housing Department

For questions, please contact Division Manager, Patrick Heisinger at (408) 975-2647.